Greetings:

On behalf of the American Council of Life Insurers (“ACLI”)¹, we offer comment on the Department of Labor’s (“Department”) proposed rule and prohibited transaction exemptions promulgated under Sections 3(21)(A)(ii) and 2510.3-21 of the Employee Retirement Income Security Act (“ERISA”) (collectively, the “Proposal”). The Proposal would cause irreparable harm to small balance retirement plan investors, including many middle and lower income investors. More specifically, the Proposal would effectively limit or deny access to guaranteed income products that are increasingly important to millions of Americans who no longer have access to a traditional pension.

¹ The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with 284 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. ACLI member companies offer insurance contracts and other investment products and services to qualified retirement plans, including defined benefit pension and 401(k) arrangements, and to individuals through individual retirement arrangements (IRAs) or on a non-qualified basis. ACLI member companies also are employer sponsors of retirement plans for their own employees.

Circular 230 disclosure: This document was not intended or written to be used, and cannot be used, to: (1) avoid tax penalties, or (2) promote, market or recommend any tax plan or arrangement.
Executive Summary and Index of ACLI Comments

Introduction and Key Principles (pp. 5-7)

- It is essential that revisions be made to the Proposal to:
  - Ensure that providers, plan sponsors, plan fiduciaries, and IRA owners retain the freedom to define the nature and scope of their relationship.
  - Preserve and expand the investment education principles of Interpretive Bulletin 96-1 which have served participants well for nearly 20 years.
  - Preserve reasonable and customary commission-based practices with an exemption that offers compliance certainty and avoids increased costs.
  - Be protective of the interests of savers and retirees through a workable rule that not only addresses conflicts of interests, but supports and encourages key educational activities when interests align.
  - Encourage access to a savings plan at work and provide the opportunity to learn about and access annuities, the sole means available in the marketplace by which retirees can secure income for life.
  - Ensure access to important workplace benefits such as life, disability income, long-term care, and other non-medical insurance products.
  - Enable insurers and their distribution partners to engage small business owners to encourage them to establish savings plans for employees.
  - Encourage access to annuities for workers and retirees so that they may save and secure additional guaranteed lifetime income beyond Social Security.
  - Base the cost-benefit analysis on a carefully examination of the impact of the rule on the availability of annuities and workplace benefit insurance products.

Specific Comments on the Fiduciary Proposal

I. The Proposal’s definition of “advice” is unnecessarily broad and should be narrowed and/or clarified (pp. 7 – 11)

A. The Department should clarify that advice “individualized to the advice recipient” is not simply personalized, but is advice that implicates relationships of trust and expectations of impartiality, as described in the Proposal (pp. 7 - 8)

B. “Directed to” is not synonymous with “individualized” advice and should be eliminated from the definition (p. 8)

C. The regulatory definition should clearly link fiduciary advice with a contemporaneous transaction (pp. 9)

D. Clarify agreements, arrangements, and understandings are to be mutual (p. 9)
E. The regulatory definition must more closely align itself with the statute and past practice in focusing on activities which are “investment” in nature (p. 9 - 10)

F. The regulatory definition should be revised to exclude welfare benefit plans (p. 10)

G. Suggested edits to the Proposed §2510.3-21 definition of “Fiduciary” and addition of two new terms to clarify application of the rule (pp. 10 – 11)

II. The proposed exceptions or “carve-outs” are unnecessarily narrow, inconsistent with policies to expand retirement coverage and savings, and generally disruptive to the marketplace, without any discernible economic or other net benefit to consumers (pp. 11 – 18)

A. The counter-party carve-out should be expanded to cover all plans and IRA accounts (pp. 12 -14)

B. The platform carve-out should clarify that an annuity contract is a “platform or similar mechanism” and should be extended to IRAs (pp. 14 – 15)

C. The Proposal should include an exception for financial professional responses to proposal requests (pp. 15 – 16)

D. The education carve-out should be amended (pp. 16 – 18)
   1. The availability of distribution guidance should be expanded
   2. Education regarding features inherent in previously-purchased products should be included in the carve-out
   3. Education as to which investment options fit into various asset classes should be permitted
   4. “Anti-cashout” interventions should be included in the carve-out

III. PTE 84-24 must be revised to ensure sufficient exemptive relief for annuities and other insurance contracts (pp. 18 – 22)

IV. The Best Interest Contract Exemption (BICE) must be revised and re-proposed since, absent substantial changes, it has no utility for the insured retirement industry (pp. 22 – 39)

A. The impartial conduct standards that form the foundation of the BICE are unacceptably ambiguous (pp. 26 – 31)
   1. The BICE is not clear as to which forms of variable compensation are permissible
   2. The prohibition on differential compensation should be eliminated
   3. The Proposal should utilize one definition of reasonable “and customary”
   4. The structure of the BICE makes compliance uncertain and therefore, unworkable
   5. The definition of Financial Institution and the imposition of fiduciary status through the BICE, not the definition of fiduciary, are unacceptable

B. Even if the compliance ambiguities were clarified, the technical requirements under the BICE render the exemption unworkable in the absence of significant changes (pp. 31 – 39)
   1. The Best Interest contract standard as drafted is unduly restrictive and impractical
   2. The BICE pre-recommendation contract requirement is incompatible with customary business practices in the financial services industry, and is simply impracticable
3. BICE contracts should be subject to negative consent and should not require the adviser to be a party
4. The narrow scope of the exemption will eliminate an adviser's ability to provide advice to certain small plans and plan participants eligible for a distribution
5. The BICE has implications under Investment Advisers Act for agents and brokers that enter BICE agreements acknowledging fiduciary status
6. The exception's requirements for advisers that offer a limited range of investment options or proprietary products render it unfeasible
7. The required BICE disclosures should be harmonized with other disclosures
8. Forego a "low cost" prohibited transaction exemption
9. The BICE language, at various points, should be amended to target actual, rather than perceived, conflicts

V. The proposed transition rule should be revised and expanded (pp. 39 - 40)

VI. Eight month delayed applicability date is unreasonable (p. 40)

VII. The cost-benefit analysis in the proposal is deficient (pp. 40 – 56)

A. Executive, statutory and judicial precedent (pp. 40 – 42)

B. Measuring the regulatory impact analysis against executive, statutory and judicial precedent (pp. 42 – 49)
   1. The statement of potential benefits is flawed
   2. The Proposal inflicts an “advice gap” on individuals who can no longer obtain financial advice
   3. Insufficient analysis of direct costs
   4. The cost-benefit analysis does not consider annuities

C. The Proposal unacceptably excludes the protections of the current regulatory framework from its quantification of need (pp. 49 – 50)

D. The status of non-cash compensation regulation (pp. 51 – 52)

E. Commissions compared to fee-only investment advice (pp. 52 - 53)

F. Correcting observations of fact and law (pp. 53 – 55)

G. Concluding observations about the Proposal’s fulfillment of executive, statutory and judicial standards governing cost-benefit analyses in rulemaking (pp. 55 – 56)

Appendix
Introduction and Key Principles

ACLI has long supported responsible regulation that brings confidence to the marketplace. We believe such regulation is a win-win, a win for consumers and a win for ACLI member companies, who take pride in offering savings and investment services and retirement income solutions to millions of Americans. However laudable the goal of this particular rulemaking, care must be taken to ensure that unintended consequences do not serve to deprive or limit access to the products and services Americans need for meaningful savings and a secure retirement. Caution is particularly appropriate when considering rules that will significantly limit access to investment information, assistance, education and guidance, as well as to important income protection products. While the Department estimates – for purposes of the Proposal - investor losses due to conflicts at $21 billion per year (somewhat higher than the Council of Economic Advisor’s estimate of $17 billion per year), investor losses associated with an absence of professional assistance, according to the Department’s own figures, were estimated to be $114 billion in 2010 alone,² almost seven times greater per year. Without significant changes to the Department’s Proposal, ACLI is concerned that there will be a dramatic decrease in:

- access to guaranteed lifetime income solutions;
- the number of small business retirement plans;
- access to important workplace benefits such as life, disability income, long-term care, and other non-medical insurance products; and
- investment and distribution education and guidance.

These results will come at a cost to plan sponsors, participants, beneficiaries and IRA owners far in excess of the Department’s estimates. In summary, unintended consequences should – and do – matter.

ACLI supports rulemaking that is consistent with the Department’s statutory authority, accommodates the Department’s interest in minimizing the impact of conflicts of interest on plans, participants and IRA owners, and avoids significant disruptions in access to saving and retirement products and services. At a minimum, a rule defining “fiduciary” status for purposes of investment advice should:

- Ensure that service providers, financial professionals, plan sponsors, plan fiduciaries, plan participants and IRA owners retain the freedom to define the nature and scope of their relationships, including the freedom to sell, purchase, negotiate and contract without a regulatory presumption of a fiduciary relationship and without codifying assumptions regarding the assumed competence – or lack thereof – of any group of plan fiduciaries or the general public.

- Preserve reasonable and customary commission-based practices with an exemption that offers compliance certainty and avoids increased costs.

- Narrowly focus on persons who provide advice regarding investments.

¹ 76 Fed Reg 66151 (October 25, 2011). While the Department estimated reductions in that figure resulting from advice provided pursuant to the statutory exemption under ERISA section 408(g) and Internal Revenue Code section 4975(f)(8), the fact is that the exemption is not relied upon heavily, therefore any likely reductions in investor losses attributable to their own errors would be marginal.
- Preserve and expand the current rules regarding investment education in the Department’s Interpretive Bulletin 96-1, the benefits of which were recognized by the Department in 2010 and have served participants well for nearly 20 years.

To protect the interests of savers and retirees, there must be a workable rule that not only addresses conflicts of interests, but supports and encourages activities when interests align. For example, the insurance industry and its distribution partners encourage greater savings, which can help Americans secure life-long income. Both industry and the saver benefit when that goal is achieved. This alignment of interest must be fostered, not encumbered. Likewise, retirees need a variety of guaranteed lifetime income solutions from which to choose the level of security they desire and for which they are willing to pay. Rules and exemptions should not frustrate, through expressed limitations or ambiguity and uncertainty, this alignment of interests. To do otherwise would harm, not help, the interests of savers and retirees.

With so many Americans reaching retirement age each day and given the decline of traditional employer-sponsored pension plans, now more than ever, seniors need the income protection available in annuities and other guaranteed lifetime income products offered by America’s life insurance industry. Many people first learn of the benefits of annuities from a life insurance agent or broker. Continued access to information and education regarding annuities is consistent with the Administration’s efforts to facilitate access to lifetime income. However, if the Department’s fiduciary proposal moves forward without substantial changes, Americans’ understanding of and access to guaranteed lifetime income in retirement will be effectively limited, and longstanding and customary practices involving retirement plan and IRA guidance will be prohibited.

Annuities are the sole means available in the market place today by which retirees can secure income for life. With fewer and fewer workers eligible for workplace pensions, there is a greater need to save for retirement in 401(k) and other defined contribution plans as well as IRAs. Annuities serve as a means to convert these savings into a personal pension to supplement Social Security. To ensure that Americans have a secure retirement, it is of utmost importance that they have access to a savings plan at work and the opportunity to learn about and access annuities. Without substantive changes, ACLI is seriously concerned that, under the proposal, insurers and their distribution partners will no longer be able to engage small business owners to encourage them to establish savings plans for employees. Without access, workers are less likely to save and secure additional guaranteed lifetime income beyond Social Security.

Annuities are not well known by the general public. Academics write of the “annuity puzzle,” i.e., why so few retirees annuitize defined contribution benefits when annuities provide much needed income protections. Research shows that people have difficulty placing a value on annuities.3 They underestimate the value of the annuity when considering a purchase. This adds to the challenge faced by insurers, agents and brokers. They must introduce savers and retirees to annuities, help them to understand the value proposition, and educate them on the variety of annuities available with features that can address concerns regarding liquidity, inflation, premature death, etc. Given the need for a high level of education about annuities and the buy and hold nature of guaranteed lifetime income products, it is important that the Department recognize that these elements led to the customary compensation practices in place which differ from those that govern the sale of other types of investments or investment advisory and management services. ACLI members are gravely concerned that the Proposal, as currently drafted, will drive distributors to level compensation structures that will no longer appropriately compensate agents for the sale of annuities which in turn will result in less access by the public to these important retirement security products.

When writing rules, agencies are required to “strike the right balance” and develop more affordable, less intrusive rules to achieve the same ends, giving careful consideration to benefits and costs. While the Proposal mentions annuities 172 times, acknowledges that “31 percent of IRAs include investments in annuities,” and notes that “insurance companies [will] be significantly affected by the proposal,” the cost-benefit analysis fails to examine the impact of the Proposal on insurers, the annuity market, or on the availability of lifetime income.

Finally, it is well recognized that workplace saving programs play a critical role in retirement preparedness. As leading providers in the small plan formation marketplace, life insurers are particularly concerned that this Proposal would impede the important policy goal of expanding small plan coverage. The Proposal negatively impacts small plan formation by restricting sales activities that encourage small business owners (those with less than 100 employees) to start, maintain, or improve their employee benefit plans. The DOL has limited the “sales exception” to certain large plans, while impeding the sale of products and services to small businesses. Only 50 percent of workers employed in small businesses have access to a workplace retirement plan. There needs to be greater incentives for these small businesses to start and maintain retirement plans—not new barriers.

The Fiduciary Proposal

We share the Department’s interest in seeing that plan sponsors, plan participants and IRA owners receive advice that is in their best interest. At the same time, we are concerned that, in its pursuit of this objective, the Department has crafted a proposal that creates risks and uncertainties for insurers, their agents, and brokers that may result in less, not more, investment and annuity information. Our comments are consistent with the Department’s objective of protecting retirement investors while avoiding unnecessary disruption and negative impacts to plans, participants and individuals.

Plans, plan participants and beneficiaries, IRA owners and small business owners need a financial services market place that engages them and assists them in saving and investing and in addressing critical needs for income in retirement. An unnecessarily narrow focus on conflicts of interest oversimplifies the massive undertaking this nation faces in getting workers to save and retirees to secure guaranteed lifetime income. Insurers, agents, brokers, and savers/investors need to have confidence that a fiduciary standard will not disallow the reasonable and customary payment of sales commissions and other traditional forms of distribution-related compensation nor expose them to unnecessary litigation. This is required to ensure that American retirees maintain free and unfettered access to educated and committed financial intermediaries. Parties engaged in transactions with ERISA plans and IRAs need clear, unambiguous rules by which to determine their duties and obligations in order for them to effectively and confidently serve the marketplace and to ensure that plans, plan participants, and IRA owners continue to have access to a broad range of insurance products and services, investment advice and educational services. We offer these comments to assist in the development of such rules. However, given the voluminous and complex nature of the Proposal, we intend to continue our review and may submit additional or supplemental comments to the Department.

I. ACLI members are concerned that the definition of “advice” is unnecessarily broad and provides the following recommendations for the Department’s consideration.

A. The Department must clarify that advice “individualized to the advice recipient” is not simply personalized, but is advice that implicates relationships of trust and expectations of impartiality, as described in the Proposal.

The current regulatory definition provides that, in order to be considered a fiduciary by nature of providing investment advice, a person must “render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies
or strategy, overall portfolio composition, or diversification of plan assets.\(^4\) The degree of clarity in the
existing definition has allowed the investment advice community to draw clear distinctions between
advice that may be personalized, but not “individualized to” an advice recipient for purposes of ERISA.
This would include general investment communications delivered via targeted sales calls, individually
addressed marketing materials, or brochures selected and distributed in an effort to match
informational content with a particular investor’s potential needs. Simply adding a salutation to the
beginning of a letter should not be deemed to be “individualized” although it might be considered
“personalized.” Instead, “individualized to the advice recipient” should be read to include
recommendations that take into account a particular individual’s unique circumstances. It would be
helpful if the Department clarified this interpretation in the preamble of the regulation.

In order to clarify the Department’s intent, we recommend adopting language outlined in the
preamble to describe the relationships that the Department seeks to cover – specifically, those
relationships that create an expectation of trust between the financial professional and the investor.
Section I(G) includes suggested changes to the text of the Proposal to address this point.

**B. “Directed to” is not synonymous with “individualized” advice and should be eliminated
from the definition.**

We believe the “directed to” concept adds complexity and ambiguity to investment advice
determinations that will only serve to significantly limit one-on-one communications between providers
and potential or existing customers. The Department itself cited studies that show historically in-person
engagements may produce benefits that are not afforded by similar on-line services.\(^5\) The ACLI sees no
benefit to plan sponsors, plan participants or IRA owners of discouraging one-on-one or other personal
contacts given their obvious value toward understanding products, services, and choices.

The investment advice industry has long functioned under the premise that “investment advice”
that creates a trusted relationship between the financial professional and an investor must be
customized and deemed suitable for and based on the needs of the specific investor. The Department’s
decision to capture communications that are merely “directed to” the recipient upends traditional
passive marketing activity that is often the primary way by which investors become aware of their
product and service options. In effect, the inclusion of “directed to” serves to create a presumption of
investment advice/fiduciary status, in circumstances when neither was intended, expected or agreed
upon. Further, the lack of clarity within the rule will have a chilling effect on all types of marketing
activity, because the line between traditional marketing and fiduciary investment advice cannot be
determined in advance with any degree of certainty.

Directed communications, by definition, are not “individualized” communications, and should not
be treated as individualized for purposes of determining ERISA fiduciary status. For instance, directed
mailings, general advertising focused in specialty markets, group communications that are focused on
the needs of investors of a particular age, marital status, or demographic region, and general investment
seminars open to members of a particular organization or community are all advice communications that
may be “directed to” a recipient, but should not be treated as an attempt to offer fiduciary investment
advice.

Accordingly, the definition should be limited to fiduciary advice that is truly “individualized” and
understood to be “individualized” by the parties. Again, the “directed to” language should be eliminated.
Section I(G) includes suggested changes to the text of the Proposal to address this point.

---

\(^4\) 42 CFR 2510.3-21(c)(1)(ii)(B)
\(^5\) 76 Fed Reg 66155 (October 25, 2011)
C. **The regulatory definition must clearly link fiduciary advice with a contemporaneous transaction.**

With the Department’s decision to significantly broaden the definition of “fiduciary”, including the elimination of certain tests that served to place parameters around the advice being rendered, such as the “regular basis” requirement, ACLI members are concerned that advice, when provided, may be construed by a plan sponsor, participant or IRA owner as on-going in nature, rather than constrained by context, events and/or time. Typically, a recommendation to engage in or refrain from taking a particular course of action is based on a variety of factors then prevailing. A financial professional should not be liable for transactions that occur after a change in the relevant factors (e.g., market conditions, interest rates). In this regard, we recommend that the Department make clear that, as part of an agreement or understanding, the parties are free to define the period to which the advice applies. We also recommend that, in the absence of any such agreement or understanding, there is presumption that the advice will be acted upon within a time frame that is reasonably contemporaneous in light of the type of recommendation given with the rendering of the advice, in the absence of facts to the contrary.

D. **Clarify agreements, arrangements and understandings are to be mutual.**

A written or verbal agreement is, by its nature, mutual. So too is a written or verbal arrangement. However, an understanding may not necessarily be mutual. We suggest that “written or verbal” also affix to “arrangement” and that “mutual” be a condition of any understanding. Section I(G) includes suggested changes to the text of the Proposal to address this point.

E. **The regulatory definition must more closely align itself with the statute and past practice in focusing on activities which are “investment” in nature.**

ERISA section 3(21)(a)(ii) states that a person is an investment advice fiduciary only to the extent that he provides “investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan . . . “. The functional nature of this statutory definition limits the Department’s regulatory interpretation to certain activities that relate to the investment or management of assets. While the term “investment” has a number of meanings, to stay within the authority granted by Congress, the rule should be limited to advice regarding the investment of plan assets.

The term “investment” should not include a contract issued by an insurance company for the provision of benefits under a welfare benefit plan such as a life, disability income, or long term care contract. Investment activities generally involve an expectation of achieving a profit. Thus, while these insurance contracts may be an investment as that term is used to describe a good use of resources, they are not investments as that term is used in the phrase “investment advice” under ERISA.

In addition, a recommendation regarding a person who may be willing to serve and might be hired as an investment advice fiduciary is not a recommendation regarding the investment of plan assets. Whether or not such person is to be “entrusted with investment authority” is a determination to be made by another party. The Department should not discourage parties-in-interest from helping plan fiduciaries identify other possible service providers.

Also, absent specific advice regarding investments, a recommendation regarding the distribution of benefits is not investment advice. For example, a recommendation from a party-in-interest regarding the availability of a hardship withdrawal to a homeowner in need of funds to make repairs to her home after a major storm should not be construed as investment advice. While distributions do require investment activity, when investments are disposed to fund the proceeds of a withdrawal either in accordance with the terms of the plan or at the direction of the investor without a recommendation to do so, no “investment advice” has occurred.
There is no indication that Congress intended or directed that the Department extend its regulatory interpretation beyond advice regarding an investor’s portfolio or investment products. However, the Department’s current revision of the definition of investment advice appears to do just that, potentially capturing discussions relating to the purchase of products and activity never intended to be captured by this rule. This expansion of the statute not only is inconsistent with the Department’s interpretation of “investment advice” for any other purpose under ERISA, it is also a considerable expansion of the statutory language.

Finally, while we understand that a person may, through or together with an affiliate of such person, “indirectly” represent or acknowledge that it is acting as a fiduciary, we cannot understand how one would indirectly render investment advice. The Department does not explain the application of the phrase “through or together with an affiliate.” Fiduciary status should not apply to persons that are not directly involved with the provision of advice. There is no reason why the status quo should change. ERISA §(3(21)) does not contemplate “indirect” investment advice.

Section I(G) includes suggested changes to the text of the Proposal to address these points.

F. The regulatory definition should be revised to exclude welfare benefit plans.

Furthermore, ACLI recommends that the Department exclude welfare benefit plans from this rule, preserving both the current rule and prohibited transaction exemptions pending further analysis. Regarding welfare benefit plans, we note the lack of any analysis or explanation in the preamble to the Proposal regarding the application of law or the Proposal to these plans, an absence of any analysis of the impact of the Proposal on these plans in the Regulatory Impact Analysis, nor an attempt to conform the proposed new and amended prohibited transaction exemptions to provide clear exemptive relief to transactions involving these plans. Should the Department decide to act on rulemaking regarding these plans, we ask that the Department: (1) clearly identify the statutory authority to capture recommendations regarding the purchase of a contract to provide welfare benefits under the definition of “fiduciary investment advice” and seek public comment on its position; (2) afford the public an opportunity to comment on its regulatory impact analysis regarding the impact of such rulemaking to welfare benefit plans; and (3) propose prohibited transaction exemptions or appropriate amendments that conform to transactions involving welfare benefit plans. Section I(G) includes suggested changes to the text of the Proposal to address this recommendation.

G. Taken together, our suggestions in Section I would revise the base definition and add two new terms to clarify the application of the rule as follows:

§ 2510.3-21 Definition of “Fiduciary.”

(a) Investment advice. For purposes of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (Act) and section 4975(e)(3)(B) of the Internal Revenue Code (Code), except as provided in paragraph (b) and (g) of this section, a person renders investment advice with respect to moneys or other property of a plan or IRA described in paragraph (f)(2) of this section if—

(1) Such person provides, directly to an investor a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner the following types of investment advice, whether one time or ongoing, in exchange for a fee or other compensation, whether direct or indirect:

    (i) A recommendation as to the advisability of acquiring, holding, disposing or exchanging investments or other property, including a recommendation to take a distribution of benefits or that includes a recommendation as to the investment of assets or other property to be rolled over or otherwise distributed from the plan or IRA;
(ii) A recommendation as to the discretionary management of investments by a party other than the party making the recommendation, securities or other property, including recommendations as to the management of moneysecurities or other property to be rolled over or otherwise distributed from the plan or IRA;

(iii) An appraisal, fairness opinion, or similar statement whether verbal or written concerning the value of investmementsecurities or other property if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such investmentsecurities or other property by the plan or IRA;

(iv) A recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (i) through (iii); and

(2) Such person, either directly or indirectly (e.g., through or together with any affiliate),—

(i) Represents or acknowledges, either directly or indirectly (e.g., through or together with any affiliate), that it is acting as a fiduciary within the meaning of the Act with respect to the investment advice described in paragraph (a)(1) of this section; or

(ii) Renders the investment advice pursuant to a written or verbal agreement, or arrangement, or mutual understanding that the advice is individualized or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA, to meet the specific investment goals of the investor, and is provided at the request of the investor pursuant to the agreement, arrangement, or understanding.

(f) Definitions. For purposes of this section –

(2) (i) “Plan” means any employee benefit plan described in section 3(32) of the Act ....

(9) “Investor” means a plan, plan fiduciary (with discretionary authority over plan assets), plan participant or beneficiary, IRA, or IRA owner.

(10) “Investments” means securities, insurance and annuity contracts, property or other financial instruments held by a plan or IRA. The term “investments” does not include any contract issued by an insurance company for the provision of benefits under a plan described in section 3(1) of the Act.

(g) Welfare benefit plans. For purposes of section 3(21)(A)(ii) of the Act, with respect to a plan described in section 3(1) of the Act, the definition of “fiduciary” set forth in §2510.3-21 as filed with the Federal Register on October 28, 1975 shall apply.

II. ACLI members are concerned that the proposed exceptions or “carve-outs” are unnecessarily narrow, inconsistent with policies to expand retirement coverage and savings, and generally disruptive to the marketplace, without any discernible economic or other net benefit to consumers.

According to the Proposal, the revised definition of investment advice fiduciary is subject to certain specific exceptions (referred to in the Department’s Proposal as ‘carve-outs’) for communications that are “best understood as non-fiduciary in nature” and that “parties would not ordinarily view as communications characterized by a relationship of trust or impartiality”. However, the proposed exceptions exclude critical details regarding investment activities that are not considered fiduciary in nature, or advance inaccurate assumptions regarding plan and investor activity that erode the efficacy of the exception. Furthermore, in order to preserve access to traditional assistance for retirement investors with smaller accounts, several specific exceptions must be included in the final rule.

6 21929
A. The counter-party carve-out should be expanded to cover all plans and IRA accounts.

According to the preamble, the purpose of the seller’s exception is to “avoid imposing ERISA fiduciary obligations on sales pitches that are part of an arm’s-length transactions where neither side assumes the counterparty to the plan is acting as an impartial trusted adviser, but the seller is making representations about the value and benefits of proposed deals.” The Department’s stated purpose recognizes that sales activities naturally include recommendations to purchase and invest in products and services offered by the seller, and that financial institutions such as life insurers and their sales representatives should not be categorized as fiduciaries under ERISA or Code section 4975(e)(3)(B) when they are engaged in selling activities and are clear that they are acting in a sales capacity.

Unfortunately, we do not believe the Department’s recognition of the distinction between sales and advice in the preamble or in the Department’s prior proposal is adequately reflected in the limited scope of the sellers/counterparty carve-out in the operative language. In fact, rather than recognizing that marketing and sales activities do not constitute advice, the Department appears to start from the premise that those activities traditionally thought of as sales and marketing are tantamount to rendering investment advice— unless such activities meet certain conditions, without regard, to any understanding or agreement on the part of the parties that such activities are in fact sales or marketing. And, to further confuse things, the Department, with no pertinent economic or other analytical support, opts to treat all selling and marketing activities as fiduciary investment advice when that activity is directed to small plans and IRA accounts; again, without regard to any understanding or agreement of the parties to the contrary.

We are concerned that the Department’s efforts go far beyond the statute in its interference into practices that are clearly recognized as the sales and marketing of products and services. We also are concerned with the apparent arbitrariness of the Department’s framework, as well the supposition that size is a substitute for understanding one’s responsibilities under ERISA, even if one is otherwise held accountable for understanding and compliance with the – reporting, disclosure, fiduciary, and prohibited transaction – rules. In essence, the Proposal creates a new second-class plan fiduciary for small plans and calls into question whether the Department would support a lower standard of care for small plan fiduciaries generally given this assumption that these employers lack sophistication. Similarly, we are concerned with the Department’s assumption, again with little, if any, support, that IRA owners generally are not sufficiently sophisticated to distinguish advice from sales and marketing. A simplified disclosure describing the sales function would be a much better option than forcing financial professionals to abandon the small balance investor. The approach pursued by the Department in the Proposal effectively eliminates for all plan sponsors, participants, IRA owners, the ability to acknowledge and define the parameters of their engagements with third parties. We believe this, and other aspects, of the Proposal go far beyond what Congress intended and far beyond what can be construed as a reasonable reading of the statute.

Most importantly, we are concerned that the Proposal will unnecessarily complicate interactions with all plans, as well as increase operational and compliance costs for providers and their customers. Further, the inability to conduct traditional sales and marketing efforts to small plans will significantly impede, if not preclude, efforts to close the retirement coverage gap, which is particularly acute among small employers. As the Department is aware, millions of working Americans do not currently have retirement savings opportunities through their workplace. The Department’s Proposal will significantly increase costs and risks attendant to reaching out to the small employer community and, in our opinion, further exacerbate private-sector efforts to bring retirement savings opportunities to all working Americans.

7 80 FR 21941.

8 Under the proposal, the exception may apply to sales activities relating to an employer’s 120 participant 401(k) plan, but not the employer’s 65 participant defined benefit plan or 70 participant frozen welfare benefit arrangement. The exception may apply to sales activities relating to a $100 million dollar defined benefit plan trust, but not to sales of insurance contracts to a large unfunded welfare benefit plan.
Americans. For many of the same reasons, the Department’s limits on sales and marketing to new and existing IRA owners will, in our view, increase the risk of leakage, thereby reducing retirement savings. An inability to reach out to potential and existing IRA owners in an efficient and cost-effective way will leave far too many individuals and retirees on their own to gather information and materials about their options, while being subject to potentially competing demands from family and others to use accumulated savings for non-retirement purposes. Marketing and sales activities serve to educate consumers about their choices and ensure competitive pricing of products and services.

We recommend that the sellers/counterparty exception be modified to:

- **Include sales to any investor.** The definition should provide that, without regard to plan size or whether the engagement involves a plan participant or IRA owner, in the absence of a mutual understanding or agreement that products or services are being offered or marketed in a fiduciary capacity, such offerings or products shall be treated as sales/marketing not covered by the “advice” definition. Plan fiduciaries are, by law – and without regard to the size of their plan or the amount of assets within the plan –, required to act prudently and in the interest of the plan’s participants and beneficiaries. We believe that such standard imposes an obligation – and not a particularly difficult one – to ascertain the nature of the relationships in which they engage, including distinguishing a sales activity from a fiduciary activity (with respect to which they may have co-fiduciary liability). In the case of a plan participant considering a rollover or IRA owners generally, they too are expected to be cognizant of the rules and tax considerations governing IRAs and, in many cases, have reviewed the IRA marketplace in conjunction with selection an IRA with investments and fees that meet their criteria. Unlike plan participants, IRA owners have the flexibility – and therefore an inherent protection – to transfer their assets to a competing IRA if and when they become dissatisfied with investments and/or services. The knowledge and understanding of IRA owners should not be discounted by the Department in the absence of an empirical assessment of IRA owners’ capabilities and the impacts on the Department’s regulations on those owners.

- **Remove the requirement to obtain a written representation when acting in a sales capacity.** The definition should be revised to eliminate any requirement for a seller/counterparty to obtain written representations regarding the capacity in which a plan fiduciary is acting (or regarding plan size, assets – see above) or the plan fiduciary’s understanding that the seller/counterparty is not acting in a fiduciary capacity. Such representations are not, and should not be, part of pre-sales or sales discussions. Starting any relationship with an explanation that the seller is not permitted to discuss product or service offerings until written representations are obtained, that the individual is in a position to act and that she is sufficiently sophisticated to understand that the seller is a seller, not a fiduciary – may be received as unwelcomed and condescending. Despite the Department’s perception, albeit unfounded, that no one is really capable of distinguishing sales from fiduciary activities, we believe such confusion has not been an issue of any measurable degree and that such requirement should be eliminated.

- **Remove the burden of proof from the seller.** The definition should be revised to eliminate putting a seller/counterparty in the position of having to establish/prove that any given fiduciary has sufficient expertise to evaluate the transaction and determine the prudence of the transaction with respect to the plan. We believe if a plan fiduciary is acting as such in connection with a sales or marketing engagement, it is reasonable for any seller/counterparty to assume that the fiduciary understands their duties under ERISA (or the in case of an IRA account owners, their right to act on information they determine to be in their best interest). Moreover, the Department does not provide guidance on how one could possibly discharge such an obligation with any degree of certainty. If the Department is intent on a test, we strongly suggest that the requirement be rephrased to establish a presumption of competence on the part of a plan fiduciary, in the absence of clear evidence indicating otherwise. In this regard, we note that
even ERISA fiduciaries – directed trustees – are not required to second guess the competence of a named fiduciary absent extraordinary circumstances. Certainly a seller/counterparty should not be held to a higher standard that a directed trustee.

- **Remove any doubt that common pre-sale activities could be considered fiduciary advice.** The definition should clarify that pre-sales activities, such as responses to RFP’s and similar solicitations in which a seller/counter is not initiating an action, but rather is providing information regarding products and services in the context of a request, the parameters of which are defined by a plan fiduciary or IRA owner constitute activities covered by the sale/counterparty exception.

In the alternative, the current seller’s carve-out should be eliminated in favor of a carve-out that requires the seller to fairly inform the investor that: (A) such person is not undertaking to provide impartial financial advice (i.e., not acting as a fiduciary for purposes of ERISA); and (B) such person has a financial interest in the matter. This approach achieves the Department’s stated goals without codifying assumptions regarding the assumed competence – or lack thereof – of any group of plan fiduciaries or the general public.

ACLI recommends the following revision to the text of the Proposal.

“§ 2510.3-21(b)(1)(i) Counterparties to the investor -- In such person’s capacity as a counterparty (or representative of a counterparty) to an investor, the person provides advice to an investor who is independent of such person and who exercises authority or control with respect to the management or disposition of investments held by a plan or IRA, with respect to an arm’s length transaction, if, prior to providing any recommendation with respect to the transaction, such person has not acknowledged in writing that it is acting as a fiduciary (within the meaning of this subsection) with respect to the transaction and the person does not receive a specific separate advisory fee for such recommendation; such person fairly informs the investor that: (A) such person is not undertaking to provide impartial financial advice; and (B) such person has a financial interest in the matter.”

**B. The platform carve-out should clarify that an annuity contract is a “platform or similar mechanism” and should be extended to apply to IRAs.**

As with other carve-outs proposed by the Department, the platform carve-out is “designed to draw an appropriate line between fiduciary and non-fiduciary communications, consistent with the text and purpose of the statutory provisions.” The platform carve-out appears to be intended to allow platform providers who provide access to investments through a retirement plan platform and help plan fiduciaries select or monitor investment alternatives perform those services without triggering fiduciary status.

The platform provider exception is made available to individuals who market and make available “securities or other property through a platform or similar mechanism”. However, the carve-out stops short of defining “other property” or a “similar mechanism” that might be an appropriate vehicle for the carve-out. While our members presume that annuity contracts are a “platform or similar mechanism” for purposes of the carve-out, for the avoidance of doubt, the Department should make this clear. Failure to clarify this point would place insurance companies, the sole manufacturers of variable annuity products, at a serious competitive disadvantage with regard to other financial institutions in the retirement plan market.

---

9 Field Assistance Bulletin 2004-03 (December 17, 2004)
The Department requested comments on whether the scope of the platform provider exception should be limited to large plans similar to the scope of the seller’s exception. ACLI recommends that this exception apply to all plans, regardless of plan size, as currently provided in the Proposal. Adequate protection is provided to small plans due to the disclosures that are required of providers relying on this exception.

Furthermore, while the preamble suggests that the “platform” carve-out is available for a platform that has preset investment options, this is not entirely evident from the text. Many platform providers offer participant-directed plans platforms with pre-selected investments, chosen without regard to the individualized needs of any particular plan or plan participant. Since there is no inherent conflict in the selection of these standardized investment platforms, they should be explicitly covered by the carve-out. Additionally, the carve-out should make clear that the platform can include products such as annuity contracts, including one or more deferred annuities and/or qualified longevity annuity contracts or “QLACs.”

ACLI further suggests that where a provider is merely offering a platform of predefined investment options, the offering of such platforms or platform choices, like sales, should not be treated as advice. In such situations, the provider is merely offering a non-individualized platform of investment options from which an IRA owner can choose or monitor on a take it or leave it basis. For this reason, ACLI also supports extending the selection and monitoring exception in order to ensure that providers can, without assuming fiduciary liability, be responsive to an IRA owners request for investments meeting specific objective criteria specified by the IRA owner. The fact is that IRA owners can only benefit from information – and the ability to compare products and services – in a competitive marketplace. The Department should be encouraging and facilitating IRA owner access to this information, not, as under the Proposal, creating impediments to affording IRA owners options for enhancing their retirement savings.

ACLI members therefore recommend the following change to 2510.3-21(b)(3) and (4):

(3) Platform providers. The person merely markets and makes available to an Investor, without regard to the individualized needs of the Investor, investments through a platform or similar mechanism (which may include one or more annuity contracts) from which an Investor may select or monitor investment alternatives offered without regard to the individualized needs of the Investor. If the person discloses in writing to the Investor that the person is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.

(4) Selection and monitoring assistance. In connection with the activities described in (b)(3) of this section with respect to an employee benefit plan (as described in section 3(3) of the Act), the person –

Note that the language above assumes the Department will include the definition of “Investments” offered in Section I(G) above. If not, we ask that the phrase “insurance and annuity contracts” be included along with “securities, or other property.”

C. The Proposal should include an exception for financial professional responses to proposal requests.

Under the Proposal, any communication that constitutes a “recommendation” falls within the scope of fiduciary investment advice. A “recommendation” is defined as a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.\(^\text{10}\) While ACLI members

\(^{10}\) 80 Fed. Reg. at 21960.
appreciate the opportunity to offer further comment on the appropriateness of this definition, at base, it is currently drafted broadly enough to require several revisions to protect customary marketing practices. For instance, insurance companies routinely market themselves in response to requests for proposal which are, by definition, intended to encourage plan sponsors to engage in a “particular course of action”. In some cases, a response to a request for proposal may be binding if accepted. It appears that such responses would be considered “recommendations” – and by extension, investment advice – under the current definition. The plan size and asset restrictions currently made part of the seller’s exception do not rectify this inadvertent fiduciary problem. While there is an indication in the preamble that a response to a request for a proposal is not fiduciary advice, members seek a specific carve-out for requests for proposals.

Such carve-out could be worded as follows:

“(X) Certain Proposal Responses and Related Activity. The person merely markets and makes available to an employee benefit plan (as described in section 3(3) of the Act), informational, marketing or similar materials at the request of a plan fiduciary, in order to encourage a plan fiduciary to engage the services of the adviser and/or an affiliate, irrespective of whether such materials or information are specifically individualized or directed to the plan or identify individual offered investment alternatives.”

D. The education carve-out should be amended.

At the outset, we wish to commend the Department for recognizing the importance of retirement-related materials and programs and extending the principles of Interpretive Bulletin (IB) 96-1 to encompass such as part of the proposed rule. With 10,000 individuals reaching retirement age every day, the importance of helping individuals prepare for their retirement years is of critical importance and by clarifying that many activities designed to assist them do not constitute fiduciary investment advice is, in our view, a major step forward.

However, while taking a step forward in encouraging and facilitating the education of plan participants, the Department simultaneously took a major step backward in the area of investment education. For almost 20 years, the principles of IB 96-1 have served to afford participants access to meaningful investment-related educational materials and programs. The value and benefits of IB 96-1 were evident in the Department’s 2010 effort to modify the “fiduciary” definition. In that proposal, the Department could not have been clearer in its recognition of the importance of IB 96-1 by preserving IB 96-1 in its entirety and without change. In this Proposal, however, the Department takes the position that any reference of investments or options in conjunction with asset allocation models or other materials constitute “advice.” Not only a major change to well-established and relied upon guidelines that have proved valuable to millions of plan participants, but change that appears wholly premised on speculation (from a GAO report) that some participants “may” or “might” believe such references constitute advice – despite representations to the contrary or that some participants “may” or “might” not understand – despite explanations – that other investments might be available to them. With the proposed change, the Department has effectively shifted the obligation to populate asset allocation models to the plan participant, who for a wide variety of reasons is unlikely to do so, thereby significantly undermining what has been a valuable tool for millions of plan participants.

Participants and IRA owners need more, not less, education on annuities and other distributions options. The education carve-out requirement to avoid specificity regarding the investment or distribution options available under a plan or IRA should be amended to preserve investor education activities that are critical to managing longevity risk and stemming retirement plan leakage. While the Department makes attempts to cover common distribution-related information “including information
relating to annuitizations and other forms of lifetime income payment”\textsuperscript{11}, the text of the carve-out falls short of achieving its stated goal.

Interpretive Bulletin (IB) 96-1, as restated and incorporated into a Department’s regulation, acknowledges the important role of financial professionals in providing participants with educational materials without exposing them to potential fiduciary liability. The Proposal’s replacement of IB 96-1 with a carve-out renders it only marginally useful in this regard. Specifically, the Department’s narrowing of the definition of investment education with respect to specific investments makes it less effective, at best, and counterproductive, at worst. Investors will expect that the education received from financial professionals provides them with sufficient information to make informed investment decisions on their own; in fact, this will no longer be case.

The education carve out should extend to participant enrollment services where participants are being enrolled into investments that have been designated by a plan fiduciary who is independent of the party providing the enrollment services, provided that no recommendations of specific investments are made in the course of such enrollment, and in the case of an investment product under the plan, such as an annuity contract, that is distributed in-kind from the plan, whether as an IRA (and thus effectively a rollover) or a non-transferable 401(g) annuity.

ACLI members therefore have specific suggestions for improving this carve-out. Each of these changes fit squarely into the Department’s intent to carve-out “general information that helps an individual assess and understand income needs past retirement and associated risks (e.g. longevity and inflation risk) or explains general methods for the individual to manage those risks both within and outside the plan...”\textsuperscript{12}

1. **Distribution guidance should be expanded.** For education to be meaningful, the requirement to avoid specificity on distribution options available under the plan or IRA must be eliminated.

2. **Education regarding features inherent in previously-purchased products should be included in the carve-out.** As the carve-out is currently written, it appears that a plan or an insurer cannot educate a participant or IRA investor about the features of a particular product that has already been purchased. For example, a customer service representative could not educate a policyholder about the decision to annuitize a previously-purchased contract, because that discussion would involve a communication regarding a “specific investment”. Similarly, a customer service representative could not read the terms of the annuity contract to the policyholder, answer routine questions regarding the annuity or restate contract terms or that of a prospectus.

3. **Education as to which investment options fit into various asset classes should be permitted.** Participants and IRA owners need more information about investments, not less. Plan service providers should be permitted to assist the public in classifying investment options into the correct asset class without fear that they are inadvertently providing advice. More importantly, we need to be helpful to plan participants. General information about asset allocation that omits any information about available investment options will only confuse and frustrate participants.

4. **“Anti-cashout” interventions should be included in the carve-out.** Plan service providers have a financial interest that supports the public interest in retaining participant assets in employer sponsored plans and IRAs. Investment education discouraging participants and IRA owners from “cashing out” their accounts, and investment education promoting IRA rollovers

\textsuperscript{11} 80 Fed. Reg. at 21939.

\textsuperscript{12} Id. at 21944.
(including rollovers into IRAs affiliated with the person providing the education) by participants, owners, and beneficiaries who are and as an alternative to a cash-out must be permitted. Taking an early lump-sum can have a devastating impact on retirement security. Firms should be encouraged to intervene to educate terminated participants about the consequences of taking their savings out to the tax-advantaged retirement system.

With these goals in mind, ACLI members offer the following revisions to the investment education carve-out:

“(6) Investment education. The person furnishes or makes available any of the following categories of investment-related information and materials described in paragraphs (b)(6)(i) through(iv) of this section to a plan, plan fiduciary, participant or beneficiary,....

(ii) General financial, investment and retirement information. Information and materials on financial, investment and retirement matters that do not address specific investment products, specific plan or IRA alternatives or distribution options available to the plan or IRA or to participants (other than a limited menu of options approved by the plan fiduciary or IRA owner), beneficiaries and IRA owners, or specific alternatives or services offered outside the plan or IRA, and inform the plan fiduciary, participant or beneficiary, or IRA owner about—

(A) General financial and investment..

(iii) Asset allocation models....

(C) Such models do not include or identify any specific investment product or specific alternative available under the plan or IRA To the extent that an asset allocation model and related materials identify one or more investment alternatives or products available under the plan or IRA, the model is accompanied by a statement indicating that other investment alternatives having similar risk and return characteristics may be available under the plan or IRA and identifying where information on those investment alternatives may be obtained; and

...(v) Anti-cashout information. General methods and strategies that encourage participants to avoid in-service distributions when possible or suggest alternative post-distribution retirement plan savings vehicles designed to preserve retirement savings, including IRAs and similar products.”

III. PTE 84-24 must be revised to ensure sufficient exemptive relief for annuities and other insurance contracts.

In order to allow both plans and IRAs to continue to purchase insurance and annuity contracts in the normal course of business, PTE 84-24 should be expanded to treat variable annuity purchases as covered transactions, and should allow for greater flexibility within the definition of “commission” to allow for traditional forms of adviser compensation. Furthermore, the exemption should clarify that compensation and other possible revenue or profit received by the insurer (rather than the adviser) is not subject to consideration, should provide for relief for existing transactions that rely on the exemption in its current form, and should clarify the Proposal’s definition of a “material conflict” that is subject to disclosure. We ask that the conditions imposed in Section IV with respect to insurance sales be no more cumbersome than those imposed on mutual fund sales. Finally, we suggest edits to clarify the application of PTE 84-24 to IRA transactions.
As proposed, the Department’s amendments would revoke PTE 84-24 for advice provided to IRA owners with respect to transactions involving variable annuity contracts and other annuity contracts that constitute securities under federal securities law, as well as transactions involving the purchase of mutual fund shares. According to its Regulatory Impact Analysis, the Department believes that investment advice transactions involving variable annuity contracts and mutual fund shares are so similar to securities transactions that they should occur under the conditions of the BICE. However, the Department’s assessment in this regard ignores certain critical risk characteristics of variable annuity contracts that align these contracts more closely with insurance than securities. Thus the Department’s failure to include these contracts under the amended PTE is unwarranted and does not contribute to investor protections.

Annuity contracts do not convert from insurance products to securities products with the addition of a variable investment feature. Variable annuity contracts are not simply securities products; they are first insurance contracts. Contrary to the Department’s assertions in the preamble, they do not cease being the latter when they become the former. Instead, a variable annuity combines traditional insurance concepts with certain mutual fund principals to solve two increasingly important problems in retirement planning – rising life expectancy and the declining value of the dollar. Variable annuity contracts share many of the features of a fixed annuity contract, including fixed (general account) option with interest guarantees, mortality-based investment guarantees, retirement income guarantees, and the availability of additional life-contingent withdrawal options. These features are not available in a securities investment. Also unlike an investment in securities, both fixed and variable annuities provide for the liquidation of principal and income actuarially over a lifetime, with the insurance company assuming the risk of miscalculating mortality predictions in computing benefit payments. Whether an annuity contract is fixed or variable, the insurance company still bears the risk of the investor outliving capital. Given that, in practice, both fixed and variable annuity contracts require the company to bear longevity risk, these arrangements are far more similar to each other than to securities investments in any regard. Accordingly, the Department should reconsider the current distinction between these contracts under the amended PTE 84-24, and revise the PTE to cover the sale of all annuity contracts to IRAs.

In addition, the definition of “insurance commissions” under the amended PTE is far too narrow, and should be broadened to include more traditional forms of compensation. Under the Proposal, insurance commissions would be newly defined as commissions paid by the insurance company or any affiliate of the insurance agent, insurance broker, or pension consultant for effecting the purchase or sale of an insurance or annuity contract. It would include renewal fees and trailers, but would prohibit advisers from receiving relief under the PTE for many other traditional revenue sources, such as revenue sharing and administrative and marketing fees, as well as payments from third parties. This revision would prohibit advisers from receiving these types of payments for sales to both plans and to IRA owners.

This is a significant constriction of the protection afforded by the exemption as it has been interpreted for more than 30 years. While ACLI appreciates the Department’s attempt to carve certain forms of potentially conflicted revenue sources out of the exemption, defining commissions largely by

---


16 Although ACLI members understand that relief for the sale of variable annuity contracts may still be available under the BICE exemption, due to the uncertainties regarding that exemption’s “reasonable compensation” requirement, the inability of the industry to access and compile information necessary for the required disclosures, and the general liability risks created for advisers and affiliates under the exemption, the BICE is not a viable option of the sale of these contracts. Please see section ___ of this comment letter for additional details.

indicating what the term excludes, rather than what the term includes, will create an uncertain compliance environment for insurers. In its current form, the amended definition forces advisers to postulate as to the Department’s expectations regarding other types of permissible commission sales under an exemption relied upon heavily by the industry. Insurance companies will have no guidance as to whether other basic revenue sources, such as sales incentives that allow advisers to earn credits toward retirement and health benefits and guaranteed income overrides to third parties paid for overseeing adviser activity, remain permissible. For instance, the revised definition would prohibit payments from third parties and payments that result from the underlying investments that are held pursuant to the insurance contract. This prohibition, as it is currently worded, could restrict the sale of annuities entirely, since both variable and fixed annuities generally include an account that has the potential to generate revenue to the insurer.

An inclusive definition of “insurance commission” would be a helpful step toward alleviating these concerns and correcting the practical issues raised by the amended PTE. However, given the complexity of the insurance market and the various methods insurers use to help facilitate distribution, an inclusive definition of commissions should be flexible enough to allow for the various interpretation and terms used to identify permissible compensation sources.

In addition, we ask the Department to confirm that when necessary, Section I(a)(4) of PTE 84-24 covers an insurance company’s receipt of the revenue and any profit that is the necessary result of the sale. This is critical for the sales of proprietary annuities by an insurance company, including its employees, and sales by advisers associated with affiliated selling firms. If the insurance company’s revenues and profits are not permitted, this exemption will have no utility for proprietary product sales, which we do not believe is the Department’s intent.

Furthermore, the Department offers no reason why an exemption that allows for additional traditional forms of compensation, such as revenue sharing, cannot be fashioned to protect investors’ rights. A robust disclosure structure that fully and accurately describes any potential conflict associated with variable sources of revenue would reduce disruption in the market and provide for greater choice for investors. To this end, ACLI members assert that the categories of commissions that would align with Congressional directives under ERISA section 408(a) are far broader than simply renewal fees and trailers. We note that these other forms of commissions, including revenue sharing and similar forms of compensation, are already subject to ERISA’s reasonable compensation standards through the disclosure regime currently in place pursuant to section 408(b)(2). Specifically, those disclosures require service providers to disclose any compensation paid from the provider to third parties or affiliates acting as subcontractors if paid on a transaction basis. Such disclosures are also required to the extent such compensation is charged directly against the covered plan’s investment and reflected in the net asset value of the investment. Given that this compliance structure already drives the types and amount of commissions that can reasonably be paid to financial professionals, there is little to no additional benefit to be gained by using a highly restrictive definition of “insurance commissions” in the proposed amendment to PTE 84-24.

The insurance industry has taken great pains to deliver quality products, compensate financial professionals, and protect the best interests of retirement investors in a manner that complies with ERISA, securities law, FINRA guidance and applicable state law. The ability to protect that revenue from ERISA prohibited transaction laws does not rest with restricting the types of commissions advisers receive. It rests instead with the Department’s success in crafting clear, definitive compliance parameters for investment advice fiduciaries that align with the interests of investors – including their interest in the availability of a wide range of annuities and other investment products.

With respect to proprietary sales, the amended PTE must clarify that revenues to the insurer for group annuity recommendations will not be restricted by the revised definition of “insurance commissions.” Often, insurance companies will receive various sources of revenue when group annuity
products are offered to plan sponsors by an affiliated or unaffiliated financial professional, including revenue payments from third parties. These payments present no potential conflict, because their receipt by the company does not influence the adviser’s recommendations. Because these revenues are not included in the definition of “commissions”, it not clear that such revenue would receive the protection of the PTE, even if the revenue does not vary depending on the product chosen by the plan fiduciary. We therefore strongly encourage the Department to add clarifying language to provide for this protection in the final exemption.

The revised exemption also provides no protection for arrangements that currently rely on PTE 84-24. Variable commission sales and sales involving 12b-1 commissions, for instance, would be stripped of the exemption’s protection, without immediate recourse for advisers and investors who have relied on the existing interpretation in good faith. If the Department truly seeks to protect customary retirement savings arrangements that have been successfully executed over the past 30 years, the final exemption should provide grandfather protection for existing contracts that currently fall outside of the bounds of the amended PTE.

Regarding the Impartial Conduct Standards, while we agree that disclosure of material conflicts of interest is not only optimal, but absolutely crucial to protecting investor interests, the proposed amendments to PTE 84-24 do not sufficiently define the term “material conflict”. Again, further clarification regarding this standard will be critical if the failure to disclose a material conflict of interest will be deemed to be a misleading statement, and will violate a key exemption requirement. To the extent that PTE 84-24 compliance is premised on such an opaque standard, the insurance industry will find it necessary to discontinue relationships that have traditionally relied on the protection of exemption. As a result, investor access to professional advice from highly-regarded financial professionals will be reduced, particularly among IRA owners. There is a risk that an inadvertent failure to disclose something minor, for example the fiduciary’s receipt of a minor benefit such as a routine lunch or dinner paid for by the insurance company issuing the insurance or annuity contract, would result in the transaction and all attendant compensation being prohibited and subject to disgorgement and excise taxes. This result would be harmful and wholly disproportionate to any possible harm caused by the inadvertent disclosure failure.

With respect to transactions involving insurance and annuity contracts, Section IV(b)(2) of the proposed PTE 84-24 requires that the “independent fiduciary acknowledge in writing the receipt of the required disclosures”. For transactions involving mutual funds, Section IV(c)(2) requires the independent fiduciary to approve the transaction following the receipt of the required disclosures. ACLI asks that these be aligned to require the approval of the transaction without the need for a “written acknowledgement.”

While the amendments to PTE 84-24 are characterized as covering transactions involving IRAs, the covered transactions and conditions for relief do not describe IRAs (e.g., the use of the phrase “with plan assets”). This language should be revised to clearly include the assets of an IRA. Likewise, the conditions in Section IV require the engagement of an independent fiduciary. This person should also include an IRA owner or a fiduciary engaged by the IRA owner to act on their behalf.

While ACLI members appreciate the certainty that a definition brings to the existing exemption, significant amendments will be necessary in order to make the exemption a viable option for the insurance industry going forward.

Accordingly, ACLI recommends the following changes to the text of the exemption in its proposed form:

Revise the phrase “with plan assets” to read “with plan or IRA assets” as it appears in Section I(a)(1)-(4).
Revise each instance the phrase “independent fiduciary” appears in Section IV to read “independent fiduciary or IRA owner.”

Revise Section I(a)(4) as follows:

(4) The purchase, with plan assets, of an insurance or annuity contract from an insurance company and the resulting receipt of compensation by the insurance company in connection with the purchase.

Strike Section I(b).

Revise Section VI(b) as follows:

(b) The insurance agent or broker, pension consultant, insurance company or investment company Principal Underwriter that is a fiduciary acts in the “Best Interest” of the plan or IRA is when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances and needs of the plan or IRA, without regard to by placing the interests of the Retirement Investor before the financial or other interests of the fiduciary, any affiliate or other party.

Revise Section VI(f) as follows:

(f) The term “Insurance Commission” means (1) a sales commission paid by the insurance company or an Affiliate to the insurance agent or broker or pension consultant for the service of effecting the purchase or sale of an insurance or annuity contract, including renewal fees, trailers, gross dealer concessions and overrides, and but not (2) revenue sharing payments, administrative fees, marketing payments, and other payments from parties other than the insurance company or its Affiliates.

Revise Section VI(h) as follows:

(h) A “Material Conflict of Interest” exists when a person has a material financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA.

IV. The Best Interest Contract Exemption (BICE) must be revised and re-proposed since, absent substantial changes, it has no utility for the insured retirement industry.

In theory, the BICE would permit investment advice fiduciaries to receive otherwise prohibited compensation in connection with transactions involving IRA owners, plan participants and beneficiaries with direct investment authority, and plan sponsors of certain non-participant directed plans. These individuals are referred to collectively in the exemption as “Retirement Investors.” To receive the protection of the exemption, fiduciaries would need to:

- Act in the “Best Interest” of the Retirement Investor, and
- Receive no more than “reasonable compensation”, and
- Not make any misleading statements, and
- Admit fiduciary status under ERISA, and
- Prior to offering any recommendation, along with a “Financial Institution,” enter into a contract with the Retirement Investor that:
Includes warranties that state that the fiduciary and “Financial Institution” –

- Will comply with all applicable federal and state securities laws, and
- Has written policies and procedures to mitigate conflicts of interest, and
- Has identified any material conflicts and adopted measures to make sure that they do not violate the BICE “impartial conduct standards”, and
- Does not use incentives, quotas or other personnel actions, bonuses, contests, special awards, differential compensation or other actions that would encourage an adviser to make recommendations that are not in the Best Interest of the investor, and
- Does not contain any exculpatory provisions disclaiming or otherwise limiting the liability of the adviser or financial institution for a violation of the contract’s terms, or waives their right to bring a class action regarding the dispute.

In addition, the fiduciary must:

- Detail material conflicts of interest;
- Inform the Retirement Investor of his or her right to obtain information about fees;
- Disclose whether the fiduciary offers proprietary products or receives 3rd party payments with respect to the purchase, sale, or holding of any asset, and provides the website where that information can be located (the “initial disclosure”);
- Provide point of sale disclosures explaining the total projected cost of the assets available for investment (the “point of sale disclosure”);
- Provide an annual disclosure of each asset purchased and sold in the past year, and the compensation received by the adviser (the “annual disclosure”);
- Maintain a website that shows the cost and the direct and indirect compensation paid to the adviser, the financial institution, and each affiliate for each assets in the plan (the “website disclosure”);
- Make a range of investment options available that is broad enough to enable the adviser to make recommendations from all the asset classes “reasonably necessary to serve the investor’s Best Interest, or, if they do not offer such range, make a written finding that limits on the assets offered do not prevent the adviser from providing advice that is in the Best Interest of the Retirement Investor; and
- Provide, upon request, detailed and sensitive information related to the activity within a customer’s account, personal information related to advisers which the Department can post publicly and detailed information related to investments offered under the exemption.

The BICE does not meet the administrative exemption requirements under ERISA §408(a), and therefore should re-proposed after further consideration. We also ask that a final rule regarding the definition of fiduciary not be effective until a workable exemption is also made final and effective.

ERISA §408(a) grants the Department authority to grant administrative exemptions from the prohibited transaction provisions of ERISA and the Code for a class of transactions or for individual transactions. However, in order to grant an administrative exemption, the Department must make a determination that the exemption is (1) administratively feasible; (2) in the interest of the plan and its participants and beneficiaries; and (3) protective of the rights of plan participants and beneficiaries.

The BICE does not meet the requirements for an administrative exemption under §408(a). As detailed herein, the BICE is far from administratively feasible -- it requires entities that are not functional
ERISA fiduciaries to adopt fiduciary status; it is strikingly opaque regarding basic compliance concepts such as 'reasonable compensation'; it is incompatible with standard business practices in the financial services industry; it may inadvertently subject agents and brokers to the Investment Advisers Act of 1940; and its disclosure requirements potentially conflict with SEC and FINRA compliance rules. While a broad exemption is clearly necessary under the Proposal, BICE also does not serve the interests of plans, participants, and IRA owners, because its will eliminate financial professionals' ability to provide advice to certain small plans and participants eligible for a distribution. Finally, the BICE is not protective of the rights of plan participants and beneficiaries, because it will reduce access to the types of helpful investment education that participants in self-directed plans and IRAs have come to expect, and provides no substantive transition relief to allow retirement investors to maintain their existing arrangements under the current terms if they so choose.

Given that the Department has issued more than 120 separate requests for public comment and assistance with regard to the BICE alone, it stands to reason that the exemption deserves further agency attention consistent with the administrative exemption principles in ERISA §408(a). ACLI therefore urges the Department to withdraw the BICE, and to consider re-proposing the exemption following a more robust period of public comment in which all stakeholders have the opportunity to address the Department's questions and concerns.

In the preamble to the BICE, the Department inquired as to the distribution methods and channels applicable to annuity products that are not securities. As you consider the following comments, it is important to note that annuities are offered through a broad spectrum of distribution channels. These include agents (via insurance agencies or by insurer's own employees), affiliated or independent broker-dealers, wirehouses, financial planners, and financial institutions such as banks. Agents appointed by a company offering annuities may be “captive,” offering only that company’s proprietary products. Some annuity companies may allow their agents to offer other companies’ products in limited circumstances, such as when the customer is looking for a type of annuity the carrier does not offer. Some insurers and external distribution partners such as banks, wirehouses, and independent broker-dealers offer products including annuity products in addition to an insurer’s proprietary products. Some annuity carriers contract with independent “marketing organizations” that act as an intermediary between independent insurance agents and the annuity carrier. These marketing organizations may perform services such as agent recruiting, contracting, licensing, continuing education, and sales support.

Individuals that offer an insurer’s fixed annuities and other non-security annuity contracts must be appropriately licensed and appointed by the company. For an annuity that is a security (i.e. a variable annuity), the individual also must have a security license and also be properly registered with FINRA and applicable state security departments. Annuities that are securities may be offered through affiliated or non-affiliated broker-dealers.

As for the types of annuities that are offered and to whom they are offered, this varies. Some insurance companies only utilize agents whereas others utilize the full spectrum of agent and third party distribution partners. Sales of proprietary products may be more concentrated within an insurer’s career agent salesforce. Broker Dealers may sell annuity-based IRAs and nonqualified annuities to individuals, while annuity sales to qualified plans may be more concentrated in a smaller number of registered representatives. Bank channels may sell more fixed than variable annuity products while wirehouses tend to offer more variable products such as variable annuities with living benefits. However, there does not appear to be a consistent trend in the prevalence of the type of annuities that are offered through different distribution methods across insurers.

In our review of the BICE, by any measure, it is the most prescriptive exemption ever issued by the Department. We have a number of concerns regarding the BICE as proposed. Set forth below is an
explanation of these concerns, as well as recommendations for the Department’s consideration as to how the BICE could be modified.

The BICE imposes fiduciary status on insurers even when the insurer is not a fiduciary under the proposed definition. The proposed definition requires that a person both (1) provide a recommendation regarding an investment or financial professional (or offer and appraisal), directly to a plan or IRA owner and (2) acknowledge fiduciary status or provide advice pursuant to an arrangement or understanding. Under the BICE, a “Financial Institution” is defined as an entity that retains an Adviser who is an independent contractor, agent or registered representative. Financial Institutions do not provide advice directly to plans or IRA owners; as such, they would not be fiduciaries under the proposed regulatory definition. However, although not fiduciaries, Financial Institutions must nevertheless agree to be fiduciaries in order for the Adviser to take advantage of the exemptive relief of the BICE. As the BICE requires a contract be signed before a recommendation could be made, Advisers who conduct business with a variety of Financial Institutions and/or are retained by more than one Financial Institution will need to have the investor sign agreements with each and every one before they enter into a discussion.

Generally, if a fiduciary does not comply with the every requirement of the BICE, the fiduciary risks engaging in a prohibited transaction. However, certain requirements of the exemption are so ambiguous that it would be difficult for any fiduciary to confirm that she is in compliance with BICE. The Impartial Conduct Standard requires that the adviser and financial institution agree contractually that they will not recommend an investment if the total amount of compensation anticipated to be received in connection with the recommended transaction exceeds reasonable compensation in relation to the total services provided. ACLI is concerned that the use and meaning of “reasonable compensation,” which is not explained in the exemption, is intended to have some meaning other than as applied under the statutory exemption found at ERISA §408(b)(2) and the regulations promulgated thereunder. ACLI also questions the propriety of measuring the sum total of all compensation received in connection with the sale of a proprietary annuity product against the reasonable costs of services provided to the advice recipient. Insurance products include charges that are assessed not merely for the provision of services, but also for the provision of the guarantees and other financial benefits set forth in the insurance contract. Prohibited Transaction Exemption 84-24, which also contains a reasonable compensation condition, takes this incremental additional cost into account by including not just the costs of fees related to the provision of services but also the fees and other considerations received in connection with the purchase of the insurance or annuity contract for purposes of determining the reasonableness of total cost. ACLI urges the Department to extend this approach to the BICE.

The BICE requires advisers and financial services companies to represent that the investment will, in essence, meet the ERISA prudent man standard. As noted in an April 2005 article in the Journal of Pension Benefits, “The prudent man rule is only 42 words long, but it is the parent of scores of litigated cases and millions of words of analysis. Despite this volume of information the rule still creates confusion and discomfort. That is doubly true in the context of participant directed plans.” The Second Circuit Court of Appeals called the ERISA prudence standard “one of the highest duties known in the law.” To add additional untested and undefined standards to the prudence obligation leaves the overall requirements for the BICE so uncertain as to expose fiduciaries seeking to utilize the exemption to potentially enormous financial risks, the scope of which cannot reliably be estimated in light of the legal uncertainties introduced by the Department’s new language. These uncertainties are so great that many financial institutions may conclude that reliance on the BICE would itself be imprudent to the company’s other constituencies, including its other policyholders, its employees and shareholders. ACLI requests that, at a minimum, the changes recommended here be adopted and that the Department consider providing a detailed definition of each standard.

---

18 See Donovan v. Bierwirth, 680 F.2nd 263, 272 n.8 (2nd Cir. 1982).
A. The impartial conduct standards that form the foundation of the BICE are unacceptably ambiguous.

1. The BICE is not clear as to which forms of variable compensation are permissible.

The BICE impartial conduct standards include two separate requirements that create unacceptable ambiguity as to whether the customary compensation practices would be permitted going forward. First, the BICE requires financial institutions to warrant that they do not pay their advisers differential compensation that would tend to incent the adviser to make recommendations that are not in the best interest in of Retirement Investors. Second, financial institutions are required to represent that the compensation received by the financial institution, the adviser, affiliates and related parties is reasonable for the services provided to the retirement investor. Furthermore, if the financial institution places limits on the investments it offers, then under Section IV of the exemption, the Department sets forth an even higher standard that requires the financial institution to justify each payment stream with separate and distinct services. These requirements are over and above the basic requirement that the adviser only make recommendations that are in the best interest of investors. These additional requirements under the BICE impartial conduct standards should be eliminated, sufficiently contextualized, or the extent of the obligations should be clearly defined. The Department states in the preamble to the exemption that the BICE is designed to allow continued receipt of commissions, yet the text of the rule does not create a clear, operational standard that accounts for the industry’s diverse business models. BICE ambiguity as to permissible compensation structures results in the courts or the Department, rather than the Retirement Investor or the market, deciding the manner in which a retirement investor can pay for services. Allowing a court or a regulator to decide after the fact whether differential compensation in the form of commissions satisfies this standard is plainly unworkable.

2. The prohibition on differential compensation should be eliminated.

The Department describes the BICE exemption as a business model-neutral means by which a fiduciary may receive differential compensation without triggering a prohibited transaction. By the Department’s determination, the BICE “accommodates a wide range of current business practices while minimizing the impact of Conflicts of Interest...” 19 However, in practice, the BICE is primarily suited for a business model that does not actually exist among insurance-based financial services institutions – one that does not pay advisers differential compensation for the sale of products. According to the BICE, “[n]either the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity uses quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Notwithstanding the foregoing, the contractual warranty set forth in this Section II(d)(4) does not prevent the Financial Institution or its Affiliates and Related Entities from providing Advisers with differential compensation based on investments by Plans, participant or beneficiary accounts, or IRAs, to the extent such compensation would not encourage advice that runs counter to the Best Interest of the Retirement Investor (e.g., differential compensation based on such neutral factors as the difference in time and analysis necessary to provide prudent advice with respect to different types of investments would be permissible).” (emphasis added). 20 Given this highly subjective, ambiguous text, this condition creates considerable uncertainty as to how the Department would interpret—after the fact—whether Financial Institutions used differential compensation, or took other actions, that “tended” to encourage “individual Advisers” to make recommendations that are not in the Best Interest of the Retirement Investor. This can be interpreted to require that each firm prove that the differences in the compensation received by the adviser and firm (e.g., commission rates, loads, third party payments, breakpoints, payout grids, etc.) amongst and within different products (e.g., stocks, bonds, annuities, mutual funds, etc.) are justified based on neutral factors (and are therefore in the client’s best interests) rather than set by the market.

19 80 FR 21947
The Department states in the Preamble that the BICE is designed to allow continued receipt of commissions, yet the text of the rule does not create a clear, operational standard that accounts for the industry’s broker-dealer models. In fact, the financial services industry is vast, the products are varied, and the distribution channels and compensation structures are far more complex than anticipated by the Department. This is evident, for example, in the “neutral” differential compensation models identified as permissible, such as models that compensate advisers based on “time and analysis” necessary to provide advice with respect to different types of investments, use a fee-offset model, or rely strictly on an “assets invested” calculation. These models are not currently employed by most insurers, and even if they were more clearly defined, could not be instituted without significant changes to the very core of their compensation models. The result is that middle class Americans could lose access to commission-based products, including annuities and mutual funds, the very products they should be invested in to fund their retirement. Currently, 98% of investor accounts with $25,000 or less in their IRAs are in brokerage relationships. This makes commission based accounts the most effective way for middle class investors to save for retirement and secure guaranteed lifetime income so that they do not outlive their retirement assets.

In the preamble to the proposed BICE, there are a number of examples of how a firm may mitigate conflicts. We ask that, when issuing a final BICE, the following example be included to illustrate how a firm may reasonably mitigate conflicts when customary compensation differs based on products and services. As proposed, the BICE would not provide this firm any certainty as to whether compensation paid is permitted or prohibited.

Example: Balancing of asset-based and commission compensation. The Financial Institution permits the Adviser to receive either a commission or asset-based compensation, but not both, for any single affiliated or unaffiliated investment product, provided however that only a commission may be paid with respect to an investment product with no account value, such as an immediate annuity or a qualifying longevity annuity contract (QLAC), unless an actuarial present value will be provided periodically by the contract issuer. The Financial Institution does not offer any investment product or alternative that pays a commission which materially exceeds the average commission rates for similar products (as determined through periodic market surveys or analysis), or for which the aggregate of product fees and account advisory fees would exceed the cost to the client of a comparable commissioned product available to the Financial Institution and the Adviser. The Financial Institution also encourages, but does not require, the use of financial plans applying generally recognized principles of retirement income planning, to determine an appropriate allocation to annuity contract income guarantees.

Under the Proposal, however, clients will likely be required to enter into a managed account (an account favored by the BICE) and such clients may find that managed accounts are the only accounts available in order to receive any guidance:

- Advisory-fee based accounts typically require minimum investment of amounts between $50,000 to $250,000 (depending upon the services and whether it is a retirement account). Thus, commission-based accounts are often the only way in which investors with less to invest can obtain any form of guidance.

- Managed programs, which charge ongoing fees based upon assets under management, can be more expensive and are generally not a good choice for buy and hold investors, such as those investors who seek lifetime income guarantees.

Annuities are generally sold on a commission basis and not in a managed account, decreasing a retiree’s opportunity for guaranteed retirement income.

FINRA and the SEC do not consider managed accounts suitable for investors who do not trade very often. The SEC encourages such investors to maintain brokerage accounts rather than paying an ongoing fee in an advisory account.

The cost of losing access to retirement security products and services is not something American savers and retirees can afford. An Oliver Wyman study estimated that direct costs to savers who use brokers and are forced into managed accounts in order to continue to receive access to retirement products and services would increase from anywhere from 75 percent to 195 percent. In response to various stakeholders raising this concern, the Department has consistently assured Congress, consumers and financial professionals that their Proposal would not ban commission based products and services. The Department has essentially banned commission-based products and accounts by adding conditions that simply do not work for brokerage accounts and annuities.

The current language regarding compensation models that “tend to” encourage conflicts should be eliminated. The standard is far too broad. Rather than forming the basis of an objectively determinable standard, this particular language assures subjectivity and confusion among plaintiffs, defendants and the courts themselves. We would suggest that the warranty section related to policies and procedures should be eliminated entirely. Firms will have sufficient incentive to adopt policies and procedures given the impartial conduct standard requirements of the contract. Adding additional requirements that create confusion and ambiguity related to commission-based sales is not helpful or necessary. The Impartial Conduct Standards and the other affirmations made under the Section II(d) Warranties provide extensive and sufficient consumer protections. These warranties include the disclosure of Material Conflicts of Interest. Thus, Section II(d)(4) is not only redundant, but unnecessarily creates uncertainty as to the utility of the BICE. This further supports the need to re-propose the exemption in a workable form.

ACLI recommends Section II(d)(4) be eliminated.

3. The Proposal should utilize one definition of reasonable “and customary” compensation.

The Department uses three different formulations of the concept of “reasonable compensation” within the BICE creating unnecessary and harmful confusion. With respect to the “reasonable compensation” requirement under the BICE’s impartial conduct standard as well as the supposedly heightened standard found in Section IV of the BICE, we are concerned that the wording used by the Department seems to require fiduciaries to justify each third-party payment they receive in relation to specific services provided to a particular IRA owner or 401(k) participant. Consistent with revenue sharing practices used for many years in the 401(k) industry, it is common for providers, like broker-dealers, who offer IRAs to use third-party payments like revenue sharing and sub-transfer-agent fees to help pay for the platform and keep down direct costs to the clients. Due to economies of scale, these negotiations with the product providers are done at a book of business level, rather than at an individual investor level, and are based on the relevant negotiating powers of the parties. Third-party payments, like revenue sharing, are not typically paid to advisers so generally do not create a conflict under the differential compensation warranty mentioned above. Furthermore, it would be untenable to match up any particular payment to any particular investor. In fact, some investors may pay slightly more due to the funds they select while others may pay slightly less even though the services are basically the same. Higher net-worth clients with larger account balances subsidize those with more modest lower account balances. This subsidization permits investors with smaller balances to save for retirement at lower costs and is inherent in many investment products in the market place, including mutual funds, which by their very nature and purpose mutualize the costs of investing. We would appreciate the Department clarifying that such variances are reasonable by deleting the “in relation to the total services they provide to the
Retirement Investor” language in Section II(c)(2) and by deleting the supposedly heightened “reasonable compensation” provision in Section IV (we explain why the entire Section IV is misguided and should be deleted in its entirety later in this letter).

Our members know of no repository, public or private, of information regarding market rates for various types of firms, advisers, investments, or services. Without a measurable standard, not only is the reasonable compensation standard meaningless, it is impossible to meet this standard with any degree of accuracy. Furthermore, the Department offers no proposed definition of reasonable compensation that would specifically offer us the opportunity to offer meaningful comment. Although the Department makes reference to reasonable compensation “under the circumstances” in the preamble, no such context is made part of the proposed exemption. Any such references presumably are to the standard generally applicable to fiduciaries when they are engaging a third party to provide a product or service to the plan. Such a fiduciary is generally expected to have a reasonable process for determining the reasonableness of the compensation, whether based on multiple bids or otherwise. Under the Department’s Proposal, it is that same fiduciary – or plan participant or IRA owner – who will instead be challenging the reasonableness of the compensation, and absent further clarification from the Department the fiduciary adviser will have no clear standard to assert in its defense, whatever the level of the compensation may be. The Department should confirm that a reasonable process for the investment advice fiduciary would be sufficient to establish that the fiduciary’s compensation is reasonable and customary.

The concept of reasonable compensation is already inherent in ERISA, and is therefore redundant as part of the exemption as to retirement plans. ERISA section 408(b)(2) provides an exception for “reasonable arrangements” for necessary services for which no more than “reasonable compensation” is paid. While this standard does not apply to IRA plans, the Department would eliminate significant administrative duplicity by simply requiring a warranty with regard to reasonable and customary compensation – and an identifiable standard therefore – as part of the BICE as it applies to IRAs.

With these points in mind, ACLI members recommend amending Section II(c)(2) as follows:

“..., if the total amount of compensation anticipated to be received by the Adviser, and Financial Institution and Affiliates and Related Entities in connection with the purchase, sale or holding of the Asset by the Plan, participant or beneficiary account or IRA, will exceed that which is reasonable and customary for the products and services provided reasonable compensation in relation to the total services they provide to the Retirement Investor; and comply with the following:”

4. The Structure of the BICE Makes Compliance Uncertain and Therefore, Unworkable

The principles-based nature of the BICE creates considerable exposure for advisers seeking the protection of the exemption, rendering it unusable from a compliance standpoint. In order to meet the requirements of the BICE and avoid a prohibited transaction, fiduciaries would not only be required to contractually obligate themselves to act in the client’s best interest but would also have to comply with the best interest standard to avoid a prohibited transaction. This formulation makes it impossible for financial institutions to have confidence that they have ever met the conditions of the BICE and is unnecessary to protect retirement investors. By requiring a contractual obligation, the Retirement Investor will have a legally enforceable cause of action against a financial institution for breach of contract if the client is harmed by recommendations that were not in his or her best interest. This legal cause of action is what the Department claimed was necessary to protect Retirement Investors. However, the Department also makes compliance with the best interest standard a condition of the exemption itself. Because such compliance is purely subjective, financial
institutions will never be certain whether the conditions have been met and that no excise taxes are owed. Furthermore, the penalty for breach of contract will be to compensate the Retirement Investor for any harm suffered. The penalty for a prohibited transaction is an excise tax that is due regardless of whether any harm occurred.

In addition, financial institutions are also required to warrant, or guarantee, certain conditions that are likely to be determined only in retrospect, such as:

- That they are in continuous compliance with all state and federal securities laws,
- That each “material” conflict has been identified and disclosed; and,
- That they have personnel policies appropriately align with the Best Interest standard.

If a court determines that a fiduciary breached any of these warranties, or even if a court determined that a fiduciary’s fees were “unreasonable”, the fiduciary could be subject to undeterminable monetary damages based on a new state-law contract right of action. Allowing courts to be determine ERISA fiduciary compliance in hindsight without any clear mitigation strategy is simply not an acceptable business model for any responsible ERISA fiduciary, and many advisers will strongly consider exiting the retirement market due to inability to properly assess the risks.

Even in the absence of litigation, it is not clear that an adviser would be able to determine whether an excise tax is due. A fiduciary that takes reasonable measures to maintain reasonable fees may find that as market conditions shift, those fees may be deemed ‘unreasonable’ under the very same standard. As the law develops in this area, a fiduciary may find that her firms’ compensation practices may be deemed to inappropriately promote propriety products over non-proprietary products. It is unclear, under the BICE, whether this knowledge alone triggers an excise tax under Code section 4975, and an attendant duty to self-report.

The language in the preamble to the BICE only adds to the ambiguity associated with compliance. The preamble states that the “effect of noncompliance with any condition [of the exemption] depends on whether the condition applies to a single transaction or multiple transactions. The compensation associated with the prohibited transaction, or segment of the prohibited transaction, would not receive the relief.”

This language is wholly unhelpful in assessing compliance risk associated with the BICE.

As currently constructed, no fiduciary could ever be certain that the BICE applied to its advice, exposing fiduciaries to a punitive excise tax scheme even for an inadvertent failure to comply. There would be no need for the Retirement Investor to demonstrate that harm has occurred, or even to demonstrate that he or she did not benefit from the recommendation.

The BICE exemption should be overhauled to include bright-line rules for compliance and safe harbors that would allow a fiduciary, at the first instance, and a court, at the second, to determine when compliance is compromised. The impartial conduct standards that are not objectively measurable, such as whether a fiduciary has acted in the Best Interest of a customer, whether his or her compensation is reasonable, and whether a potential conflict is ‘material’ enough to trigger a disclosure requirement, should be made contractual representations, rather than conditions of the exemption.

22 80 FR 21976
At minimum, section II(c) of the BICE should be amended as follows:

“Impartial Conduct Standards. The Adviser and the Financial Institution affirmatively agree to, and comply with, the following:”

5. The definition of Financial Institution and the imposition of fiduciary status through the BICE, not the definition of fiduciary, are unacceptable.

Fiduciary status should be addressed by the definition promulgated under ERISA §3(21)(A)(ii) and not imposed as a condition of exemptive relief. Financial Institutions that do not provide advice directly to plans or IRA owners would not be fiduciaries under the proposed regulatory definition. Under the BICE definition, in addition to an employer of an Adviser, a Financial Institution is to include any entity that “otherwise retains such individual as an independent contractor, agent or registered representative...” Thus, firms that have granted the Adviser permission to sell products and who otherwise are not treated as fiduciaries under the ERISA or the proposed regulatory definition nevertheless must agree to fiduciary status under the BICE in order to sell products and allow the Adviser to obtain the relief provided by the exemption. This is the case despite the fact that they do not function as ERISA fiduciaries, do not directly control the actions of the Adviser, and have no ability to influence the Adviser’s recommendations. This is not acceptable.

Furthermore, the application of this particular provision of the BICE on Advisers that have numerous relationships with a number of entities including multiple insurance companies is not administratively feasible. An Adviser may serve as a licensed investment adviser for a registered investment advisory firm, a registered representative of a broker dealer, and a licensed insurance agent of an insurance agency. She may be an employee of one of these firms. She may have a variety of products to offer a customer from a multitude of product manufacturers. Under the BICE, the Adviser and every potential “Financial Institution” that may be a part of her discussion with the investor must enter into a contract with an investor prior to a recommendation and, as noted, the acknowledge status as a fiduciary.

ACLI recommends that the BICE definition of “Financial Institution” be limited to only those entities that are fiduciaries under the definition of fiduciary. Entities that, under the definition of a fiduciary, would not be treated as a fiduciary under the definition of fiduciary should be required to accept such status under the BICE.

Section VIII(e) of BICE should be revised to read as follows:

“(e) "Financial Institution" means an entity that is an "affiliate" (as defined in ERISA §2510.3-21(f)(7)) of the Adviser who, together with the Adviser, functions as a fiduciary under ERISA §2510.3-21 for purposes of the covered transaction.”

B. Even if the compliance ambiguities were clarified, the technical requirements under the BICE render the exemption unworkable in the absence of significant changes.

Even aside from the compliance risks associated with the BICE, our members believe that they would not be able to preserve their current business models and rely on the BICE for a number of very fundamental reasons. Each of these reasons is itemized and reviewed in detail below.
1. The Best Interest contract standard as drafted is unduly restrictive and impractical.

Section VIII(d) of the BICE states investment advice is in the “Best Interest” of the Retirement Investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing... without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.\(^{23}\)

This provision could easily be interpreted to imply that if an adviser has any financial interest in a retirement plan or IRA the transaction at all, he or she has violated the Best Interest standard. This includes having an interest in receiving any commission in any amount. This standard is more restrictive than even the standard for fiduciaries under ERISA, which the Department has recognized allows for certain incidental benefits due to the fiduciary’s relationship to the plan.\(^{24}\) While it is unlikely that the Department expects that advisers as fiduciaries could interact with any customer entirely without regard to whether or not they will be compensated, the definition should be amended to make this fact clear.

The definition of Best Interest in Section VIII(d) should therefore be amended as follows:

“...and needs of the Retirement Investor, without regard to placing the interests of the Retirement Investor before the financial or other interest of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party;”\(^{25}\)

Corresponding revisions should be made to the following sections:

Section II(c)(1):

“...and needs of the Retirement Investor, without regard to placing the interests of the Retirement Investor before the financial interests of the Adviser, Financial Institution or any Affiliate;”

Section IV(b)(4):

“...and needs of the Retirement Investor, without regard to placing the interests of the Retirement Investor before the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party) or otherwise adhering to the Impartial Conduct Standards;”

2. The BICE pre-recommendation contract requirement is incompatible with customary business practices in the financial services industry, and is simply impracticable.

As written, the BICE requires that a customer execute a contract prior to any discussion occurring. This requirement is inconsistent with the manner in which advisers currently conduct business – imagine walking into a store and being asked to sign a contract before you can view any of the store’s merchandise – and creates significant operational challenges for most financial professionals’ business models.

\(^{23}\) 80 FR 21987


\(^{25}\) We bring to the Department’s attention that the language of the preamble, which states that the Best Interest standard requires advisers to “put the interests of the Retirement Investor ahead of the financial interests of the Adviser”, which approaches the standard recommended by ACLI here.
It is impractical for an investor to execute a legally binding contract before she can determine whether to do business with a financial professional. It is also impractical under standard corporate governance to have every employee of the firm and its affiliates enter into legally binding contracts on behalf of the firm. It is common that only those individuals at a relatively high level within the firm may execute contracts on behalf of the firm. Furthermore, the BICE would require a contract between the investor and each employee at the firm who may be treated as a fiduciary under the broad terms of this Proposal. As a practical matter, we expect the public would not find this to be a positive customer service experience. We request that a contract issued by the fiduciary or the fiduciary’s employer concurrent with a transaction executed through negative consent be sufficient.

Additionally, financial professionals generally begin their discussions with a new customer with a general consultation. This consultation may include a sales pitch in some form. It may also involve an offering of basic, high-level suggestions regarding investment strategies as a way to demonstrate their competency and communication style. The customer has an opportunity to ask questions about the adviser and to assess whether the services that the adviser offers meet his or her individual financial needs. The adviser may offer a pre-analysis with suggested approaches based on preliminary financial data from the potential customer. The adviser will also surmise whether the customer meets the adviser’s customer criteria. Only after the parties agree that the relationship would be mutually beneficial would the adviser then take the first “live order” and enter into an engagement agreement.

Requiring advisers to enter into an agreement during the first meeting in which a potential “recommendation” is made is far too early in the relationship, and would require contracts to be executed prior to an adviser having a conversation about what products and services the adviser has to offer. ACLI members propose that the exemption require any contract to be executed within a “reasonable period of time” before or after the commencement of any trading or transaction activity. In order to protect prior recommendations, the contract could contain a provision that retroactively applies the Best Interest standard to any recommendations made prior to execution. The contract would provide that fiduciary status would affix concurrently with the receipt of compensation to the adviser.

In addition to creating operational difficulties for new customers, the need for a pre-recommendation contract will frustrate the use of the BICE by financial institutions that employ staff to engage with benefit eligible participants seeking lump sum distributions. These interventions result in assets remaining in plans or in the savings system via rollovers, and reduce retirement plan leakage. A retro-active contract executed once the transaction commences would therefore preserve plan assets as well.

3. BICE contracts should be subject to negative consent and should not require the Adviser to be a party.

The exemption should allow for negative consent to the BICE contract as the Department requires the key terms of the contract to favor the investor. In addition, the requirement that the adviser also be a party to the contract is inconsistent with industry practice, is unnecessary and would create operational headaches that would not benefit anyone. As long as the financial institution is a party to the contract and takes responsibility for the actions of its advisers then there would be no additional protection provided to the retirement investor by having the adviser be a party to the contract. However, it would be extremely difficult to operationalize this requirement where a retirement investor works with multiple advisers. Take for example a financial institution that provides plan participants or IRA owners with recommendations through a call center. Would each phone representative have to be a party to each contract or would calls have to be directed to the adviser or advisers that were a party to the contract for that particular plan participant or IRA owner? Either way, if there is any level of turnover then the contract would need to be amended to add new advisers on a constant basis. Even with respect to advisers who work in a close one-on-one basis with retirement investors it has become more common for these advisers to work in a team
practice with advisers that specialize in different products and issues. Such a team practice environment acknowledges the difficulty in being an expert at everything and should be encouraged as it benefits retirement investors. However, it creates the same problem as the call center example above as turnover on teams is to be expected particularly as younger advisers decide to start up their own practices and are replaced with new advisers. For these reasons we respectfully request that the Department change the requirement to require that only the financial institution be a party to the contract.

4. The narrow scope of the exemption will eliminate an adviser’s ability to provide advice to certain small plans and plan participants eligible for a distribution.

As it is currently written, the BICE is not available for fiduciaries that provide advice to small participant-directed plans. Clearly, the employers that offer these plans should have the same access to advice that is in their best interest as any other employer. There does not seem to be any policy reason to exclude these employers from receiving the guidance they currently enjoy and expect to continue to be available in the future. ACLI members request that these plans be included so as to not be inadvertently disadvantaged.

In addition, under the Proposal, recommendations to distribute benefits and/or rollover benefits are fiduciary recommendations regardless of whether the recommendation identifies specific investments to purchase or sell. In Section I of this letter, we recommend a change to the definition of fiduciary that treats a distribution recommendation as advice only when it is in conjunction with a recommendation regarding the disposal or exchange of an investment. Should the Department refrain from incorporating our suggested change, we ask that the BICE be extended to distribution and rollover recommendations.

5. The BICE has implications under Investment Advisers Act for agents and brokers that enter BICE agreements acknowledging fiduciary status.

Investment Advisers Act of 1940 (the “Advisers Act”) establishes a clear line between selling agents who are primarily in the business of selling securities for a commission and investment advisers who offer advice regarding investments and receive a fee for their expertise in that regard. Under the Advisers Act, anyone who is in the business of providing investment advice for compensation must register as an investment adviser. However, in order avoid an overly broad application of the law, the Advisers Act specifically excludes certain individuals, companies, and services from coverage and registration. These include lawyers, accountants, engineers, and teachers who provide investment advice that is solely incidental to the practice of their profession; publishers of a bona fide newspaper, magazine, or financial publications that may include investment advice; and any broker or dealer whose performance of advice services is solely incidental to the conduct of his business, and who receives no special compensation therefore.

Insurance-based broker-dealers have carefully complied with this requirement, taking great pains to provide no more than incidental advice in order to avoid the need to submit to the SEC’s regulatory scheme under the Advisers Act. The BICE will call these efforts into question, at best, and may involuntarily make broker-dealers subject to the Advisers Act, at worst. BICE will require broker-dealers to admit fiduciary status at the outset of any sales transaction, irrespective of whether any investment advice provided by the broker is incidental to the sale of a product. This admission of fiduciary status will likely cause the broker-dealer to fall outside of the current Advisers Act exception for non-fiduciary,

---

26 Section 202(a)(11), Investment Advisers Act.
“incidental” advice, and may obligate the broker monitor that advice on an ongoing basis. This will be the case despite the fact that most investors do not expect, or may not want to pay additional fees for such monitoring by a broker-dealer who is primarily a sales agent.

Ultimately, the true impact of the required fiduciary declaration under the BICE for Advisers Act purposes will rest with the SEC. Given this potential conflict between the BICE and the Advisers Act, ACLI encourages the Department to coordinate with the SEC as part of the BICE comment and review process in order to manage this conflict. If the fiduciary declaration requirement is made part of the final BICE, ACLI further requests that the Department work with the SEC to issue guidance contemporaneous with the final BICE that offers comfort that broker-dealers will not be subject to statutory investment adviser status by seeking the protection of the exemption.

6. The exemption’s requirements for advisers that offer a limited range of investment options or proprietary products render it unfeasible.

ACLI members recommend that the Department eliminate the requirements in Section IV, instead, require the fiduciary to disclose to the investor if the fiduciary offers only certain types of investments or proprietary products and whether the fiduciary is subject to any other limits on its advice recommendations.

The exemption currently requires a financial institution to offer a range of investment options that is broad enough to enable the adviser to make recommendations from all of the asset classes reasonably necessary to serve the investor’s Best Interest. This requirement is simply unfeasible in a number of respects. We have several concerns with this requirement.

First, this suggests that the BICE is not available to financial institutions that specialize in one type of product or investment. For instance, a broker who specializes in international bonds would apparently not be able to use the BICE even if they were willing to be held to a best interest standard when selling those bonds to an IRA or retirement plan. Second, the Department has not identified any objective standard for determining what this test would require. Our members feel strongly that they do offer a broad range of investment options such that advisers can make recommendations in the best interest of clients. However, subsection (b) provides additional rules where an investment provider has limited the Assets available for purchase, sale or holding based on whether the Assets are Proprietary Products, generate Third Party Payments, or for other reasons. It is not clear how subsections (a) and (b) are meant to work together. We would note as a threshold matter that we know of no Financial Institution that makes every Asset available for purchase. On the other hand, virtually every Financial Institution makes a range of investment options that is broad enough to permit advisers to make recommendations in the best interest of clients. Thus, it is entirely unclear whether anyone or everyone is required to meet the heightened requirements of subsection (b).

To the extent that subsection (b) is determined to apply, our members assert that it is inappropriate, at best, for the Department to require an investment provider to offer any specific product or range of products, or to require an adviser to disclose if the he or she does not offer every product ever made available in the marketplace. Insurers, as product providers, and agents and brokers who sell these products should have the freedom to choose what products are offered without an undefined disclosure that the products offered are “limited,” especially if the product recommended meets customer needs. For broker dealers, the discrimination regarding products offered is the result of careful due diligence and vetting for FINRA Rule 2111 suitability standards, and is not a reflection of a lack of prudence in recommendation of securities. Even if an institution is a fiduciary, the decision by a financial institution to decide which products or investment funds to offer on its platform is a settlor function. Based on a firm’s individual business models, risk profiles, and particular customer-bases, each firm makes its own independent determination as to which products to offer.
Second, the impartial conduct standard of Section II already requires the adviser to make recommendations that are in the best interest of the client and the reasonable compensation provision requires that the total compensation paid by the retirement investor is reasonable in light of the services they have received. It is difficult to understand why the Department feels it necessary to layer on even more requirements unless it is to make absolutely sure no firm that sells proprietary products or receives third party payments can use the exemption. If that is the Department’s intent, then the Department needs to do so in a transparent manner so that financial services firms can have a meaningful opportunity to comment. Furthermore, the reasonable compensation requirement at Section IV(b)(2) differs from all of the other instances in which reasonable compensation applies within the Proposal, the BICE and other prohibited transaction exemptions including ERISA §408(b)(2). This particular requirement is not business model neutral, but rather envisions the deconstruction of products and services into a la carte offerings. How one will determine the fair market value of a 1-800 call center, internet or mobile app account service? If such services are made available, but not used, have they been “specifically provided?”

7. The required BICE disclosures should be harmonized with other disclosures.

The Department should consider the effects of its proposed BICE disclosures on plan participants and IRA owners. The BICE disclosures are to be delivered in addition to all other applicable disclosures required by ERISA and other federal and state law. At the very least, the Department should seek to align the BICE requirements with ERISA’s existing disclosure regime. ACLI members would propose substantial changes to the initial, annual, point-of-sale, and website disclosures required under the exemption. The insurance and financial services industries have consistently supported disclosure requirements to mitigate potential conflicts. We also believe that markets should hold firms accountable to ensure that fees are reasonable. However, firms do not currently have the capabilities necessary to comply with the disclosure rules. Much of the information requested by the Department does not exist in the format requested or must be obtained from third parties, such as fund manufacturers. For liability reasons, it would be inappropriate for advisers and firms to deliver third-party data on projected costs, for instance, without any way to verify that data. In addition, the disclosures may be cost-prohibitive for small firms to develop a disclosure system that would comply with the exemptions’ requirements, limiting annuity sales opportunities for those institutions.

We are particularly concerned about the annual disclosure because it requires the disclosure of all compensation paid to the adviser and financial institution. The requirement is so broad that the Department has not been willing to state that it would not require the disclosure of spread revenue. Spread revenue is earned by financial institutions in a wide range of products including bank deposits, corporate bonds, and fixed accounts within both fixed and variable annuity products. No financial institution can determine the exact amount of spread revenue it has earned over any particular period not should it have to. The Department has consistently, and appropriately, considered spread revenue to be outside the term “compensation” because it is more accurately considered to be akin to investment earnings. The financial institution takes on risk and if it successfully manages that risk it earns spread revenue. However, in some cases the financial institution may experience risk losses and lose revenue. The Department should clarify in BICE that spread revenue is not compensation that the financial institution must disclose on an annual basis or on its website.

Second, it will be extremely difficult if not impossible for firms to identify the total indirect compensation paid by each retirement investor on its platform. In particular, it will be extremely expensive for financial institutions to track the movements of each retirement investor’s account and then match up the retirement investor’s holding each day with the internal expense ratio of each
investment. Such detailed disclosure is not required under the Department’s 404(a)(5) disclosures presumably because it would be too costly yet the Department somehow thinks it would be feasible under the BICE.

Third, the website disclosure would require the development of a website that included specific information related to every investment available on the financial institution’s platform. For many brokers, this would require disclosure at the CUSIP level of thousands and thousands of individual stocks, bonds, mutual funds, ETF’s, variable annuities, etc. Even worse, because the website must include specific information related to how much an adviser is paid on each of these individual CUSIPs, a financial institution would likely have to create a separate website disclosure for each financial adviser! This could mean the creation of 10,000 websites for a financial institution who compensates advisers differently depending on a number of factors. This is not some hypothetical issue but rather the customary way that brokers pay their registered representatives today.

Fourth, the reporting obligations of Section IX are truly unprecedented. We particularly object to the concept of the Department gathering account level data related to our customers (including unique identifiers necessary for the Department to track each client’s individual returns and tie those returns to their adviser) and then reserving the right to publish that data aggregated at an adviser level. The idea that the Department would identify individual advisers on its website along with the rate of return of the advisers’ client is truly misguided. We note that the Department has not requested any specific information related to the adviser’s clients that might be helpful in informing an opinion as to whether the adviser is doing a good job for each client. For instance, the Department is not looking for the age or risk tolerance of the adviser’s clients, whether the adviser made any recommendations to the client and/or whether the client followed such recommendations, or whether other factors might have played a role in the returns such as an investment strategy that was otherwise sound but did not work well in a particular market environment. Instead, the Department appears satisfied to use such data to impugn the reputation of any adviser whose clients experience a lower return than the clients of other advisers even when that adviser provides services to more conservative investors. The Department should not take any step that may discourage advice that includes a recommendation to invest in a fund with low risk/return characteristics.

Even if the Department did not threaten to publish the data, the mere collecting of client data is very troubling. Given recent headlines related to data held by the federal government that was hacked by third parties, we suspect that many investors will be concerned that their data is being handed over to the federal government.

Information disclosures should be meaningful and actionable for retirement investors. The current disclosures under ERISA sections 408(b)(2) and 404(a)(5) should, in fact for point of sale purposes, suffice for many accounts. Those disclosures require detailed information regarding “reasonable compensation,” much of which overlaps with the information requested under the BICE. Additionally, the annual disclosures required under Form 5500 Schedules A and C are not coordinated with the newly required annual disclosures in the BICE. Complying with the disclosure requirement by referencing existing ERISA disclosures will reduce the potential for investor information overload, and will make it more likely that investors will recognize the importance of the disclosure regime that the Department has worked very hard to develop for the retirement plan market.

To the extent that existing ERISA disclosures are not sufficient (for instance, in the IRA context), the Department should harmonize BICE disclosures with other disclosure regimes already existing in the securities industry. For instance, advisers should be permitted to disclose information requested by reference to documents such as the Form ADV disclosure, the prospectus, the NSCC database, some variation of the “compensation grid” used by used by a firm or adviser, the
Regarding IRAs, the Department should consider harmonizing the BICE point-of-sale disclosure requirements with current IRA disclosure requirements under Treasury Regulation §1.408-6. We understand that the Department may be reluctant to harmonize BICE disclosures with the current compensation and fee disclosure requirements issued pursuant ERISA section 408(b)(2), since these requirements apply only to plans, not IRAs. However, because IRAs are already subject to a separate, comprehensive cost and fee disclosure regime under Internal Revenue Service regulations, we encourage the Department to harmonize the BICE point-of-sale disclosures for IRAs with these existing rules.

Pursuant to Treasury Regulation §1.408-6, IRA providers must give IRA owners certain disclosures upon the establishment of an IRA and periodically thereafter. The regulations require providers to issue a disclosure statement and a copy of the governing instrument to the owner at establishment of the IRA, and to update these later with any amendments. The disclosure statement must set forth, in nontechnical language, concise explanations of the requirements of Code section 408, the income tax consequences of establishing the account and certain statements regarding the consequences of engaging in a prohibited transaction.

In addition, the disclosure statement must also contain a financial disclosure explaining the potential value of the account at various points in the future. The disclosure must comply with different rules depending on whether any assets are subject to guaranteed contracts. If no amount is guaranteed under the account and no projection can be made, the financial disclosure must assume level annual contributions of $1,000 and must describe, in nontechnical language, (1) each type of charge (and amount) which may be made against a contribution, (2) the method for computing and allocating annual earnings, and (3) each other charge which can be applied to the account in determining the net amount of money available to the IRA owner.

These existing disclosure requirements for IRAs approximate, in streamlined form, the information required under proposed BICE point-of-sale disclosure requirements. Allowing this disclosure (or a substantially similar form of this disclosure) to stand as the point-of-sale disclosure for IRAs under the BICE achieves the Department's goals of making the total cost of the IRA "clear and salient" to the Retirement Investor, providing cost information that can be compared across different Assets, and informing the Retirement Investor of the impact of costs for the IRA over time. In addition, these disclosures would be combined with the disclosures required for the underlying investments, such as mutual funds, to provide even greater cost transparency for IRA owners.

ACLI members have been encouraged by recent statements from the Secretary suggesting that the Department will work to deliver finalized guidance that "accomplishes [the Proposal's] goals in the simplest, least burdensome way for all concerned". We encourage the Department to take a small step forward in this vein by harmonizing the BICE point-of-sale disclosure requirements with the existing IRA disclosure requirements under Treasury Regulation §1.408-6.

8. Forego a "low cost" prohibited transaction exemption.

We agree with the Department's repeated caution to plan fiduciaries that fees are a consideration but certainly not the only consideration, and we believe that caution answers why a low cost prohibited transaction exemption would be inappropriate. The only rational response to such an exemption would be for a fiduciary to avoid offering certain services and products in order to achieve the fee level required for the fiduciary to rely on the low cost prohibited transaction exemption. Not only would that be a grave error on its own, it would substantially reduce the likelihood that critical retirement lifetime income guarantees would be available to individual plan...
participants and IRA owners. Rather than push for a streamlined exemption for the types of investments the Department may favor at this time, we would urge the Department to resist the urge to pick winners and losers and rather let the market decide which products should be offered in the marketplace. We believe the Department should work to make the BICE a streamlined and workable exemption.

9. The BICE language, at various points, should be amended to target actual, rather than perceived, conflicts.

It is common for a plan sponsor to designate a menu of plan investments from which participants and beneficiaries may select. In so doing, a responsible plan fiduciary must determine whether the compensation to be received by the financial institution providing such investments receives reasonable compensation for its services. We suggest that when advice is provide to plan participants and beneficiaries regarding the plan’s designated investments, there is no need for fiduciary advisers to second guess the plan’s determination regarding the reasonableness of any compensation to be received.

We recommend Section II(c)(2) be revised as follows:

“... regarding the Asset other than an Asset which is a designated investment alternative under the Plan, ...”

State law bars insurers from making false statements. Clearly, statements on which an investor relies for her investment decision must not mislead. However, the phrase “relevant to a Retirement Investor” raises a subjective rather than objective analysis of whether or a particular statement is “misleading.”

We recommend Section II(c)(3) be revised to provide greater certainty as to the exemption relief offered by the BICE:

“(3) The Adviser’s and Financial Institution’s statements about the Asset, fees, Material Conflicts of Interest, and any other matters relevant to reasonably relied upon by a Retirement Investor’s when making an investment decisions, will are not be misleading.

V. The proposed transition rule should be revised and expanded.

We urge the Department to make application of a final regulation, including changes to prohibited transaction exemptions (particularly PTE 84-24) prospective only to apply to fiduciary advice with respect to retirement accounts opened or insurance contracts issued after the regulation’s compliance date. Prospective application would allow for continued ongoing customer assistance for existing accounts. This is particularly important for commission-based annuity contracts, as retirement investors may have already paid for services. If the Proposal is applied retroactively, annuity owners would incur additional expense to transition to fee-based arrangements. For IRA owners with variable annuity contracts sold in reliance on PTE 84-24, the Proposal does not provide recourse for advisors and investors who have relied on this exemption in good faith. Without a reasonable grandfather provision, IRA owners may be compelled to surrender their annuity contracts to obtain advice.

While ACLI appreciates that the Department has included a form of transition relief in its BICE proposal, such relief is extremely narrow, and it is questionable whether it provides any meaningful relief beyond what would be provided by operation of law.
First, transition relief should be provided for excluded assets. Investments that do not meet the definition of “Assets” under the BICE may not be liquid and readily sold. As a result, financial institutions will have no way to dispose of these assets prior to the effective date of the new regulatory regime. Even when liquid, financial institutions generally do not have discretionary authority to sell out an investor’s account. The only way for an institution to “get rid” of these investments is to resign as the IRA custodian which may result in a taxable distribution and potentially a 10% early withdrawal penalty. It seems unlikely that this is the intent of the Proposal, yet there is no discussion of this issue in the preamble or regulatory impact analysis.

At a minimum, fiduciaries should be able to make sell and hold recommendations on any investments that the Department excludes from relief under the BICE, to the extent that the excluded assets were purchased before the regulation became effective. Furthermore, to the extent that the excluded asset includes rights that are appurtenant to the investment, fiduciaries should be able to provide recommendations related to the exercise of those rights as long as the fiduciary does not earn additional compensation related to such recommendations.

Second, relief is needed for existing customers who reject the Best Interest Contract. When a new contract requirement is imposed, it is inevitable that there will be some percentage of customers that will not sign or agree to the new contract. Even if the Department permits negative consent as we have requested, there may be agreements in place that do not permit amendments via negative consent. Transition relief is necessary to permit the financial institution to amend existing contracts or bring an orderly close to these accounts.

Third, if transition relief is not expanded, investors will be unable to obtain any information about existing products from service providers unwilling or unable to service in an ERISA fiduciary capacity.

VI. Eight month delayed applicability date is unreasonable.

Assuming the substantial modifications necessary to make the exemption workable raised here, compliance with the Proposal will be a major undertaking for financial institutions and advisers. The Proposal will not be administrable within the proposed applicability date of 8 months from the publication of a final exemption. ACLI recommends the Department provide at least three (3) years for the public to digest the final rule and the final exemptions, including the final amended PTE 84-24 (the Department plans to provide at least 140 days for a review of the Proposal), plan and implement changes to comply with the rule including the development and implementation of proper disclosures, the training of advisers to ensure compliance with each of the conditions, a review of all marketing materials, and the building appropriate supervisory procedures. Of note, the Department provided two years from the publication of interim final regulations under ERISA Section 408(b)(2) and the effective date of final regulations.

VII. The cost-benefit analysis in the Proposal is deficient.

Congress, courts, and the executive branch of government have issued unequivocal guidance mandating thorough, objective cost-benefit analysis in rulemaking. Collectively, these standards ensure that federal agencies “strike the right balance,” and develop “more affordable, less intrusive rules to achieve the same ends--giving careful consideration to benefits and costs.”28 Notwithstanding its extensive “regulatory impact analysis,” the Department of Labor failed these standards by overstating benefits, understating costs, and disregarding harm to small retirement plans. Our suggested revisions

to the rule rectify these shortcomings, and more accurately balance benefits against costs. The cost-benefit standards and deficiencies are explained below.

A. Executive, statutory and judicial precedent.

Executive branch mandates for cost-benefit analysis began in 1981 with Executive Order 12,291 that created a new procedure for the Office of Management and Budget (OMB) to review proposed agency regulations, and ensured the president would have greater control over agencies and improve the quality and consistency of agency rulemaking. Cost-benefit analysis formed the core of the review process. The order unambiguously stated that “regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society.”

Regulatory agencies, therefore, must balance the benefits of proposed rules against their costs.

In 1993 Executive Order 12,866 superseded the 1981 order, but retained cost-benefit analysis as a fundamental requirement in rulemaking. Executive Order 12,866 instructs that “in deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating.” In a manner parallel to the 1981 order, Executive Order 12,866 advises that agencies must perform their analysis and choose the regulatory approach that maximizes net benefits.

President Obama reaffirmed the importance of cost-benefit analysis in 2011 through Executive Order 13,563, and reinforced the core principles in Executive Order 12,866 by emphasizing that “each agency must . . . propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs.” Importantly, five administrations between 1981 to present have consistently made cost-benefit analysis a threshold for federal agency rulemaking.

The OMB provided federal agencies with extensive guidance to perform cost-benefit analysis in its Circular A-4.21, which identifies three fundamental elements to federal agency rulemaking: (i) a statement of the need for the proposed regulation; (ii) discussion of alternative regulatory approaches; and, (iii) an analysis of both qualitative and quantitative costs and benefits of the proposed action and the leading alternatives. The analysis should attempt to express both benefits and costs in a common measure—monetary units—to facilitate the assessment. When benefits or costs cannot be quantified in monetary terms or in some other quantitative measure, the agency should describe them qualitatively.

The Administrative Procedure Act (APA) provides comprehensive standards governing federal agency rulemaking, and includes guideposts for judicial review of agency rulemaking under an arbitrary and capricious threshold. The Regulatory Flexibility Act (RFA) of 1980 (5 U.S.C. §§601-612) requires federal agencies to assess the impact of their forthcoming regulations on “small entities,” which the RFA

---

31 The 1981 and the 1993 executive orders emphasize different approaches to the same cost–benefit end. The 1981 order required that the benefits “outweigh” the costs, while the 1993 order required only that the benefits “justify” the costs. See generally Peter M. Shane, Political Accountability in a System of Checks and Balances: The Case of Presidential Review of Rulemaking, 48 ARK. L. REV. 161, 176-78 (1994) (comparison of 1981 and 1993 executive orders with additional detail and observing that the 1993 “order focuses on a similar mandate, but describes it with greater nuance”).
32 Exec. Order 13,563, § 1(b), 76 Fed. Reg. 3821 (Jan. 18, 2011). The order further notes that “each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.”
33 Office of Mgmt. & Budget, Circular No. A-4, Regulatory Analysis (Sept. 17, 2003), last available at http://www.whitehouse.gov/OMB/circulars/a004/a-4.pdf. OMB invited full public comment on his 48-page circular in draft form, which contains detailed instructions about conducting cost-benefit analysis, and provides a standard template for running the analysis.
34 To ensure that agencies perform cost-benefit analysis and select the most cost-effective regulatory options, OMB and the White House Office of Information and Regulatory Affairs (OIRA) review agency cost-benefit analysis before proposed regulations become effective.
defines as including small businesses, small governmental jurisdictions, and certain small not-for-profit organizations. Under the RFA, cabinet agencies must prepare a “regulatory flexibility analysis” when final rules are issued. The RFA requires the analysis to describe, among other things, (1) reasons why the regulatory action is being considered; (2) small entities to which the proposed rule will apply and, where feasible, an estimate of their number; (3) projected compliance burdens of the proposed rule; and (4) any significant alternatives to the rule that would accomplish the statutory objectives while minimizing the impact on small entities.

In three significant cases involving SEC rulemaking beginning in 2005, the Court of Appeals for the District of Columbia Circuit overturned major rules due to the SEC’s failure to conduct adequate cost-benefit analysis which the court viewed as arbitrary and capricious actions contrary to the mandates of the APA.\(^{35}\) The holdings depart from the court’s traditionally more deferential approach to review of agency rulemaking in other administrative law contexts and provide a template for measuring appropriate cost-benefit analysis in federal agency rulemaking. These three rulings are significant because they were rendered by the federal court that typically reviews agency actions and, thus, serves as a touchstone for appropriate federal rulemaking in general. Additionally, the rulings provide an avoidable roadmap to litigation for insufficient cost-benefit analysis in rulemaking. On June 29, 2015, the U.S. Supreme Court underscored the primacy of a carefully balanced and quantified cost-benefit analysis in federal agency rulemaking.\(^{36}\) In sum, therefore, the guidance established by statutes, executive Orders, and seminal recent court cases strongly warrant a more carefully balanced and detailed cost-benefit analysis before the Proposal moves forward.\(^{37}\)

**B. Measuring the regulatory impact analysis against executive, statutory and judicial precedent.**

The Proposal was accompanied by a 243 page “regulatory impact analysis” and seven supporting documents.\(^{38}\) While significant in length, this cost-benefit analysis is fundamentally flawed in several significant respects, particularly as it pertains to variable annuities.

The Department justifies its Proposal with the claim that there is a “substantial failure in the market for retirement advice”.\(^{39}\) The Department’s analysis fails to prove this assertion and contains at least three significant flaws which undermine its proposed solution. Specifically, the regulatory impact analysis: (1) calculates the cost of conflicted advice and the benefits of the proposed rule through selective and imbalanced use of academic studies of mutual funds that are misinterpreted and misapplied to the entire market for retirement advice; (2) overlooks the negative impact of the proposed

\(^{35}\) See Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005), Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166 (D.C. Cir. 2010), and Bus. Roundtable & U.S. Chamber of Commerce v. SEC, 647 F.3d 1144 (D.C. Cir. 2011). In the Business Roundtable and US Chamber of Commerce case, the D.C. Circuit overturned proxy access Rule 14a-11 adopted by the SEC in August 2010. The court determined that the SEC’s failure to "apprise itself--and hence the public and the Congress--of the economic consequences of a proposed regulation" made promulgation of the rule arbitrary and capricious and not in accordance with law. The American Equity case involved the SEC’s adoption of Rule 151A under the Securities Act of 1933 which provided guidance as to whether fixed index annuities were entitled to rely on the exclusion provided under Section 3(a)(8) of that act. The court indicated that the SEC did not disclose a reasoned basis for its conclusion that Rule 151A would increase competition and the SEC did not make any finding as to existing level of competition in the marketplace under state insurance law regimes or the efficiency of existing state insurance law regimes. The Court remanded Rule 151A back to the SEC for “reconsideration,” solely because it found that the SEC had not given proper consideration to the rule's effect on “efficiency, competition, and capital formation” in the annuity industry.

\(^{36}\) Michigan v. EPA, No. 14-46 (June 29, 2015) [http://www.supremecourt.gov/opinions/14pdf/13-1314_3ea4.pdf]. In this case, the Court sent a rule under the Clean Air Act back to the EPA to objectively quantify and balance the benefits and costs under the rule before it could become operative.


\(^{38}\) Department of Labor documents pertaining to the proposed rule can be found here: [http://www.dol.gov/ebsa/regs/conflictsofinterest.html](http://www.dol.gov/ebsa/regs/conflictsofinterest.html).

rule on lower-wealth investors, the likelihood that the supply of financial advice will decline and price of advice increase, and the increased costs inflicted on employer plan participants; and, (3) bases estimates of direct costs of the Proposal on inadequate and incomplete data and insufficient consideration of the time required to implement changes necessary to comply with the Proposal.

Additionally, though the proposed rule and cost-benefit analysis mention annuities a total of 172 times and acknowledge that “31 percent of IRAs include investments in annuities” (p. 54) and that “insurance companies [will] be significantly affected by the proposal” (p. 56), the cost-benefit analysis makes no attempt to examine the impact of the proposed rule on insurers, the annuity market, or on the availability of lifetime income, nor does it attempt to assess the value of variable annuities or their role in retirement security.

1. The statement of potential benefits is flawed.

The Department justifies the need for the proposed rule based on a selective review of six refereed studies and three working papers (see pp. 95-96 of the CBA for the complete list of studies),40 Though the primary justification of the proposed rule is the elimination of conflicts of interest, the Department admits that “[n]one of these papers attempts to detect some major possible sources of underperformance of IRA assets attributable to conflicts of interest” (p. 97). The studies do, however, focus on either the returns of load vs. no-load mutual funds or the returns of broker-sold vs. direct-sold mutual funds. Most of these studies found that during the period under consideration broker-sold front-load mutual funds (which comprise only about 13 percent of the IRA market) may not have performed as well as other funds and that direct-sold mutual funds may have performed better than broker-sold mutual funds. None provide support for the assertion that fiduciary-advised accounts perform better than other types of accounts. The Department relies on these very narrowly focused studies as proof of market failure and does not utilize other bodies of work which would be useful for their analysis, such as the literature on the benefits of using a financial adviser.41

Based on the cited studies, and on the assumption that IRA holders who purchase broker-sold front-load mutual funds received conflicted investment advice which resulted in lower returns, the Department determined that investors holding such funds can expect their investments to underperform by an average of 100 basis points annually. Using this figure and implicitly assuming that this level of underperformance will continue and that investors will not adjust their portfolios, the Department concludes that “underperformance associated with conflicts of interest -- associated with the mutual fund segment alone -- could cost investors more than $210 billion over the next 10 years and nearly $500 over the next 20 years (p. 13).”42 The Department contends that if the Proposal is adopted and conflicted advice eliminated, costs would be lowered, and IRA investors would benefit by “approximately $40 billion over 10 years and almost $90 billion over 20 years (p. 101).”


42 Throughout their analysis the Department provides a very wide range of cost estimates associated with conflicted advice and with the benefits of the proposed rule. On the lower end, the Department estimates that the “expected gain would total between $20 billion and $22 billion over 10 years (p. 108)”. On the higher end, the Department estimates that “under current rules, advisor conflicts could cost IRA investors as much as $410 billion over 10 years, and $1 trillion over 20 years (p. 8)”, and that “underperformance associated with conflicts of interest ... could cost IRA investors $210 to $430 billion over the next 10 years and approximately $500 billion to $1 trillion over the next 20 years (p. 211)”. In a related analysis, the Council of Economic Advisors estimates that conflicted advice costs investors $17 billion annually.
There are, however, at least three major weaknesses in relying on these studies and estimating the benefit of the proposed rule based on their results. First, all of the studies use data from the 1990s and early to mid 2000s. This is highly problematic because competition has significantly increased in recent years, driving down fees. In effect, the market has changed such that any analysis based on old data is in no way applicable in the current market and should not be used to formulate or substantiate regulations. For example, contrary to the findings of the cited studies, by some estimates, front-load fund shares sold between 2007 and 2013 outperformed Morningstar average returns for all funds with similar objectives by 27 basis points per year.  

Secondly, none of the cited studies examine a representative sample of investor portfolios through time, but rather the performance of one type of mutual fund at one point in time. The relative performance of only one type of fund in a given year offers a very limited view of the world. By relying solely on the cited studies to formulate the cost estimates of conflicted advice and benefit estimates of the proposed rule, the Department implicitly assumes that all investors, whether using a broker or not, are “buy and hold” investors. This is not a realistic assumption. In a competitive market, if returns are low investors will eventually shift their assets to more appropriate funds. Ideally, the performance of representative samples of entire portfolios which would include various types of funds and annuities, through time, should be considered. Such an approach would more properly control for critical additional factors, including demographics, wealth, investor sophistication, and different levels of risk tolerance, generating a more accurate analysis of the market. Although the working paper by Chalmers and Reuter cited in the Department analysis consider portfolio-level data, their sample is not representative of the US population -- and their data is unacceptably stale. Chalmers and Reuter examine defined contribution plan accounts of faculty and administrators employed by the Oregon University System from 1996 to 2007. This is hardly representative of the general U.S. population today. 

Finally, though results may be fairly consistent with regard to front-load mutual funds sold through broker-dealers in the 1990s and part of the 2000s, the results concerning other types of investments, such as revenue-sharing mutual funds, are much less conclusive. In fact, Christoffersen, Evans, and Musto (2013), a study the Department analysis relies upon most heavily and which appears to underpin all of the Department’s benefit estimates, do not contain strong evidence of a negative relationship between broker-sold revenue-sharing mutual funds and performance, suggesting that the Department may have selectively used more favorable results to estimate the benefit of the proposed rule. For these reasons, the cited studies should not be used to justify the need for, or determine the potential benefits of, the proposed rule and should not be relied on to formulate well-intentioned rules which can, in fact, have a detrimental impact on plan participants, particularly retirees and pre-retirees, as well as the financial services industry overall.

2. The Proposal inflicts an “advice gap” on individuals who can no longer obtain financial advice.

In the Proposal, the Department acknowledges that a comprehensive analysis of the proposed rule “would consider pure social welfare costs – that is, reductions in economic efficiency – which are not the same as simple compliance costs (p. 99)” . Although the Department analysis evaluates indirect effects and social welfare implications, including the impact on supply and demand for advisory services, it does so inadequately and unrealistically.

The Department cost-benefit analysis asserts that:

“Advisers can provide the same quality of advice while receiving non-conflict-based payments as they can when receiving a payment of equal amount based in conflict. The cost of advice depends primarily on the resources necessary to provide it ... rather than the form of the adviser’s compensation. Thus, an adviser receiving payment through non-conflicted structures should be able to provide advice at the same cost as an adviser receiving conflicted payments, as long as the inputs in time and infrastructure are equal (p. 217).”

It is unclear why the Department assumes that inputs in time and infrastructure would be equal or that the market for financial advice would not change. The price of financial advice is determined by supply and demand. The time, resources and financial burdens of complying with the proposed rule will be greater than under current regulations. This, along with the increased risk of litigation, will induce some advisers to leave the business, lowering supply and increasing the price of advice. This will be particularly true of life insurance agents, a very large percentage of whom are nearing retirement age. Because consumers will face a higher price, many will be priced out of the market and may face the prospect of retirement planning without a financial professional. The advisers who remain in business are more likely to focus on wealthier customers. An increase in the cost of advice and fewer financial professionals will most impact small account IRA rollovers, the segment of the market the Department is most concerned with. In fact, most IRA rollovers are for small amounts. In 2013, 61.4% of IRA rollovers were for amounts less than $50,000 and 75.1% were under $100,000. Almost half (47.8%) were for amounts less than $25,000.

Though the cost-benefit analysis claims the opposite, there is compelling evidence that following the introduction of the Retail Distribution Review (RDR) in the U.K., which the Department extols in support of the Proposal, a significant percentage of small investors were priced out of the market and are now considered ‘stranded customers’. Due to the parallels between the Proposal and the RDR, the same regrettable consequences may also occur in the US due to the Proposal if adopted.

In June 2006 the United Kingdom’s financial regulator, the Financial Services Authority (FSA), created its Retail Distribution Review (RDR) program with the intention of enhancing consumer confidence in the retail investment market and eliminating ‘conflict risk’. In June 2007, the principal discussion paper on RDR was published, and on December 31, 2012, the RDR was implemented. The RDR has three general components: (1) a clear division between independent and restricted advice; (2) a ban on commissions; and, (3) greater minimum qualifications for investment advisers and a requirement that knowledge be maintained. Critics were concerned that the RDR would inherently change the incentives faced by investment advisers resulting in fewer advisers and a shift in focus toward high net worth investors, resulting in an ‘advice gap’ and a large number of ‘stranded customers’. Their assessment was correct.

Though the RDR was implemented at year-end 2012, the UK’s financial services industry was adjusting to the coming changes in the years leading up to implementation. The number of investment advisers was steadily declining pre-RDR. According to the Association of Professional Financial Advisers (APFA), in 2010 there were 43,937 investment advisers in the U.K. and by 2013 there were 31,132, almost a 30% decline. This decline can be primarily attributed to the new qualification standards and the ban on commissions, and to many older advisers choosing to retire earlier than they had planned rather than navigate the new system.

There is also evidence that there is indeed a growing ‘advice gap’. According to data collected by the APFA, in the years leading up to the implementation of RDR, about two-thirds of financial product sales took place with the help of an adviser. By 2012/2013 (the latest data available) this had declined

---

to half and has likely declined since. This is further supported by the results of an annual survey conducted by Mintel, a well-respected marketing research firm. Mintel has administered an annual survey of retail financial advice for U.K. investors since 2009. Their data shows that the number of investors who received financial advice in the wake of the RDR regulation has declined dramatically (see table below). In fact, about half as many investors get advice from the largest advice channel in the U.K. than before the regulations took effect, and the second largest channel has been on a downward trend since the RDR was implemented on December 31, 2012.

<table>
<thead>
<tr>
<th>Year</th>
<th>Bank or Building Society Staff/Adviser</th>
<th>Independent Financial Adviser or Planner</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>32.0%</td>
<td>22.0%</td>
<td>54.0%</td>
</tr>
<tr>
<td>2010</td>
<td>28.0%</td>
<td>24.0%</td>
<td>52.0%</td>
</tr>
<tr>
<td>2011</td>
<td>29.0%</td>
<td>14.0%</td>
<td>43.0%</td>
</tr>
<tr>
<td>2012</td>
<td>31.0%</td>
<td>12.2%</td>
<td>43.2%</td>
</tr>
<tr>
<td>2013</td>
<td>24.5%</td>
<td>17.3%</td>
<td>41.8%</td>
</tr>
<tr>
<td>2014</td>
<td>20.3%</td>
<td>14.7%</td>
<td>35.0%</td>
</tr>
<tr>
<td>2015</td>
<td>16.0%</td>
<td>12.2%</td>
<td>28.2%</td>
</tr>
</tbody>
</table>

*Source: Mintel. Survey response to “which of the following, if any, have you used for financial advice in the last 3 years?”.*

A recent City University of London study noted that “the unintended consequences of the RDR initiative, accompanied by rapid change in technology and social media, is likely to further extend the ‘advice gap’, leaving aside those who have too few assets to merit attention from professional advisers, though they may well be in need of financial advice. This is an undesirable outcome (see Clare, Andrew; Thomas, Stephen; Walgama, Omal; Makris, Christina, “The Impact of the RDR on the UK’s Market for Financial Advice: Challenge and Opportunity”, Cass Consulting, Cass Business School, City University of London, June 2013).

An August 28, 2014 story by Morningstar UK reported that “eleven million investors consider financial advice too expensive and have fallen through the ‘advice gap’ following industry regulation”, and that “some investors prefer not to have an upfront cost for financial advice – as this prices them out of the advice market. Investors with a portfolio of £10,000 for example would understandably be unwilling to hand over a tenth of their assets for an initial consultation cost – whereas the old advice model which took out of the profits along the way would be easier to swallow”.

Even regulators have admitted that there is a growing advice gap. According to a September 10, 2013 Financial Times report, “FCA chief executive Martin Wheatley has admitted ‘concern’ over the post-RDR advice gap”. According to Wheatley “it is a concern that people with portfolios below £50,000 to £100,000 are not getting the same service they were getting...most advisers have worked out you can’t provide a fully advised service without five or six hours work and that costs money. Therefore we are seeing less of that model but we are seeing more web-based, entrepreneurial models delivering advice in a different form.” In fact, automated ‘web-based’ advice is being aggressively pushed by the UK regulator, though it is likely not a good substitute for face-to-face advice or for “five or six hours of work” by an investment professional.
Though seemingly upbeat in its assessment, in a recent post-RDR review, the UK’s Financial Conduct Authority concluded that “by revealing the true cost of advice, the RDR has led some consumers to consider the extent to which the advice they receive represents value for money, and in some cases conclude it does not” (see: Financial Conduct Authority, “Post-Implementation Review of the Retail Distribution Review – Phase 1”, December 2014). A related analysis by the firm Europe Economics finds that “…advice can be seen as a credence good, with its fundamental quality difficult for the consumer to assess ex ante – or even ex post. This means that there is a scope for advisers to compete on measures which consumers believe are good proxies for quality, but which may not in fact be reliable indications of underlying quality”, and that “[f]irms are increasingly segmenting their consumers and considering the service they provide to different groups of consumers, with some focusing on services to those with higher levels of investible assets” (see: Europe Economics, “Retail Distribution Review: Post Implementation Review”, December 16, 2014).

Several years ago the European Union Directorate General on Internal Markets and Services considered a ban on commissions in the insurance market. The EU asked the consulting firm PWC Luxembourg to conduct a study, part of which considered the impact of different solutions to conflicts of interest and remuneration.46 The study concluded that a ban on commissions could have a negative impact on consumers and would create an information gap. Due in part to that experience, a European standard setting group has declined to uniformly impose a ban on commissioned sales, and chose instead to leave the commission issue to each state.

The Department acknowledges that comment letters on its 2010 proposal made a case that the initiative would result in diminished access to investment advice, particularly for low-balance savers, but appears unconcerned with this possibility, suggesting that ‘robo-advisers’ will fill any gaps that result from the proposed regulation. 47 However, robo-advisers are a new and untested method of providing financial advice and are not necessarily more cost-effective than in-person advice.48 At year-end 2014 robo-advisers managed only $19 billion in assets, compared to $24.7 trillion in total U.S. retirement assets, about 0.077% of the market or 77 cents out of every $1,000.49

There are no rigorous, refereed studies examining whether a robo-adviser is a good substitute for a human being. Numerous scholarly studies have shown, however, that there are clear positive effects from dealing with a human adviser, such as: encouragement to save more, less speculative trading, a more diversified portfolio, and greater discipline when faced with a volatile market. In fact, during financial downturns and market volatility, investors turn to human advisers for reassurance and are typically dissuaded from emotional investing. Because it is so recent, robo-advising has only been in existence during a bull market. It is unclear how this system would fare in a downturn. Depending on how many people utilize such a resource, there could be systemic implications which would be particularly devastating to retirees and pre-retirees, as well as the economy as a whole.

As noted above, the proposed rule will significantly increase the costs and risks associated with selling and marketing to small employers (99 employees or less). Life insurers provide products and services to 31.8 million employer plan participants, about 35% of the entire market. About 60% of plan participants who work for a small employer (7.1 million employees) rely on life insurers for products and services.50 Virtually all small plan participants will be adversely impacted by the proposed rule.

49 This assumes that the entire $19 billion were retirement assets. It is likely that considerably less than $19 billion is in robo-adviser IRAs. See CCI and www.wsj.com/articles/putting-robo-advisers-to-the-test-1429887456 and http://www.forbes.com/sites/samanthasharf/2015/01/28/can-robo-advisers-survive-a-bear-market/.
50 Based on a 2015 ACLI survey of life insurers. Survey respondents represent 81% of industry assets.
3. Insufficient analysis of direct costs.

The Department estimated that the cost of complying with the proposed rule would range from $2.4 billion to $5.7 billion over ten years, and assert that the higher end of the range is likely an overestimate. Shockingly, these estimates are based on two comment letters from trade associations (neither of which represent the life insurance industry), one of which is admittedly a rough estimate based on a survey of only 18 members and which was discounted by the Department because “the data appear to significantly overstate the cost of compliance”. Relying on two comment letters and entirely ignoring the implementation and compliance cost imposed on the life insurance industry to estimate the cost of significant new regulation on a $24.7 trillion industry is wholly insufficient. Further, the likelihood that a greater regulatory burden and new administrative and compliance costs would negatively affect positive innovation is not sufficiently considered in the initiative.

Additionally, the cost-benefit analysis does not adequately consider the time needed to implement the changes required to comply with the proposed rule. According to a recent industry survey, on average, life insurers will require at least 24 months to fully implement changes necessary to comply with the proposed rule, with 20% of companies requiring at least 36 months.

4. The cost-benefit analysis does not consider annuities.

One element of the Department’s regulatory impact analysis calculates the burden of fees and charges on the performance of selected investments. However, the Department’s analysis does not offer any direct evidence on the costs of conflict related to variable annuities, but rather applies academic studies on mutual fund costs to variable annuity products held in IRA accounts. In effect, because the Department presents no empirical analysis of any costs of conflicted advice for variable annuity products, the many cost estimates provided are not relevant to this sector of the market.

The Department also does not consider the benefits of variable annuity products for IRA holders. Variable annuities are not simply investments, but rather insurance products which can ensure well-being and financial security for life. According to a 2013 Gallup survey, 87 percent of annuity owners intend to use their annuity as a financial cushion for living beyond their life expectancy. Variable annuities offer consumers a variety of insurance features, including the option of enhanced death benefits, accrual guarantees, and lifetime withdrawal benefits. Customers actively and voluntarily choose to elect various combinations of features tailored to their specific insurance needs and risk profiles. Survey data shows that annuity owners are pleased with the products they purchase. According to a recent LIMRA study, the vast majority of variable annuity owners are satisfied with their annuity, and five out of six deferred annuity owners would recommend an annuity to their family and friends. Additionally, a recent study by Towers Watson found that among retirees of similar wealth and health characteristics, those with annuitized incomes are happiest. Much like buying a house or choosing where to send your children to college, choosing the right annuity requires time, education, and guidance in order to make the right decision. The current Proposal may effectively eliminate or curtail these services.

As is the case in any competitive market, the costs of the variable annuity products vary in relation to the number of features selected. Some consumers choose to pay more in order to have greater risk protection and insurance benefits. According to a recent, ongoing study which relies on a unique sample of contract-level variable annuity qualified account data from 13 life insurance companies.

---

51 See DOL cost-benefit analysis p. 157 for details.
companies representing over 25% of the variable annuity industry, and which includes a representative sample of over 237,000 individual contracts, 40% variable annuity customers have chosen a living benefit, about one-third elected some form of enhanced death benefit, and 7% explicitly included an accumulation guarantee benefit which may guarantee growth rates or lock-in returns during the accumulation phase, before the owner chooses to annuitize."  

Concerning surrender charges associated with insurance products like annuities, it appears that the Department presumes that: (1) all annuities have surrender charges; (2) all surrenders are for the full amount of the annuity; (3) annuity contracts never waive surrender charges in cases of hardship (such as serious illness or entering a nursing home); and, (4) surrender charges are applied 100% of the time. None of these presumptions are correct. In fact, if an annuity has a surrender charge it is contingent and incurs only if a contract is discontinued before the conclusion of the surrender period, which typically is about seven years.

In order to offer guarantees, protection, and insurance features, insurers are required to set aside reserves and hold capital. Given the nature of how insurers are required to invest and the nature of guarantees they offer, it is reasonable to discourage withdrawals for a period of time. Thus, if an annuity has a surrender charge, and if the contract owner does not surrender the contract prematurely, surrender charges will not be incurred. In fact, very few contract holders pay surrender charges. Based on contract-level data collected from life insurers, a recent ongoing study has found that 17.8% of annuity contracts do not have surrender fees and that a large majority of companies offer at least some contracts with no surrender fees. Of those contracts which do have surrender fees, when a surrender or withdrawal occurs over 75% of annuity owners do not pay any surrender fees (i.e. the median surrender fee paid is 0%). Surrenders can be full, where the entire account is withdrawn, or partial, where only some portion of the account is withdrawn. Considering only partial surrenders, 81.7% paid no surrender fee. The average fee paid for all surrenders was 0.84% and for partial surrenders only 0.39%, 616 bps and 661 bps below the 7.00% the Department suggests is the norm. It is also important to note that, in the database referred to above, 100% of the firms that offer policies with surrender charges in the sample considered allowing contract holders to withdraw some percentage of their account balance each year with no fee. Additionally, in the sample, most firms that offer policies with surrender charges allow contract holders a contingency event waiver in the event of healthcare emergencies such as being checked into a nursing home.

Additionally, allegations of ‘churning’ also appear to be unfounded. According to the study referred to above, less than 2% of contracts issued in 2012, 2013, 2014, or 2015 have been fully surrendered. These findings demonstrate that the Department’s assumptions regarding surrender charges are grossly overstated and inflate the Department’s conclusions.

C. The Proposal unacceptably excludes the protections of the current regulatory framework from its quantification of need.

In its justification for the Proposal, Department asserts that current regulatory protections are inadequate to address Department’s concerns about advice to retirement plan participants. We disagree with the wholesale disregard of detailed systems of significant protection from the analysis of regulatory need. The scope of the Proposal can be responsibly tempered with an objective integration of these fundamental protections and prophylactics in the redesign of the Department Proposal. It is contrary to the guiding statutory, executive, and judicial standards to impose new and redundant elements governing advice to plan participants that are already served quite well under complementary patterns of significant regulation.

---

55 NERA study, forthcoming.
56 NERA study, forthcoming.
A detailed regulatory framework governs conduct in the sale of insurance products. A brief synopsis about these requirements provides helpful background to the issues under study. Life insurance companies and their associated persons currently fulfill a broad array of regulation administered by state insurance departments, the Securities and Exchange Commission (SEC), the Department, the Financial Industry Regulatory Authority (FINRA), and various state securities departments.

We offer input about this comprehensive regulatory framework to provide background for evaluating the benefits, needs and the costs of the Department Proposal. Business conduct standards regulate important aspects of the customer relationship, including suitability standards, disclosure, advertising, supervision, maintenance of customer account assets, data collection, training, compensation, and supervision of associated persons. In general, the federal securities laws and FINRA rules govern individual variable insurance contracts, and state insurance laws and regulations apply to fixed insurance products. In some cases, insurance products invoke both federal and state laws. Collectively, this body of regulatory provisions and oversight provide important consumer protection and strong enforcement tools.

We have attached an Appendix to highlight the extensive network of laws and regulations governing insurance product sales activities. Laws and regulations most relevant include:

- The NAIC Suitability in Annuity Transactions Model Regulation;
- FINRA Rule 2330 governing suitability and supervision in the sale of variable annuities;
- FINRA Rule 2320 governing non-cash compensation for variable products and mutual funds;
- The NAIC Annuity Disclosure Model Regulation;
- The NAIC Model Replacements Regulation, and state insurance regulations such as New York Regulation 60 which governs replacements;
- The NAIC Unfair Trade Practices Act and the prohibition on “unfair financial planning practices;” and,
- State insurance consulting laws governing the simultaneous receipt of product commissions and fees for insurance consulting services.

Life Insurers provide significant written disclosures at the point of sale to satisfy multiple regulators’ requirements and to help customers understand the nature of their various products and relationships. These disclosures include many product related materials (insurance sales illustrations, policy contracts, required “buyers guides,” prospectuses), marketing materials describing the firm’s offerings, documents that provide the terms for a brokerage or advisory relationship (brokerage account agreements, advisory account agreements, Form ADV, investment policy statements), and other required disclosures. There also is a considerable amount of post-sale disclosure depending on the nature of products and services provided, such as in-force insurance ledgers, transaction confirmations, periodic performance reporting for investment accounts, and updated Form ADV brochures. Several state and federal laws are designed to ensure appropriate sales practices and suitable recommendations consistent with customers’ financial objectives and best interests.

Insurance products are the only products in today’s financial marketplace with free-look provisions extending for 10, or more, days. These features give consumers a meaningful opportunity to carefully evaluate purchases after the sale and to change their mind for any reason, including cost factors, to receive a refund.
D. The status of non-cash compensation regulation.

Discussion surrounding the Department Proposal has referenced inappropriate influences of non-cash compensation. Many of the observations reflect isolated circumstances and appear ignorant of significant constraints on non-cash compensation practices. A brief explanation about the standards governing non-cash compensation may illuminate objective analysis leading to more balanced revisions to the Proposal.

Life insurers comply with regulations that regulate permitted non-cash compensation practices. FINRA Rule 2320 applies to broker-dealers selling variable insurance contracts and mutual funds, respectively, and limit non-cash compensation to: (1) gifts of up to $100 per associated person annually; (2) an occasional meal, ticket to a sporting event or theater, or comparable entertainment; (3) payment or reimbursement for training and education meetings held by broker-dealers or issuers/sponsors for the purpose of educating associated persons of broker-dealers, so long as certain conditions are met; (4) in-house sales incentive programs of broker-dealers for their own associated persons; and, (5) contributions by any company or other FINRA member to a broker-dealer’s permissible in-house sales incentive program, subject to the following explicit conditions:

- Non-cash compensation arrangements between a broker-dealer and its associated persons or a company and its sales personnel who are associated persons of an affiliated member, are conditioned on (1) the member's or non-member's non-cash compensation arrangement, if it includes variable contract securities, is based on the total production of associated persons with respect to all variable contract securities distributed by the member; (2) the non-cash compensation arrangement requires that the credit received for each variable contract security is equally weighted; (3) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and (4) the record keeping requirement in the rule is satisfied.

- With regard to training and education meetings, the rule imposes strict additional conditions that require associated persons to obtain their broker-dealers’ prior approval to attend the meeting and that (1) attendance by a member’s associated persons is not conditioned by the broker-dealer on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by the rule; (2) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the broker-dealer, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings; (3) the payment or reimbursement is not applied to the expenses of guests of the associated person; and, (4) the payment or reimbursement by the offeror is not conditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement allowed under the rule. These limitations successfully assure that training and education meetings are appropriate.

Rule 2320 requires broker-dealers to maintain records of all non-cash compensation received by the broker-dealer or its associated persons in permitted non-cash compensation arrangements. The records must include: the names of the offerors, companies or other broker-dealers making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the broker-dealer and its associated persons with the rule.
Life insurers support the spirit and purpose of Rule 2320, and actively participated in its
development through comment letters and constructive suggestions to achieve an effective, consumer-
protective regulation.\textsuperscript{57} ACLI regularly compiles and digests all FINRA disciplinary actions to capture data
involving the distribution of variable products and broker-dealers affiliated with life insurance
companies. In a survey of the past five years, there have been no reported disciplinary actions involving
non-cash compensation associated with insurance product sales. These results demonstrate that FINRA
Rule 2320 works efficiently and effectively.

E. Commissions compared to fee-only investment advice.

The Proposal is founded on a premise that commissioned products influence advisers to provide
conflicted advice to the detriment of retirement plan participants. As such, the Proposal elevates fee-
based advice and automated robo-advice systems as preferable alternatives because they are cheaper
and aligned with the interests of retirement plan participants. These premises are incorrect in many
cases. Recommendations under the Proposal may generate the least expensive product that may
actually disserve and impair the participant’s best interests. While fee-based or automated advice is
appropriate for some individuals, it is not necessarily appropriate for all.

In truth, financial product recommendations and associated compensation arrangements are
most objectively evaluated according to the unique facts and needs of each financial customer and the
individual compensation arrangement. Financial advisers who obtain their compensation through annual
fees based on assets under management (“wrap fees”) would not likely recommend certain commission-
based products, like annuities, because that purchase is not generally included within the assets under
management on which the annual, recurrent fees are assessed by this type of fee-based financial
adviser. Recurrent annual fees may be ill-suited to individuals with moderate assets needing little annual
advice, and may exceed the total value of a commissioned-based adviser.

FINRA issued guidance about fee-based arrangements, recognizing that while fee-based
programs are beneficial for some customers, “they are not appropriate in all circumstances.”\textsuperscript{58} FINRA instructs that

Firms must consider the overall needs and objectives of the customer when determining the
benefits of a fee-based account for that customer, including the anticipated level of trading
activity in the account and non-price factors such as the importance that a customer places on

\textsuperscript{57} In a similar regulatory vein, New York Insurance Code Section 4228 permits certain non-cash compensation practices for
life insurance policies and annuities. New York Insurance Code Section 4228(e)(6) provides that:

A company, including any person, firm or corporation on its behalf or under any agreement with it, may pay or award,
per permit to be paid or awarded, prizes and awards to agents and brokers pursuant to a plan of agent or broker
compensation, provided that no single prize or award may exceed a value of two hundred fifty dollars, and that the
total value of such prizes and awards paid or awarded to any agent or broker within a calendar year may not exceed
one thousand dollars. Notwithstanding the foregoing, a company may also pay or award not more frequently than
monthly a prize or award valued at not more than twenty-five dollars.

An implementing regulation places monetary limits on the value of prizes and awards that insurers can provide agents. The
records must include: the names of the offerors, companies or other broker-dealers making the non-cash compensation
contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash
compensation received; the location of training and education meetings; and any other information that proves compliance by
the broker-dealer and its associated persons with the rule. The New York Department of Financial Services website contains
additional information about what steps life insurers must take to comply with Section 4228.

\textsuperscript{58} See Notice to Members 03-68, Fee-Based Compensation-NASD Reminds Members That Fee-Based Compensation Programs
Must Be Appropriate, \url{http://www.finra.org/sites/default/files/NoticeDocument/p003079.pdf}.
aligning his or her interests with the broker. Additionally, firms must take into account the nature of the services provided, the benefits of other available fee structures, and the customer's fee structure preferences.59

As FINRA aptly observes, under some customer circumstances, compensation through commission arrangements may be more appropriate than fee-based arrangements. Quite correctly, FINRA explained that the appropriateness of fee-only financial arrangements should be evaluated on the unique circumstances of each customer and their financial needs. The same is true with evaluations of commissioned recommendations to purchase certain financial products like annuities.60 There are many customers for whom annuities provide a valuable and appropriate means to achieving retirement security and guaranteed lifetime income. The fact that the salesperson was compensated by commissions does not diminish the important role annuities play in financial and retirement security. Commission-based compensation can be the most economical and appropriate form of compensation in advisory arrangements with consumers owning moderate amounts of retirement assets, and may be significantly less expensive than non-commissioned forms of compensation, such as asset management fees.

For all of these reasons, the Proposal’s recurrent conviction that commission-based advice is always conflicted fails to fulfill the statutory, executive, and judicial mandates that the cost-benefit analysis should be balanced, and consider several solutions to proposed rulemaking.

F. Correcting observations of fact and law.

To ensure that agencies properly perform cost-benefit analysis and select the most cost-effective regulatory options, the White House Office of Information and Regulatory Affairs (OIRA) reviews agency cost-benefit analysis before proposed regulations become effective. To the extent views from that office reflect the January 15, 2015, White House Memorandum and the White House Fact Sheet61 supporting the Department of Labor’s proposed fiduciary rule, we offer some corrections of fact and law that may be helpful in the Proposal’s cost-benefit analysis.

According to the memorandum “many firms recommend that prospective customers roll over 401(K) plan assets into an IRA without any knowledge of a customer’s financial situation.” Salespersons recommending the purchase of a variable annuity on an IRA roll over must fulfill FINRA’s suitability and supervision Rule 2330, which requires the salesperson to obtain specific information from the customer (such as the customer’s investment objectives, liquid net worth, financial sophistication, and tax status). This information is recorded on a customer account record that forms the basis of suitability determinations and supervisory review. Further, Rule 2330 requires the salesperson to make an

59 See Fee-Based Questions and Answers, http://www.finra.org/industry/fee-based-account-questions-answers . FINRA stated that

Certain potential problems have been identified through our examination program. For example, it is not always clear that customers receive adequate disclosure about the distinctions and features of fee-based versus commission-based accounts, including the differences in fee structures and that fees will probably be higher in a fee-based account if the level of activity is modest. Training and education at some firms are minimal, particularly in giving brokers guidance on how to evaluate whether a customer is appropriate for a fee-based account.

60 Elisse B. Walter, who served as acting SEC chair, SEC Commissioner, and FINRA Senior Executive Vice President, noted:

In a nutshell, while fee based accounts can be a good thing, they are not always the right thing, or the best thing. We need you to look at each customer and determine what kind of fee works best for him or her. The Tully Report itself recognized that investors with low trading activity would probably be better off with a commission-based program that charges only when trades are made. See Elisse Walter, Current NASD Regulatory Issues on Sales and Marketing (Sept. 28, 2004) http://www.finra.org/newsroom/speeches/092804-remarks-27th-annual-sia-sales-and-marketing-conference.

61 The Fact Sheet is entitled Middle Class Economics: Strengthening Retirement Security by Cracking Down on Backdoor Payments and hidden Fees and was released February 23, 2015.
affirmative determination that the "customer would benefit from certain features of a deferred variable annuity (e.g., tax-deferred growth, annuitization or death benefit."

Rule 2330 imposes a significant supervisory obligation requiring the broker-dealer’s registered principal to review the recommendation and consider the extent to which:

- the customer would benefit from certain features of a deferred variable annuity;
- the customer’s age or liquidity needs make the investment inappropriate; and,
- the customer involved an exchange of a deferred variable annuity; will incur surrender charges, face a new surrender period, lose death or existing benefits, have increased mortality and expense fees, appears to have a need for any potential product enhancements and improvements, or had another deferred variable annuity exchange within the preceding 36 months.

Likewise, the NAIC Suitability in Annuity Transactions Regulation imposes suitability and supervision standards for fixed annuity sales that are modeled on FINRA Rule 2330. This model regulation has been adopted in most jurisdictions. It is factually incorrect, therefore, that recommendations to purchase a fixed or variable annuity in an IRA roll over are done "without any knowledge of the customer’s financial situation."

The memorandum states that “advisers steer investors into variable annuities and other complex products with high fees. Advisers can exploit their customer’s low level of financial literacy by recommending riskier and more complex investments.” (emphasis added). Most, but not all, contemporary fixed and variable annuities have surrender fees, which only occur if the customer cancels the contract within a specified period, usually about seven years on average. Annuities are purchased and sold as long-term accumulation vehicles for retirement security, not as short-term trading vehicles. If customers purchase the contract and hold it for the surrender period, they will not incur surrender charges. The White House memorandum does not appear to understand these mechanics.

As explained above, FINRA Rule 2330 and the NAIC Suitability in Annuity Transactions Model Regulation impose suitability and supervision standards that are designed to ensure that annuity purchases are appropriate for customers, including those with low levels of financial literacy.

Variable annuities provide permanent annuity purchase rate guarantees for purchasers upon annuitization, and many variable annuities provide optional riders for guaranteed benefits, such as lifetime payouts, withdrawals and death benefits. Variable annuities are designed to track the growth in the economy and provide protection against lower purchasing power due to inflation. The White House statement overlooks the fact that variable annuities can provide a valuable solution to the risk that consumers will have inadequate retirement assets. The memorandum’s statements associating variable annuity recommendations with high fees, exploitation of low financial literacy and riskier investments is generally incorrect.

The memorandum states that “consumer protections for investment advice in the retail and small plan markets are inadequate.” This unqualified observation is overbroad and ignores substantial consumer protections under the federal securities laws governing the activities of investment advisers and broker-dealers. Likewise, it ignores analogous protections under state laws such as the NAIC Suitability in Annuities Transactions Model Regulation. A fiduciary duty is currently enforced under the Investment Advisers Act for registered investment advisers that may be involved in recommendations about IRA roll over options. SEC Commissioner Daniel Gallagher addressed this observation in a recent public speech, noting that the memorandum’s statement
is not accompanied by any analysis or study of the current protections consumers receive from the regulatory oversight of brokers and investment advisers by the SEC and SR0s-in fact, it blatantly ignores this comprehensive regulatory oversight. Indeed, the memo manages to avoid any mention of either the SEC or FINRA.\textsuperscript{62} 

The statement in the memorandum disregards other significant regulatory protections that currently exist under the federal securities laws.

The Fact Sheet references “outdated regulations” that provide consumer protections under IRA roll over recommendations. FINRA Rule 2330 and the NAIC Suitability in Annuities Regulation were recently adopted to significantly upgrade consumer protections in fixed and variable annuity sales.

The memorandum states that “loads encourage advisers to excessively churn their customers’ investments.” FINRA and SEC regulations explicitly prohibit churning of customer accounts. Indeed, FINRA Rule 2330 requires the adviser and supervisor to specifically consider whether a customer involved an exchange of a deferred variable annuity:

will incur surrender charges, face a new surrender period, lose death or existing benefits, have increased mortality and expense fees, appears to have a need for any potential product enhancements and improvements, or had another deferred variable annuity exchange within the preceding 36 months.

In response to this assertion in the memorandum, SEC Commissioner Gallagher noted “our (SEC) rules expressly prohibit brokers from churning customer accounts, and the SEC and SROS have sophisticated tools designed to monitor for such activity.”\textsuperscript{63} Likewise, the NAIC Suitability in Annuities Transaction demands that recommendations, and accompanying supervision, are suitable. Churning would not be suitable.

G. Concluding observations about the Proposal’s fulfillment of executive, statutory and judicial standards governing cost-benefit analyses in rulemaking.

Our submission provides numerous suggestions that will more appropriately align the Proposal with the Department’s mission and the Proposal’s purpose in a manner that respects the proper balance of costs and benefits while also protecting retirement plan participants. Our suggestions achieve a constructive improvement to the original proposal and help the Department forestall post-adoption challenges to the adequacy of its cost-benefit analysis as required under executive, statutory and judicial standards.

The Proposal is exposed to judicial challenge because it:

- Fails to calculate the impairment to small retirement plans through the loss of advisory channels, as required under the Regulatory Flexibility Act;
- Presents inflexible approaches that are arbitrary and capricious under APA standards and bypassing less burdensome alternatives on a cost-benefit yardstick;
- Neglects the judicial precedent in the trio of recent cases rejecting SEC rulemaking due to defective cost-benefit analysis;
- Rejects or ignores the comprehensive pattern of regulation that imposes significant protections against conflicts of interest and erects prophylactics to protect retirement plan participants; and

\textsuperscript{62} See Remarks at The SEC Speaks by Daniel M. Gallagher (Feb. 20, 2015) at 3.
\textsuperscript{63} See Remarks at The SEC Speaks by Daniel M. Gallagher (Feb. 20, 2015) at 3.
• Ignores the impact of the rule on small businesses as required under the Regulatory Flexibility Act.

The Proposal’s exposure to post-adoption legal challenges can be mitigated by incorporating our recommended modifications. In the end, the Proposal should fully evidence the 2011 Executive Order issued by President Obama and the spirit of his comments, which emphasized:

• “Sometimes, rules have gotten out of balance, placing unreasonable burdens on business—burdens that have stifled innovation;”

• “As the executive order I am signing makes clear, we are seeking more affordable, less intrusive means to achieve the same ends—giving careful consideration to benefits and costs. This means writing rules with more input from experts, businesses and ordinary citizens. It means using disclosure as a tool to inform consumers of their choices, rather than restricting those choices;” and,

• “We’re looking at the system as a whole to make sure we avoid excessive, inconsistent and redundant regulation. And finally, today I am directing federal agencies to do more to account for—and reduce—the burdens regulations may place on small businesses.”

*****

On behalf of the ACLI member companies, thank you for consideration of these comments. We welcome the opportunity to discuss these comments and engage in a productive dialogue with the Department on this Proposal.

Respectfully,

James H. Szostek

---


65 Id.

66 Id.
Table of Contents for Appendix to ACLI Submission to the Department of Labor on the Fiduciary Rule

FINRA Rule 2330: Suitability and Supervision in the Sale of Variable Annuity Contracts...1

NAIC Suitability in Annuity Transactions Model Regulation: A Coordinated Approach to Suitability and Supervision in the Sale of Individual Annuity Contracts.................................8

ACLI Issues Status Chart: NAIC Annuity Disclosure, Suitability in Annuity Transactions & Senior Specific Certifications Model Regulations..............................................................15

State Laws Governing Suitability in Variable Life Insurance Sales........................................53

The NAIC Annuity Disclosure Model Regulation: Disclosure Standards in Annuity Distribution.........................................................................................................................59

NAIC Buyer’s Guide for Deferred Annuities.............................................................................64

NAIC Buyer’s Guide for Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities..........................................................................................................................75

NAIC Insurance and Annuities Replacement Model Regulation...........................................104

ACLI Law Survey: Replacement of Life and Insurance and Annuities.................................119

NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities..............................................168

The Impact of State Insurance Consulting Laws on Producers Performing Financial Planning Services................................................................................................................171

A Comprehensive System of State Regulations Governs the Distribution of Insurance and Annuity Contracts........................................................................................................196

ACLI Law Survey: Free Look/Right to Return Requirements................................................203
July 21, 2015

Office of Regulations and Interpretations  
Office of Exemption Determinations
Employee Benefits Security Administration  
Employee Benefits Security Administration
U.S. Department of Labor  
U.S. Department of Labor
200 Constitution Avenue, NW  
200 Constitution Avenue, NW
Room N-5655  
Suite 400
Washington, DC 20210  
Washington, DC 20210
Attention: Conflicts of Interest Rule  
Attention: D-11712 and D-11850

Re: Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice  
RIN 1210-AB32
Re: Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters  
ZRIN 1210-ZA25
Re: Proposed Best Interest Contract Exemption  
ZRIN 1210-ZA25

To Whom it May Concern:

The Insured Retirement Institute (“IRI”) is pleased to provide these comments with respect to the Department of Labor’s notice of proposed rulemaking concerning the Definition of the term “fiduciary” of an employee benefit plan (the “Proposed Regulation”), the related proposed amendment to and proposed partial revocation of prohibited transaction exemption 84-24 (the “Proposed Amendment to PTE 84-24”), and the proposed Best Interest Contract Exemption (the “Proposed BIC Exemption”) (collectively, the “Proposal”).


**About the Insured Retirement Institute**

As the only national trade association that represents the entire supply chain for the insured retirement strategies industry, IRI is uniquely positioned to comment on the implications of the Proposal for manufacturers, distributors and consumers of annuity products that provide guaranteed lifetime income. IRI has more than 500 member companies, including major insurance companies, broker-dealers, banks, and asset management companies. Member companies account for more than 95% of annuity assets in the United States, include the top 10 distributors of annuities ranked by assets under management, and are represented by more than 150,000 financial professionals serving over 22.5 million households in communities around the country. IRI members therefore represent not only their own views, but also those of their clients across Main Street America.

**Executive Summary**

The following is an overview of our comments regarding the Proposal. We respectfully offer these comments to assist the Department in determining how to formulate a final rule that will enhance consumer protection while preserving consumer choice and access to the products and services they need to attain a financially secure and dignified retirement.

**Core Principles** (See pages 7-10)

1. Financial professionals should be held to a best interest standard when recommending investments to retirement savers. (See page 8)

2. Consumers are entitled to freedom of access to retirement income guarantees. (See page 8)

3. In the post-defined benefit plan era, the availability of guaranteed retirement income through IRA rollovers meets a critical consumer need. (See page 8)

4. Rules for annuity products must be specifically crafted to account for their guaranteed lifetime income features. (See page 9)

5. Competitive annuity markets serve consumer interests. (See page 9)

6. Consumers have a right to choose their preferred source of retirement advice, including the option to work with advice providers who are experts on proprietary products, and how their advice provider is compensated. (See page 9)

7. The Administration’s public policy position in favor of access to and utilization of guaranteed lifetime income products should be advanced. (See page 10)
The Context for IRI’s Comments on the Proposal: America’s Retirement Income Challenge and the Need for Retirement Income Products (See pages 10-13)

1. Americans today are living longer than ever before, while access to traditional defined benefit pension plans continues to decline, creating a significant risk that many people will outlive their assets. It is critical that the regulatory environment allows consumers to access products that meet their need to protect against this increased longevity risk. (See pages 10-11)

2. Annuities are the only products available in the private market that can provide retirees and pre-retirees with a guaranteed source of income to ensure they can enjoy a financially secure and dignified retirement. (See pages 11-12)

3. Consumers who receive assistance from financial professionals save more throughout their working years, make better use of available retirement planning products and strategies, and commonly experience better returns on their investments, and therefore are better prepared for retirement than those who do not have access to retirement planning advice. (See pages 12-13)

Comments Relating to the Proposed Definition of the Term “Fiduciary” (See pages 13-28)

1. The definition of an investment advice “fiduciary” in the Proposed Regulation needs to focus more precisely on conduct that is appropriately regarded as fiduciary in nature rather than all manner of sales activities. The proposed definition would deprive retirement investors of access to information and would inappropriately limit advice sources. (See pages 15-20)
   a. The “specifically directed to” element of the Proposed Regulation will cause fiduciary status to arise as a result of ordinary advertising and marketing activities. This is unnecessary and harmful, and the phrase should therefore be removed from paragraph (a)(2)(ii) of the Proposed Regulation. (See pages 15-16)
   b. To provide predictability and certainty, both for consumers and financial professionals, the “individualized to the advice recipient” element of paragraph (a)(2)(ii) of the Proposed Regulation should be modified to read “sufficiently individualized as to form a reasonable basis for reliance by the advice recipient as a source of unbiased and impartial advice.” (See pages 16-17)
   c. The “for consideration” element of paragraph (a)(2)(ii) of the Proposed Regulation is overly broad and should be changed to require that recommendations be made “for the purpose of” making investment decisions. (See pages 17-18)
d. The definition of “recommendation” as a suggestion to engage in or refrain from taking a particular course of action, as set forth in paragraph (f)(1) of the Proposed Regulation, is too broad and should be redefined as “a communication that, based on its content, context, and presentation, would reasonably be viewed as a call to take action or to refrain from taking action.” (See pages 18-19)

e. To avoid inappropriately giving rise to fiduciary status, the phrase “either directly or indirectly (e.g., through or together with any affiliate)” should be moved from paragraph (a)(2) of the Proposed Regulation to paragraph (a)(2)(i) immediately following the word “acknowledges.” (See pages 19-20)

2. To ensure consumers continue to have access to guaranteed lifetime income products and related advice, an additional, generalized carve-out is necessary to accommodate sellers of financial products and services, and modifications to the proposed carve-outs are needed to accommodate reasonable and necessary business practices. (See pages 20-25)

   a. The Department should add a new carve-out from fiduciary status for a person who: “provides advice or recommendations . . . under facts and circumstances where there can be no reasonable expectation on the part of the advice recipient that the advice provider is undertaking to provide unbiased and impartial advice.” (See pages 20-21)

   b. The proposed counterparty carve-out safe harbor should be broadened to apply to 401(k) plans of any size as well as participants, beneficiaries and IRA holders. (See pages 21-23)

   c. The platform providers carve-out should be available to IRAs and should clarify that merely tailoring a sub-platform to a particular marketplace segment should not be regarded as individualization rendering the carve-out unavailable. (See pages 23-25)

3. The investment education carve-out should, consistent with the current language of I.B. 96-1, permit the identification of specific investment alternatives in connection with asset allocation education and the identification of specific distribution products in connection with the provision of distribution information when accompanied by a statement that other investment products with similar risk and return characteristics and other distribution products may be available under the plan and indicating where to obtain information about those other products. (See pages 25-28)
Comments Relating to the Proposed Amendment to PTE 84-24 (See pages 28-34)

1. All fixed and variable annuities, whether registered as securities or not, are insurance products that provide guaranteed lifetime income, and therefore should be treated the same under PTE 84-24. Given the need for a level playing field for all annuities, exemptive relief should be available for all sales of both variable annuities and fixed annuities under both the Proposed Amendment to PTE 84-24 and the Proposed BIC Exemption. (See pages 28-30)

2. The definition of the term “Insurance Commission” in the Proposed Amendment to PTE 84-24 is overly narrow and should be broadened to ensure that advisers are not inadvertently prohibited from receiving customary employee benefits, such as health insurance coverage and access to an employer-sponsored retirement plan. (See page 30)

3. The Definition of the term “Best Interest” in the Proposed Amendment to PTE 84-24 is overly prescriptive and should be revised to make clear that advisers and financial institutions must always put their clients’ interests first, but would not be required to completely disregard their own legitimate business interests. (See pages 31-32)

4. The Department should clarify that a recommendation to rollover a plan account balance or an existing IRA to an annuity is covered by PTE 84-24. (See pages 32-33)

5. The Department should clarify that the exemptive relief provided by PTE 84-24 is available for both the purchase of the annuity and the selection of investments under the annuity contract. (See page 33)

6. To level the playing field for annuities and mutual funds under PTE 84-24, the Department should extend to annuities the same independent fiduciary approval presumption provision that applies to mutual fund transactions. (See page 34)

Comments Relating to the Proposed Best Interest Contract (“BIC”) Exemption (See pages 35-51)

1. To avoid disruptions in the availability of annuity products and their guaranteed lifetime income features to millions of retirement savers, and advice about whether these products fit their needs, the requirements in the Proposed BIC Exemption must be revised in a workable manner. (See pages 35-43)

   a. The terms of the BIC exemption should be clarified to indicate that a counter-signature on the part of the advice recipient is not needed to satisfy the condition. Advisers and financial institutions should be permitted to comply with this requirement through a unilateral agreement furnished to the advice recipient. (See page 35-38)
b. The contract timing requirement under the Proposed BIC Exemption should require the contract to be executed prior to the transaction, not prior to the recommendation. (See page 38)

c. The definition of the term “Best Interest” in the Proposed BIC Exemption is overly prescriptive and should be revised to make clear that advisers and financial institutions must always put their clients’ interests first, but would not be required to completely disregard their own legitimate business interests. (See pages 39-41)

d. Given that the duty to act in a client’s best interest is contained in the required contract under the Proposed BIC Exemption, the warranties required under the Exemption serve no useful consumer purpose, but expose Advisers and Financial Institutions to risks of frivolous and costly litigation, adding to the expense associated with serving retirement investors. (See page 41)

e. The “reasonable compensation” conditions of the Proposed BIC Exemption are focused on the value of services and fail to take into account the costs of annuity products’ guaranteed features. Moreover, the conditions unfairly disadvantage proprietary products. For purposes of annuity product recommendations, the definition of “reasonable compensation” contained in the Proposed BIC Exemption should be conformed to the corresponding provision in the Proposed Amendment to PTE 84-24. (See pages 41-42)

f. The Adviser’s and Financial Institution’s agreement to comply with the Impartial Conduct Standards by delivering a Best Interest Contract should be sufficient to satisfy the conditions of section II(c) of the Proposed BIC Exemption. Violations of the Impartial Conduct Standards should not result in loss of the exemption. (See pages 42-43)

2. The Department should take steps to preserve proprietary annuity distribution models, which provide consumers with invaluable and irreplaceable sources of knowledge about annuity products and how annuities can be used to provide guaranteed lifetime income to retirees. To that end, the “Limited Range of Investment Options” requirements included in section IV of the Proposed BIC Exemption should not apply to Advisers and Financial Institutions that offer proprietary annuity products. (See pages 43-45)

3. The proposed point of sale, website, annual and ongoing information maintenance requirements impose exceedingly burdensome and expensive disclosure requirements on annuity product providers and distributors. In addition, many of these disclosure requirements are duplicative of, and in many cases conflict with, existing SEC prospectus
disclosure rules. For these reasons, the disclosure provisions should be removed from the Proposed BIC Exemption. (See page 45)

a. The point of sale disclosures required under the Proposed BIC Exemption should be made through the provision of a prospectus for registered annuity products and should be replaced by a reference to the statutory prospectus disclosure requirement. (See pages 45-47)

b. The website disclosure requirements for annuity products should be eliminated in favor of the settled disclosure regimes under applicable federal securities laws and state insurance laws. (See pages 47-48)

c. The annual disclosure requirement under paragraph III(b) of the Proposed BIC Exemption is overly burdensome, would be exceedingly costly to develop and does not advance investor interests, and should therefore be removed. (See page 49)

d. The Proposed BIC Exemption’s provision authorizing public disclosure of Adviser return information will provide no meaningful benefit to consumers but will be extremely expensive to implement, and should therefore be deleted. (See pages 49-50)

4. The condition to the exemption for pre-existing transactions prohibiting additional advice following the applicability date of the regulation creates inappropriate incentives and would render the exemption worthless in practice, and should therefore be removed. (See pages 50-51)

Comment on Timing of Implementation for Proposal

1. The Department should extend the proposed implementation period to ensure the industry has adequate time to develop the necessary compliance processes. The proposed eight-month timeline would result in significant and harmful market disruptions. (See pages 51-52)

The Insured Retirement Institute’s Seven Core Principles

A set of rules that would deprive consumers of access to guaranteed lifetime income products and the professional assistance needed to knowledgeably acquire and use those products would clearly run counter to the best interests of American working men and women. To help the Department formulate a final set of rules that avoids this result, IRI has prepared detailed comments that advance the core principles listed below.
Core Principle No. 1 – Financial Professionals Should be Held to a Best Interest Standard When Recommending Investments to Retirement Savers.

As noted above, IRI supports the application of a best interest standard when a financial professional provides investment advice or recommendations to plans, plan participants and beneficiaries, and IRA holders. IRI believes the vast majority of financial professionals already act in the best interest of their clients, and recent IRI research found that nearly all consumers agree.¹ The standard must be carefully crafted, however, to avoid any implication that acting in clients’ best interest requires that financial professionals must completely disregard their own interests in order to recommend the “best product” (which can only be determined with any degree of certainty with the benefit of hindsight years or decades after the recommendation is made) or the cheapest product (which would prevent recommendations of higher-cost products that provide guarantees or other features many consumers want and need).

Core Principle No. 2 – Consumers are Entitled to Freedom of Access to Retirement Income Guarantees.

IRI believes it is in the best interests of American working men and women to have the freedom to shop the financial marketplace for annuity products and to procure a source of secure retirement income. Unfortunately, the Proposal would severely constrain individual access to annuity products based on the assumption that, “as a rule,” individual workers are too uninformed to look out for their own interests.² IRI disagrees with the premise that all consumers should be pre-judged to be incapable of looking after their own affairs and that existing regulations do not appropriately require financial professionals to act in the best interest of their clients.

Core Principle No. 3 – In the Post-Defined Benefit Plan Era, the Availability of Guaranteed Retirement Income through IRA Rollovers Meets a Critical Consumer Need.

As a result of dramatic declines in defined benefit plan coverage, coupled with the fact that very few defined contribution plans provide lifetime income forms of distribution, IRI believes individual annuity purchases through IRAs are, on a de facto basis, the primary means, other than Social Security, through which retirees procure guaranteed retirement income.³ IRI is concerned that the Proposal will effectively cut off access to guaranteed

---

³ An independent study conducted for the Department of Labor in 2011 reported that only about 1% of defined contribution plans offer a deferred annuity. By contrast almost all defined contribution plans offer the option of a lump sum distribution upon job separation, which may be rolled over into an IRA and used to purchase an annuity. The same study noted that although only about 6.1% of workers who retire with a defined contribution plan convert their account balance into an annuity “substantial additional annuitization takes place after retirement
income products for most Americans at the exact moment in history when ready access is most urgently needed.

**Core Principle No. 4 – Rules for Annuity Products Must be Specifically Crafted to Account for their Guaranteed Lifetime Income Features.**

IRI believes annuity products, by virtue of the guaranteed lifetime income and other guarantees they provide, are uniquely suited to provide the financial safety and security sought by many retirees. The Proposal fails to account for the benefits and costs associated with these guarantees. In particular, the levelized distribution compensation structures that appear to be compelled by the Proposed BIC Exemption are incompatible with well-functioning individual annuity product distribution models and would curtail the availability of those products.

**Core Principle No. 5 – Competitive Annuity Markets Serve Consumer Interests.**

IRI believes a competitive product marketplace is clearly in the best interests of retirement investors. Marketplace competition between and among manufacturers and other investment providers, and between and among affiliated and unaffiliated distributors, fosters innovations and efficiencies that advance consumer interests. IRI is concerned that the Proposal would stifle product innovation and price competition by superimposing a “value of services” compensation model that ignores the intrinsic value consumers derive from insurance guarantees of safety and security.

**Core Principle No. 6 – Consumers Have a Right to Choose their Preferred Source of Retirement Advice, including the Option to Work With Advice Providers who are Experts on Proprietary Products, and How their Advice Provider is Compensated.**

IRI believes in a best interest standard that gives consumers freedom of choice over who they receive advice from, whose product(s) their adviser may offer (i.e., affiliated or unaffiliated), how their adviser is compensated, and how their retirement savings are invested. In particular, consumers should not be denied access to advice providers who have acquired in-depth knowledge and expertise by concentrating or dedicating their practices to the products of a single company or a select group of companies. In the current regulatory framework, for example, 86% of Baby Boomers say they are better prepared for retirement as a result of their adviser’s help, validating existing distribution models. The conditions of the Proposed BIC Exemption include a bias that favors unlimited product

---

choice over expertise. This bias poses a threat to proprietary annuity distribution models. The proprietary distribution model emphasis on adviser training and expertise is vital to a healthy marketplace and needs to be preserved.

**Core Principle No. 7 – The Administration’s Public Policy Position in Favor of Access to and Utilization of Guaranteed Lifetime Income Products Should be Advanced.**

IRI enthusiastically supports Department of the Treasury and Department of Labor efforts to facilitate retirement savers’ access to and use of guaranteed lifetime income products. In particular, the Department of Labor’s recent rulemaking initiative to require defined contribution account balances to be expressed not only as a lump sum amount, but also as a retirement income stream, would help transform the way Americans think about the adequacy of their accumulated retirement savings to replace pre-retirement monthly income flows. If that public policy initiative is to be a success, it is essential for workers who have been newly sensitized to the importance of retirement income guarantees through their account statements to be able to meet their guaranteed income needs by purchasing annuities in the private marketplace.

**The Context for IRI’s Comments on the Proposal: America’s Retirement Income Challenge and the Need for Retirement Income Products**

With unprecedented growth in the number of retired Americans, the nation’s retirement system is at a crossroads, and policymakers in Washington have clearly taken notice. Numerous retirement-focused bills have been introduced in Congress over the past several years, and, as noted above, the Obama Administration has been working to make guaranteed lifetime income products more widely available. The Proposal would, unfortunately, undermine these efforts.

**Longevity Risk** - Americans today are living longer than ever before, while access to traditional defined benefit pension plans continues to decline, creating a significant risk that many people will outlive their assets. It is critical that the regulatory environment allows consumers to access products that meet their need to protect against this increased longevity risk.

Americans today are at risk of outliving their assets. This longevity risk has never been greater. The rapid and continuing shift away from defined benefit plan designs in favor of a defined contribution plan model, increasing life expectancies, and rising health care costs are combining to exert significant pressures on individual consumers, in particular middle-income Americans, seeking a financially secure retirement. These challenges simply did not exist in earlier generations.

---

At their peak in 1985, over 114,000 private-sector defined benefit plans were in place, but by 2012, less than 26,000 of these defined benefit plans remained. Only 19 percent of private-sector workers had access to a defined benefit plan in 2014.

Individuals today are living longer than in past generations. The population of older Americans continues to increase at a faster rate than the overall population. For example, between 2000 and 2010, the number of Americans aged 85 to 94 grew by 29.9 percent; by comparison the entire U.S. population increased by 9.7 percent during that timeframe. Moreover, according to the Society of Actuaries, a married couple age 65 has more than a 65 percent chance of one or both spouses living to age 90 and a 35 percent chance of one spouse living to age 95.

As a result of these trends, today more than 30 million Baby Boomers are “at risk” for inadequate retirement income; that is, a lack of sufficient guaranteed lifetime income. Just as concerning, nearly half (45 percent) of Generation Xers (ages 36-45) are “at risk” for inadequate retirement income. Alarmingly, only 40 percent of Americans 30 to 49 years of age have tried to determine how much they need to save by the time they retire. Meanwhile, nearly one-third of Baby Boomers cite having adequate retirement assets as a top concern, while over three-quarters said they will work for income in retirement, meaning they actually will not be retired, a goal that might not be feasible. This reality underscores the critical importance of a regulatory environment that allows consumers to access products that meet their need to protect against longevity risk.

**Guaranteeing Lifetime Income with Insured Retirement Products** – Annuities are the only products available in the private market that can provide retirees and pre-retirees with a guaranteed source of income to ensure they can enjoy a financially secure and dignified retirement.

Outside of Social Security and private pensions, annuities are the sole source of guaranteed lifetime income during retirement. Only insurance companies and their distribution partners can provide these products. With proper planning and use, annuities can provide retirees with

---

14 Insured Retirement Institute. *Baby Boomers and Generations Xers: Are They on Track to Reach Their Retirement Goals?*
guaranteed lifetime income and the security of knowing that they will not outlive their savings. Boomers who own insured retirement products, including all types of annuities, have a higher confidence in their overall retirement expectations, with nine out of 10 believing they are doing a good job preparing financially for retirement.\textsuperscript{16} Compared to non-annuity owners, Baby Boomers who own annuities are more likely – by more than a two-to-one ratio – to be among those who are most confident in living comfortably throughout all their retirement years.\textsuperscript{17} Baby Boomer annuity owners also are more likely to engage in positive retirement planning behaviors than Baby Boomer non-annuity owners, with 68 percent having calculated a retirement goal and 63 percent having consulted with a financial adviser.\textsuperscript{18}

Annuities appeal to Americans of all income levels and consumers who do not have access to other retirement savings vehicles. In fact, annuity owners are overwhelmingly middle-income. Seven in 10 annuity owners have annual household incomes of less than $100,000. Unfortunately, as we will explain in greater detail below, the Proposal would unreasonably limit consumer access to annuity products through employer-sponsored retirement plans and IRAs at precisely the point in time when access to annuities is most vitally needed.

\textbf{Benefits of Working With a Financial Professional} – Consumers who receive assistance from financial professionals save more throughout their working years, make better use of available retirement planning products and strategies, and commonly experience better returns on their investments, and therefore are better prepared for retirement than those who do not have access to retirement planning advice.

Financial professionals play a critical role in helping consumers understand the wide variety of annuity products available in the market and how best to utilize them to prepare for retirement. Americans accumulate more savings when working with a financial professional, saving twice the amount over a seven- to 14-year period.\textsuperscript{19} Working with a financial professional has a positive influence on retirement planning behaviors including: increased usage of tax-advantaged savings vehicles, improved asset allocation, greater portfolio diversification and less-speculative investing.\textsuperscript{20} Financial professionals have also been shown to help consumers earn 1.59 percent in additional returns, which over time leads to 22.8 percent

\begin{footnotes}
\footnote{\textsuperscript{16} Insured Retirement Institute. \textit{Boomer Expectations for Retirement 2011}.}
\footnote{\textsuperscript{17} Insured Retirement Institute. \textit{Survey of Americans Aged 51 to 67}.}
\footnote{\textsuperscript{18} Insured Retirement Institute: \textit{Tax Policy and Boomer Retirement Saving Behaviors}.}
\footnote{\textsuperscript{20} Ibid.}
\end{footnotes}
more income in retirement. Moreover, financial professionals help their clients overcome the emotional aspects of investing, which can add one percent to two percent in net return.

It is also significant to note the particular benefits of retirement planning advice for women and minorities. Women are more than twice as likely to be confident in their outlook on retirement when they work with a financial professional. African Americans are nearly three times more likely to save in an IRA and four times more likely to have an annuity when working with a financial professional. Similarly, nearly 90 percent of Hispanic Americans contribute to a retirement plan when working with a professional, compared to only 54 percent working on their own.

Many of the problematic provisions in the Proposal appear to be designed to eliminate conflicts of interest. However, recent IRI research found that conflicts of interest are not a significant concern for most retirement savers. In fact, an overwhelming majority of people indicated they are aware of potential conflicts of interest but are nevertheless highly satisfied with their relationship with their adviser and would recommend their adviser to a friend or relative.

IRI’s Comments on the Proposal

While both the President and leaders in Congress have recognized that positive changes are needed to help Americans be financially prepared to enjoy longer lifespans, the Proposal runs contrary to this goal. By making the revisions IRI recommends in this comment letter, DOL can adopt a rule that imposes a best interest standard of care without the harmful consequences that would result from the current Proposal.

I. Comments Relating to the Proposed Definition of the Term “Fiduciary”

The Proposed Regulation would significantly expand the circumstances under which a person would acquire fiduciary status under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), and section 4975 of the Internal Revenue Code of 1986, as amended (“Code”), as a result of giving investment advice to a plan, its participants or beneficiaries, including an individual retirement account (“IRA”), for a fee or other compensation.

---

IRI supports the Department’s efforts to assure that the term “fiduciary” clearly includes those relationships that are appropriately regarded as fiduciary in nature and clearly excludes those that are not. Moreover, IRI is supportive of applying a “best interest” standard of care to those relationships that involve recommendations of financial products.

However, following careful evaluation and discussion by our membership, we are extremely concerned that the Proposed Regulation inappropriately characterizes as fiduciary in nature a broad spectrum of financial marketing and sales activities where no reasonable expectation can exist that an advice provider has been engaged by an advice recipient to act as an unbiased and impartial source of recommendations under a legal obligation to disregard its own interests as a seller of investment products or asset management services. Simply put, IRI believes annuity distributors should be permitted to recommend products they believe are in an advice recipient’s best interest without necessarily triggering fiduciary status by virtue of having made such a recommendation. A fiduciary standard that requires advice providers to completely disregard their own interest in earning compensation is inappropriate, overly burdensome, and frustrates the Administration’s stated policy goals of increasing access to and utilization of guaranteed lifetime income products.

Annuity providers and investment managers engage in a number of activities that simply should not be considered “advice” that would give rise to fiduciary status within the ambit of this rulemaking. According to a recent study conducted for IRI by Deloitte & Touche (a copy of which is attached as Appendix 1 to this letter), this significant expansion of the definition of “fiduciary” will create “creates operational risk considerations and obligations that may cause insurers to restrict or end certain types of communications, products and services that consumers rely on to plan for their financial security in retirement.”27 The following are just a few examples of activities engaged in by our members that do not reasonably give rise to a fiduciary relationship yet appear to be captured under the Proposed Regulation and would likely have to be discontinued if the Proposal is adopted without the modifications recommended in this letter:

- giving a mere factual description of the features of an annuity product, such as an immediate fixed annuity or a deferred variable annuity, and explaining how the product can meet certain needs;
- responding to a Request for Proposal by submitting a description of a product that may be a fit for the needs of a plan, including a sample fund line-up;
- answering questions from plan participants about the operation of an “in-plan” guaranteed lifetime income product and its available features;

27 Deloitte & Touche LLP. Anticipated Operational Impacts to the Insured Retirement Industry of the Department of Labor’s Proposed Rules for the Definition of Fiduciary Advice.
proprietary product “wholesaling” activities where representatives of an annuity product provider meet with financial professionals – either one-on-one or in group sessions – to explain the features of the product and to conduct training;

providing a brochure to a prospective purchaser describing the features of one or more annuity products available for sale through a registered broker-dealer;

presenting to a prospective annuity purchaser a list of investments that are available under a variable annuity product;

explaining basic asset allocation concepts and providing examples of how one or more particular annuity products could be used to implement an individual’s asset allocation plan;

counseling a recent retiree about his or her likely income replacement needs and the features available under various annuity products that could help meet those income replacement needs;

chatting with friends or family about what an advice provider does for a living and expressing his or her professional enthusiasm for and confidence in the products he or she makes available; and

the referral of a client by one financial professional to another who specializes in annuity products and has specialized knowledge and training in annuity features.

We offer the following suggestions on how the proposed definition of fiduciary should be changed in order to more properly distinguish conduct that is fiduciary in nature from ordinary sales and marketing activity which is not.

A. General Comment on the Definition of “Fiduciary”: The definition of an investment advice “fiduciary” in the Proposed Regulation needs to focus more precisely on conduct that is appropriately regarded as fiduciary in nature rather than all manner of sales activities. The proposed definition would deprive retirement investors of access to information and would inappropriately limit advice sources.

Under the Proposed Regulation, fiduciary status arises virtually any time a communication is made that is in any way suggestive of a plan investment or investment management activity and is either individualized for or specifically directed to an advice recipient for consideration in making investment or management decisions. Moreover the Proposed Regulation would have fiduciary status attach at the time a recommendation is made, even in circumstances where no business relationship has been established.

1. Specific Comment: The “specifically directed to” element of the Proposed Regulation will cause fiduciary status to arise as a result of ordinary advertising
The mere fact that a suggestion is “specifically directed to” a plan, participant or IRA owner is simply not relevant to the question of whether a fiduciary relationship has been created. Institutions that offer products and services in the retirement plan marketplace generate specifically directed communications every day in the course of advertising and marketing to existing and potential clients. Specifically directed communications are vital to the functioning of the financial marketplace. Without these kinds of communications, plans, participants and IRA owners might never become aware of or learn about products and services that may be a fit for their needs. By the same token, providers and distributors of annuities and other financial services products require the freedom to utilize specifically directed marketing communications to identify consumers with a potential interest in purchasing those products.

In this regard, a provider or distributor of insured retirement products should be able to provide advertising and marketing materials describing the insurance products it makes available, including detailed information about the key features and pricing of these products, to retirement investors in the course of marketing its products. Such material would be delivered to a particular individual (e.g., by mail), thereby falling within the “specifically directed to” element of the Proposed Regulation. Yet it would be wholly inappropriate for generalized, albeit “specifically directed,” marketing communications activities to result in the establishment of a fiduciary relationship. The same materials would be sent to hundreds if not thousands of recipients and would not be customized or tailored to the unique retirement circumstances of any particular recipient.

The mere fact that materials are mailed directly to a recipient or handed to a recipient in person should not give rise to fiduciary status where there is no customization or individualization based on the recipient. For these reasons, we request that the Department delete the “specifically directed to” element from the Proposed Regulation.

2. **Specific Comment:** To provide predictability and certainty, both for consumers and financial professionals, the “individualized to the advice recipient” element of paragraph (a)(2)(ii) of the Proposed Regulation should be modified to read “sufficiently individualized as to form a reasonable basis for reliance by the advice recipient as a source of unbiased and impartial advice.”

In our view, a fiduciary relationship should only arise when a communication with a retirement investor is sufficiently tailored, within the context of a particular relationship, to provide a basis for the investor’s reliance on that communication as an impartial and unbiased investment recommendation. Consistent with our general observation that the Proposed Regulation should clearly differentiate between relationships that are appropriately classified as fiduciary in
nature from those that are not, IRI believes the Department should modify the “individualized to the advice recipient” element of paragraph (a)(2)(ii) to more precisely specify the degree of individualization needed to give rise to fiduciary status. It could be argued, for example, that any written communication addressed to an advice recipient is “individualized” since it bears the individual’s name. Moreover, it could be argued that the mere sending of a brochure describing one product versus another based on the recipient’s age or level of assets qualifies as an “individualized” communication.

The preamble to the Proposed Regulation indicates that the Department is seeking to cover those relationships where the advice provider is in a position of trust with respect to the advice recipient. Yet the mere naming of an individual in a communication, or picking one brochure over another, would not ordinarily be viewed as placing an adviser in a “position of trust.” Likewise, the delivery of information by customer service representatives of an annuity provider in response to an inquiry, while undoubtedly individualized, does not “implicate relationships of trust and expectations of impartiality.” This important concept should be clearly set forth in the language of the definition itself, and not tucked away in preamble references.

IRI feels strongly that without this important modification, all sales activity in the retirement investment space will be chilled and consumers will lose access to guaranteed retirement income products and information, in contravention of IRI’s Core Principles and the Department’s articulated goal of protecting the interests of plan sponsors, participants and IRA customers.

3. **Specific Comment:** The “for consideration” element of paragraph (a)(2)(ii) of the Proposed Regulation is overly broad and should be changed to require that recommendations be made “for the purpose of” making investment decisions.

The Proposed Regulation describes the delivery of recommendations “for consideration in making investment or management decisions with respect to securities or other property of the plan.” The “for consideration” element of the definition sets an inappropriately low bar and should be changed.

Virtually every conversation regarding retirement investment products and services between plans, participants and IRA owners on the one hand, and professional investment providers including insurers, brokers, advisers, and managers, on the other hand, involves an exchange of information “for consideration in making investment decisions.” Information may be provided

28 See, e.g., 80 Fed. Reg. 21938 (the proposal “avoids burdening activities that do not implicate relationships of trust and expectations of impartiality.”); 80 Fed. Reg. 21941 (“In each instance, the proposed carve-outs are for communications that the Department believes Congress did not intend to cover as fiduciary ‘investment advice’ and that parties would not ordinarily view as communications characterized by a relationship of trust or impartiality.”).
“for consideration” in the context of a conversation that is entirely objective and factual. On this basis, we are of the view that the “for consideration” phrase is vague and does little to help consumers or financial professionals ascertain whether fiduciary status has arisen.

We believe requiring an understanding between an advice provider and client that impartial, unbiased advice will be provided “for the purpose of” making investment decisions is consistent with the purposes of ERISA and the Department’s goal to broaden the range of providers subject to fiduciary duties.

4. **Specific Comment:** The definition of “recommendation” as a suggestion to engage in or refrain from taking a particular course of action, as set forth in paragraph (f)(1) of the Proposed Regulation, is too broad and should be redefined as “a communication that, based on its content, context, and presentation, would reasonably be viewed as a call to take action or to refrain from taking action.”

Under the Proposed Regulation, a “recommendation” means “a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.” (Emphasis added.)

Again, IRI is very concerned that the range of communications that could be deemed to be “recommendations” is overbroad and that common activities related to marketing and selling will fall within the definition of recommendation even if the parties do not intend or expect a fiduciary relationship to arise.

Particularly troubling about this definition is that a communication that can be reasonably viewed as a suggestion to act or not act can be a “fiduciary” communication. Virtually all communications, including marketing materials, mailings, brochures, and comparative charts describing investment products, could potentially be viewed as suggestive in nature. Any advertisement might suggest that a prospective customer utilize one product or investment rather than another product or investment.

Guidance issued by the Department in other contexts recognizes the distinction between communications that are merely suggestive and those that may be viewed as an endorsement of a particular program. The Department’s safe-harbor exclusion from ERISA coverage for certain group-type insurance programs offered by an employer to employees requires that:

> the sole function of the employer or employee organization with respect to the program are, without endorsing the program, to permit the insurer to publicize the program to employees or members, to collect premiums
through payroll deductions or dues check offs and to remit them to the insurer; 29

Under this regulation, an employer who “endorses” an insured benefit program would not be eligible for this ERISA-coverage exclusion, and would risk subjecting the program to ERISA’s requirements. Moreover, an employer who “endorses” such a program within the meaning of the regulation risks becoming an ERISA fiduciary with respect to the ERISA plan created by the program. 30 Importantly, however, the Department’s regulation in this context recognizes that employers can make such programs available to employees without “endorsing” them.

Similarly, FINRA guidance concerning the distinction between recommendations and non-recommendations focuses not on the existence of a mere suggestion, but on whether there has been a communication that could be viewed as a “call to action” that might reasonably influence an investor to trade a particular security or group of securities. 31 IRI believes such FINRA guidance may usefully be applied to distinguish an objective description of the features of an investment product or service (including performance and benchmarking information) from communications that constitute a “recommendation.” The definition of “recommendation” should not require a provider to cease marketing its products and communicating with potential purchasers about the provider’s products in order to avoid becoming a fiduciary.

5. **Specific Comment:** To avoid inappropriately giving rise to fiduciary status, the phrase “either directly or indirectly (e.g., through or together with any affiliate)” should be moved from paragraph (a)(2) of the Proposed Regulation to paragraph (a)(2)(i) immediately following the word “acknowledges.”

Consistent with the approach taken in paragraph (a)(1) of the Proposed Regulation, which requires the direct provision of a recommendation to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner as one of the necessary elements that would give rise to fiduciary status, IRI believes that written or verbal agreement, arrangement or understanding element of paragraph (a)(2)(ii) should also be provided directly by the same advice provider providing the recommendation and by the same advice recipient receiving the recommendation described in paragraph (a)(1). IRI is concerned that the modifying language “either directly or indirectly (e.g., through or together with any affiliate)” as set forth in paragraph (a)(2) of the Proposed

---

29 C.F.R. § 2510.3-1(j)(3); see also 29 C.F.R. § 2510.3-2(d) (identical condition with respect to IRA safe harbor).

30 The Department has issued similar guidance in the context of IRAs. 29 C.F.R. 2510.3-2(d). And, in Interpretive Bulletin 99-1 with respect to payroll IRAs, the Department made clear the circumstances under which an employer that offers employees access to a payroll deduction IRA may avoid creating an ERISA-covered pension plan. In that Bulletin, the Department clarified the circumstances under which an employer will not be deemed to “endorse” the IRA, and therefore avoid ERISA coverage. DOL Interpretive Bulletin 99-1, 29 C.F.R. 2509.99-1(c).

31 See NASD Notice to Members 01-23.
Regulation could be misapplied in a manner that could give rise to fiduciary status by a direct party to a recommendation but not to the necessary written or verbal agreement, arrangement or understanding described by paragraph (a)(2)(ii).

B. General Comment on the Carve-Out Provisions: To ensure consumers continue to have access to guaranteed lifetime income products and related advice, an additional, generalized carve-out is necessary to accommodate sellers of financial products and services, and modifications to the proposed carve-outs are needed to accommodate reasonable and necessary business practices.

1. Specific Comment: The Department should add a new carve-out from fiduciary status for a person who: “provides advice or recommendations . . . under facts and circumstances where there can be no reasonable expectation on the part of the advice recipient that the advice provider is undertaking to provide unbiased and impartial advice.”

The Department states throughout the preamble that it views as “fiduciary” in nature those investment recommendations where there is an expectation that the advice provider will provide unbiased and impartial advice. IRI agrees that providers who are engaged by a plan or a retirement investor (including an IRA owner) to provide advice that is loyal to the recipient and untainted by conflicts of interest, and are paid a direct or indirect fee for his or her loyalty to the interests of the consumer, should be held to ERISA’s fiduciary standards.

IRI believes the Department should recognize that financial professionals who interact with plans, plan participants and beneficiaries, and IRA owners may undertake to provide advice that does not purport to be unbiased or impartial. For example, an advice provider that engages in the distribution of proprietary annuity products may work with a prospective client to identify a particular product that fits the customer’s needs. The customer, who has been informed that the advice provider offers proprietary annuity products, is under no illusion that the advice provider is unbiased or impartial.

Based on the customer’s lack of any expectation of receiving unbiased or impartial advice, it would be inappropriate to impose fiduciary status on such a relationship. Therefore, IRI proposes to add a new carve-out from fiduciary status that would apply where there can be no reasonable expectation that impartial advice in the client’s best interest will be provided. The new carve-out would read as follows:

The person provides advice or recommendations to a plan fiduciary who exercises authority or control with respect to the management or disposition of plan assets, or to a plan participant or beneficiary or IRA owner, under facts and circumstances where there can be no reasonable expectation on the part of the
advice recipient that the advice provider is undertaking to provide unbiased and impartial advice.

We believe structuring this as a carve-out from fiduciary status is appropriate because it would place the burden on the advice provider (rather than the recipient) to demonstrate that any expectation of unbiased advice on the part of the recipient was not reasonable in light of the surrounding facts and circumstances.

2. **Specific Comment:** The proposed counterparty carve-out safe harbor should be broadened to apply to 401(k) plans of any size as well as participants, beneficiaries and IRA holders.

The Department has expressed the view that the counterparty carve-out cannot and should not be applied to transactions involving retail investors, including small plans, IRA owners and plan participants and beneficiaries, because, “as a rule,” investment recommendations to such retail customers do not fit the arm’s length characteristics that the seller’s carve-out was designed to preserve.32

IRI does not agree with the Department’s determination that, “as a rule,” retail customers are incapable of looking out for their own best interests by engaging in arm’s length bargaining with financial service providers for favorable terms. We also note that this determination is inconsistent with the position taken by Congress in enacting ERISA § 404(c). The conclusion that all individuals and small 401(k) plan fiduciaries are so lacking in financial sophistication as to be incapable of independent thought and choice has not been adequately supported by the Department, and will deprive plans and individuals of the opportunity to shop the financial services marketplace for the investment arrangements that best fit their needs.

a. **Given that ERISA imposes the same fiduciary duties on all plan sponsors, regardless of the size of their plans, limiting the counterparty carve-out to plans with 100 or more participants is arbitrary, unsupportable and should be removed.**

The Department states that the “overall purpose” of the seller’s carve-out is “to avoid imposing ERISA fiduciary obligations on sales pitches that are part of arm’s length transactions where neither side assumes that the counterparty to the plan is acting as an impartial trusted adviser, but the seller is making representations about the value and benefits of proposed deals.”33 The Department makes available a counterparty exception for transactions with all plans willing to provide a written representation from an independent plan fiduciary that it will not rely on the

---

32 80 FR 21941
33 80 FR 21941.
seller to act in the best interests of the plan, to provide impartial investment advice, or to give advice in a fiduciary capacity, unless the plan has fewer than 100 participants.

For purposes of assessing fiduciary responsibility, the ERISA statute draws no distinction between small and other plans. ERISA commands all plan fiduciaries, regardless of plan size, to have sufficient knowledge and skill to make prudent decisions on behalf of the plan. ERISA section 404(a)(1)(B) requires a fiduciary to “discharge his duties . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in like a capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”

Courts agree that ERISA requires plan fiduciaries to recognize when they lack the knowledge to satisfy the prudence standard of section 404(a)(1)(B), and to hire independent experts to supply the necessary expertise.

By making the seller’s carve-out unavailable for transactions with small plans, the Department has in essence decided to force the fiduciaries of all such plans to do business with a fiduciary adviser whether or not a fiduciary adviser is wanted or needed. Financially sophisticated fiduciaries of small plans might wish to shop the marketplace of competing products and services to find the best fit for their plan’s needs, and would benefit from the price competition that such shopping activity tends to induce. IRI believes that small plans should not be constrained from arm’s length bargaining with sellers where they knowingly represent their non-reliance on a counterparty for impartial investment advice.

b. The counterparty carve-out safe harbor should be available to cover sales activities with plan participants, beneficiaries and IRA owners.

The Department’s bright line assumption that “[a]s a rule, investment recommendations to [plan participants, beneficiaries, and IRA owners] do not fit the ‘arm’s length’ characteristics that the seller’s carve-out is designed to preserve” is simply not true in many cases.

The Proposed Regulation’s blanket exclusion of individual retirement investors from the scope of the seller’s carve-out is inappropriate and unnecessary in regards to individuals who would represent to the advice provider, in writing, that they have sufficient expertise to evaluate the

35 See, e.g., Katsaros v. Cody, 744 F.2d 270, 279 (2d Cir. 1984) (“The trustees, being ill-equipped to evaluate the soundness of the proposed loan, failed to observe their duty to seek outside assistance.”); Harley v. Minn. Mining & Mfg. Co., 42 F. Supp. 2d 898, 907 (D. Minn. 1999) (“[I]f a fiduciary lacks the education, experience, or skills to be able to conduct a reasonable, independent investigation and evaluation of the risks and other characteristics of the proposed investment, it must seek independent advice.”); Liss v. Smith, 991 F. Supp. 278, 297 (S.D.N.Y. 1998) (“In such circumstances, where the trustees lack the requisite knowledge, experience and expertise to make the necessary decisions with respect to investments, their fiduciary obligations require them to hire independent professional advisors.”)
36 80 FR 21942
transaction being recommended and are not relying on the advice provider as a source of unbiased or impartial advice.

This approach would allow individuals interested in shopping the market for guaranteed lifetime income products to engage in discussions with advice providers on an arm’s length basis, and is more consistent with the Department’s stated purpose for the seller’s carve-out than a blanket exclusion, which takes no account of the expectations of the individual retirement investor.

3. **Specific Comment:** The platform providers carve-out should be available to IRAs and should clarify that merely tailoring a sub-platform to a particular marketplace segment should not be regarded as individualization rendering the carve-out unavailable.

The platform providers carve-out under paragraph (b)(3) of the Proposed Regulation is available to any person who “merely markets and makes available .... without regard to the individualized needs of the plan, its participants, or beneficiaries, securities or other property through a platform or similar mechanism” subject to the condition that such person “discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.”

As a preface to the comments that follow, IRI observes that the need for such a carve-out lends further support for our initial comment that the Proposed Regulation is over-inclusive and would capture a broad spectrum of marketing and sales activities where no reasonable expectation could exist that an advice provider has been engaged by an advice recipient to act solely in the recipient’s best interest and to disregard its own interests as a seller. In this case the Department appears to have acknowledged that, in its view, the non-individualized marketing of an investment platform to plans would be included within the definition of fiduciary investment advice but for the carve-out provision.

If the provisions of paragraph (a)(1) of the Proposed Regulation retain their sweeping breadth, IRI believes it is essential for the platform providers carve-out to be modified in several important respects, as described below, to make the carve-out workable.

a. The platform providers carve-out should be clarified and broadened to cover the mere marketing and making available of securities and other property to IRAs and similar arrangements through a platform. In this regard, the phrase “or to any plan described in section 4975(e)(1) of the Code, including an IRA” should be added immediately after the phrase “to an employee benefit plan (as described in section 3(3) of the Act),” the phrase “or to an IRA or IRA owner” should be added immediately after the phrase “the plan, its
participants, or beneficiaries,” and the phrase “or IRA owner” should be added immediately after the phrase “the plan fiduciary.”

As previously noted, the mere marketing of a non-individualized platform or similar menu of investment products and choices as being available for selection by an IRA owner cannot reasonably be regarded as a basis for giving rise to a fiduciary relationship between the platform provider and the individual who is considering making use of the platform and its offerings. Yet the very presence of the platform providers carve-out implies that such a result could arise, given the sweeping nature of the Proposed Regulation’s definitions. In light of that inherent difficulty, the platform providers carve-out should be broadened to cover non-individualized mere marketing efforts to all plans that fall within the definition assigned to that word under the Proposed Regulation, including plans described in section 4975(e)(1) of the Code.

b. The platform providers carve-out should clarify the meaning of the term “individualized needs” for purposes of that provision. Specifically, the following sentence should be added as the final sentence of paragraph (b)(3) – “For purposes of this paragraph (b)(3), the subdivision of a provider’s overall investment platform into separate platform offerings for different market segments, but not for a particular plan, shall not be treated as taking into account the individualized needs of the plan, its participants or beneficiaries.”

Most if not all providers of investment platforms in the marketplace offer not the sum total of all the investment products and securities that they have available, but rather various subsets of that overall investment universe; each subset is organized so as to consist of investment products that tend to appeal to a particular marketplace segment (e.g., individual IRA investors, small 401(k) plans, medium sized 401(k) plans, etc.). IRI is concerned that if not clarified, the language as proposed could be construed as requiring a provider to offer its full array of investment products to each and every investor, even though certain of those products would have little appeal to certain segments of the marketplace or be inapplicable (e.g., commingled pools in IRA context). IRI urges the Department to make the language modification as suggested above as a means of assuring the availability of the carve-out to these sorts of common platform subdivisions.

c. An annuity product that makes available a selection of securities and other investment options is functionally identical to a retirement plan platform, and therefore should itself be deemed a “platform” for purposes of the platform providers carve-out.

The Department should clarify that a variable annuity contract (whether group or individual) constitutes a “platform” for purposes of the carve-out. Variable annuity contracts (“VAs”) are
offered both in the group and individual markets. Group VAs offer employees access to a number of mutual fund or separate account investment options and fixed investment options among which participants can direct their account balances during their working years as they accumulate retirement assets. The key advantage offered by VAs is that they give participants and beneficiaries the ability to convert their accumulated plan balances to lifetime income streams at retirement. A VA contract can include anywhere from tens to hundreds of different investment options. In the context of an ERISA-covered plan, the plan fiduciary selects which of the available investment options will be made available under the plan. As such, a group variable annuity contract is functionally identical to a platform of investments made available by a recordkeeper or other platform provider, but offers the added benefit of lifetime income protection through the annuitization guarantee.

Individual VAs operate identically to group VAs but are offered to individuals. These products are often offered to participants who may be considering rolling their account balances out of an ERISA plan to an IRA. Like group VAs, an individual VA contract will offer the individual access to numerous investment alternatives, including mutual funds, separate accounts and fixed options.

Under the current language of the platform providers carve-out, it is not clear that the Department intended to cover group VAs and individual VAs. With respect to group VAs, the Department should make clear that a group VA contract qualifies as a “platform” for purposes of the carve-out. Given that individual VAs function identically to group VAs, IRI believes there is no rational basis for treating group VAs offered to plan investors differently under the platform providers carve-out than individual VAs offered to participants and IRA holders. To be very clear, IRI is not suggesting that the recommendation to a participant or IRA holder of specific mutual funds or other investment options available through an individual VA contract should necessarily always be exempt from the definition of fiduciary investment advice. Rather, IRI strongly believes that making available and presenting an individual annuity contract to a participant or IRA holder, without any specific recommendations respecting the investments that are available through the individual VA contract, should fall within the platform providers carve-out. Accordingly, we ask the Department to provide this clarification by adding to the end of paragraph (b)(3) (following the additional language that IRI has proposed in section 4.b. of this comment) the following language: “the term ‘platform’ shall include a variable annuity contract that offers the investor access to a number of investment alternatives.”

4. **Specific Comment**: The investment education carve-out should, consistent with the current language of I.B. 96-1, permit the identification of specific investment alternatives in connection with asset allocation education and specific distribution products in connection with distribution information when accompanied by a statement that other investment products with similar risk and return
characteristics and other distribution products may be available under the plan and indicating where to obtain information about those other products.

IRI supports the Department’s proposal to include a carve-out for the provision of investment education largely modeled after the existing carve-out found in Interpretive Bulletin 96-1, 29 C.F.R. § 25.09.96-1 (“IB 96-1”). We believe that the framework reflected in IB 96-1 has led to greater access to educational information for countless individuals over the past two decades, thereby improving their chances at a financially secure retirement.

The Department proposes to modify IB 96-1 in two significant ways. One proposed modification would expand the scope of the education carve-out to cover education relating to post-retirement planning. IRI supports this proposed modification, as we strongly believe that individuals are far less likely to achieve retirement security without an adequate understanding of post-retirement needs, including longevity risk and inflation risk.

However, IRI is deeply concerned about the Department’s proposal to modify IB 96-1 by including new requirements that any materials used to educate retirement investors refrain from identifying any specific investment products available under the plan or IRA. We appreciate the Department’s acknowledgement that this “represents a significant change” and its invitation to comment on whether the change is appropriate.37 In our view, the change would have the effect of dramatically reducing the value of participant education initiatives by making it exceedingly difficult, if not impossible, to impart the information needed by participants to implement their investment and distribution decisions.

A rule designed to protect retirement investors by prohibiting references to specific investment and distribution products available under a retirement investor’s plan or IRA ignores the critical fact that many retirement investors specifically request such information. They do so because they find it to be helpful information to be taken into account when making decisions about how to plan for retirement. For many retirement investors – especially those retirement investors who lack financial expertise, and whose interests the Department seeks to protect in this rulemaking – the most important question that educational information can answer is, “how does this information impact my retirement?” This is particularly the case with distribution-related education. It is difficult, if not impossible, to educate participants and IRA owners about the features of one or more annuity products without making some reference to the provider of the annuity because the details of annuity distribution features may differ considerably from one provider to another.

The following example shows that this proposed requirement, whatever its merits in theory, would be counterproductive in practice. Consider an adviser who is speaking to a group of employees enrolled in a 401(k) plan. The presentation includes a discussion of proper asset

---

37 80 FR 21945.
allocation based on each individual participant’s risk profile and time horizon. Afterwards, an employee approaches the adviser and says, “I really enjoyed your presentation. I’m just starting my career, so my time horizon is long, and I’m comfortable with some level of risk. I would like to invest my portfolio primarily in growth and income funds – say, 70% to 80% – with the rest divided between fixed income and cash. Could you please identify for me which of the investment options available in my plan fall within the growth and income class? I would like to make sure I am selecting funds that fall within that asset class.”

Under IB 96-1, the adviser can answer this question by identifying one or more of the particular funds available under the plan that the participant could use to implement his asset allocation plan. As long as the adviser furnishes a statement that other investment alternatives with similar risk and return characteristics may also be available, and informs the participant where information about those alternatives can be found, the provision of this information in response to the employee’s request would not render the adviser a fiduciary.

But under the Proposed Regulation, the adviser has a dilemma. The answer described above would cause the adviser to be an investment advice fiduciary, even though the “advice” consisted of factual information provided in response to a specific request from a participant. To avoid fiduciary status, the adviser would have two choices in deciding how to respond. First, the adviser could decline to provide an answer in order to stay within the education carve-out. This outcome frustrates, rather than furthers, the Department’s goal of increasing retirement investors’ access to educational information. The second option is for the adviser to express a willingness to answer the participant’s question, but only after the participant reviews and signs a lengthy written contract that complies with the requirements of the Best Interest Contract exemption. Based on the experience of our members, we doubt seriously whether many retirement investors would proceed in the face of such a request.

In support of the proposed departure from IB 96-1, the Department states that it “now believes that, even when accompanied by a statement as to the availability of other investment alternatives, these types of specific asset allocations that identify specific investment alternatives function as tailored, individualized investment recommendations, and can effectively steer recipients to particular investments, but without adequate protections against potential abuse.”38 But less drastic solutions are readily available to address this “steering” concern.

For example, before issuing IB 96-1, the Department released an exposure draft of the rule for public comment which included a requirement that if “a model asset allocation identifies or matches any specific investment alternative available under the plan with a generic asset class, then all investment alternatives under the plan with similar risk and return characteristics must

38 80 FR 21945.
be similarly identified or matched." Noting the difficulty that would arise if investment alternatives with multiple service providers are offered under a single plan, the Department did not include this requirement in the final version of IB 96-1. Instead, in the preamble to IB 96-1, the Department “encouraged” service providers to identify other available investment alternatives where possible.

In our view, the Final Rule should be conformed to IB 96-1 by permitting educational materials to identify specific investments or products, but only if accompanied by a statement indicating other investments or products with similar characteristics may be available under the plan and identifying where information on those products and investments may be obtained.

In this respect, it is significant that “the Department believes that FINRA’s guidance in this area may provide useful standards and guideposts for distinguishing investment education from investment advice under ERISA.” The Department has asked for comments on the discussion in FINRA’s “Frequently Asked Questions, FINRA Rule 2111 (Suitability)” of the term “recommendation” in the context of asset allocation models and general investment strategies. IRI has reviewed FINRA’s guidance in this area, and it clearly supports the position that an otherwise educational asset allocation model does not become fiduciary investment advice merely because it identifies a specific investment alternative.

The identification of a specific investment alternative is not seen by FINRA as a determinative factor as to whether educational information about investment strategies is subject to the Suitability Rule. More broadly, FINRA’s approach in this context recognizes that “recommending” a particular security is a distinct action from the mere identification of a particular security in an asset allocation model. In its answers to the questions posed in Regulatory Notice 12-25, FINRA repeatedly refers to recommendations based on asset allocation models. Put another way, FINRA’s focus is on whether a recommendation has been made which identifies particular securities, not on simply whether such securities have been identified.

II. Comments Relating to the Proposed Amendment to PTE 84-24

A. General Comment on the Proposed Removal of Variable Annuities Sold to IRAs from the Scope of PTE 84-24: All fixed and variable annuities, whether registered as securities or not, are insurance products that provide guaranteed lifetime income, and therefore should be treated the same under PTE 84-24. Given the need for a level playing field for

---

39 61 FR 29586, 29587.
40 Id.
41 80 FR 21945, FN 24.
42 Id.
43 See, e.g., FINRA Regulatory Notice 12-25, at Q&A-8 (Suitability Rule would not apply to a recommendation “if the recommendation is based on an asset allocation model that meets the above criteria . . . .”)
all annuities, exemptive relief should be available for sales of both variable annuities and fixed annuities to IRAs under both the Proposed Amendment to PTE 84-24 and the Proposed BIC Exemption.

IRI estimates that approximately 30 million Americans own variable and fixed annuities. PTE 84-24 has for decades been the primary pathway for exempting the sale of annuity and insurance products to plans, including IRAs, and IRI believes it should continue to be available to exempt the sale of all such products. Under the Proposed Amendment to PTE 84-24, variable annuities sold to IRAs would no longer be eligible for this exemption. The Department has not provided any evidence to support the need for this disparate treatment and IRI therefore strongly urges the Department to remove the exclusion for variable annuity IRA sales from the Proposed Amendment to PTE 84-24.

The Proposed BIC Exemption is available to cover the sale of both fixed and variable annuity products to IRAs. That same even-handed treatment, which facilitates the application of uniform sets of exemptive relief conditions to sales of annuity contracts of all types, whether fixed or variable, should prevail under PTE 84-24. Given that the Proposed Amendment to PTE 84-24 includes the same “best interest” and “reasonable compensation” requirements as the Proposed BIC Exemption, IRI does not believe excluding IRA sales of variable annuities from PTE 84-24 would provide a greater level of protection for consumers. Moreover, IRI believes it is critical that exemptive relief for transactions involving the purchase of both variable and fixed annuity products by IRAs be available under both the Proposed BIC Exemption and PTE 84-24.

The Department’s decision to propose this change to PTE 84-24 appears to be based on an inaccurate perception that variable annuities are nothing more than a “package” or “bundle” of mutual funds. IRI strenuously rejects this notion. Like fixed annuities, variable annuity products contain lifetime income guarantees. Those guaranteed lifetime income features, and not merely the product’s investment features, are the primary attribute of the variable annuity contract. In that vein, IRI observes that variable annuity contracts have more in common with fixed annuity contracts than with mutual funds. The same concerns cited by the Department in not restricting the availability of exemptive relief for the purchase of fixed annuities by IRAs pertain equally to variable annuity products – namely, the BIC exemption’s focus on expense comparisons, when applied to variable annuity products, tends to foster the false conclusion that all variable annuity contract expenses are investment related and are too expensive relative to non-insurance products. In fact, variable annuity contract expenses include both investment-related expenses and expenses associated with guaranteed lifetime income product features.

For these reasons, many financial institutions may wish to utilize PTE 84-24 as the exclusive pathway for exempting the sale of all annuity products, fixed as well as variable, to IRAs. In light
of the lifetime income guarantees available under both types of products, PTE 84-24 should be revised to allow the same exemptive relief for all fixed and variable annuity product sales.

By contrast, some financial institutions engaged in the sale of annuity and other products to IRAs may decide to develop systems and compliance support designed to support sales of products under the Proposed BIC Exemption exclusively. Since the Proposed BIC Exemption is available to cover sales of both variable and fixed annuity products to IRAs, financial institutions would have the ability to make this decision if they so choose. Our recommendation to restore variable annuities to PTE 84-24 is not intended and should not be interpreted to infer any suggestion about changing the availability of the Proposed BIC Exemption for all annuities.

B. *General Comment on Definition of Term “Insurance Commission”*: The definition of the term “Insurance Commission” in the Proposed Amendment to PTE 84-24 is overly narrow and should be broadened to ensure that advisers are not inadvertently prohibited from receiving customary employee benefits, such as health insurance coverage and access to an employer-sponsored retirement plan.

For purposes of maintaining a highly trained and professional sales force, a number of annuity providers maintain “career” or “captive” agent sales forces. Individual members of these distribution arms agree to devote all or substantially all of their sales efforts to the products of single insurance carrier. In exchange for that commitment, the insurance carrier provides member of its selling force with various benefits, all of which are subject to continuing production and service requirements, such as health and retirement plan coverage and contributions, office allowances, travel expense reimbursements and other benefits customary in the industry. The re-proposed definition of “Insurance Commission” describes only “sales commissions” including “renewal fees and trailers.” The Department needs to clarify to annuity providers and their career agents that the other forms of compensation described above are also covered under the definition so these vital and longstanding insurance product distribution channels are assured of coverage under the exemption.

As such, we recommend that the Department revise the definition of “Insurance Commission” the Proposed Amendment to PTE 84-24 to conform to the definition used in the instructions to Schedule A of the Form 5500 Annual Report:

> ...commissions and fees including sales and base commissions and all other monetary and non-monetary forms of compensation where the [insurance agent or broker or pension consultant’s] eligibility for the payment or the amount of the payment is based, in whole or in part, on the value (e.g., policy amounts, premiums) of contracts or policies (or classes thereof) placed with or retained by an ERISA plan [or IRA], including, for example, persistency and profitability bonuses.
C. General Comment on Definition of “Best Interest” Standard: The definition of the term “Best Interest” in the Proposed Amendment to PTE 84-24 is overly prescriptive and should be revised to make clear that advisers and financial institutions must always put their clients’ interests first, but would not be required to completely disregard their own legitimate business interests.

IRI fully and unequivocally supports the fundamental notion that a “best interest” standard of care should govern the conduct of a fiduciary to a plan or an IRA as a condition to obtaining exemptive relief under the Proposed BIC Exemption. However, IRI is gravely concerned that the best interest standard articulated by the Department appears to require a complete disregard of any financial interest of the fiduciary and its affiliates. In particular, the phrase “without regard to the financial or other interests of the fiduciary, any affiliate or any other party” is problematic because it appears to require that any advice provided wholly ignore the business and economic reality that advisers and annuity providers have to generate enough revenue to cover their costs and earn a reasonable profit in order to stay in business.

We do not believe the Department intended to require annuity advisers and providers to completely disregard their own business interests. Rather, IRI believes that the Department intended to require compliance with ERISA’s prudence rule and ensure that the investor’s interests are always considered first and foremost. Accordingly, we respectfully urge the Department to modify the text of the best interest standard to more clearly reflect this intent. Without this clarity, it will be impossible for any adviser or financial institution to rely on PTE 84-24, meaning millions of Americans would lose access to advice.

Our belief regarding the intent of the standard derives from the Department’s statement that it “expect[s] the standard to be interpreted in light of forty years of judicial experience with ERISA’s fiduciary standards and hundreds more with the duties imposed on trustees under the common law of trusts.” Judicial authorities interpreting ERISA’s general fiduciary standards have agreed that an ERISA fiduciary’s receipt of an incidental benefit from a transaction that otherwise is primarily for the benefit of a plan, will not itself cause a violation of ERISA’s fiduciary standards. In other words, many courts have held that where taking the best course of action for a participant or beneficiary would lead to an "incidental benefit" to a plan fiduciary, such incidental benefit is permitted by ERISA.

In addition, the Department’s Fact Sheet about the Proposal described the best interest standard as follows:

The “best interest contract exemption” will allow firms to continue to set their own compensation practices so long as they, among other things, commit to putting their client’s best interest first and disclose any conflicts that may prevent them from doing so. Common forms of compensation in use today in
the financial services industry, such as commissions and revenue sharing, will be permitted under this exemption, whether paid by the client or a third party such as a mutual fund.

This notion of putting the investor’s interests first is repeated by the Department in numerous places throughout the Proposal to describe the best interest standard. Moreover, the Department has repeatedly described the exemption as preserving the ability of financial Advisers to rely on common compensation practices such as payments from third parties and funds.

To ensure the best interest standard is implemented and interpreted consistent with the referenced authorities, IRI urges the Department to revise the definition in Section VI(b) of the Proposed Amendment to PTE 84-24 to read as follows (new language is underlined):

...the “Best Interest” of the Plan or IRA is when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the plan or IRA, and that subordinates the financial or other interests of the fiduciary and its affiliates to those of the plan or IRA. [or, “and that places the interests of the plan or IRA ahead of the financial or other interests of the fiduciary and its affiliates.”]

D. Other Comments on the Proposed Amendment to PTE 84-24

1. **Specific Comment:** The Department should clarify that a recommendation to rollover a plan account balance or an existing IRA to an annuity is covered by PTE 84-24.

The Proposed Amendment to PTE 84-24 specifies that the exemption may be used to cover recommendations to an IRA or IRA holder to purchase annuity products that are not securities (e.g., fixed annuities). We believe a recommendation to roll an existing IRA to a second IRA product – or to roll an ERISA plan account balance into an IRA product – that will be invested in an annuity, should be covered by PTE 84-24. Specifically, these recommendations should be encompassed within the transactions described in Section I(a)(1) (receipt of an Insurance Commission in connection with a purchase of an annuity contract), Section I(a)(3) (the “effecting” of a purchase of an annuity contract), and/or Section I(a)(4) (the purchase of an annuity contract with plan assets from an insurance company).

We also note that a recommendation to roll an existing IRA to a second IRA – or to roll an ERISA plan account balance into an IRA – that will be invested in an annuity necessarily involves an implicit recommendation to sell securities held in the existing IRA or ERISA plan. We believe the
Department should make clear that PTE 84-24 would also cover any implied recommendation to sell securities in an existing IRA or plan account in order to purchase an annuity.

2. **Specific Comment:** The Department should clarify that the exemptive relief provided by PTE 84-24 is available for both the purchase of the annuity and the selection of investments under the annuity contract.

The Department should clarify that the exemptive relief available for purchases of insurance or annuity contracts under PTE 84-24 also applies to “downstream” transactions which occur pursuant to the operation of such contracts. This clarification is necessary in light of the proposed definitions of “Insurance Commission” and “Mutual Fund Commission” for purposes of PTE 84-24, both of which expressly exclude revenue sharing and certain other payments.

In a typical transaction involving the purchase of an annuity, the selling agent receives a commission from the insurance company. The investor who purchases the contract will then make selections from a menu of investment options available under the contract. The selected underlying investments commonly pay fees to the issuing insurance company pursuant to revenue sharing arrangements between the insurance company and the underlying investments. Under current law, the relief provided by PTE 84-24 applies to the entire transaction, including any payments made to the insurance company relating to underlying investments.

It is unclear whether the same relief would be available under the Proposed Amendment to PTE 84-24. The exclusion of revenue sharing and certain other payments from the definitions of the terms “Insurance Commission” and “Mutual Fund Commission” casts doubt as to whether exemptive relief is available for commissions paid in connection with sales of annuity contracts that include such “downstream” payments.

IRI does not believe the Department intended to preclude payments relating to the underlying investments held pursuant to an insurance contract. Foreclosing relief under PTE 84-24 whenever such arrangements are present in a transaction would lead to adverse consequences for many retirement investors. For example, the receipt of such payments by insurance companies permits those companies to charge lower fees to self-directed defined contribution plans for investment, recordkeeping, and other services.

IRI therefore urges the Department to clarify that, under the Proposed Amendment to PTE 84-24, an insurance company issuer of a variable annuity contract, or an underwriter of a mutual fund, can still receive 12b-1 fees, administrative fees, marketing payments, revenue sharing payments, and other payments that are excluded from the proposed definitions of “Insurance Commission” and “Mutual Fund Commission.”
3. **Specific Comment:** To level the playing field for annuities and mutual funds under PTE 84-24, the Department should extend to annuities the same independent fiduciary approval presumption provision that applies to mutual fund transactions.

IRI believes the same independent approval presumption available for transactions involving the purchase of securities issued by a mutual fund (or the receipt of a Mutual Fund Commission thereon) should be available for transactions involving the purchase of an insurance or annuity contract (or the receipt of an Insurance Commission thereon).

The proposed amendment carries forward the different treatment afforded to mutual fund transactions relative to annuity and insurance transactions under PTE 84-24 with respect to satisfying the condition that an independent fiduciary approve the transaction following the receipt of the disclosure materials required to be delivered to the independent fiduciary in advance of the transactions.

In the case of an annuity transaction relying on PTE 84-24, an insurance agent or broker is generally required to disclose to an independent fiduciary with respect to the plan or IRA: (i) whether it is an affiliate of the insurer whose product is being recommended and whether its advice is limited by the insurer; (ii) initial and ongoing commission amounts; and (iii) a description of any fees and charges under the contract. After receiving these disclosures, the independent fiduciary for the plan or IRA must acknowledge “in writing” the receipt of the information and approve the transaction (impliedly, the approval of the transaction must also be in writing).

By contrast, PTE 84-24 provides that for mutual fund transactions, the independent plan fiduciary’s “approval may be presumed if the fiduciary permits the transaction to proceed after receipt” of the disclosures, absent facts or circumstances to the contrary.

No reasonable basis exists for the disparate and more onerous independent fiduciary approval condition that applies to annuity transactions. The presumption of independent fiduciary approval that applies to mutual fund purchase transactions should also be available for annuity transactions. There is simply no reason to apply more rigorous requirements for annuity transactions than those that apply to mutual funds. IRI believes the playing field should be level between mutual funds and insurance products, and therefore urges the Department to extend the presumption approval provision to annuity transactions.

Accordingly, IRI respectfully requests that the Department remove the words “in writing” from the first sentence of Section IV(b)(2), and add the following as the second sentence thereof: “Unless facts or circumstances would indicate the contrary, the approval may be presumed if the fiduciary permits the transaction to proceed after receipt of the written disclosure.”
III. Comments Relating to the Proposed Best Interest Contract (“BIC”) Exemption

As noted in part II of this letter, IRI believes it is essential for the exemptive relief available under both PTE 84-24 and the Proposed BIC exemption be available to cover recommendations for the purchase of both fixed and variable annuity products by IRAs. IRI anticipates that some distributors of annuity products that also engage in the distribution of mutual funds and general securities may prefer a single prohibited transaction compliance regime to cover all IRA product recommendations and sales. In order to preserve the availability of these distribution channels as a source of annuity products and guaranteed lifetime income information to consumers, it is essential that the Proposed BIC Exemption be modified as discussed below. If the Proposed BIC Exemption is not modified, IRI believes its conditions will prove to be so onerous and so difficult to comply with that vital sources of annuity product distribution information to consumers will cease to be available, thereby denying consumers access to lifetime income.

A. General Comment on the Department’s Formulation of a Best Interest Standard and the Conditions Requiring the Formation of a Best Interest Contract: To avoid disruptions in the availability of annuity products and their guaranteed lifetime income features to millions of retirement savers, and advice about whether these products fit their needs, the requirements in the Proposed BIC Exemption must be revised in a workable manner.

IRI believes the interests of retirement investors are best protected when they are aligned with the financial professionals that advise them. A properly trained and supervised professional acts in a client’s best interest by recommending the product that fits that client’s needs. Where a financial professional will be compensated on the basis of a recommended transaction, an alignment of interests will take place where the client’s needs are met and the adviser has been fairly compensated; the adviser can only be compensated fairly where the client has been well served. Further, the administrative processes for implementing the best interest standard need to be sufficiently streamlined to afford advisers the opportunity to freely interact with clients and prospective clients. The Department’s proposed methods of implementation do not conform with common business practices and would deprive millions of retirement investors of access to retirement planning advice. We understand the Department has expressed a willingness to make the Proposed BIC Exemption administratively workable. The following comments are intended to help the Department achieve this critical objective.

1. Specific Comment: The terms of the BIC exemption should be clarified to indicate that a counter-signature on the part of the advice recipient is not needed to satisfy the condition. Advisers and financial institutions should be permitted to comply with this requirement through a unilateral agreement furnished to the advice recipient.
In many circumstances, it may be administratively unfeasible for an advice provider to procure a manual or so-called “wet” signature on a best interest contract before acting upon a client’s request to implement a recommended transaction. The parties may be doing business over the phone, for example. It is also foreseeable that some advice recipients may not be willing to sign a best interest contract notwithstanding the fact that the same client wishes to accept a recommended transaction. The contract requirement would be especially problematic with respect to existing annuity contracts. As noted in the attached Deloitte report, if Advisers and Financial Institutions are required to enter into contracts with existing clients, they would have to build systems and processes to identify, contact and track implementation. Given the fact that approximately 30 million Americans currently own variable and fixed annuities, this would be an extremely onerous undertaking that would likely take several years to fully complete.\footnote{Deloitte & Touche LLP. \textit{Anticipated Operational Impacts to the Insured Retirement Industry of the Department of Labor’s Proposed Rules for the Definition of Fiduciary Advice}.}

In light of these practical difficulties, it should be sufficient that the Adviser and the Financial Institution unilaterally agree to the terms required to be contained in the best interest contract described by the exemption, either orally or in writing (including electronic written form).\footnote{IRI urges the Department to clarify that, where more than one Financial Institution is involved in the sale of product (e.g., a broker-dealer firm engaged in the distribution of a variable annuity product and the insurance company issuer of the product), the Financial Institution primarily responsible for supervising the conduct of the Adviser with respect to the Adviser’s recommendation is the proper party to the contract.}

In a unilateral contract, only one of the contracting parties makes a promise; the other party manifests assent by performance.\footnote{Corbin on Contracts § 1.23 (3d ed. 2004); see also United States ex rel. Modern Elec., Inc. v. Ideal Elec. Security Co., 81 F.3d 240, 241 (D.C. Cir. 1996) (citing the “well-recognized” principle that “in a unilateral contract, performance constitutes acceptance of an offer”).} Accordingly, “[t]he legal result is that the promisor is the only party who is under an enforceable legal duty. The other party to this contract is the one to whom the promise is made, and this promisee is the only one in whom the contract creates an enforceable legal right.”\footnote{Corbin on Contracts § 1.23.}

Moreover, no signature is required for a unilateral contract to be enforceable. Rather, parties may become contractually bound by indicating their assent through a variety of other means, such as by accepting and acting upon the contract, ratifying the contract, or accepting the performance by the other.\footnote{17A Am. Jur. Contracts 2d § 173; see also Words, Inc. v. Xerox Corp., 205 F.3d 1336, at *1 (4th Cir. 2000) (per curiam) (“If the party against whom the contract is being enforced has indicated through some unequivocal act or through performance that it intends to adopt the contract, then a signature by that party is not required for the contract to be binding.”).}
The unilateral contract is supported by the same consideration that would support a signed bilateral contract. That is, engagement of the financial services firm by the customer constitutes sufficient consideration to create a legally binding relationship.

The principles of the unilateral contract are perfectly-suited to the BIC exemption, where the goal should be to hold a single party — the financial services firm — to an enforceable legal duty. This can be achieved by requiring firms wishing to use the exemption to post a statement on their website (or other accessible venue) that sets forth the BIC standards and commits to act in accordance with those standards when providing covered investment services. The client would be advised of this promise, the standards, and where to review them at the time covered services were offered. This could be done orally, when the interaction is by telephone or in person, or in writing, when the interaction is computer-based. The client would accept the firm’s offer by proceeding to use the firm’s services, thereby forming an enforceable agreement under basic principles of contract law.49

These principles of contract law would be sufficient to bind financial services firms to the BIC without the unnecessarily cumbersome and costly difficulties associated with an actual signed written agreement. However, the doctrine of promissory estoppel would serve as an additional means to enforce the BIC’s terms. Under promissory estoppel, if a party changes its position substantially either by acting or forbearing from acting in reliance upon a clear and unambiguous promise, then that party can enforce the promise even though the essential elements of a contract are not present.50

In the context of the Proposed BIC Exemption, that doctrine would apply if a firm represented to a customer that it would abide by the best interest standards when providing services, and the customer accepted those services in reliance on that assurance. In these circumstances, even if a court were to determine that for some reason no enforceable contract exists, a customer could use the doctrine of promissory estoppel to enforce the firm’s representations. The customer’s enforcement rights could be further enhanced if, on its website (or in some other publicly-accessible format), the firm is required, as a condition of the exemption, to

49 See Corbin, supra; see also Coulier v. United Airlines, Inc., 2015 WL 2452393, at *5 (S.D. Tex. May 21, 2015) (the portion of defendant’s website guaranteeing lower price for tickets purchased on the website was a “unilateral contract that the customer must accept by performance”); Edquist v. Bidz.com, Inc., 2013 WL 1290130, at *1 (D. Mass. Mar. 29, 2013) (“[A] person such as the plaintiff who accepts the terms offered by the defendant on its website by participating in an online auction governed by those terms has entered into a contractual relationship with the defendant.”).

50 Restatement (Second) of Contracts § 90; see also Williston on Contracts § 8:7 (4th ed. 2008) (“[B]oth versions of the Restatement recognize that in certain circumstances, a promise might be enforced despite the absence of consideration — and, according to some courts, despite the absence of other elements necessary to form a traditional contract — based on the promisee’s foreseeable, reasonable, justified and detrimental reliance on the promise”); Allen v. A.G. Edwards & Sons, Inc., 606 F.2d 84, 87 (5th Cir. 1979) (recognizing promissory estoppel where broker-dealer, “[h]aving benefitted from oral agreements transacted through local agents, [] cannot now be heard to complain of failure to observe formalities”).
acknowledge the enforceability of its BIC promise and the client’s reliance on that promise in engaging in the interaction.

For all of these reasons, there is no need for the Department to require a signed, bilateral contract for the BIC. The proposed exemption should be revised to permit firms to become legally bound in the manner described.

2. **Specific Comment:** The contract timing requirement under the Proposed BIC Exemption should require the contract to be executed prior to the transaction, not prior to the recommendation.

The contract timing rule set forth in the Proposed BIC Exemption is simply unworkable in many respects. Due to the breadth of the Proposed Regulation’s definition of “recommendations” that will rise to the level of fiduciary advice, IRI is concerned that most sales presentations involving retirement investors will be swept into the status of fiduciary conduct. Accordingly, the Proposed BIC Exemption will become a key compliance strategy for insurance brokers and agents in their dealings with ERISA plans, participants and IRA holders.

The Proposed BIC Exemption requires that the contract be entered into prior to “recommending” that the investor purchase, sell or hold an Asset. As a practical matter, this timing requirement will be impossible to satisfy in many cases, particularly with respect to activities that have been historically viewed as sales activities but will now be considered fiduciary “recommendations.”

Typically, an adviser would make a “recommendation” in the context of a sales presentation before an investor has had the opportunity to make a judgment about whether the recommendation is worthy of serious consideration. We believe many ERISA investors would be unwilling to enter into a contract with an adviser before they understand the nature of the recommendations that the adviser will make. Moreover, requiring a prospective investor to sign a detailed, tri-party contract before the adviser is permitted to give the client any of his or her recommendations whatsoever will have the unnecessary effect of stopping sales presentations dead in their tracks.

IRI believes the point in time when it is most critical for a customer to understand the nature of the relationship between the parties is prior to the execution of the transaction, meaning the time that the investor acts on the advice and either purchases, sells or holds an asset based on the recommendations of the adviser. Accordingly, IRI requests that the Department revise Section II(a) of the Proposed BIC Exemption to state:

(b) **Contract.** Prior to the transaction for which relief is sought under Section I, the Adviser and Financial Institution provide a unilateral agreement to the Retirement Investor that incorporates the terms required by Section II(b) – (e).
3. **Specific Comment**: The definition of the term “Best Interest” in the Proposed BIC Exemption is overly prescriptive and should be revised to make clear that advisers and financial institutions must always put their clients’ interests first, but would not be required to completely disregard their own legitimate business interests.

IRI fully and unequivocally supports the fundamental notion that a “best interest” standard of care should govern the conduct of a fiduciary Adviser to Retirement Investors as a condition to obtaining exemptive relief under the Proposed BIC Exemption. However, IRI is gravely concerned that the best interest standard articulated by the Department appears to require a complete disregard of any financial interest of the Adviser, the Financial Institution or any Affiliate, Related Entity or other party to the transaction. In particular, the phrase “without regard to the financial or other interests of the Adviser, Financial Institution or an Affiliate, Related Entity or other party” is problematic because it appears to require that any advice provided wholly ignore the business and economic reality that advisers and financial institutions have to generate enough revenue to cover their costs and earn a reasonable profit in order to stay in business.

We do not believe the Department intended to require an Adviser and Financial Institution to completely disregard their own legitimate business interests. In our view, if the Adviser, Financial Institution and their Affiliates have absolutely “zero” interest in a transaction, there would be no potential conflict of interest and therefore no need for the transaction to comply with an exemption in the first place. Rather, IRI believes that the Department intended to require compliance with ERISA’s prudence rule and ensure that the investor’s interests are always considered first and foremost. Accordingly, we respectfully urge the Department to modify the text of the best interest standard to more clearly reflect this intent. Without this clarity, it will be impossible for any adviser or financial institution to rely on the Proposed BIC Exemption, meaning millions of Americans would lose access to advice.

Our belief regarding the intent of the standard derives from the Department’s statement that it “expect[s] the standard to be interpreted in light of forty years of judicial experience with ERISA’s fiduciary standards and hundreds more with the duties imposed on trustees under the common law of trusts.” Judicial authorities interpreting ERISA’s general fiduciary standards have agreed that an ERISA fiduciary’s receipt of an incidental benefit from a transaction that otherwise is primarily for the benefit of a plan, will not itself cause a violation of ERISA’s fiduciary standards. In other words, many courts have held that where taking the best course of action for a participant or beneficiary would lead to an "incidental benefit" to a plan fiduciary, such incidental benefit is permitted by ERISA.

---

51 80 FR 21970.
52 See, e.g., *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982). (“[O]fficers of a corporation who are trustees of its pension plan do not violate their duties as trustees by taking action which, after careful and impartial
In addition, the Department’s Fact Sheet about the Proposal described the best interest standard as follows:

The “best interest contract exemption” will allow firms to continue to set their own compensation practices so long as they, among other things, commit to putting their client’s best interest first and disclose any conflicts that may prevent them from doing so. Common forms of compensation in use today in the financial services industry, such as commissions and revenue sharing, will be permitted under this exemption, whether paid by the client or a third party such as a mutual fund.\textsuperscript{53}

This notion of putting the investor’s interests first is repeated by the Department in numerous places throughout the Proposal to describe the best interest standard.\textsuperscript{54} Moreover, the Department has repeatedly described the exemption as preserving the ability of financial Advisers to rely on common compensation practices such as payments from third parties and funds.\textsuperscript{55}

To ensure the best interest standard is implemented and interpreted consistent with the referenced authorities, IRI urges the Department to revise the definition in Section VIII(d) of the Proposed BIC Exemption to read as follows (new language is underlined):

Investment advice is in the “Best Interest” of the Retirement Investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, investigation, they reasonably conclude best to promote the interests of participants and beneficiaries simply because it incidentally benefits the corporation or, indeed, themselves . . . .”); \textit{Hughes Aircraft Co. v. Jacobson}, 119 S. Ct. 755, 764 (1999) (incidental benefits conferred upon an employer when it amends a plan do not constitute a fiduciary breach under section 404); \textit{Trenton v. Scott Paper Co.}, 832 F.2d 806, 809 (3d Cir. 1987) (“[T]he fact that a fiduciary’s action incidentally benefits an employer does not necessarily mean that the fiduciary has breached his duty.”); \textit{Siskind v. Sperry Ret. Program, Unisys}, 47 F.3d 498, 506 (2d Cir. 1995). See also, Restatement (Third) of Trusts § 78 cmt. d (2007) (“[A] trustee’s action or decision that is motivated by and taken in the best interest of the beneficiaries does not violate [the trustee’s duty of loyalty] merely because there may be an incidental benefit to the trustee.”).

\textsuperscript{54} See, e.g., 80 Fed. Reg. at 21970 (“Under this standard, the Adviser and the Financial Institution must put the interests of the Retirement Investor ahead of the financial interests of the Adviser, Financial Institution or their Affiliates, Related Entities or any other party.”).
\textsuperscript{55} See, e.g., 80 FR 21961 (“Certain types of fees and compensation common in the retail market, such as brokerage or insurance commissions, 12b-1 fees and revenue sharing payments, fall within these prohibitions . . . . [T]he exemption would allow certain investment advice fiduciaries, including broker-dealers and insurance agents, to receive these various forms of compensation ”); see also 80 FR 21966 (“[T]he BIC Exemption] seeks to preserve beneficial business models by taking a standards-based approach that will broadly permit firms to continue to rely on common fee practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers.”)
financial circumstances, and needs of the Retirement Investor, and that
subordinates the financial or other interests of the Adviser, Financial Institution,
or any Affiliate, Related Entity or other party to those of the Retirement Investor.
[or, “and that places the interests of the Retirement Investor ahead of the
financial or other interests of the Adviser....”]

For consistency, a similar change should also be made to the parenthetical language in Section
II(c)(1).

4. **Specific Comment:** Given that the duty to act in a client’s best interest is contained
in the required contract under the Proposed BIC Exemption, the warranties
required under the Exemption serve no useful consumer purpose but expose
Advisers and Financial Institutions to risks of frivolous and costly litigation, adding
to the expense associated with serving retirement investors.

The primary enforcement mechanism under the Proposed BIC Exemption is the contractual
promise that the Adviser and Financial Institution will act in the client’s best interest. An advice
recipient who believes the best interest promise has been breached can pursue contractual
remedies. IRI believes the requirement that the Adviser and Financial Institution also promise
to adhere to extremely rigorous warranties will likely give rise to nuisance litigation claims for
warranty violations in circumstances where a claim of a failure to act in the advice recipient’s
best interest cannot be supported. These warranties would not provide any additional benefits
for consumers beyond the protections provided by the best interest standard, but would
provide ample fodder for frivolous litigation. For those reasons, IRI strongly urges the
Department to remove the written warranties required under paragraph II(d) of the BIC.

5. **Specific Comment:** The “reasonable compensation” conditions of the Proposed BIC
Exemption are focused on the value of services and fail to take into account the
costs of annuity products’ guaranteed features. Moreover, the conditions unfairly
disadvantage proprietary products. For purposes of annuity product
recommendations, the definition of “reasonable compensation” contained in the
Proposed BIC exemption should be conformed to the corresponding provision in
the Proposed Amendment to PTE 84-24.

Section III(c) of PTE 84-24, as re-proposed, contains a “reasonable compensation” condition
that distinguishes between (1) amounts paid for the provision of services to a plan or an IRA,
and (2) amounts paid in connection with the purchase of the annuity contract itself. The total of
both such amounts may not exceed reasonable limits, yet the distinction between amounts
paid for services and amounts paid for insurance is useful for purposes of ascertaining
compliance with the condition.
The Proposed BIC Exemption contains “reasonable compensation” conditions in Sections II(c)(2) and IV(b)(2). The measurement of reasonable compensation for purposes of the BIC exemption, however, lacks PTE 84-24’s distinctions between costs of services and costs of insurance. Instead, the proposed BIC exemption measures reasonable compensation strictly in relation to the services they provide.

By measuring the reasonableness of total annuity costs purely in relation to the provision of services, the Proposed BIC Exemption overlooks the fact that much of the value provided by annuities (and to which many of the costs of annuities are attributable) pertains to their guaranteed features. The assumptions of risk associated with the provision of annuity guarantees has significant value, but it is not a value that can be measured in relation to the services provided by the Adviser.

This same difficulty is magnified in the case of proprietary annuities. The BIC Exemption’s reasonable compensation test measures the reasonableness of total compensation received by the Adviser, Financial Institution, Affiliates and Related Entities against services provided to a retirement investor. An Adviser offering a non-proprietary product would be required to test only the reasonableness of the amounts he and the Financial Institution he represents receive (since the issuing insurer is not an Affiliate of the Adviser, amounts payable to the insurer would not be counted). By contrast, where an Adviser offers a proprietary product for the same price and for the same level of services, the total compensation would have to include the amounts paid to the Affiliated annuity issuer in addition to the amounts received by the Adviser and the Financial Institution he represents, making the reasonable compensation condition much more difficult to satisfy despite the fact that the actual amount of compensation paid in these two scenarios would be the same.

To remedy these issues, IRI urges the Department to substitute the same reasonable compensation measure contained in section III(c) of PTE 84-24 in place of the counterpart language contained in Section II(c)(2) and IV(b)(2) of the Proposed BIC Exemption, for purposes of applying the BIC exemption conditions to annuity products. As noted in part II of this comment letter, IRI strongly believes that both the BIC Exemption and PTE 84-24 should be available as sources of exemptive relief for annuity transaction recommendations to IRAs.

6. **Specific Comment**: The Adviser’s and Financial Institution’s agreement to comply with the Impartial Conduct Standards by delivering a Best Interest Contract should be sufficient to satisfy the conditions of section II(c) of the Proposed BIC Exemption. Violations of the Impartial Conduct Standards should not result in loss of the exemption.

The Department has proposed the contractual enforcement mechanism described by the Proposed BIC Exemption as the means by which plans, plan participants and IRA holders may
hold their Adviser and the Financial Institution accountable for a breach of the Impartial Conduct Standards. This is particularly important for IRA holders who would have no remedies under ERISA for breaches of fiduciary duty. As proposed, the exemption would not only subject Advisers and Financial Institutions alleged to have breached the Impartial Conduct Standards to potential contract liability but would also subject them to excise tax liability under section 4975 of the Code in connection with prohibited transactions associated with the provision of advice.

IRI is concerned that the lack of clarity regarding the best interest standard will create unnecessary disputes and uncertainty as to when the exemption applies and when it does not. Excise tax liability is a self-assessed and self-reported tax under section 4975 of the Code. Although it is generally 15% of the amount involved in the prohibited transaction, the tax escalates to 100% of the amount involved if the IRS asserts liability for the tax before it has been self-reported and assessed.\textsuperscript{56} Needless to say, these amounts can be substantial and there are penalties and interest associated with failures to timely file and pay excise tax liabilities.

It is essential that Financial Institutions and Advisers know for certain when their activities will be covered by the BIC Exemption and when the BIC Exemption may be lost. In order to give Financial Institutions and Advisers certainty regarding when excise tax liability arises, IRI asks the Department to revise the Proposed BIC Exemption so that compliance with the Impartial Conduct Standards is not a condition of the Proposed BIC Exemption, but remains a requirement of the contract. Specifically, the phrase “and comply with” should be removed from section II(c) and should solely be a requirement of the contract entered into under the BIC Exemption. This would be consistent with the treatment of the warranties under the Proposed BIC Exemption, under which the best interest contract is required to contain the warranties, but violations of the warranties would not cause the exemption to be lost.

B. \textit{General Comment on Treatment of Propriety Products under the Proposed BIC Exemption:}

The Department should take steps to preserve proprietary annuity distribution models, which provide consumers with invaluable and irreplaceable sources of knowledge about annuity products and how annuities can be used to provide guaranteed lifetime income to retirees. To that end, the “Limited Range of Investment Options” requirements included in section IV of the Proposed BIC Exemption should not apply to Advisers and Financial Institutions that offer only proprietary products.

Some IRI members only offer proprietary investment menus in connection with individual or variable annuity contracts and IRA products. There are good reasons why this type of business model exists. A number of insurers maintain career agent distribution forces, comprised of individuals who contractually agree to limit their annuity sales and servicing efforts primarily or exclusively on products offered by a single insurance carrier. In consideration of that

\textsuperscript{56} I.R.C. § 4975(b).
commitment, an insurer may sponsor benefit plans to cover qualifying career agents, provide office housing allowances and offer substantial training and education support. Yet section IV of the Proposed BIC Exemption seems to imply that such arrangements are inherently problematic by imposing an additional layer of conditions on Advisers and Financial Institutions that offer only proprietary products. Specifically, under section IV(b) the Financial Institution must make a written finding that the limitations it has imposed on Assets made available to an Adviser do not prevent the Adviser from providing advice in the Best Interest of the investor. Moreover, before giving recommendations to the investor, the Adviser or Financial Institution must give the investor written notice of the limitations placed on the Adviser. The Adviser must notify the investor if it does not recommend a sufficiently broad range of Assets to meet the investor’s needs.

IRI asks that the Department make clear that the use of a proprietary-only product platform would not necessarily and in every case require the provider to be subject to the “Limited Range of Investment Options” requirements of section IV(b) of the Proposed BIC Exemption. In other words, the Department should clarify that an annuity provider that exclusively offers proprietary products is not subject to section IV(a), and will not be subject to the disclosure conditions of section IV(b).

IRI also believes Section IV(b) should not apply when a plan participant or IRA investor seeks investment advice solely on a source of guaranteed lifetime income. Similarly, the Department should clarify that an Adviser can provide investment recommendations on a limited range of asset classes specified by the investor without requiring compliance with section IV(b) of the Proposed BIC Exemption.

Finally, IRI is concerned that it may not be possible to offer a platform of exclusively affiliated investments and still satisfy the Best Interest standard as proposed. In this regard, the Proposed BIC Exemption requires an Adviser and Financial Institution to act in the “Best Interest” of a Retirement Investor; and this standard is met if they provide “advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.” The final phrase of this standard – requiring that both the Adviser and Financial Institution act “without regard to” the financial interests of themselves, Affiliates and other parties – raises the question of whether a proprietary-only platform could be consistent with this standard. We do not believe that the Department intended the Best Interest standard to be a complete bar to the use of a proprietary-only platform. Given the significant concern in the industry on this point, we urge

57 Prop. BIC Exemption, § VIII(d).
the Department to make clear that the Proposed BIC Exemption is still available, and the Best Interest standard itself can still be satisfied, where a Financial Institution offers (or an Adviser makes available) exclusively proprietary products. We note that our earlier recommendation in section III.A.3 of this letter to delete the phrase “without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party” is consistent with this comment.

C. General Comment on the Disclosure Conditions of the Proposed BIC Exemption: The proposed point of sale, website, annual and ongoing information maintenance requirements impose exceedingly burdensome, expensive and duplicative disclosure requirements on annuity product providers and distributors, and should be removed from the Proposed BIC Exemption.

1. Specific Comment: The point of sale disclosures required under the Proposed BIC Exemption should be made through the provision of a prospectus for registered annuity products and should be replaced by a reference to the statutory prospectus disclosure requirement.

The proposed point of sale disclosure requirements under Section III(a) are problematic and not calibrated for annuity products in many respects. As written, the proposed initial disclosure must include: (i) the all-in costs and anticipated future costs of an asset in a summary chart and the total costs to the retirement investor for 1-, 5- and 10-year periods expressed as a dollar amount; and (ii) the total costs of investing in an asset. These disclosures must be expressed based on the specific dollar amount invested by the investor.

As a threshold matter, with respect to variable annuities at least, the proposed point of sale disclosure would appear to ignore the ready availability of appropriate fee and expense disclosures contained in the SEC mandated prospectus for such products. The variable annuity prospectus includes not only a fee table that summarizes the various fees and charges that apply (e.g., sales charges, ongoing asset-based charges, rider charges, and transaction charges) but also hypothetical expense examples for 1, 3, 5, and 10 year periods based on certain assumptions relating to such things as: (a) the amount invested, (b) the performance of such investment, (c) the underlying fund fees applied, and (d) whether the investor surrenders or annuitizes at the end of the stated periods.

The SEC’s carefully designed fee table and expense examples, with which the industry and millions of investors have decades of experience, provide exactly the type of simple, succinct, and uniform disclosure and comparability the Department seeks. The SEC’s disclosure regime accommodates the various types of mortality and expense risk charges as well as rider charges

that may be imposed under a variable annuity, and addresses countless other matters specific
to variable annuities, such as the method for converting flat annual charges into asset based
charges for purposes of preparing the required expense examples. In addition, the SEC and the
industry have considered and worked out a myriad of other disclosure issues relating to fees
and charges, all consistent with investor protection and the public interest. For example, the
SEC long ago streamlined the volume of expense information required to be shown regarding
underlying funding options by allowing issuers to present a high/low range to avoid
overwhelming investors with a paralyzing blizzard of numbers. Moreover, the SEC has
developed appropriate disclosure standards for annuity products under which the carrier
guarantees a particular interest rate and retains the difference between the rate credited and
the earnings on the assets invested rather than imposing fees and charges.

The Department should leverage the SEC’s decades of experience to avoid getting mired in the
enormous task of trying to create a separate but equal disclosure regime. For example, the
Proposed BIC Exemption would require disclosure of the “total costs” of ownership a variable
annuity investor might incur over time, but does not explain how an insurance company would
calculate this amount. As a practical matter, because many variable annuity fees and charges
are based on the amount of the investors’ assets, which may fluctuate over time, the Proposed
BIC Exemption would appear to require that an insurer assume or “project” some degree of
future performance in order to compute the total costs of the investment. The SEC has declared
it would be materially misleading to suggest that past performance may be indicative of future
results, and FINRA rules on communications with the public expressly prohibit projections of
performance except under limited circumstances. For this reason, and to facilitate
comparability, the SEC requires the use of an assumed 5% hypothetical return in its fee table
expense examples. This point illustrates how a seemingly simple requirement proposed by the
Department may actually present a significant challenge were the SEC’s disclosure regime not
to be followed.

In addition, the Proposed BIC Exemption would require an adviser to develop a unique
disclosure tailored to each investor’s investment amount. Putting to one side the potential
confusion and lack of comparability that might result in the absence of a standard and common
set of assumptions for fees and charges, it would be extremely expensive for annuity providers
to develop new systems to comply with these disclosure requirements. As a practical matter, it
would be impossible for annuity providers to develop these systems within eight months after
the Proposed BIC Exemption is finalized. A recent study conducted by Deloitte & Touche for IRI
found that creating and implementing the systems changes needed to comply with the

---

59 See, e.g., Rule 482(b)(3)(i) and FINRA Rule 2210(d)(1)(F), respectively.
requirements of the Proposed BIC Exemption will be a multi-year process. In addition, the inevitable delays in providing individualized disclosures to annuity investors would likely result in inaction, which is exactly what the White House does not want to have happen to people on the cusp of retirement who need to take action.

Accordingly, IRI respectfully submits that the Department should permit the point of sale disclosure requirement to be met for annuity products that are registered as securities through the provision of a prospectus or summary prospectus that meets SEC requirements by revising Section III(a) of the Proposed BIC Exemption to add the following as the final sentence thereof:

With respect to the purchase of an Asset that is an annuity contract registered under the Securities Act of 1933, the requirements of this subsection (a) shall be deemed satisfied if, prior to the execution of the purchase of the Asset by the Plan, participant or beneficiary account, or IRA, the Adviser furnishes to the Retirement Investor a copy of the statutory prospectus or summary prospectus for such Asset.

2. Specific Comment: The website disclosure requirements for annuity products should be eliminated in favor of the settled disclosure regimes under applicable federal securities laws and state insurance laws.

IRI is concerned that the website disclosure provision in the Proposed BIC Exemption would require that extensive information about the costs of annuity products be provided by each selling firm rather than the product issuer. This could result in different consumers receiving different information about the same product, which would generally conflict with securities and insurance industry disclosure standards that emphasize accuracy and consistency of product cost disclosure across distribution channels.

In the insurance industry, product disclosures, including cost disclosures, are typically controlled by the product issuer, and not the individual adviser or selling firm. This has the benefit of increased uniformity of disclosure, in that hundreds of sales persons selling for an issuer can use the same consistent, carefully reviewed sales materials. For that reason, insurance product issuers typically contractually prohibit distributors from independently generating product-related sales materials.

In the context of SEC-registered investment products, consistency and comparability of disclosure are critical elements of facilitating investor understanding and informed choice. All issuers of registered securities, such as variable annuities, are required to prepare a standard offering document, i.e., a prospectus that not only must contain specific disclosures, but also

---

60 Deloitte & Touche LLP. Anticipated Operational Impacts to the Insured Retirement Industry of the Department of Labor’s Proposed Rules for the Definition of Fiduciary Advice.
must follow certain “ordering requirements,” so that the information conveyed appears in a specific sequence that is intended to facilitate comparability and assist in consumer comprehension and understanding.\textsuperscript{61}

Moreover, in the case of a variable annuity product, the website disclosures required under the Proposed BIC Exemption would likely constitute advertising material under state insurance laws, and an advertisement under the federal securities laws that would have to be filed with FINRA, and that would be subject to highly detailed disclosure and computational requirements. For fixed annuities, any advertising material would have to comply with state insurance model advertising regulations.

With respect to annuities that are not registered with the SEC, appropriate disclosure requirements have been established by the National Association of Insurance Commissioners (NAIC) in its Annuity Disclosure Model Regulation.\textsuperscript{62} This NAIC model regulation was carefully crafted through the combined efforts of the state insurance regulators, industry representatives, and consumer advocates to ensure that consumers are provided the information they need in order to fully understand annuities and their costs and benefits. IRI encourages the Department to allow advisers and financial institutions to utilize disclosures meeting the requirements of the NAIC model regulation to satisfy the disclosure requirements for non-registered annuities under the Proposed BIC Exemption.

Further, the website disclosure requirements are not at all tailored to the nuances of annuity products. For example, the Proposal would require the website to disclose the direct and indirect compensation paid to the Adviser, the Financial Institution, and any Affiliate in connection with each Asset purchased, held or sold within the last 365 days, and the source of the compensation. Because of the sheer number of transactions for which Financial Institutions will undoubtedly rely on the Proposed BIC Exemption, the website would quickly become so unwieldy as to not provide any useful information to Retirement Investors. Furthermore, the overwhelming investors with such disclosures would make it difficult for them to find the information they most need and want. Investors arguably would benefit most from knowing (a) that the intermediary with whom they are dealing is a compensated and, therefore, motivated sales person, (b) any conflicts of interest that result from such compensation, and (c) the product pricing and pricing variations available to the investor. Details of intercompany revenue sharing arguably would be of little or no meaningful use to the investor, and likely would distract the investor from focusing on the key information that is essential to making an informed investment decision.

\textsuperscript{61} See, e.g., SEC Forms N-4 (variable annuities) and N-1A (mutual funds).
\textsuperscript{62} Available at http://www.naic.org/store/free/MDL-245.pdf.
3. **Specific Comment:** The annual disclosure requirement under paragraph III(b) of the Proposed BIC Exemption is overly burdensome, would be exceedingly costly to develop and does not advance investor interests, and should therefore be removed.

IRI notes that much of the information that would be required under the Proposed BIC Exemption’s annual disclosure condition is already available to investors through their quarterly account statements, which report sales and purchase activity and which list account holdings. IRI questions the need for an annual restatement of the previous four quarterly statements. The condition would also require complex, dollarized disclosures of fees and expenses paid and amounts received by various parties in connection with account transactions. In this regard, IRI notes that the merits and countervailing costs of such dollarized disclosures were a major topic of the Department’s multi-year, recently finalized plan-level and participant-level disclosure regulations under sections 408b-2 and 404a-5 of the Department’s ERISA regulation, respectively. In both of those efforts, following extensive public comment and discussion, the Department elected not to require dollarized disclosures in its final rulemaking. IRI questions the need to re-open that same issue, which was only recently decided. The annual disclosure requirement of section III(b) should be removed or conformed with the Department’s recently finalized disclosure requirements under sections 408b-2 and 404a-5 of the ERISA regulations.

4. **Specific Comment:** The Proposed BIC Exemption’s provision authorizing public disclosure of Adviser return information will provide no meaningful benefit to consumers but will be extremely expensive to implement, and should therefore be deleted.

IRI is highly concerned about the Department’s right to publicly disclose information provided pursuant to the Data Request provision of section IX(d). First, developing the systems necessary to compile the required information on a quarterly basis, including cash flows going to or from the portfolio, for each Retirement Investor will be an enormously expensive and resource-intensive task for Financial Institutions. Moreover, since annuity products feature guaranteed values as well as cash values it is unclear how portfolio beginning and ending “values” should be calculated for individual and group annuity products that include lifetime income guarantees in addition to an investment component.

However, even if Financial Institutions could compile and provide this information at the Retirement Investor level, we are highly concerned that any disclosure of information by DOL, as expressly permitted under section IX(e), would be unhelpful at best and misleading at worst. Advisers who will rely on the Proposed BIC Exemption will be engaged in the marketing and selling of everything from bank deposits and CDs, to bank collective funds and mutual funds and insurance and annuity products, all of which have different risk and return features.
Moreover, these recommendations will be made to unique plans, plan participants, and IRA investors that have very different characteristics as well as investment goals and horizons. The “return” information for these various Assets will not tell any coherent story or be useful to any specific person.

Moreover, DOL’s own investment prudence regulation makes clear that the prudence of an investment choice is not measured in hindsight by return alone, but by a consideration of several factors as applied to the investor’s unique facts and circumstances at the time the investment is made. We strongly believe that a public disclosure of “return” information alone on a per-Adviser basis sends the wrong information to the public about investment prudence in the ERISA space and will not be informative.

We ask the Department to delete section IX(e) on the basis that compliance with this provision will be extremely costly, while public disclosure of this information will not provide any meaningful information to plan participants or IRA owners.

C. Other Comments on the Proposed BIC Exemption.

1. Specific Comment: The condition to the exemption for pre-existing transactions prohibiting additional advice following the applicability date of the regulation would render the exemption worthless in practice, and should therefore be removed.

While IRI appreciates the Department’s efforts to provide relief from ERISA’s prohibited transaction rules for certain arrangements entered into prior to the effective date of the proposed regulatory changes, we have serious concerns that the conditions placed on such relief create inappropriate incentives for Advisers and Financial Institutions not to service existing clients that would run counter to the best interests of Retirement Investors.

Specifically, section VII(b)(3) of the Proposed BIC Exemption makes exemptive relief available only if “[t]he Adviser and Financial Institution do not provide additional advice to the Plan regarding the purchase, sale or holding of the Asset after the Applicability Date.”

In effect, this condition requires Advisers and Financial Institutions to ignore the ongoing needs of their clients in order to take advantage of the relief provided by the Department. Such a result would be contrary to the overall purpose of DOL’s broader regulatory proposal, which is aimed at requiring Advisers and Financial Institutions to always act in the Best Interest of Retirement Investors. It would also run afoul of FINRA’s regulatory expectations that advisers should periodically check back with clients to see if their needs or objectives have changed and if their holdings remain appropriate. Furthermore, the condition makes no distinction between

---

63 See 29 C.F.R. § 2550.404a-1(b); see also DOL Adv. Op. 98-04A (May 28, 1998) (applying this standard to the selection of investment options in a participant-directed 404(c) plan).
advice that is initiated by an Adviser or Financial institution and advice provided in response to a customer-initiated request. This means that if a Retirement Investor, following the applicability date of the Proposed BIC Exemption, contacts his Adviser to ask whether he should continue to hold shares in a mutual fund he purchased on the Adviser’s recommendation one year prior, the Adviser would only be able to answer the customer’s question if he otherwise satisfies the conditions of the Proposed BIC Exemption because the pre-existing transaction exemption would no longer be available.

In short, the condition requiring that no additional advice be given either: (i) discourages Advisers from their existing customers’ ongoing retirement planning needs; or (ii) eliminates any usefulness that the exemption for pre-existing transactions would otherwise provide. In practice, Advisers will be forced to preemptively target all pre-existing customers in order to enter into tri-party contracts which satisfy the Proposed BIC Exemption’s requirements, and they will need to do so immediately upon the applicability date of the Proposed BIC Exemption. IRI urges the Department to delete this condition so that Advisers and Financial Institutions may continue to look out for their customers’ best interests with respect to pre-existing investments without forfeiting exemptive relief.

IV. Comment on Timing of Implementation for Proposal

A. The Department should provide an implementation period of at least three years to ensure the industry has adequate time to develop the necessary compliance processes. The proposed eight-month timeline would result in significant and harmful market disruptions.

IRI is concerned that the Department has significantly underestimated the amount of time annuity providers and distributors will require to come into compliance with the rules under the Proposal. The requirements and conditions included in the Proposal are exceedingly complex and would require massive information technology re-design and build outs to support. Our members believe it would take a minimum of three years to complete this work.\(^\text{64}\)

The Department allowed for a two year implementation period for service providers to implement the section 408(b)(2) regulations. By comparison, the Department is proposing a compressed eight month timeframe for the industry to meet the far more challenging and complex requirements under the Proposal.

IRI urges the Department to reconsider its proposed abbreviated timetable. Many institutions will simply not be able to meet the Proposal’s requirements within such a short time frame and would be forced to suspend the delivery of services to customers. A timeframe of at least three years is necessary to ensure compliance without disrupting the market.

\(^{64}\) Deloitte & Touche LLP. Anticipated Operational Impacts to the Insured Retirement Industry of the Department of Labor’s Proposed Rules for the Definition of Fiduciary Advice.
years would be far more realistic and would avoid the unnecessary market disruptions inherent in the Department’s eight month timeframe.

**Conclusion**

In an age when saving and preparing for retirement is squarely on the shoulders of individuals, financial professionals will have an important part in helping their clients develop retirement plans and grow their savings. As currently formulated, IRI and its members are extremely concerned that the Proposal will limit consumer choice or deprive lower- and middle-income consumers from accessing affordable assistance with retirement planning. The revisions recommended in this letter will enable the Department to establish a best interest standard while preserving Americans’ access to retirement planning products and advice.

If you have any questions about any of our recommendations or if we can be of any further assistance as the Department works to improve the Proposal, please feel free to contact me or Lee Covington, IRI’s Senior Vice President and General Counsel.

Sincerely,

Catherine J. Weatherford
President & CEO
Insured Retirement Institute
July 21, 2015

FILE E D ELECTRONICALLY

Office of Regulations and Interpretations  Office of Exemption Determinations
Employee Benefits Security Administration  Employee Benefits Security Administration
U.S. Department of Labor  U.S. Department of Labor
200 Constitution Avenue, N.W.  200 Constitution Avenue, N.W.
Room N-5655  Suite 400
Washington, DC 20210  Washington, DC 20210

Re: Definition of the Term Fiduciary; Conflict of Interest Rule (RIN 1210-AB32)
Proposed Amendment to Proposed Partial Revocation of Prohibited Transaction Exemption 84-24 (ZRIN: 1210-ZA25)
Proposed Best Interest Contract Exemption (ZRIN 1210-ZA25)

We are writing on behalf of the Committee of Annuity Insurers (the “Committee”) to comment on the proposed regulation published by the Department of Labor (the “Department”) that redefines the circumstances in which a person is considered an investment-adviser fiduciary under the Employee Retirement Income Security Act of 1974 (“ERISA”) and section 4975 of the Internal Revenue Code of 1986 (“Code”). The Committee is a coalition of life insurance companies formed in 1982 to participate in the development of federal policy with respect to annuities. The Committee’s current 29 member companies represent more than 80% of the annuity business in the United States and are among the largest issuers of annuity contracts to IRAs and employer-sponsored retirement plans. A list of the Committee’s member companies is attached. This letter provides comments on the proposed regulation and the proposed exemptions (new and revised) that are relevant to annuities, particularly the Prohibited Transaction Exemption (“PTE”) 84-24 and the Best Interest Contract Exemption (“BICE”).

INTRODUCTION AND SUMMARY OF RECOMMENDATIONS

President Obama’s Administration has made great strides to elevate a critical issue for the retirement security of Americans – enhancing access to and understanding of lifetime income options like annuities. The Department of the Treasury and the Department of Labor have both recognized that as workers and savers increasingly find their retirement savings in the form of 401(k) plans, 403(b) plans, and IRAs, it is critical that we facilitate better access to, and more use of, arrangements designed to provide a stream of income that is guaranteed to continue as long as
an individual lives.\textsuperscript{1} The Committee shares these goals and is deeply appreciative of the Administration’s efforts. The member companies of the Committee fully support a regulatory regime that requires financial professionals who provide investment advice to act in the best interest of their clients. Nevertheless, it would be a disservice to both Americans preparing for retirement and those already retired if we did not clearly express the Committee’s belief that the Department’s current proposal will seriously undermine the Administration’s goal of advancing the availability and use of lifetime income products and strategies.

As described below, the proposal makes it harder, not easier, to help individuals understand how and when an annuity might be appropriate for their retirement planning. The proposal potentially turns any conversation about an annuity used to accumulate or distribute plan or IRA\textsuperscript{2} retirement benefits into a fiduciary discussion. Further, because the Department has proposed to curtail the availability of PTE 84-24 and because the costs and risks associated with the BICE make the BICE uneconomical to use except for the wealthiest clients, we are very concerned that there will be reduced access to and use of guaranteed income for life for those who most need it. Our comments are offered with the goal of avoiding these very unfortunate and unintended consequences.

Our key recommendations are as follows:

- The Department should fully consider the costs of its rulemaking and the potential consequences thereof and proceed with appropriate regulatory coordination.
- Unless the Department expands the seller’s carve-out, the regulation will severely limit access to and use of annuities and other lifetime income products in retirement plans and IRAs. Thus it is critical that the Department provide that ordinary sales activities with plans (of all sizes) and IRA owners do not trigger fiduciary status in situations where there is no expectation that impartial advice is being provided.
- The Department should not draw a distinction in PTE 84-24 between different kinds of annuities. Rather, we strongly recommend that, with appropriate conditions to ensure an adviser acts in the customer’s best interest, PTE 84-24 should be available for all annuities and insurance products.
- The Department should clarify certain aspects of the fiduciary status test to avoid sweeping in non-fiduciary communications.

\textsuperscript{1} See e.g., Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans, 75 Fed. Reg. 5253 (Feb. 2, 2010) (seeking input on steps that could be taken to facilitate “access to, and use of, lifetime income or other arrangements designed to provide a stream of lifetime income after retirement” in light of “the continuing trend away from traditional defined benefit plans to 401(k) defined contribution plans …” under which employees are increasingly responsible “for ensuring that their savings last throughout their retirement years and, in many cases, the remaining lifetimes of their spouses and dependents”).

\textsuperscript{2} In this letter, we often refer to “IRAs.” Unless otherwise noted, we mean both individual retirement accounts described in section 408(a) of the Code and individual retirement annuities described in section 408(b) of the Code. Some annuities are held within an IRA account and some are held as an IRA annuity. In fact, one key concern we have is that the Department has not recognized in the proposal the importance individual retirement annuities play in the retirement security of American savers.
The proposal should not cover advice about distributions that does not involve an investment recommendation.

- The proposal should be modified to preserve valuable education for IRA owners and plan participants.
- The platform carve-out should be amended and clarified to ensure it works as the Department intends.
- The Department should clarify that ordinary annuity valuations are not fiduciary investment advice.
- The Department should clarify that current law advice programs are still available.
- PTE 84-24 should be the model for the Department’s “principles-based” exemption, because the Committee has significant concerns about whether the BICE is workable.
- An additional “low-fee” exemption is inappropriate without significant additional public input through a separate regulatory process.
- The Department should provide a transition period of at least three years and fully grandfather all communications related to annuities that have previously been issued.

I. The unique nature and function of annuities in providing retirement security.

A. The insurance protections annuities provide.

Retirement presents many financial risks for Americans. Prior to retirement, an individual must attempt to accumulate adequate savings. During retirement, an individual must draw down those savings over life without exhausting those savings prematurely. Annuity contracts in their various forms are uniquely suited to help meet both these goals because they can both facilitate retirement savings and guarantee income for as long as a retiree lives.

During the savings or “accumulation” phase of retirement, individuals must determine how much they need to save over time in order to have a sufficient amount to live on for up to two or three decades in retirement. Critical to that effort is the long-term rate of return the individual is able to achieve on his or her savings. If the rate of return is insufficient to keep pace with inflation, the purchasing power of an individual’s savings will be eroded over time, putting retirement security in real jeopardy. On the other hand, investments in equity securities or similar assets that can bring higher returns to help address inflation risk also bring with them exposure to market volatility and risk of loss.

Deferred annuities in their various forms can help address both these risks while simultaneously guaranteeing an employee or IRA owner the right to convert – at a guaranteed rate – the savings accumulated under the annuity into a stream of lifetime income. This is because a “deferred annuity” has two phases that correspond to the two phases of retirement planning just described – an accumulation phase and a distribution phase. During the accumulation phase, the owner contributes savings to the annuity contract and those savings grow with interest or earnings to generate an account value (often referred to as the “cash value” or the “cash surrender value”). During the distribution phase, the owner can apply the account value to one of several payout options offered under the contract at rates guaranteed from the inception of the contract, such as monthly payments guaranteed to continue for at least the
owner’s life. The longer that the contract is in the “accumulation” phase, the more valuable these guaranteed payout rates may become, because the guaranteed rates are based on mortality tables in effect at the time that the contract is issued and not the reduced payout rates that would result from subsequent increases in longevity.

Accumulating retirement savings is only one half of the retirement security equation. The other half is making those savings last throughout a retirement period of unknowable duration. Converting retirement savings into a sustainable stream of retirement income can be a daunting task for an individual to undertake without the right tools. In addition to uncertainty about future personal expenses, inflation, and asset returns, it is impossible for an individual to predict how long he or she will live and therefore how long his or her savings will need to last. As a general matter, individuals are living longer and spending more time in retirement than ever before, which could leave too many Americans with little or no income in the later years of retirement. This risk of guessing wrong about how long savings will need to last – longevity risk – is a risk that every retiree faces. And with 77 million baby boomers beginning to enter retirement, the societal need to help individuals address that risk is escalating.

Annuities, again, offer an extremely valuable solution. Other than Social Security and defined benefit plans, annuities are the only means that Americans have to guarantee they will not outlive their retirement income. This type of insurance guarantee is becoming increasingly important in light of factors such as reduced coverage by employer-sponsored defined benefit plans and the limited availability of annuity options in defined contribution plans.

Absent guaranteed lifetime retirement income from an annuity, many Americans may run out of savings or face very difficult circumstances. On the other hand, retirees who receive guaranteed lifetime income from annuities are more likely to have an adequate standard of living, even if they live into their 90s or beyond; live more independently (and avoid becoming a burden on others, i.e. relatives and the government); and have the peace of mind that guaranteed lifetime income can bring.

Annuities, both those that are securities and those that are not, provide insurance protection against longevity risk by pooling that risk among a large group of individuals, so that no single individual bears the burden of the entire risk alone. Guaranteed lifetime income from an annuity is available in a variety of forms that can be tailored to meet the individual’s specific needs, including traditional fixed life contingent annuity payments, life contingent variable

---

3 Americans typically substantially underestimate their life expectancy. This, of course, can lead to inadequate savings, but also multiplies the risks of spending savings too rapidly (or too slowly) upon retiring. See Society of Actuaries, 2011 Risks and Process of Retirement Survey Report 9 (March 2012) (survey demonstrates that more than half of retirees and pre-retirees underestimate “how long the average person their age and sex can expect to live”) available at https://www.soa.org/files/research/projects/research-2011-risks-process-report.pdf.


5 See infra note 24.
annuity payments, and guaranteed lifetime withdrawal benefits. In addition, the benefits of lifetime income can be obtained either by converting the savings accumulated in a deferred annuity to a stream of lifetime payments or by purchasing an immediate annuity or longevity insurance with savings accumulated elsewhere. An immediate annuity has no accumulation phase and thus can facilitate the conversion of other sources of retirement savings into retirement income that begins at (or shortly after) the time the contract is purchased. Longevity insurance (sometime referred to as a deferred income annuity) provides yet another important way to receive guaranteed lifetime income by allowing an individual to purchase a dollar amount of lifetime income that will begin at a later age, e.g., a purchase at age 65 of $500 of monthly income beginning at age 85.

Annuities often combine insurance against longevity risk with other “living benefits” that protect against additional financial risks that retirees face, including investment risk and inflation risk. In all their various forms, however, the key feature of annuities is that they mitigate the longevity risk individuals face because they provide a retirement income stream that is guaranteed to continue for life. Life insurance companies are the only entities that can provide this protection other than defined benefit plans and the government itself.

B. The nature and cost of annuity guarantees.

As described above, annuities provide a variety of guarantees that are critical to individuals assuring themselves a secure retirement. The guarantees can cover multiple risks, including longevity risk (the risk that an individual will outlive her assets), mortality risk (the risk that an individual will die before, e.g., she receives payments from her annuity equal to the amount paid for it), investment risk (the risk that an individual’s assets will fail to grow at an expected rate or will lose value), and expense risk (the risk that the expenses associated with an the annuity will exceed specified maximums). These risks are typically of a long-duration. For example, in the case of a deferred fixed or variable annuity, the insurer is guaranteeing from the time the contract is purchased that the owner will always have the right to convert at a specified price the savings accumulated in the annuity to a stream of periodic payments that will then continue for as long as the owner lives. Thus, for example, if Jill Smith purchases a deferred IRA annuity at age 50, she will have the right for however long she lives to turn the amounts she invests and the earnings on those amounts into a life annuity.

When a life insurance company issues an annuity contract, the employee, IRA owner, or retiree is shifting the risks covered by the annuity guarantees from herself and her family to the insurance company.6 These guarantees provide financial (and often emotional) security to workers and retirees, but in making the guarantee the insurance company has assumed risks for which it must be compensated to assure it can provide the benefits promised. In simple terms, premiums and other charges plus the investment returns on retained funds must be adequate to

---

6 The insurance company pools the risks it assumes from its policyholders and then distributes them among the policyholders. Since no individual knows how long she will live, the annuity pool allows individuals to protect themselves from longevity risk without having to accumulate retirement savings that will carry them through to the latest possible date to which they might live. See, e.g., KENNETH BLACK, JR. ET AL., LIFE INSURANCE 38 (14th ed. 2013).

AR040589
fund the current and future benefits that the insurance company promises under the annuity, as well as related expenses, taxes, contingencies and profits.7 (Increasingly, the product must be priced to take into account the costs associated with compliance and the risk of litigation.) In other words, annuity products must be designed and priced so that the insurer can satisfy the guarantees for many years into the future.

The risks assumed by insurance companies with respect to the annuities they issue are substantial. At the end of 2013, the reserve liabilities of U.S. life insurance companies with respect to annuity contracts issued in connection with tax-qualified retirement plans and IRAs were in excess of $1.5 trillion.8 Reserves assure that the contractual commitments insurers make to their annuity policyholders will be paid. In substance, these reserve liabilities represent the dollar value of the protections provided to retirement savers and retirees through qualified annuities, including IRA annuities, at year end 2013.9

Annuity reserves must be funded in a manner prescribed by the insurance laws and regulations of the states. These funds come from the premiums paid by individuals and their employers, the periodic charges assessed by insurance companies under the terms of the annuity contracts, and the investment return insurers receive on those premiums and charges. In simple terms, if insurance companies are to provide protections against longevity and similar risks faced by Americans in connection with retirement, they must charge those savers for doing so. As the authors of the standard textbook on annuities and life insurance contracts observe in the most recent edition of their text:

[T]he annuity industry is largely driven by buyers who elect investment guarantee options that prevent significant losses while retaining the opportunity for modest investment gains. These include guarantees as to minimum withdrawal, income, and/or accumulation and as to life-time withdrawals. Equity-indexed and inflation-indexed annuities also provide guarantees.

Of course, guarantee options are not free. Insurers charge for them, thereby, reducing benefits. Savers may find guarantees more attractive than pure annuities, because they are perceived to be less as a gamble, reduce the possibility of regret, and/or maintain increased liquidity.10

---

7 Id. at 378.
8 AMERICAN COUNCIL OF LIFE INSURERS, 2014 LIFE INSURERS FACT BOOK 75 (Table 8.2 Group Annuities); BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FEDERAL RESERVE STATISTICAL RELEASE Z.1, FINANCIAL ACCOUNTS OF THE UNITED STATES, FIRST QUARTER 2015 127 (IRAs held by life insurance companies).
9 See, e.g., Black supra note 6, at 298. (“A life insurer’s most important source of financing is premium income, and its most prominent liability is the policy reserve, which represents a segregation and dedication of premium and investment income to the payment of future claims. Reserves represent the net of the expected present value of future benefits and future premiums, both using interest and mortality assumptions defined in the applicable valuation statute.”).
10 Id. at 602-603.
As noted above, the premiums and other charges for annuities, plus the investment returns on retained assets, must also fund expenses, taxes, and contingencies related to the contracts, as well as a return on the insurer’s capital. The expenses incurred by an insurer in connection with any insurance product, including annuities, include the costs of distributing or selling the product to those who would benefit from the insurance protections provided. These distribution costs include the compensation paid to those who sell the insurance product. One element of the compensation that must be paid to individuals selling an insurance product is for the time and effort they must invest in (1) developing an understanding of the particular products they offer to consumers, and (2) gaining an understanding of the needs of the particular consumer they are interacting with so they can assure an appropriate match between the needs of the consumer and the features of the insurance product.

Although not all annuity contracts are complex, many are. The complexity is driven by insurers’ attempts to meet consumer need to provide insured retirement income. The academic literature and the annuity market place both recognize that individual consumers often are hesitant to purchase the simpler forms of annuity contracts. For example, many consumers understandably desire the protections a life annuity provides, but also want the liquidity provided by other investments. Guaranteed lifetime withdrawal benefits (“GLWBs”) are one response to this need. While the benefits of a GLWB to a consumer are valuable, an insurance agent must invest significant amounts of time in learning how the benefits work and then explaining those benefits, risks, and costs to a potential policyholder. Similarly, many consumers desire the protection of a guaranteed investment return with the possibility of turning their investment and the return into a life annuity, but also want some of the potential upside of the equity markets. Fixed indexed annuities can provide this combination of benefits through the insurer’s guarantees. Here, too, it is of course incumbent on the individual who is selling the product to understand the contract and be able to explain the advantages and disadvantages of the contract to potential purchasers. Not surprisingly, given the complexity and risk/reward tradeoffs, not


12 One study exploring the reasons more individuals do not annuitize has specifically pointed to GLWBs as a product development that appears to overcome consumer resistance to annuitization. See Jeffrey Brown et al., Why Don’t People Choose Annuities? A Framing Explanation, The Retirement Security Project, at 2 (March 2008) (noting the “recent relative popularity of variable annuities offering ‘guaranteed minimum withdrawal benefits for life,’ perhaps because these products successfully blend some features of a life annuity with some features of a more traditional investment product”) available at: http://www.brookings.edu/~media/Projects/retirementsecurity/03_choosing_annuities.PDF.

13 Under the National Association of Insurance Commissioners (“NAIC”) Suitability in Annuity Transactions Model Regulation (Model 275), which has been adopted by most states, there are express training obligations imposed on insurers and insurance producers with respect to annuity products. These training obligations are intended to ensure that licensed insurance producers understand annuity products generally, and also understand the annuity products issued by a specific insurer. In that regard, Section 7 of Model 275 includes a requirement that a licensed producer is required to complete a training course on annuities, approved by the state insurance department, that focuses on, among other things: the types of annuity contracts; the parties to an annuity contract; how fixed, variable and indexed annuity contract provisions affect purchasers; and appropriate sales
every retirement investor decides to purchase an annuity. This is appropriate but in turn requires a compensation arrangement (i.e., up-front commissions) that recognizes a significant time commitment with an uncertain outcome.

Given these considerations, it is understandable and appropriate that the “cost” of an annuity contract can in many instances be materially greater than the “cost” to an employee or IRA owner of purchasing an index fund. An individual who purchases an annuity contract is obtaining multiple guarantees, with the particulars of those guarantees depending on the specific type of contract purchased. The insurance company must charge an appropriate premium to assure that it can pay the benefits it has promised, which can have a long duration and often require complex investment strategies. Likewise, it must compensate the sales agent for the time, effort, knowledge, and experience that the agent brings to the sale. We would also point out that a one-time upfront commission with a small trailer will often be substantially less compensation to the adviser than they would earn from an ongoing advisory fee when holding periods are long, which is often the case with annuities.

The Committee recognizes that there have been instances in which individuals purchase an annuity with their retirement savings when they would have been better advised to diversify their retirement savings, to purchase a different type of annuity, or not have bought an annuity at all. The annuity industry, in combination with state insurance regulators and self-regulatory organizations like the Financial Industry Regulatory Authority (“FINRA”),¹⁴ have taken

practices, replacements and disclosure requirements. In addition, Section 6(F)(1)(c) of Model 275 requires that the insurer’s supervisory system also includes product-specific training that explains all the material features of its annuity products to its licensed insurance producers. Many states have also adopted the NAIC’s Annuity Disclosure Model Regulation (Model 245) that requires the delivery of an appropriate “Buyer’s Guide” and disclosure document to the annuity purchaser to assist with understanding the annuity product. Finally, to the extent the annuities being offered are variable annuities sold through a broker-dealer, FINRA imposes ongoing continuing education requirements that must be satisfied by the registered individual, delivered both through FINRA (the “regulatory element”) and through the firm itself (the “firm element”).

¹⁴ Starting in 1996, FINRA has provided specific guidance and taken other regulatory action with respect to the application of its suitability rules to variable annuity sales. In May 2008, a targeted variable annuity suitability rule – FINRA Rule 2330 – became effective. That rule creates heightened suitability obligations, expanded principal review and approval requirements, and supervisory and training requirements with respect to deferred variable annuity transactions. While the rule makes exception for certain transactions involving employer-sponsored retirement or benefit plans, it applies in full force to recommendations made to individual qualified plan participants and recommendations in the context of IRAs. Recent remarks from FINRA officials suggest that the FINRA exam staff has seen improved controls around variable annuity sales practices since the adoption of Rule 2330. See Remarks of Richard G. Ketchum, Chairman and CEO, FINRA at IRI Government, Legal, and Regulatory Conference (June 28, 2011) available at: https://www.finra.org/newsroom/speeches/062811-remarks-iri-government-legal-and-regulatory-conference.

In 2003, the NAIC adopted the Senior Protection in Annuity Transactions Model Regulation. The Regulation originally applied to recommendations to individuals who are sixty-five years old and older on transactions involving annuity products. In March 2006, the regulation was expanded to all individuals, not just those over the age of sixty-five and was renamed the NAIC Suitability in Annuity Transactions Model Regulation. The expanded Model Regulation was further revised and updated in 2010, with the changes closely modeled on FINRA Rule 2330 and adding a training requirement. The Model Regulation applies to recommendations of all immediate and deferred fixed and variable annuity contracts used to fund IRAs, including recommendations of all immediate and deferred fixed and variable annuity contracts made in connection with rollovers to IRAs. (It does not
numerous steps over the years to better assure that an annuity purchase matches the needs and
the interests of the purchaser. These efforts have produced positive results and will continue.

It is critical that the Department’s efforts to assure that America’s retirement investors
receive the protections they need and deserve – and that are required by ERISA and the Code –
do not result in reduced access to and use of guaranteed income for life for those who most need
it. Our comments in the remainder of this letter are offered with the goal of avoiding these
unfortunate and unintended consequences.

II. The Department should fully consider the costs of its rulemaking and the potential
consequences thereof and proceed with appropriate regulatory coordination.

The proposed regulation is inarguably the Department’s most sweeping rulemaking in a
generation. In the limited time since the proposal’s many pieces were released in April, the life
insurance industry has just begun to understand the proposal’s implications. The definition of an
investment-adviser fiduciary is foundational to both ERISA and the prohibited transaction rules
of the Code. It determines the extent to which a person providing investment-related services is
subject to fiduciary standards of conduct under ERISA and the extent to which the prohibited
transaction rules are potentially applicable. Existing practices associated with the sale and
distribution of annuities have developed in light of the current regulation, and any changes will
have potentially far sweeping consequences for interested stakeholders.

The threat of personal fiduciary liability will chill valuable education. Like others, the
Committee supports rules ensuring that those who provide investment advice act in their clients’
best interest. But the Department must also understand that fiduciary status comes at great
expense. It increases the cost of providing the product or service and creates the risk of
expensive litigation, which takes years and millions of dollars to win even when frivolously
brought. This is particularly true if the standard comes encumbered with numerous additional
requirements that cast doubt on whether commission-based sales are permitted at all, as is the
case with the Department’s new proposal. In addition to the costs on organizations, ERISA

apply to transactions involving contracts used to fund plans covered by ERISA and plans described by sections
401(a), 401(k), 403(b), 408(k) or 408(p) of the Code.)

15 Insurers and/or their distributors perform the required suitability analysis before issuing a contract.
Contracts that are deemed unsuitable for the potential customer are declined. One Committee member provided the
following example: In 2014, 12,095 transactions were subject to the insurer’s suitability review process. Of those
transactions, 4,804 passed initial suitability review and 83 (1.7%) were declined on the basis of suitability. The
remaining 7,291 transactions were subject to an enhanced suitability review. Of those, 201 (2.8%) were declined on
the basis of suitability. These actions serve to weed out unsuitable annuity sales, which are outliers. Under the
NAIC model suitability regulation, described supra note 13, as adopted by most states, the insurer is responsible for
the suitability of its products for the consumer, regardless of whether the actual suitability review and evaluation is
done by the insurer or is delegated to a third party. Even if that function is delegated, the insurer is required to
monitor the sales activity of the third party distributor for any red flags indicating sales practice/suitability issues and
provide reports to the third party with its findings.

16 Appendix A describes in more detail the various forms of annuities and their benefits, including the
relationship between the guarantees provided by an annuity and the costs of these guarantees.
threatens personal liability on individuals, which is rarely presented anywhere else in the business world. Thus, under the proposal, every call center employee for an insurance company who speaks with a customer is continuously subject to the possibility of personal fiduciary liability for every single conversation. Retirement savers will bear the significant costs of imposing fiduciary duty where it does not belong.

**Substantive changes to the proposal are necessary.** The Department’s stated goal for the 2010 proposal was to close loopholes in the current regulation that frustrated enforcement by the Department; for example by allowing persons who represented that they were providing impartial fiduciary advice to escape fiduciary status because the advice covered only a single transaction. While the Committee supports closing inappropriate loopholes, we believe that the proposed regulation and exemptions do not strike the correct balance. Accordingly, we believe substantial changes to the proposed regulation and exemptions are necessary and we fully expect the Department will receive significant comments. We strongly urge the Department not to rush this project to completion before thoughtfully considering the comments.

**Substantial time will be needed for insurers and others to implement the new rules.** It is self-evident from the materials the Department released that Department staff has worked very hard on the reproposal. We know the Department wants to get this right and would want future Administrations to support the results of the final rule. For that reason, the Department needs to proceed carefully and fully consider all the comments it receives. Further, as we explain in more detail below, because the proposal will affect nearly every interaction an insurance company and its employees, agents, and brokers have with nearly every plan and IRA owner, an immediate effective date, with an eight month “applicability” date, is simply not workable. We recommend that the proposal not be effective for at least three years after publication of a final rule.

**Exclusion for annuity contracts previously purchased.** We also strongly urge the Department to provide that the proposal will not apply to annuities purchased and arrangements entered into prior to the effective date of the regulation. Simply to continue to interact with existing customers after the regulation is in place means significant new costs. These new costs have not been priced into products sold before the Department issued the final regulation. This is particularly disruptive for annuities, because annuities are long term commitments from an insurance company priced with certain assumptions about the obligations of the insurer.

---

17 See ERISA § 409.

18 While the Department, of course, put many years of thought into this reproposal, the reproposal is substantially different from the 2010 proposal. Therefore, appropriate consideration must be put into addressing the comments on the reproposal.

19 If the Department elects not to provide an effective date and implementation period of at least three years, and demonstrates a compelling public policy need consistent with applicable administrative procedure requirements for a shorter effective date, then we urge the Department to consider a phased implementation, for example providing more time to put procedures in place to satisfy the complex conditions of the various prohibited transaction exemptions.
Further coordination with the SEC and FINRA is needed. In addition, the Committee urges the Department to further consult with the staff of the Securities and Exchange Commission (“SEC”) and FINRA to ensure that the proposal does not subject investment advisers and broker-dealers to requirements that create undue compliance burdens and conflicts with their obligations under these other laws and rules. In this regard, we note that during the Committee’s review of the proposal, we have identified a number of inconsistencies and conflicts between the proposal and the applicable federal securities law framework. By way of example:

- The BICE would require a financial institution to enter into a written agreement before any recommendation may be made. In contrast, the federal securities laws do not require that a broker-dealer or adviser enter into a written agreement and where such entities do enter into agreements, the timing of the execution is flexible.

- The BICE would require a chart prior to sale in which the adviser is directed to make “reasonable assumptions” about the future investment performance of an amount proposed to be invested. The proposed chart is contrary to the communications required or permitted by the federal securities laws and relevant rules. For example, the SEC requires mutual fund and variable prospectuses to set forth a “Fee Table,” which is required to be standardized – based upon a $10,000 investment—and calculated on a 5% return. FINRA rules regarding communications with the public prohibit projections of future investment performance. The advertising rules set forth under the Investment Advisers Act of 1940 (“Advisers Act”) prohibit projections of investment returns.

- Finally, as discussed below, the BICE requires an affirmative statement that the Financial Institution and Adviser are fiduciaries with respect to recommendations. This affirmative statement causes questions as to whether broker-dealers and their registered representatives, who affirmatively state they are fiduciaries, may rely on the broker-dealer exception in the Advisers Act. If the SEC were to determine that the broker-dealer exception is not available under such circumstances, there would be formidable business, compliance, and legal complexities attendant with registering these firms and individuals as advisers and investment adviser representatives.

As noted, we offer the above as examples. There are a number of other instances where further coordination with staff of the SEC and FINRA is critical.

III. The Need for a Workable Seller’s Carve-Out.

A. Introduction.

The underpinning of the entire proposal is that any communication that would reasonably be viewed as a “suggestion” that a person engage in or refrain from taking a particular course of action, if that suggestion is individualized or directed at the recipient for consideration, potentially triggers ERISA fiduciary status, the highest duty known to law. The Department has
cast this wide net, apparently, on guidance from FINRA. 20 We question whether the FINRA standard makes sense here. That standard has been developed to determine which communications fall within the scope of FINRA’s suitability rule. Even if the Department decides to use the FINRA standard, we believe that it is not being applied consistently with FINRA’s rules. In this regard, we note that communications that fall short of a “call to action” are not deemed to be recommendations under FINRA’s suitability rules. We also note that FINRA’s suitability rule excludes general financial and investment information, descriptive information about an employer-sponsored retirement or benefit plan, and certain asset allocation models to the extent that they do not include a recommendation of a particular security or securities.

Because the Department’s net is so wide, it is critical, as the Department recognizes, that the proposal “appropriately distinguishes incidental advice as part of an arm’s length transaction with no expectation of trust or acting in the customer’s best interest, from those instances of advice where customers may be expecting unbiased investment advice that is in their best interest.” 21 However, the proposal currently limits this “seller’s carve-out” to discussions with fiduciaries of large plans. We strongly recommend that the seller’s carve-out not be limited to fiduciaries of large plans, but rather should be available in appropriate circumstances for discussions with all plan fiduciaries, participants, and IRA owners.

We understand that discussions with a plan fiduciary, participant or IRA owner in the context of the sale of an annuity should not be presented as unbiased advice. For that reason, the conditions that the Department attached to the seller’s carve-out in this proposal and in the 2010 proposal would be appropriate to ensure that selling is not misrepresented. For example under the new proposal, in the context of persons who are fiduciaries of plans with 100 or more participants, a counterparty (a) must obtain a written representation that the person will not rely on the counterparty to act in the plan’s best interest, provide impartial investment advice, or give advice in a fiduciary capacity; (b) must inform the person of the existence and nature of the counterparty’s financial interests; (c) cannot receive a fee for the provision of investment advice; and (d) must receive a written representation that the person has sufficient expertise to evaluate the transaction and to determine whether the transaction is prudent. If those conditions are satisfied, whether the person is a plan fiduciary, participant, or IRA owner, it is hard to see how in any sense the person would be confused that they are expecting unbiased investment advice. Thus we would be supportive if similar conditions were imposed on a seller’s carve-out expanded to small plans and IRAs.

An example of a situation – but by no means the only situation – in which a person would not be confused or expecting unbiased investment advice is a direct sale of a product. Many insurance companies distribute their products directly, and the salesperson is a common law or statutory employee of a single insurance company. In such a case, the financial interest of the company is obvious, and there cannot be any confusion about the existence of that financial interest. The research cited by the Department does not call into question the self-evident point

---


that any functional adult understands that “I work for Company X, and I think Company X’s product is excellent” and would not think unbiased impartial advice is being provided. We all deal with this conversation every time we walk into a store. To be clear, however, a direct sale is just one example of these situations and we believe that the seller’s carve-out should be available however a product is sold.

B. The proposal should recognize the importance of providing IRA owners and plan participants the same choice that large plan fiduciaries have – to choose if they want to enter into a fiduciary relationship.

If insurance companies and their distribution partners become ERISA fiduciaries just by selling products to IRA customers and plan participants, insurers may have to limit and restrict these types of sales, either because they are unwilling to take on fiduciary status or are unwilling or unable to comply with a prohibited transaction exemption. That means less choice, not more.

While we appreciate the Department’s concern regarding the possibility of confusion by retail investors, such as IRA owners and plan participants, we disagree that the Department has made the case that as a rule, IRA owners and plan participants are wholly and always incapable of looking out for their own interests and understanding that people in the world do not work for free. If these individuals are given sufficient information and disclosures about the retirement products, including IRA rollovers, and there are rules against making misleading statements, then informed decisions can be made.

Unless the Department expands the seller’s carve-out to IRA owners and plan participants, the Department is taking away a choice by forcing all savers to hire (and pay for) a fiduciary simply to save for retirement.

C. Without an expanded seller’s carve-out, small plans will not have access to plan investments, including annuities, and will receive no information.

We think that, with appropriate disclosure, any adult can understand when someone is acting as a seller or other counterparty, but we think it particularly troubling that the Department has limited the seller’s carve-out to large plan fiduciaries. The apparent justification is that only fiduciaries of large plans are sophisticated enough to act prudently. Fiduciaries of plans, regardless of size, are required by ERISA to have a minimum level of expertise and knowledge. The Department has made clear that “[the duty of prudence] requires expertise in a variety of areas, such as investments. Lacking that expertise, a fiduciary will want to hire someone with that professional knowledge to carry out the investment and other functions.”

22 In this section, we refer to both IRA owners and plan participants, but because plan choices are largely made by the plan fiduciary, we expect that the seller’s carve-out is most likely relevant for IRA owners and for rollovers to IRAs.

Without an expansion of the seller’s carve-out to all plan fiduciaries, there is very little way to provide any information to the fiduciary of a small 401(k) or 403(b) plan beyond marketing the platform of investments. A small plan fiduciary cannot receive any guidance about guaranteed income investments that may be available for the plan if that information in any way suggests the plan fiduciary should take an action (or not take an action). (The education carve-out is not available here because any such information must by necessity reference a particular investment.) The real world effect, it appears, is that the cost of starting and maintaining a small plan will entail the additional cost of an independent adviser; the economic effects of which on plan creation and maintenance and savings outcomes do not appear to have been considered by the Department.

D. A lack of a carve-out for sales contexts will have significant adverse implications.

As described in section I, annuities are vital to our retirement system. They are critical for lifetime income from defined contribution plans and IRAs and are critical for defined benefit plans.

By most estimates, the vast majority of savers in defined contribution plans do not have access to a product that can generate guaranteed income in retirement.²⁴ While the Committee has supported various measures to increase the availability of annuities in plans, for most Americans saving in defined contribution plans, the only means for those who wish to obtain guaranteed lifetime income is through a rollover into an IRA annuity. If the proposal essentially prevents an agent, broker, or insurance company from being able to sell and explain an annuity without taking on significant fiduciary obligations and costs, annuities outside of plans will be less available and cost more when offered.

Receiving less attention, but still critical, is the effect on annuities issued to defined benefit plans, particularly terminating plans. As best we can tell, the Department’s economic analysis did not address the additional costs, and lost information, that will occur because of the expansion of the rule to the provision of annuity contracts to terminating defined benefit plans.²⁵ Congress requires that defined benefit plans (including small plans) “purchase” irrevocable commitments from an insurance company to provide all plan benefits upon the termination.²⁶ The Department’s longstanding position is that the selection of an annuity provider is a fiduciary

---

²⁴ See, e.g., Plan Sponsor Council of America, PSCA 56th Annual Survey Reflecting 2012 Plan Experience, 76 (2013) (only 17.1% of plans offer an annuity distribution). As an example, we understand that while a number of insurance companies have begun to market IRA qualifying longevity annuity contracts (QLACs) after the Treasury Department’s QLAC regulations were finalized, QLACs are not available in the plan market because plan sponsors are not asking for them yet.

²⁵ We urge the Department to consult with the Pension Benefit Guaranty Corporation.

The Department also requires that a fiduciary must “conduct an objective, thorough and analytical search for the purpose of identifying and selecting providers.”

Thus, a fiduciary of a terminating defined benefit plan must seek out insurance companies that can provide the plan an appropriate annuity. Under the Department’s proposal, however, any recommendation to purchase the annuity – such as responding to a request for proposal (RFP) – triggers fiduciary status. It is hard to envision any interaction between a plan and the insurance company or its agent that does not involve a “recommendation” in the broad way that the proposal defines “recommendation.”

Suppose a plan fiduciary contacts an insurance agent to inquire about the possibility of the agent effecting the sale of a group annuity in connection with the termination of the plan. Unless the plan qualifies as a large plan under the seller’s carve-out, the agent cannot make any communication suggesting the fiduciary should purchase the annuity for the plan; otherwise the agent is a fiduciary, triggering fiduciary status, requiring the agent/fiduciary to act for the “exclusive purpose” of the plan and its participants. It is no answer that the BICE or PTE 84-24 may be available to avoid the inherent prohibited transaction. Whether or not a prohibited transaction has occurred, the agent is now a fiduciary. This means the agent can no longer do her job – explaining the attributes of the annuity and its issuer – and now must take on a role entirely inappropriate for the agent, namely acting on behalf of that counterparty plan.

Put another way, the adverse consequences mentioned above do not go away simply because “there is an exemption.” PTE 84-24 is not the appropriate solution for a sales context because PTE 84-24 does not prevent an insurance company or agent from having to take on fiduciary status. When a person agrees to take on an advice relationship, where the service includes impartial advice and acting in a client’s best interest, that decision is done willingly and with due consideration of the additional responsibilities, costs, and risks, including litigation risks. It is entirely inappropriate to force someone into fiduciary status simply because they wish to market a product, and reason that the sale is not per se illegal because of the existence of an exemption.

---

27 DOL Reg. § 2509.95-1(b).
28 DOL Reg. § 2509.95-1(c).
29 It is clear that an ordinary sales pitch or responding to an RFP triggers fiduciary status because the proposal includes a carve-out for such communications, but only in the context of large plan fiduciaries.
30 For the insurance company itself, if the sale of its contract triggers fiduciary status, the company may be required to act inconsistently with its obligations to the company’s shareholders or policyholders, which, after all, do not expect its business model to be a fiduciary adviser to employee benefit plans.
E. The adverse consequences mentioned above can be avoided by returning to the 2010 proposal, with appropriate additional conditions.

The adverse consequences discussed above can be easily avoided. Under the 2010 proposal, the Department included a sensible carve-out for situations in which the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in the person’s capacity as a seller of a security or other property, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice. The Department was asked to rephrase the reference to “adverse interest” to another phrase, but the concept of a seller’s exception was viewed as critical to allowing parties to be able to mutually agree to the nature of the arrangement. Insurers and those who act on their behalf must be able to define the scope and nature of the services they are willing to provide, including the extent to which they are acting on behalf of the plan or a participant.

The 2015 proposal includes some refined conditions to address some of the concerns with the 2010 approach. For example, under the 2015 proposal, advice provided by a counterparty or a representative of a counterparty must fairly inform the independent plan fiduciary of the existence and nature of the person’s financial interest in the transaction and may not receive a fee or other compensation directly from the plan or fiduciary for the provision of advice. These conditions are entirely appropriate additions to the seller’s carve-out in the 2010 proposal. With appropriate conditions, returning to the broad seller’s carve-out in the 2010 proposal is not just appropriate, it is absolutely essential to the success of the Department’s proposal.

IV. The Need to Make PTE 84-24 the Model and Available for the Sale of All Annuities.

We understand and appreciate that the Department wants to make recommendations for the purchase of securities or other property subject to fiduciary status in many situations not covered by the current regulation. The prohibited transaction rules of ERISA section 406(b) and Code section 4975(c)(1)(E) and (F) effectively prohibit many ordinary business practices, and there is no evidence Congress wished to outlaw these business practices. Thus, we agree with the Department that a workable, principles-based exemption is critical. We have a number of very serious concerns about the BICE, detailed later in this comment letter. And we have a straightforward solution that is consistent with the Department’s goals: PTE 84-24 should continue to be the exemption applicable to all annuities and other insurance products. PTE 84-24 as proposed forms a workable framework to meet the Department’s frequently stated goal to allow providers to continue common and widely accepted compensation practices so long as they “commit to putting their client’s best interest first and disclose any conflicts that may prevent them from doing so.”

The Department’s long-standing position has been that a fiduciary providing investment advice will violate the provisions of ERISA section 406(b) and Code section 4975(c)(1)(E) and

Committee of Annuity Insurers Comment Letter re: Fiduciary Proposal
July 21, 2015
Page 17 of 44

(F) if the amount of the fiduciary’s compensation, or any person in whom the fiduciary has an interest, is affected by “the use of its authority in providing investment advice” unless the payments to be received meet the requirements of an exemption.32 Because the proposed regulation is so broad, the success of this entire proposal depends on the availability of a workable exemption that addresses the problem that the prohibited transaction rules cause many compensation practices that are common today to become illegal.

Secretary Perez testified to Congress that the proposal aims to “permit firms to continue common fee and compensation practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers.”33 We agree with the Secretary that we need a “principles-based approach” that will “respect existing business models” while leaving the adviser and employing firm with the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business.

The definition of fiduciary is closely tied to a number of class prohibited transaction exemptions, which provide relief from the prohibited transaction rules for certain plan and IRA transactions involving fiduciary advice. Insurers and financial professionals who distribute insurance contracts have relied upon PTE 84-24 for more than 25 years, and we believe that PTE 84-24 has worked well. PTE 84-24 and its predecessor PTE 77-9 have applied under six different presidents, over 35 sessions of Congress, and for many different assistant secretaries of EBSA (and its predecessor PWBA), without ever being questioned. In fact, EBSA specifically held that IRAs were covered by PTE 84-24 in 2002.34 The existence of PTE 84-24, we believe, has helped increase the availability of lifetime income products in plans and IRAs. PTE 84-24 has served precisely the goals that Congress seeks for exemptions: it is in the interests of participants and IRA owners, protective of their rights, and administratively feasible.35

With a some important changes that we outline below, we believe that PTE 84-24, with the new Impartial Conduct Standards that the Department has proposed, can and should form the basis of a workable exemption that meets the goals Secretary Perez has laid out. Under PTE 84-24, as amended by the proposal:

- With respect to the transaction, the insurance agent or broker or insurance company person recommending the insurance or annuity contract must act in the “Best Interest” of the plan or IRA.

32 80 Fed. Reg. at 21,964.
35 ERISA § 408(a).
• The insurance agent or broker or insurance company person recommending the insurance or annuity contract cannot make any misleading statements about recommended investments, fees, “Material Conflicts of Interest,” or any other matter relevant to the investment decision.

• The insurance agent or broker or insurance company person recommending the insurance or annuity contract must disclose all “Material Conflicts of Interest,” which is any financial interest that could affect the exercise of best judgement in rendering advice.

These conditions are principles-based, flexible for a variety of situations, and protective of the customer. They ensure the plan fiduciary, participant, or IRA owner is not misled and understands any financial interest that the agent, broker, or financial institution has in the transaction. These conditions also avoid many of the issues that make the BICE unworkable as proposed, which we detail in section XI.

Therefore, our key recommendation is that the Department build an exemption for annuity contracts and other insurance products around the Impartial Conduct Standards in PTE 84-24. To make this work, however, we have several significant comments regarding PTE 84-24.

First, we strongly urge the Department to return to the current scope of PTE 84-24, making it available to all annuity contracts sold to IRAs. Under the proposal, PTE 84-24 would not apply to the purchase by an IRA of a variable annuity or other annuity contract that is a security under federal securities laws.

We do not believe this change to the availability of PTE 84-24 makes analytical sense in light of the importance that annuities play in the retirement system. PTE 84-24 is designed, and has for years worked successfully, to provide that the simple act of a retirement plan or IRA purchasing an annuity or other insurance product does not create a prohibited transaction. In fact, 12.8 million households have an annuity in an IRA.36 As explained in section I, annuities provide insurance protection and only annuities can provide guaranteed income for life – a paycheck for retirement.

The notion that variable annuities and other annuities that are securities are the same as mutual funds misunderstands that all annuities are designed to, and in fact do, provide insurance protection against longevity risk by pooling that risk among a large group of individuals, so that no single individual bears the burden of the entire risk alone. Moreover, typical variable annuities as well as other annuities that are securities provide significant insured investment guarantees that afford protections not found in mutual funds. These guarantees can be in the form of guaranteed death benefits and/or guaranteed living benefits (such as GLWBs, guaranteed minimum income benefits and guaranteed minimum account value benefits), wherein the insurer

36 Investment Company Institute, ICI Research Perspective, Vol. 21, No. 1A, pp. 2, 10 (January 2015) (reporting that 31% of the 41.5 million households owning an IRA hold an annuity) available at: https://www.ici.org/pdf/per21-01a.pdf.
guarantees specified minimum values or payments irrespective of market fluctuations. These guaranteed benefits in turn require insurers to have sophisticated hedging programs to back up their guarantee obligations. Therefore, while variable annuities and other annuities that are securities have contract values which can vary, that does not equate them with mutual funds.37

Indeed, in a number of key respects, the federal securities regulatory framework applicable to variable annuities and other annuities that are securities recognizes the unique and fundamentally different nature of these annuities as contrasted with mutual funds and other securities. For example:

- Pursuant to legislation recommended by the SEC and enacted by Congress in 1996, the fees and charges assessed under variable annuities are subject to an entirely different standard under the Investment Company Act of 1940 (“1940 Act”) than the 1940 Act standards, conditions and approval procedures applicable to the fees and charges assessed by mutual funds.38 This different standard was enacted in express recognition of the insurance guarantees and actuarial underpinnings of variable insurance products – features that are totally absent from mutual funds or other investment company securities.

- In recognition of the state insurance regulatory framework applicable to insurance companies and the annuity products they issue, insurers issuing annuity products registered as securities are exempt from the periodic reporting requirements in the Securities Exchange Act of 1934 that otherwise apply to all issuers of securities registered with the SEC.39

- The SEC has adopted specially tailored disclosure requirements for variable annuities that focus with particularity on the insurance benefits and guarantees these products provide.40 These disclosure requirements differ substantially from those applicable to mutual funds. Moreover, the NAIC has adopted a uniform approach to annuity disclosure, requiring the use of buyer’s guides regardless of whether the annuity is fixed, indexed or variable.41

37 These guarantees and benefit forms are described in Appendix A.

38 Amendments to Section 26 of the 1940 Act made under Section 205 of the National Securities Markets Improvement Act of 1996 replaced specified limits on the amount, type, and timing of charges that apply to variable insurance contracts. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290 (codified at 15 U.S.C.A. § 80a-26(f) (2009)). The amendments require the sponsoring insurance company for a variable insurance contract to represent, in the registration statement for such contract, that the charges deducted under the contract meet a “reasonableness” test. Id.


40 SEC Form N-4, which is used for registration of separate accounts organized as unit investment trusts that offer variable annuity contracts, is available at: https://www.sec.gov/about/forms/formn-4.pdf (last visited July 16, 2015).

• FINRA has adopted a special suitability rule for variable annuities whose requirements differ in a number of significant respects from FINRA’s general suitability rule applicable to mutual funds and other securities. And it is particularly important to note that the model suitability regulation that the NAIC has adopted for all annuities is very closely modeled on FINRA’s suitability rule, thus insuring that all annuity products, irrespective of whether the annuities are fixed or variable, are subject to substantially the same suitability regulatory framework.

Annuities that are securities under the federal securities laws (such as variable annuities) and those that are not, all have advantages and disadvantages; none is inherently better than the other. In contrast, the BICE, by design, entails significantly more conditions and thus significantly more cost. If certain kinds of annuities must be sold only through the BICE, there will be an incentive for one kind of annuity. We strongly believe that retirement savers should choose one product over another based on the actual economic benefit and what best serves their needs; not based on which annuity is subject to one prohibited transaction exemption or another. Public policy dictates that government regulation not impose differing regulatory requirements on the insurance industry that will create an unlevel market for its annuity products and result in serious unintended consequences and costs for retirement savers.

We want to be clear. Our concern about the distinction the Department has proposed in PTE 84-24 between kinds of annuities does not mean all annuities should be forced into the BICE. For a variety of reasons, BICE is not suited for annuities. Nonetheless, if the Department intends to create a single exemption like BICE that will apply to variable annuities (or any other kind of annuity), this single exemption should consist of simplified conditions based on the straightforward and workable conditions in PTE 84-24.

Second, it is critical that the Department confirm that Section I(a)(4) of PTE 84-24 provides relief for the purchase of an insurance company’s own contract if the insurance company becomes a fiduciary under the new rule, and covers the compensation inherent in the contract itself. It has long been understood in the industry that Section I(a)(4) provided this relief – in fact it must provide relief for proprietary sales or it does not provide meaningful relief at all. Because of the importance of PTE 84-24 as a result of the wide net the proposal will cast, the scope of Section I(a)(4) of PTE 84-24 is no longer a theoretical question.

42 FINRA Rule 2330: Members’ Responsibilities Regarding Deferred Variable Annuities (imposing heightened suitability, disclosure, supervision and training obligations in connection with the sale of variable annuities).


44 To explain further: Section I(a) of PTE 84-24 provides relief from the self-dealing prohibitions in section 406(b) of ERISA and section 4975(c)(1)(E) and (F) of the Code. This means that it is providing relief for transactions that otherwise involve a fiduciary dealing with plan assets in its own interest, acting in a transaction on behalf of an adverse party, or receiving compensation from a third party in a transaction involving plan assets. Section I(a)(4) provides relief for the “purchase, with plan assets, of an insurance or annuity contract from an insurance company.” A violation of the self-dealing rules could arise in the sale of an annuity where the insurance company or someone with an interest in the insurance company (like an affiliate or employee) is a fiduciary and the
When an insurance company sells an annuity, the contract generally provides the insurance company with one or more types of compensation in exchange for the benefits of the contract. First, the insurance company will receive any spread between the amount guaranteed in the form of guaranteed return or annuity payments and the earnings in the insurance company’s general account. Sometimes, the cost of the guarantee will be paid directly in the form of mortality and expense and similar insurance charges. Second, insurance-dedicated mutual funds and other investments that support the separate account of a variable annuity contract will provide payments to the insurance company in recognition of its costs associated with indirectly marketing those investments to policyholders and other services provided to the investments and contract. If the contract includes proprietary investments, the insurance company or an affiliate will receive a management fee. It is entirely appropriate for PTE 84-24 to cover all of these payments and direct and indirect compensation, as long as the insurance company meets the Impartial Conduct Standards with respect to any advice provided, including a description of any Material Conflict of Interests that the insurance company may have. Accordingly, we recommend that the Department clarify that Section I(a)(4) provides relief for “all direct and indirect compensation received by an insurance company in connection with the purchase, with plan assets, of an insurance or annuity contract from the insurance company.”

Third, if PTE 84-24 is going to provide meaningful relief, the kinds of compensation that are covered under Section I(a)(1) must be expanded beyond the new narrow definition of an “Insurance Commission.” The new definition of “Insurance Commission” makes an artificial distinction between sales commissions paid “by the insurance company or an Affiliate to the insurance agent or broker or pension consultant for the service of effecting the purchase or sale of an insurance or annuity contract, including renewal fees and trailers,” on one hand, and “revenue sharing payments, administrative fees, marketing payments, or payments from parties other than the insurance company or its Affiliates,” on the other. We see no policy reason that the exemption should be limited to a narrow definition of “commissions.” All of these payments compensate the agent or broker for effecting the purchase or sale of an insurance or annuity contract and for providing associated services, including explaining the product. All of these other payments are common in the industry and are important to support the distribution and effecting of annuities in various distribution methods. Accordingly, we recommend that the compensation covered by the exemption be amended to cover “any direct or indirect compensation paid to the insurance agent or broker or pension consultant for the service of effecting the purchase or sale of an insurance or annuity contract.”

Fourth, Committee members are concerned with how the Department has described the “best interest” standard. The standard is intended, it appears, to replicate the duties in ERISA compensation inherent in the product itself otherwise runs afoul of the rules. Accordingly, Section I(a)(4) must provide relief for this or it does not provide any relief, and the Department does not create exemptions where there is nothing to exempt.

Accordingly, we are comfortable with the notion that an insurance company would disclose that the compensation inherent in the contract creates a material conflict of interest. This does not mean we think that a dollar-based disclosure of the “spread” is appropriate (even if it were possible, which it is not). It should be sufficient, for example, for a disclosure to state: “Insurance Company X has a financial incentive to sell this product because it retains any return on the assets above the amount that is guaranteed to you under the contract.”
section 404, but includes a significant additional requirement that Congress did not impose under
ERISA. The “best interest” standard requires that any advice be provided “without regard to the
financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity,
or other party.” This particular standard presents unique litigation risks because it is hard to
imagine any business enterprise ever acting *completely without regard to its interests*. We think
that the enunciation of prudence in ERISA section 404, which looks to the actions of a prudent
fiduciary in circumstances similar to those then prevailing, is a more straightforward test, one
actually approved by Congress and that has stood the test of time. In any event, the Department
needs to clarify – in the text of the exemption and not just in the preamble – that a duality of
interests can exist provided the customer’s is placed ahead of the adviser’s.

**Fifth**, we recommend that the Department confirm that PTE 84-24 covers payments that
are not paid directly to the insurance agent or broker but are paid to someone that oversees the
agent or broker working directly with customer. These are sometimes called “override”
commissions or dealer “concessions.” Ultimately, like a traditional commission, these payments
compensate for the distribution of the contract.

**Sixth**, we recommend that the Department confirm that PTE 84-24 provides relief for
compensation structures used with common law employees of an insurance company and
“career” agents. Many insurance companies use their own employees to sell insurance and
annuity contracts or use career agents, and these individuals will receive compensation that
would not normally be categorized as a commissions, including salary and bonuses, overtime
pay, and benefits like health and retirement benefits. It would be odd if the exemption were
available for cash commission to an independent agent but not a payment or benefit in another
form for the same service to a customer.

**Seventh**, we recommend that the Department provide guidance on what it means to
disclose a “Material Conflict of Interest.” As proposed, a Material Conflict of Interest is any
financial interest that could affect the exercise of best judgement in rendering advice. While the
defined term is “Material Conflict of Interest,” the definition of the term does not actually
contain a materiality element. As a result, any financial interest that “could” affect the
judgement of a fiduciary becomes a Material Conflict of Interest. This is potentially limitless,
which is not what we believe the Department intended. We think that the Department intended
to focus on material financial interests, such as a commission or other material payment that will
be received in connection with the purchase or sale of an insurance or annuity contract.

We appreciate that there has been some attention on awards provided to successful agents
and brokers. If an individual or his firm has an arrangement that could result in material non-
cash compensation, we think this should be disclosed. A disclosure that the agent or broker will
be eligible for incentives is appropriate. In contrast, we think that ordinary business
entertainment and reimbursement of travel to conferences for education on products, which are

---

46 A “career” agent is generally an agent that primarily represents one company and principally sells only
that company’s contracts. While not a common law employee, a career agent may receive compensation roughly
analogous to that received by a common law employee.
not related to a particular sale, are not “material.” We caution that the focus of the disclosure should be on the incentives – a commission being of most importance – that materially relate to that customer. Otherwise, the disclosure of Material Conflicts of Interest will obscure the key disclosure, namely the commission to be paid.

**Eighth**, we urge the Department to confirm that PTE 84-24 stands on its own. By this we mean that PTE 84-24 should be available to provide relief for the transactions it describes even if the agent, broker, or insurance company (or an affiliate) could sell other products not encompassed by PTE 84-24. The Department has always taken the position that if an exemption is available for a transaction, then that exemption may be used to provide relief. Thus, if the sale of an insurance or annuity product meets the conditions of PTE 84-24, it should be available even if the agent, broker, or insurance company can sell products that are not within the scope of PTE 84-24.

V. **The Need to Clarify the Test for Fiduciary Status to Avoid Sweeping in Non-Fiduciary Communications.**

The Department’s goal, which we share, is to draw the right line between conversations that involve “investment advice” as Congress intended, and those that do not. We offer a number of comments to assure that ordinary conversations regarding annuities do not trigger fiduciary status.

Under the proposal, a communication that appears to suggest the acquiring of a security or other property triggers fiduciary status if there is an “agreement, arrangement, or understanding” that the advice is “individualized” or “directed to” the recipient for consideration. The line between those communications that are “individualized” or “directed to” someone is unclear, and yet the line that separates fiduciaries and other service providers that furnish important information is the foundation of ERISA. Because of the breadth of the Department’s proposal, a variety of conversations that are not fiduciary in nature could inadvertently trigger fiduciary status. It is critical that insurance companies and others be able to discuss their products with plan fiduciaries, participants, and IRA owners. To take some real world examples:

- **Strength of insurer.** Imagine an IRA customer is seeking information about an annuity, and the agent is trying to be careful not to portray himself as providing investment advice. The customer states that she wants to be sure that the annuity payments will always “be there for my entire life, so I can sleep at night.” The agent provides information that the insurance company issuing the annuity is highly rated. Because the customer has expressed a factor that is important to her decision, the agent has apparently made a suggestion that could be viewed an “individualized” to the customer.

- **Annuitzation and withdrawal options.** When a participant or IRA owner owns a deferred annuity, the participant or IRA owner often has a variety of choices in managing the annuity, including the ability to annuitize the contract at some point. These potential features may include a life annuity, a joint and survivor annuity, or an annuity with cost of living increases. The annuity might also provide a guaranteed withdrawal benefit,
allowing the individual to take withdrawals from the contract up to a specified level and to continue doing so for as long as he lives even after the account value is reduced to zero.\footnote{The “withdrawals” made after the account value is reduced to zero are actually payments to the owner made by the insurer from its own funds.} Information regarding the advantages and disadvantages of annuitization, withdrawals subject to a guaranteed withdrawal benefit, or other options to receive distributions from the contract should not be viewed as an individualized recommendation simply because the discussion will mention certain facts that might be relevant to the decision. For example, a communication regarding annuitization might point out that those with a short life expectancy should not annuitize.

- **Risk profiles.** It is common for those working with retirement savers in plans and IRAs to help customers make informed decisions through “risk profiles.” For example, those who have the lowest tolerance for risk generally gravitate to product X with little market risk, and those with higher tolerance for risk generally gravitate to product Y. Again, these risk profiles are not created with a particular customer in mind, and yet because they assist a customer in placing himself or herself in a category, could be viewed as triggering fiduciary status, which we do not think the Department intended.\footnote{These risk profiles often sort particular products into a straightforward and easy to understand risk spectrum. In doing so, the products necessarily must be mentioned. If the Department adopts our recommendation to revise the education carve-out to allow reference to particular products, this concern will be lessened.}

- **Age profiles.** Similar to risk profiles, companies often communicate age-based information. For example, companies with target retirement products will help individuals understand the products by sorting them into intended age groups by expected retirement date. A communication that lists products and notes the age ranges to which the products are intended could appear to be “individualized” simply because such a communication uses an individual characteristic (age) to sort the products. But provided the communication does not suggest someone has considered this individual’s needs, such a communication should not be considered fiduciary advice.

More generally, the Department should carefully consider how the proposal sweeps in conversations that do not suggest fiduciary status. We think that a number of improvements could be made to refine and clarify the test for fiduciary status and avoid inadvertent foot faults:

**First.** “directing” a communication at an individual should not be part of the test. Targeted communications are common with plan participants and IRA owners. For example, an insurance company may target a communication at an annuity owner that is approaching a particular age and may want to consider annuitization. Communications often are *addressed* to an individual, but that should not mean a fiduciary obligation has been created or should be expected. We urge the Department to remove the reference to a communication that is “directed to” the recipient.
Committee of Annuity Insurers Comment Letter re: Fiduciary Proposal
July 21, 2015
Page 25 of 44

Removing the reference to “directing” a communication will help clarify that merely using the word “you” should not be enough for a communication to be considered individualized or directed at an individual. For example, a communication might say “you might consider” or “this option might be right for you if you are nearing retirement.” But that alone should not trigger fiduciary status. The Department’s own publications for plan participants use the word “you” repeatedly, and no reasonable person would think these communications are “directed at” a particular individual.49

Second, the fact that a communication is “for consideration” in making decisions is too low a bar. Virtually anything that is informative is intended to be considered in making decisions. In fact we can think of no information, written or verbal, that is not supposed to be considered by the recipient. We appreciate that the Department wishes to revisit the current regulation’s requirement for a “mutual agreement” that advice will be the “primary basis” for decision making. There is clearly a middle ground. For example, the Department should consider a requirement that there is a “reasonable expectation that the advice will be relied upon” in making decisions, or will be a “material part of the decision making” and amend the regulation to incorporate these more appropriate standards.

Third, the Department should revise the proposal to make clear that simply because a communication references facts, like age, expected retirement date, risk tolerance, safety of an annuity issuer, or longevity, that help individuals understand the pros and cons of an investment product, choice, or strategy, does not mean the communication has been “individualized.”

Fourth, the Department should clarify that if a person accidentally falls into fiduciary status because a conversation slips into a recommendation, the fiduciary obligations are limited to the information provided that would constitute a “recommendation.” The proposed test for a “recommendation” lends itself to foot faults, but that should not subject someone to an unending fiduciary obligation.

Fifth, the Department should revise the definition of “recommendation” to require more than a “suggestion” that a course of action be taken (or not taken). This is too low a bar. We recommend that the definition be revised to require a “call to action” or advocacy for a course of action.

Sixth, the Department should amend the proposal to allow a carve-out where there is no reasonable expectation of fiduciary status. The foregoing comments all are aimed to try to avoid inadvertently catching non-fiduciary communications and conversations. We think that the importance of this issue suggests the Department should consider a “catch-all” rule. We agree that, when the overall context would create a reasonable understanding between the plan fiduciary, participant, or IRA owner and the adviser that recommendations will be made in the recipient’s best interest, will be impartial, and that a relationship of trust and confidence should be expected, then fiduciary status should attach. Conversely, if there would be no reasonable

49 For example, see Department of Labor, What You Should Know About Your Retirement Plan, available at: http://www.dol.gov/ebsa/publications/wyskapr.html, which uses the word “you” or “your” more than 600 times.
expectation that impartial advice will be provided, no fiduciary status should attach.\textsuperscript{50} We
suggest a “catch-all” rule that avoids fiduciary status if, under the facts and circumstances, there
is no reasonable expectation that the impartial advice is being provided.

\textbf{Clarifying the scope of fiduciary status.} In addition to the foregoing, given that many
more individuals and entities will become fiduciaries under the proposal, clarification is needed
to ensure that fiduciary status is contained to those that should be considered fiduciaries, and not
affiliates and product manufacturers.

To illustrate, take a common example. (We return to this example later in our letter in
the context of the BICE’s definition of “Financial Institution.”) Imagine a large financial
services institution that has an affiliated registered investment adviser (RIA), an affiliated retail
broker-dealer (BD), and an affiliated licensed insurance agency (IA). To sell fixed and variable
insurance products, BD and IA enter into selling agreements with various insurance companies,
to make the products of those insurance companies available to their representatives (who are
also registered Investment Adviser Representatives of the IA) for sale to the customers of BD.
Under state insurance laws, among other requirements, an agent must be “appointed” as an agent
by an insurance company to sell insurance products of that particular insurance company.

Imagine that a representative so appointed provides a recommendation (that meets the
Department’s new rules) to a customer to purchase a variable annuity contract from an
unaffiliated insurance company. This is done by the representative in his investment advisory
capacity for RIA, executed in his registered representative capacity for BD, and executed as an
insurance agent of IA.

First, it should be very clear that the \textit{insurance company} that manufactured the variable
annuity contract is not a fiduciary simply because state law requires an “appointment” of the
insurance agent. We do not believe the Department intended that the product manufacturer was
to be a fiduciary under the proposal merely because state insurance law requires that the persons
that sell its products are required to be appointed with the insurance company. Second, while the
RIA entity may be considered a fiduciary because the representative is licensed as an investment
adviser representative to provide advice, neither BD nor IA, nor any other affiliate of the
financial institution, should be considered a fiduciary. This conclusion is in line with the
Department’s longstanding view that while affiliates of fiduciaries may be parties-in-interest,
they are not automatically fiduciaries.\textsuperscript{51} Please see a further discussion of this issue in Section
XI of our letter, related to BICE.

\textsuperscript{50} We understand that the Department is concerned that carve-outs could be used as loopholes, where an
adviser acts as if he is in a position of trust and confidence, but provides a small print disclaimer. We do not support
such actions. Thus, a carve-out along these lines could fairly be based on the overall facts and circumstances, not
just on boilerplate disclosures.

\textsuperscript{51} There is a slight ambiguity in the proposal because Section (a)(2) refers to providing advice “indirectly”
through an “affiliate.” To avoid this confusion and ambiguity, the definition should be modified accordingly to
make clear that an affiliate of a person shall not become a fiduciary solely as a consequence of facilitating an
indirect representation or rendering of advice.
VI. The Need to Carve Out Distribution Advice that Does Not Involve an Investment Recommendation.

We continue to believe, as we did in 2010, that advice regarding distribution options available under the plan, if that distribution involves no investment recommendations, is not “investment advice” within the meaning of ERISA. Had Congress wanted distribution recommendations to be considered fiduciary in nature, Congress could easily have said so; in fact Congress has frequently provided rules to protect participants in the context of distributions.52

There is no inherent investment element in a plan distribution. Consider, for example, a plan participant who contacts a plan’s call center to discuss a hardship distribution, or to discuss a loan from a 403(b) contract. The call center representative may have a set of talking points to explain the adverse implications of a hardship distribution or loan, including the loss of retirement income, restrictions on future contributions, and significant tax consequences. This will likely be viewed as a recommendation not to take a hardship distribution or loan and would trigger fiduciary status. But we see no evidence Congress intended this conversation to be considered “investment” advice. Investment advice should be limited to advice regarding securities and other property (and the related rights), not to the inchoate rights associated with simply being a participant.53

This is also important for IRAs, because under the proposal a suggestion regarding a “distribution” from an IRA would be fiduciary investment advice. Take a simple example. Imagine the owner of an individual retirement annuity calls the insurance company to discuss her options to take withdrawals from the contract and understand the various implications of taking a withdrawal and not taking a withdrawal. The call center will describe those options, and because of certain facts the IRA owner provides, suggests that one course of action may be better suited for the IRA owner. For example: “You told me you want to have some of these assets available for unexpected medical expenses. You should consider taking a withdrawal rather than annuitizing at this time.”) This would hardly fall under the meaning of “investment advice” by its ordinary definition. We recommend that “distribution” advice that involves no investment recommendations be excluded from the rule.54

52 There are already mandated disclosures that specifically address the impact associated with a participant’s decision not to defer a distribution. In this regard, Congress has directed the Treasury Department to modify the disclosures required under section 411(a)(11) of the Code to include a description of the consequences of failing to defer. Pension Protection Act of 2006, Pub. L. No. 109-280, § 1102(b); Prop. Treas. Reg. § 1.411(a)-11(c). Similarly, Congress created a specific notice under section 402(f) of the Code addressing rollovers. The point here is that Congress knows the difference between “investment” and “distribution” advice.

53 Similarly, some plans allow the participant to distribute an annuity held under the plan “in kind” so that the participant can continue any insurance protections. This is a distribution decision, not an investment decision.

54 This should include routine advice about ways to manage an annuity to comply with the complex required minimum distribution (“RMD”) rules set out in the Treasury regulations under Code section 401(a)(9).
VII. The Need to Preserve Valuable Education.

We support the proposal’s inclusion of language to make clear that education regarding lifetime income is covered, including education regarding (a) annuitization and other forms of lifetime income payment options, (b) retirement-related risks, (c) methods and strategies for managing assets in retirement, and (d) estimating a retirement income stream. It is critical that individuals understand how to manage their assets in retirement and are educated about the options available to them. We also support a clarification that the education carve-out is available for IRAs and plan fiduciaries.

On the other hand, the proposal makes a striking, and in our view, ill-advised, change to Interpretative Bulletin (IB) 96-1. Under the proposal, education cannot (standing alone or in combination with other materials) make any recommendations regarding specific investments or other property. We are aware of no evidence that IB 96-1 is used now as a subterfuge for providing investment advice. To the contrary, it has been very successful in bringing education programs to participants.

In the context of lifetime income, this change to IB 96-1 will have a series of unintended and harmful effects. The owner of an IRA annuity always has the option to annuitize her contract and that option must be explained to the IRA owner. Likewise, if a plan offers an annuity distribution option, the option must be explained to the participant. It is not conceivable that an IRA owner or plan participant could be educated about the annuity distribution options without mention of the actual annuity product given the variety of annuity options available in the market and the nuances of individual products. Indeed, failing to do so would seem to be misleading.

Implications for IRAs. IRA owners that purchase deferred annuities with an annuitization option, guaranteed lifetime withdrawal benefit, or other features, need to understand those options. For example, imagine an individual purchases a deferred variable individual retirement annuity that allows for annuitization at a later date. When the individual retires, he contacts the insurance company or his agent to understand his options. This is exactly the kind of education that we think the Department is hoping to facilitate. And yet the conversation will need to reference the annuity that the individual purchased, thereby triggering fiduciary status.

A similar and common conversation that occurs with the owner of an individual retirement annuity is education regarding the taking of required minimum distributions (“RMDs”). When an IRA owner reaches her “required beginning date,” she will need to make some fairly sophisticated decisions about how and when to take withdrawals or to annuitize consistent with the IRS’ complex RMD regulations. A withdrawal generally must satisfy the “account” rules for defined contribution plans, while an annuitized contract must satisfy detailed limits on the annuity payout stream. These conversations all occur under the rubric of the specific annuity contract the individual owns.\(^{55}\)

\(^{55}\) One Committee member mentioned a common related conversation: Imagine an employee does not need to access his 403(b) savings at age 70½ and expects to continue working past that age. The employee asks his agent about rolling the funds into an IRA. The agent should be able to tell the employee that it is disadvantageous to roll
It is critical that these conversations fall under “education,” because under the Department’s proposal, they will be “directed at” the individual and could easily be understood as a “suggestion” for a particular course of action. For example, the statement “if you expect to have longer than average life expectancy, then annuitizing your contract may be right for you” is individualized, directed at the individual, and suggests a course of action. A similar statement in the RMD context might be: “if you want your payments to ramp up significantly in the next couple years, then you may wish to take withdrawals rather than annuitize, because the RMD rules require annuity payments to be basically level. However, your contract does offer an annuity payout option that has certain payment increases that continue as long as you live.” Further, owners of annuity contracts have to understand the advantages, disadvantages, and trade-offs of various options for them under the contract, and this education will by necessity “reference the appropriateness” of the specific product and options.

Implications for plans. In the context of participant directed plans, education about asset allocation must mention the specific investments that the plan fiduciary has chosen or it will be meaningless to the participant. An education document or interactive web program that suggests a particular asset allocation but does not connect that to the actual investments in the plan is useless. Again, because a communication or interactive model is trying to get the individual to take action, such as diversifying her account, it must fall under education because it would otherwise appear to be a “recommendation” under the Department’s broad definition. It is entirely appropriate for a service provider to simply connect an educational communication with an investment that has been selected by the plan fiduciary.

In most 401(k) and 403(b) plans, the service provider to a plan is typically providing education at the direction or behest of a plan sponsor. The educational program is overseen by the fiduciary, who generally does not have a prohibited transaction concern (and would not receive a fee for any “advice” provided). A service provider, on the other hand, who does not intend to be a fiduciary, cannot fall into fiduciary status because of the prohibited transaction concerns. Thus the Department should make clear that a service provider is not viewed as making a recommendation solely by implementing the plan fiduciary’s instruction to provide education about the plan’s investment options, if the education is subject to the review and oversight of the plan fiduciary.

Information about the product itself. The education carve-out is designed for education. There are many conversations that insurance company call centers have with customers that simply provide factual information about the product that the individual owns. We are concerned that call center employees – fearful of personal liability – will be wary of providing over his 403(b) into an IRA because he is not required to take minimum distributions from his 403(b) at age 70½ if he is still working but would be required to take RMDs if he rolled over into an IRA.

56 Common questions include: “What would be my surrender charge if I take a withdrawal?” “How much of a withdrawal can I take and not have a surrender charge?” “How many years left on my surrender charge period?” “Do my contract investment options include a small cap fund? Yes. What is it? ABC Fund. What is its fee? X%. OK, please transfer $XXX to that fund for me.” The bar for a recommendation – any communication that would be perceived as a “suggestion” that the customer take an action or not take an action – means even mundane factual conversations raise the risk of litigation.
even factual information about a product if that factual information might appear to “suggest” that a customer take an action or not take an action. Thus, we recommend that any information or explanation regarding an investment that is disclosed in the investment’s relevant prospectus or similar disclosure can be provided without triggering a “recommendation.” Similarly, factual information about the tax consequences of a product or exercising any option under the contract should be protected from treatment as a “recommendation.”57

VIII. The Need for Clarifications Regarding the Platform Carve-Out.

Under paragraph (b)(3) of the proposal, it is not considered investment advice if a person:

merely markets and makes available to an employee benefit plan (as described in section 3(3) of [ERISA]), without regard to the individualized needs of the plan, its participants, or beneficiaries, securities or other property through a platform or similar mechanism from which a plan fiduciary may select or monitor investment alternatives, including qualified default investment alternatives, into which plan participants or beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts, if the person discloses in writing to the plan fiduciary that the person is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.

As an initial matter, we think this “platform carve-out” is simply a common sense expression of current law. It cannot be “investment advice” for a service provider to put together a product – in this case a menu of available investments – which is offered generally to the market or segments of the market. We recommend below some clarifications to ensure the platform carve-out is effective.

First, the Department should confirm that the platform carve-out is available to investments available through variable annuities.

Although there is no formal definition, the platform carve-out implicitly defines a platform as a mechanism from which a plan fiduciary can select or monitor investment alternatives into which participants may direct the investment of their accounts. Appropriately, the definition does not specify the legal structure under which these investments must be offered.

Many plans use individual and group variable annuities as the method to provide access to a platform of investments to which participants allocate their account. For example, in the 401(k) market, it is very common for an insurance company to offer a group variable annuity

57 A similar example: Imagine an employee is getting a divorce from his spouse and they enter into a QDRO agreement agreeing to split the $80,000 cash value of a section 403(b) annuity owned by the employee. The spouse asks the servicing agent about how to best access the money, since her $40,000 cannot remain in the 403(b) annuity. The agent should be able to tell the spouse that is advantageous to roll over her portion of the 403(b) annuity into an IRA, which is preferable to a distribution from the annuity because spouse avoids penalty taxes and withdrawal charges.
with a separate account holding investments. During the accumulation phase, these various investments are available for participants to direct the investment of their accounts.

Section 403(b) plans must be held in an annuity or a mutual fund custodial account. Annuities used in 403(b) plans are often individual annuities, although not exclusively. The plan sponsor may make available the annuity of only one vendor or multiple vendors. In any case, as long as a provider’s annuity is a “mechanism” under which investments are offered into which participants may direct the investment of their account, we believe the platform carve-out should apply.

We very much appreciate that the Department clarified in the preamble that the platform carve-out is available in the 403(b) plan marketplace. To implement this commonsense interpretation, we think it would be very helpful for the Department to clarify that in multi-vendor plans, each provider’s contract can qualify as its own platform if it qualifies. (Otherwise, it might inadvertently be investment advice to market one’s own platform without discussing the other vendors available in the plan.)

A contrary interpretation would place insurance companies at a significant disadvantage by, apparently, making it a fiduciary act to simply “market” a group or individual annuity that serves as a mechanism to select or monitor the plan’s investment line-up. We do not believe the Department would intend that result.

Second, the Department should confirm that a “platform” can be a preset list of investments that can be selected and monitored as a whole by the fiduciary.

Not all “platforms” consist of a platform of thousands of mutual funds or other securities that a plan fiduciary must narrow. Some providers will make available a pre-set menu of investments that is available for selection but has not been individualized to the needs of any particular plan. In fact, a variable annuity may have a list of investments available under the contract that are described in the prospectus and available to all investors that purchase the annuity. We believe the Department intended these platforms to fall under the carve-out. As long as the provider has not individualized the platform to the needs of a particular plan or participant, and has made clear it is not undertaking to provide impartial investment advice, the platform carve-out should be available.

Similarly, some Committee members have expressed concern that the platform carve-out requires the offering of non-proprietary investments. After carefully reviewing the language and the discussion of the platform exemption in the preambles to the 2010 and 2015 proposals, we think the Department did not intend this implication. We see no evidence the Department

---

58 The insurer may also offer a general account investment as part of the line-up, such as a stable value product or guaranteed return product.

59 The Department made some subtle, but important, changes to the language for the platform carve-out from the 2010 proposal. For example, the platform carve-out has been changed to a platform from which a plan fiduciary “select or monitor” investment alternatives.
intended to force a particular platform distribution model. Nonetheless, we think it would be helpful for the Department to clarify this point through a discussion in the preamble to the final rule.

**Third, the platform exception should not be limited to ERISA plans.**

As we stated in our prior comments, the Committee firmly believes that the platform carve-outs should also apply to IRAs and Keogh plans. Many IRA providers limit the investments that may be selected through the IRA to a specified universe of investments. These investments may be solely proprietary or may include both proprietary and non-proprietary investments. The mere marketing of such an investment platform should not be viewed as investment advice to IRA owners. This should be self-evident because simply limiting the universe of investment on an IRA platform that is available to customers is not an individualized recommendation to any IRA customer where the IRA platform provider has made clear that it is not undertaking to provide impartial investment advice.

**Fourth, “marketing” a platform should include the furnishing of a sample or initial menu of investments.**

When a plan fiduciary seeks a plan provider, the fiduciary often asks the provider to suggest a sample menu that can be used to evaluate the pricing of the provider. The provider may put together this sample menu in response to a specific request in an RFP, or may do so to feature the breadth and quality of the investments available through the provider. As long as the context makes clear that the sample menu is just that – a sample – and that the provider is not undertaking to provide impartial investment advice, there should be no assumption of fiduciary status. Rather, such a sample menu is part and parcel of the marketing that the platform carve-out is intended to facilitate.

**IX. The Need to Clarify that Routine Annuity Valuations Are Not Fiduciary.**

The Department has made some significant improvements to the rules for “valuation” advice, which the Committee appreciates. First, the Department clarified that an appraisal, fairness opinion, or similar statement regarding the value of a security is considered advice only “if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such securities or other property by the plan or IRA.” Second, the Department provided a carve-out for statements of value provided to pooled separate accounts. Third, the Department expanded the carve-out for statements of value provided “solely for purposes of compliance with the reporting and disclosure provisions under [ERISA], the Code, and the regulations, forms and schedules issued thereunder, or any applicable reporting or disclosure requirement under a Federal or state law, rule or regulation or self-regulatory organization rule or regulation.”

---

60 For this purpose, a Keogh plan is a plan covering only a business owner (and his or her spouse), which is not considered an employee benefit plan because it does not cover any employees.
Informal statements from Department officials indicate that the Department’s primary concern is the purchase and sale of nontraditional assets like real estate by a plan where the plan fiduciary receives an appraisal or similar opinion regarding the value of the asset. We are concerned, however, that because the term “transaction” has been interpreted broadly by the Department in other contexts, the proposal inadvertently sweeps in routine and somewhat mechanical valuations that insurance companies may need to perform for policyholders.

The following situations involve statements of value that may not neatly fall into one of the Department’s carve-outs:

- **Roth IRA conversions.** An IRA annuity owner may contact an insurance company to request the value of his or her annuity because the owner is contemplating converting the annuity to a Roth IRA. If the IRA owner decides to perform the conversion, the owner will have taxable income. Treasury regulations require that the amount of taxable income is based on the fair market value of the annuity on the date of the conversion.\(^{61}\) IRA owners look to the insurance company to calculate this amount, as the insurance company is in the best position to perform the actuarial calculation. If the conversion occurs, it will ultimately be reported to the IRS, but that is not the sole reason for the furnishing of the statement of actuarial value, *e.g.*, the IRA annuity owner’s decision on whether to make the conversion may depend on the amount of income that she will recognize and this in turn depends on the insurance company’s valuation.

- **Required minimum distributions.** Owners of IRA annuities that have not yet been annuitized are required to take a withdrawal upon reaching the required beginning date under section 401(a)(9) of the Code. Treasury regulations require that the amount of the withdrawal be based on the “dollar amount credited to the employee or beneficiary under the contract plus the actuarial present value of any additional benefits (such as survivor benefits in excess of the dollar amount credited to the employee or beneficiary) that will be provided under the contract.”\(^{62}\) Insurance companies routinely report this information using reasonable actuarial assumptions (which the regulations require) to policyholders subject to RMDs. The information is commonly provided annually on a form (IRS Form 5498, box 5) that an insurer is required by the IRS to file. However, the furnishing of this information is done so that the policyholder can take a withdrawal, which would seem to be a “transaction” in the broad sense, and the information may be furnished to an owner other than at the time and in the manner required by the IRS.

- **Routine account balance inquiries.** There are numerous instances where an insurance company may respond to an annuity contract owner’s request for contract value information. Contract value information is often also made available to the annuity contract owner through a website or other automated system. For fixed contracts, the value would be updated to reflect interest credits through a specified date. For variable
contracts, the value would be updated to reflect the net asset value of the underlying mutual funds or other securities through a specified market close. The current surrender charges would be available. The actuarial value of other contract benefits, such as GLWBs or guaranteed minimum death benefits, may or may not be available depending on the capacity of the insurance company’s computer systems. This request of the owner for contract value information may relate to a contemplated withdrawal from or surrender or exchange of the annuity contract, or a contemplated loan if the contract is part of a qualified plan that permits loans. (These values may also be provided in paper or online account statements, which often have a coupon or online option to make subsequent contributions.)

- **Contract allocations.** Most fixed indexed annuity contracts and registered indexed annuity contracts allow the owner to reallocate funds among the available fixed and indexed investment strategies at the end of each specified term. At the end of a term, the insurance company will routinely provide information about the amount coming up for renewal. Variable annuity contracts generally allow the owner to reallocate amounts among the underlying mutual funds or other securities, and the insurer will routinely provide information concerning the balance in each option for that purpose.

- **Living benefits and death benefits.** Increasingly, IRA owners are purchasing guaranteed lifetime withdrawal benefits and similar “living benefit” guarantees. These additional benefits provide a guarantee of a minimum withdrawal from the contract despite longevity and market conditions. IRA owners routinely contact the insurance company to inquire about the value of the living benefit guarantee and ask how a withdrawal will affect the value of the guarantee. An IRA owner may also inquire about how a withdrawal may affect an enhanced death benefit provided for under the contract.

All of these situations involve an insurance company applying certain actuarial principles or algorithmic calculations to assist IRA owners in understanding the value of the contract or in complying with complex tax code requirements. Many of them will result in the issuance of a federal tax form like Form 1099-R (but not all), but that is not the sole purpose for furnishing the information. We urge the Department to either clarify that such routine valuations are not advice as contemplated by the proposal, or expand the various valuation carve-outs to encompass them.

**X. The Need to Preserve Advice Programs Under Current Law.**

Many Committee members and their affiliates already offer advice programs to plans and IRAs, either directly or through a third party. These programs involve the acceptance of fiduciary status and structuring the compensation to avoid any prohibited transactions. For example, the company may offer access to an unaffiliated third party advice service or unaffiliated adviser. Others offer computer model advice similar to the programs described in Advisory Opinion 2001-09A (SunAmerica). The proposal itself, and the new and amended exemptions, do not explicitly address these existing and successful advice programs. A number of features of the proposal, however, seemingly call them into question, and we urge the Department to ensure that these models can continue.
For example, if a service provider were to make available an advice service that uses a flat fee compensation model, if the provider made any “recommendation” that the plan should consider using the service, the provider would apparently be a fiduciary. If any fees associated with the service are paid to the service provider, it would appear this would itself be a prohibited transaction for which there is no available exemption. This means no service provider could market an advice service as part of its plan services package unless it does so for free.

Similarly, suppose that an IRA owner meets with an investment adviser that offers an asset-based advice fee. Because the investment adviser will likely recommend that the owner be hired, the adviser has made a “recommendation as to a person who is also going to receive a fee” for providing advice. And thus there is an apparent prohibited transaction, even though the compensation is structured precisely to avoid any prohibited transaction concerns.

XI. Committee Members' Significant Concern about the Best Interest Contract Exemption.

The Department has proposed a new and complex exemption, the Best Interest Contract Exemption (BICE), as its solution to the disruption that will be created in the plan and IRA market by the proposal. We think the idea of a principles-based exemption ensuring that anyone who provides advice acts in their client’s best interest is the right solution. Unfortunately, we believe the BICE as proposed falls far short of meeting the goal of balancing protecting participants and IRA owners while being workable. The BICE is not workable in its current form, and minor tweaks at the edges are unlikely to make it a workable exemption. (Major changes, of course, could create other unintended consequences that will not be known unless the Department seeks comments on them before the rule is finalized.) The cost of compliance with the exemption means that, even if the most significant concerns are addressed, the BICE is simply not worthwhile economically to provide advice or facilitate rollovers to small accounts. It is for this reason that our comments above have focused on PTE 84-24, because we believe PTE 84-24 is a workable framework to meet the Department’s goals.

First, our overall comment is that if the Department decides to maintain the distinction in proposed PTE 84-24 between annuities that are securities and those that are not, then the BICE needs to be vastly simplified to follow the straightforward conditions in PTE 84-24: the adviser

---

63 Note that the Department’s 408(b)(2) regulation would require disclosure of these fees paid to a recordkeeper, whether they are direct or indirect compensation.

64 The BICE is aimed at the sale of a security, and thus is not intended for this situation. It is also not clear that, even for large plans, the seller’s carve-out would be available, as this is not a bilateral contract.

65 As noted earlier, one key reason BICE is not suited for annuities is that, by design, it does not address spread revenue that is inherent in any product that provides a guarantee. To take a simple analogy, there is no “cost” for a bank certificate of deposit, as the “cost” is inherent in the difference between the promised interest and what the bank might (but is not guaranteed to) earn on the deposit. The Department appropriately came to the conclusion in connection with the 408b-2 and 404a-5 disclosures that “spread” is not disclosed as a “fee.”
must act in the customer’s best interest, must not make any misleading statements, and must disclose material conflicts of interests.

Second, the Department’s estimates regarding the cost of compliance with the BICE make a number of assumptions that significantly undervalue the costs of the BICE. For example, the Department assumes that a financial institution will only require 60 hours of legal work to comply with the BICE. The proposal requires a multi-business line team of lawyers, and, just based on the proposal, insurance companies and other financial institutions have created large teams of compliance lawyers working exclusively on the proposal since its release. Second, the Department assumes only 100 hours of information technology costs to build the systems to support the BICE. We understand that 100 hours will be needed simply to scope out the multiple systems that must be amended. The Department also estimates the financial institutions will send only two point of sale disclosures to IRA owners per year, even though the disclosure is required for every transaction in an IRA, and that each disclosure will require only two minutes of clerical time to print and mail. All of these estimates significantly understate the costs that Committee members expect.

Third, the BICE presents particular risks and challenges for assisting plans and IRA owners in using products that provide guaranteed lifetime income during retirement. Annuities are not the same as a mutual fund or an individual security. Annuities are more complex to explain to an individual, and they also require more personnel training, e.g., the agent needs to understand the product and when it is appropriate for a customer. The BICE puts significant pressure on any differential product compensation. Committee members express deep concern that the likely result under BICE of having to prove in court the reasonableness of any compensation difference between annuity products and other savings vehicles will result in extensive and costly litigation.

The industry should be concerned about the litigation risks involved with BICE. The 401(k) industry has been hit with a series of class action lawsuits. Plan sponsors and service providers routinely win these cases, but only after millions of dollars have been spent on litigation costs. The Department itself often intervenes in these cases to argue against their dismissal early in process. Whether or not a particular commission structure for an annuity would “encourage advice that runs counter to the Best Interest of the Retirement Investor” is going to be a facts and circumstances test that insurance companies will need to work out only through very expensive class action litigation. Informally, the Department has said that it is only concerned with “gross violations and outliers.” That may be true, but class action plaintiffs’ lawyers will not have such noble intentions, which means providers must either price the risk into the product or exit the business entirely.

Fourth, Committee members have deep concern about Section VI of the BICE, which requires the Financial Institution and the Adviser to offer a very broad range of asset classes. It

---

66 Nearly 40 lawsuits have been brought relating to 401(k) fees, with class action plaintiff firms having little success but being able to secure just enough in settlements to continue the campaign. See http://www.groom.com/media/publication/1481_401k_fee_cases_detailed_chart_January_2015.pdf.
is unclear as an initial matter what this means for the sale of annuities. Variable annuities can offer multiple asset classes with respect to the funds available for allocation in the contract’s separate account (and might also offer one or more general account guaranteed investment). The annuity features of the contract might be viewed as an “asset class” but are more properly understood as a lifetime income option. In addition, we are concerned that many agents and brokers focus on a particular product or set of similar products. In fact, many develop an expertise in a particular product like an annuity that they are comfortable explaining. The BICE presents a number of challenges in this regard. For example, Section IV of the BICE requires the “Financial Institution” to make available all asset classes, with a narrow exception subject to a number of conditions. We think the conditions in Section IV are unnecessary, because the adviser is already subject to the conditions of Section 404 of ERISA or the “Impartial Conduct Standards.” In addition, under longstanding Department guidance, it is perfectly acceptable for a fiduciary to be limited in the asset classes to which the fiduciary’s authority applies.67

Fifth, the disclosures required by the BICE are unnecessary in light of the carefully considered disclosures required under federal and state law. For example, variable annuities sold in connection with IRAs must be accompanied by a prospectus whose required content has been carefully crafted by the SEC over the years to focus on those features and costs of the annuity that are most material to an investor.68 The prospectus, which the SEC calls the “most important source of information about a variable annuity’s investment options,” contains detailed information about the product features, the fees and charges, and the investments.69 Most importantly, the prospectus is designed to allow comparability among variable annuities by standardizing the disclosure. We are aware of no evidence that the disclosures required by the SEC are insufficient. Accordingly, if the BICE is retained, we would recommend that the disclosures in Section III of the BICE be deemed satisfied if the retirement investor receives the disclosures required by federal or state law with respect to the annuity.70 In any event, as

67 DOL Reg. § 2550.404a-1(b)(1)(i).

68 Federal securities laws require that a prospectus disclose all material facts and risks and the issuer undertakes strict fraud liability for any material misleading statements and any material omissions in the prospectus.


70 The NAIC has promulgated the Annuity Disclosure Model Regulation (Model 245) for the states to adopt, reject, and/or revise at their discretion. All but twenty-one states have adopted a previous or current version of the model regulation. The NAIC Annuity Disclosure Model Regulation requires that a disclosure document and Buyer’s Guide be provided at or before the time of application in the case of a face-to-face meeting; otherwise, these documents must be sent within five days of receipt of the application by the insurer. The model rules require the following minimum disclosures:

- The name of the product, the company product name (if different), the form number, and the fact that the product is an annuity;
- The insurer’s legal name, physical address, website, and telephone number;
- A description of the contract and its benefits (emphasizing its long-term nature), including an explanation of:
  - The guaranteed and non-guaranteed elements of the contract, the limitations of the contract, and the elements used to determined indexed based interest (e.g. participation rates, caps or spread) and how those elements operate,
discussed above, the Department should coordinate with the SEC staff regarding the inconsistencies in the BICE disclosures and the requirements of the federal securities laws requiring standardized mutual fund and variable annuity fee tables; FINRA public communication rules; and the requirements applying to adviser advertisements under the Advisers Act.\textsuperscript{71}

\textbf{Sixth}, we know that the Department has heard, and will continue to hear, numerous concerns about the requirement in the BICE to enter into a contract before any discussion begins. This requirement will be impossible to satisfy in many circumstances. We think that even where the circumstances might permit it, very few individuals will want to sign a contract simply to begin conversations with an agent or broker or to hear a sales presentation. (Many individuals may want to talk to multiple financial advisors before making a decision.) Finally, we think the requirement that the contract be “tri-party” will be unworkable except in the very narrow situation in which the individual advisor will be working with the client in perpetuity. More often, an IRA owner will have interactions with multiple individuals over time.\textsuperscript{72}

\textbf{Seventh}, as noted earlier with respect to PTE 84-24, Committee members are concerned with how the Department has described the “best interest” standard because the Department has added a \textit{new} element, not contained in ERISA section 404, requiring that the Adviser act “without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.”

- The initial crediting rate and how interest is determined (this includes any bonus or introductory portion, the duration of the rate, and the fact that rates change and are not guaranteed),
- Periodic options on a guaranteed and non-guaranteed basis,
- Value reductions caused by withdrawals from or surrender of the contract,
- How values within the contract can be accessed,
- The death benefit (if any) and how it will be calculated,
- A summary of the federal tax status of the contract and any penalties applicable on withdrawal, and
- The impact of any rider;
- The specific dollar amount or percentage of charges and fees with an explanation of how they apply; and
- Information about the current guaranteed rate or indexed crediting rate formula that contains a clear notice that the rate is subject to change.

All terms must be defined in a language that a typical person to whom the disclosure is directed would understand. The model regulation also provides the standard for annuity illustrations, reporting requirements for annuities in the payout period that include non-guaranteed elements and deferred annuities during the accumulation period.

\textsuperscript{71} A related point is that the extensive reporting requirements in Section IX of BICE are excessive in light of the detailed reporting financial institutions already provide to their primary regulators.

\textsuperscript{72} We recommend that the contract requirement be removed. However, if the Department does not agree, then the contract should be required on or before the transaction that would otherwise trigger a prohibited transaction (such as the payment of compensation to the adviser or the purchase of a security or other property) occurs.
Eighth, the BICE imposes a new burden to determine the reasonableness of one’s own compensation. This is a perhaps subtle but important point. Many statutory and class exemptions include a condition requiring “reasonable” compensation, including ERISA section 408(b)(2). But the longstanding view has been that a service provider is not responsible to determine the reasonableness of the provider’s own compensation. Generally, under current law, we expect that a service provider will disclose the compensation to be received, and the independent fiduciary makes the decision. This is at the heart of the Department’s new disclosure regulation under ERISA section 408(b)(2). But the BICE imposes a different formulation, which places a party relying on the exemption in a precarious position. Section II(c)(2) provides that the Adviser and Financial Institution must affirmatively agree that no Asset will be recommended unless the total compensation to be received is reasonable. Besides being a condition for relief, this agreement is enforceable as a contractual matter, which means the service provider must be able to demonstrate compliance with the condition, through some yet-to-be-determined benchmarking. We are not sure how an insurance company could benchmark its own compensation inherent in the product, particularly the spread between a guaranteed return in the contract and the return of the insurance company’s general account. Further, in the context of an IRA, the only independent fiduciary is the IRA owner, making this “reasonableness” condition more difficult if challenged.

The Department needs to make very clear that the reasonableness of compensation for a product or service is tied to that product or service. The comparison should be to other products with similar features. Put another way, a portfolio consisting solely of index funds with no guarantee has lower fees than a variable annuity because having a guarantee costs more than not having a guarantee. We are very concerned that, unless the Department provides clear guidance, insurers and other financial service firms will be left open to frivolous litigation that attempts to make inappropriate comparisons to products that do not provide any guarantees.

Ninth, regulatory coordination is necessary to determine whether an affirmative statement as to fiduciary status compromises reliance on the broker-dealer exclusion in the Advisers Act. The Department intends that insurance agents or brokers that are not registered investment advisers under the Investment Advisers Act, but who make a recommendation that will trigger fiduciary status under the proposal, will need to comply with the BICE. These insurance agents and brokers are not providing advisory services, but rather recommendations incidental to the sale of a security or insurance contract. The BICE requires that the insurance agent or broker agree by contract to a higher duty of care than they have under current law. This includes:

- Contractually agreeing to provide advice that “reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.”
Committee of Annuity Insurers Comment Letter re: Fiduciary Proposal
July 21, 2015
Page 40 of 44

- Affirmatively warranting to comply with federal and state laws that relate to the provision of investment advice.

- Making a specific finding that the investments that will be offered represent all the asset classes that the investor may need.

We are very concerned that the very act of meeting the requirements of the BICE essentially requires the insurance agent or broker to offer a service that triggers the need to register as an investment adviser with the SEC. The SEC will, by necessity, need to address this issue, and the need to resolve it before insurance agents and brokers come into compliance with the BICE requires additional time before the proposal can be finalized and effective.

Tenth, we think that the mandated website disclosure in Section III(c) is unnecessary and excessive and should be deleted. This disclosure would require a massive amount of information regarding “the direct and indirect material compensation payable to the Adviser, Financial Institution and any Affiliate for services provided in connection with each Asset (or, if uniform across a class of Assets, the class of Assets) that a Plan, participant or beneficiary account, or an IRA is able to purchase, hold, or sell through the Adviser or Financial Institution, and that a Plan, participant or beneficiary account, or an IRA has purchased, held, or sold within the last 365 days.” The system required to build such a website is not possible in five years, let alone eight months. Because the requirement includes disclosure of adviser compensation, providers who sell through multiple advisers would presumably need one website for each of their advisers, which could number in the thousands. And it would appear to have little purpose in actually helping a retirement saver make an informed decision.

Eleventh, while we appreciate that the Department has included annuities in the “Assets” that are covered by the BICE, as a conceptual matter we think it is inappropriate to limit the assets that can be recommended under BICE. Congress has quite deliberately provided that plans and IRAs can invest in any security or other property, with limited exceptions Congress has laid out.73 In addition, since the adviser subject to BICE will be a fiduciary, it inappropriately constrains what the adviser can recommend. Finally, we think it is not consistent with the Department’s goal of making BICE a “principles-based” exception to limit the assets available under the exemption.

Twelfth, we recommend that the Department delete Section IX of the BICE. Section IX provides for detailed data retention and reporting regarding individual customers and states that the Department may post this data on its website. This is a massive data retention requirement, and the data request will be inconsistent and misleading. Further, the Department has not shown, nor could it, that such a massive record retention requirement is consistent with ERISA’s standards for the grant of an exemption. For example, we don’t believe it is administratively feasible, nor do we see how it could be in the interest of participants or protective of their rights.

73 With respect to IRAs, Congress provided only two prohibitions: life insurance and certain collectibles. Code section 408(a)(3), (m). As the Department knows, Congress decided during the consideration of ERISA to avoid the concept of “legal lists” that constrained trustees under trust law.
Thirteenth, as noted earlier, clarification is needed with respect to which institution is considered the “Financial Institution” for purposes of the contract required by BICE. To return to our earlier example: Imagine a large financial services institution that has an affiliated registered investment adviser (RIA), an affiliated retail broker-dealer (BD), and an affiliated licensed insurance agency (IA). BD and IA enter into selling agreements with various insurance companies, to make the products of those insurance companies available to their representatives (who are also registered Investment Adviser Representatives of the IA) for sale to the customers of BD. Under state insurance laws, among other requirements, an agent must be “appointed” as an agent by an insurance company to sell insurance products of that particular insurance company. Thus, an individual representative has, in some sense, a relationship with all of these entities that could meet the definition of “Financial Institution.” We think two clarifications are appropriate. First, the entities should be able to agree amongst themselves which entity will enter into the contract, but relief should be provided for all parties (to the extent a prohibited transaction might be attributable to any of them). Second, the product manufacturer should not be considered the Financial Institution unless there is no other investment advisory firm, broker-dealer, or insurance agency that employs or otherwise retains the individual as an independent contractor, agent, or registered representative.\footnote{As noted earlier, we do not believe the Department intended that the product manufacturer was to be a fiduciary under the proposal merely because state insurance law requires that the persons that sell its products are required to be “appointed” with the insurance company.}

XII. An Additional “Low-Fee” Exemption is Inappropriate Without Significant Additional Public Input.

In the preamble to the BICE, the Department asks for comments on whether it should create a separate exemption for “high-quality” and “low-fee” investments. We think it is inappropriate to adopt such an idea at this time. The regulated community does not have enough time to consider the implications of the regulation and exemptions that the Department has already proposed, and cannot meaningfully comment on a separate and vaguely defined exemption. We would urge the Department to instead focus on making the BICE, PTE 84-24, and other exemptions workable so that a streamlined exemption is unnecessary. If the Department wants to pursue this idea, it should do so only after issuing a separate Request for Information.

There are reasons to be very concerned that such an exemption might be very disruptive to the retirement savings of Americans. We are particularly concerned that such an exemption would limit access to and use of lifetime income guarantees. The Department has gone so far as to say that it is currently considering allowing only mutual funds to be recommended under this streamlined exemption. It is hard to imagine any proposal less consistent with the statutory scheme Congress envisioned in ERISA, which goes out of its way not to favor one investment structure over another.

We are also deeply concerned that the Department is now considering departing from longstanding emphasis in ERISA and 40 years of guidance on a “reasonable” fee or other

\footnote{As noted earlier, we do not believe the Department intended that the product manufacturer was to be a fiduciary under the proposal merely because state insurance law requires that the persons that sell its products are required to be “appointed” with the insurance company.}
compensation, and instead deciding that certain fees are “low” and some are not. No fee is inherently “low” or “high”—fees are only reasonable or not reasonable in relation to the services or product being purchased. In the retirement savings industry, as with any other product or service, the easiest way to keep fees low is to minimize the services. In that case, sophisticated and wealthy participants and IRA owners who can manage their own assets with minimal assistance will benefit, but anyone who needs help will lose.

The very premise of a “low-fee,” “high-quality” exemption available only to mutual funds is further evidence of the concern we expressed earlier, namely that the Department is not appreciating that annuities cost more than mutual funds because they provide a guarantee, most importantly a guaranteed lifetime income, that a mutual fund does not and cannot provide. Those guarantees have costs. But a retiree who is invested solely in mutual funds faces a cost as well—the risk that she might retire and have those savings depleted unexpectedly by a severe market event, depleted by living longer than expected, or both.

Finally, we would point out that such an exemption would not be available for one of the core retirement savings vehicles that Congress created in 1974—an individual retirement annuity described in Code section 408(b). Before proceeding with such an exemption, the Department should examine, and seek comment on, the extent to which it would be acting contrary to Congress’ intent and would disrupt the balance struck when Congress enacted Title II of ERISA.

XIII. The Need for a Reasonable Period for Compliance and Grandfathering Existing Annuities.

It is hard to imagine a regulation that is more complex, affects more aspects of the retirement industry, or crosses more business lines for service providers. There is no regulation in recent memory with this breadth. Accordingly, an eight month “applicability” period is not workable. We believe that the industry will need three years to implement the changes necessary, and will need more time if the Department does not make the changes to the proposal that we have recommended. Further, we believe that the immediate effective date is simply not appropriate, because it immediately creates thousands of new fiduciary interactions that did not exist, and creates an immediate risk of private lawsuits.

We also strongly urge the Department to provide that the proposal does not apply to annuities sold and arrangements entered into prior to the effective date of the regulation. This new regulation imposes significant costs that were not priced into products sold before the date.

---

75 A search of ERISA, the Department’s regulations, advisory opinions, and exemptions for the term “reasonable” fee or compensation returns so many results it is not useful to cite them all here. But we are not aware of anywhere in the history of ERISA providing special rules for “low-fee” investments or services.

76 To illustrate the scale of changes that will be required, one Committee member has concluded that a conservative estimate of the company’s total implementation cost of bringing systems and programs into compliance with the proposal is more than $110 million, with an additional annual cost of compliance of nearly $25 million. Institutional changes of that magnitude take multiple years to implement.
As the Department is aware, the United Kingdom’s (“U.K.”) financial services industry regulator, the Financial Conduct Authority (“FCA”) (formerly the Financial Services Authority), significantly changed the way financial advisers in the U.K. may be paid by banning all payments (including revenue sharing) from product providers to financial advisers beginning January 1, 2013. Under the FCA’s new rules (known as “Retail Distribution Review” or “RDR”), advisers in the U.K. may only be paid through charges that are set out and agreed to by a retail client up front. Despite the differences between the U.K.’s RDR and the Department’s proposal, the impact on their respective industries is expected to be similar in requiring dramatic changes to the way U.K. and U.S. financial firms and advisers operate and interact with customers. In recognition of this impact, the FCA provided the U.K. industry more than two-and-a-half years to comply with the final rules regarding adviser compensation that were published in March 2010. Yet even with a lengthy period for compliance, it has been well documented that a significant portion of the U.K. industry withdrew from providing financial advice to retail clients of moderate means leading up to and following the effective date of the new rules. Because the Department’s proposal is in many ways more complex than RDR, we urge the Department to consider the analogous U.K. experience when setting the period for compliance with the Department’s final rule.

The BICE includes a limited exception for arrangements providing “compensation in connection with the purchase, sale or holding of an Asset by a Plan, participant or beneficiary account, or an IRA, as a result of the Adviser’s and Financial Institution’s advice, that occurred prior to the Applicability Date.” We appreciate this relief, but it comes with a significant condition – the insurance company or agent cannot have any interaction with the customer after the effective date that might constitute a recommendation. For example, the customer could not be provided any information regarding annuitization options under the contract unless the insurance company is willing to take on the cost and risk associated with PTE 84-24 as amended or the BICE. This creates a perverse incentive not to even respond to an individual’s inquiry about the annuity that he or she has purchased. We strongly urge the Department to remove this condition from the exemption for pre-existing transactions.

**CONCLUSION**

The Committee of Annuity Insurers appreciates this opportunity to comment on the Department’s proposed regulation and the new and revised proposed exemptions that are relevant to annuities, particularly PTE 84-24 and the BICE. Given that the 29 member companies of the Committee represent more than 80% of the annuity business in the United States, the Committee obviously understands and values the importance of lifetime income to American workers and retirees. As we have explained in our comments (and attached Appendix), annuities are insurance products that are unique in their ability to guarantee lifetime income to individuals whose retirement savings have accumulated in individual account plans and / or IRAs. In addition, many forms of annuity products are able to provide middle-class Americans accumulating retirement savings with investment guarantees that are often unavailable except to large investors or workers in defined benefit plans. Providing these guarantees to workers and retirees – and compensating sales agents for the time and care needed to understand and explain these guarantees – necessarily entails greater costs than does offering
Committee of Annuity Insurers Comment Letter re: Fiduciary Proposal
July 21, 2015
Page 44 of 44

an index fund. More importantly, an index fund – no matter how inexpensive it may be – simply does not provide the protections most Americans will need as they prepare for and live in retirement.

As we hope we have made clear in our comments, the Committee fully supports a regulatory regime that requires financial professionals who provide investment advice to act in the best interest of their clients. Unfortunately, however, we believe the Department’s current proposal is deeply flawed and unless substantially modified in the manner we have described, will almost certainly reduce access to and use of guaranteed income for life for those who most need it. Federal retirement policy has had many successes in the last 50 years in bringing retirement security to more Americans. Those same policies, however, contain examples of the unintended consequences that can and have flowed from well-purposed laws and regulations. We respectfully submit that if the Department’s current proposal is adopted largely as written, it will be remembered in no small part as contributing to the decline of retirement security that life annuity payments provide, and helping only those few Americans who need no assistance in preparing for retirement. This would be a most unfortunate legacy for a Department and an Administration that otherwise have contributed greatly to facilitating access to lifetime income by workers and retirees.

* * * *

We appreciate this opportunity to offer input on this proposal. If you have any questions, or if we can be of any assistance in your consideration of the issues summarized above, please do not hesitate to contact either of the undersigned at 202-347-2230.

Counsel to the Committee of Annuity Insurers

Joseph F. McKeever, III
Partner, Davis & Harman LLP
jfmckeever@davis-harman.com

Michael L. Hadley
Partner, Davis & Harman LLP
mlhadley@davis-harman.com

Attachments
APPENDIX A
BACKGROUND ON ANNUITIES AND ANNUITY INSURERS

Annuities are vital to the retirement security of millions of Americans. Other than Social Security and defined benefit plans, annuities are the only means that Americans have to guarantee they will not outlive their retirement income.\(^1\) With the decline in the number of employers offering defined benefit plans and the continuing strain that an aging population places on Social Security, it will be even more important to ensure that Americans have ready access to annuities in the decades to come.

Annuities provide insurance protection against longevity risk by pooling that risk among a large group of individuals. These insurance contracts also pool and protect against other significant risks to which individuals are exposed in retirement, including inflation risk, investment risk, interest rate risk, mortality risk, and liquidity risk. For any individual, these risks can persist for 30 years or more after retirement. Annuity insurers take on these substantial and long-duration risks so that individuals do not have to bear them alone.

Because annuity insurers make long-term commitments to their policyholders to shield them from numerous forms of risk, they are subject to stringent regulation by the states. The state regulatory structure is directed squarely at policyholder protection, including requiring insurers to maintain significant reserves to back the prolonged and financially-critical benefit promises they make. This paper provides an overview of the types of annuity products, the guaranteed benefits annuities provide, the types and purposes of fees an insurer charges for an annuity, and the regulatory regimes applicable to annuity insurers.

I. TYPES OF ANNUITY PRODUCTS

Annuities come in a wide variety of forms to meet varying consumer needs. The earliest annuities date back to ancient Rome, where contracts known as *annua* “promised an individual a stream of payments for a fixed term, or possibly for life, in return for an up-front payment.”\(^2\) Annuities comprised only a small part of the U.S. insurance market until the 1930s, when Depression-era economic concerns drove investors to annuities and the financial stability insurance companies offered. This spurred the growth of flexible premium deferred annuities, which facilitate both savings accumulation and retirement income. The group annuity market also developed during this time, as corporate pension plans proliferated in the decades following World War II.\(^3\) Since then, annuity insurers have continued to produce numerous innovations in annuity products to meet the changing needs and demands of a diverse and aging population. These include consumer demands for greater protection against inflation risk, investment risk,

---


\(^3\) Id. at 15-16.
and liquidity risk. The remainder of this section provides a general overview of the types of annuities available to consumers today and the various risks they help retirees manage.

A. The Basic Forms of Annuity Contracts

All annuities share the basic feature of allowing the individual to convert a lump sum into a stream of periodic payments that are guaranteed to continue for one or more lives or another specified duration. An *immediate annuity* offers only this “payout” feature, thereby facilitating the conversion to income of retirement savings the individual accumulates outside of the annuity contract. An immediate annuity is often purchased with a single premium, and the periodic payments commence within a short time (typically a year or less) after the premium is paid. There is no “accumulation phase” where the premium is credited with interest or earnings prior to periodic payments commencing.

In contrast, a *deferred annuity* offers both a payout feature and an accumulation feature. A deferred annuity can be purchased with a single premium or multiple premiums, and the periodic payments are scheduled to commence at a specified future date, often referred to as the “annuity date” or the “annuity starting date.” The specified annuity date is usually many years after the contract is issued but the owner almost always possesses the right to begin annuity payments before the scheduled annuity date. Before the periodic payments commence, a deferred annuity typically provides an “account value” that the individual can access through withdrawals. The account value is credited with interest or earnings depending on the type of contract:

- **A deferred fixed annuity** provides an account value that is credited with interest at a guaranteed minimum rate. Additional interest may be credited based on the interest rate environment. Because principal and a minimum return are guaranteed, deferred fixed annuities are appropriate for individuals with lower tolerances for market volatility.

- **A deferred variable annuity** provides an account value that typically is invested in mutual funds or other securities and reflects the investment gains and losses on those assets. This provides access to equity-based returns, which present market risk, but which provide the opportunity to accumulate more retirement savings over the long term. Many deferred variable annuities also offer a fixed account option that functions in the same way as a deferred fixed annuity, thereby providing an additional option for the owner as his or her tolerance for investment risk changes over time.

- **A deferred fixed indexed annuity** provides an account value in which principal is guaranteed, interest may be credited at a guaranteed minimum rate, and interest is credited based on the positive performance of a market index, such as the S&P 500. This provides assurances against market losses but also access to equity-like returns.

- **A deferred registered indexed annuity** provides an account value that will reflect the performance of a market index, such as the S&P 500, but where neither the principal nor a minimum interest rate is guaranteed. However, losses are generally buffered or subject to a floor or participation rate, limiting the owner’s exposure to market losses while providing access to equity-like returns.
The foregoing basic types of annuity contracts provide traditional payout or “annuitization” options that the individual can elect based on his or her personal needs and goals. The most widely available forms of annuitization options are summarized next.

B. Basic Annuity Payment Options

I. Life-Contingent Payments

From a retirement security perspective, the most important annuity payment option available under an annuity contract is the life-contingent payout option, although other payout options may be better suited to an individual’s particular needs. Under a traditional fixed life-contingent annuity, the life insurance company guarantees that the individual will receive regularly-scheduled periodic payments that cannot be outlived. The payments can be guaranteed for a single life or for two lives. These payments can be obtained from an immediate annuity, where the contract is purchased with a single premium and the periodic payments commence shortly thereafter. Life-contingent annuity payments also can be obtained from a deferred annuity that has transitioned from its accumulation phase to its payout phase.

In that regard, all individual deferred annuity contracts include guaranteed “annuity purchase rates.” This is an insurance guarantee that each dollar of account value applied to a payment option will produce at least a specified dollar amount of periodic income payment for life varying with the age at which the payment option is elected. (The older the individual, the higher the income payment per dollar applied.) Typically, when the deferred annuity owner is ready to apply the account value to a payment option, the resulting payments will be calculated at the greater of the contract’s guaranteed annuity purchase rates or the purchase rates the insurance company is currently offering.4

Life-contingent annuity payments are sometimes compared to “life expectancy” distributions generated through the systematic sale or redemption of mutual fund shares from an individual account, such as a custodial or brokerage account. Such distributions, whether taken over life expectancy or in some other form attempting to mimic an annuity, cannot provide the same guarantees and benefits to retirees as a lifetime annuity. As a result, they cannot achieve the goal of assuring retirees an adequate income that will continue throughout their entire life:

- Periodic payments over life expectancy generated through sales or redemptions of mutual fund shares from an account, such as an IRA, provide less retirement income than a lifetime annuity purchased with an equal sum and earning an equal return. Moreover, for those individuals who live long lives, such periodic withdrawals from an account will result in dramatically decreasing income payments in the later years of life when income is needed the most, whereas lifetime annuity payments will not decrease.

4 Guaranteed annuity purchase rates may have significant future value. If medical advances result in a material increase in longevity, that increase in longevity would reduce the annuity purchase rates currently offered by an insurance company (i.e., each dollar applied to a life-contingent payment option would produce a lower dollar amount of periodic income for life). However, that increase in longevity cannot reduce annuity purchase rates locked in at the time a deferred annuity contract is issued.
Lifetime annuities can pay this extra income because life insurance companies pool the premiums and longevity risks of many individuals. This also is true for lifetime annuities that include a refund feature, e.g., one that makes payments for the longer of the annuitant’s life or 15 years.5

The following illustration compares the income from a lifetime annuity stream with the income from life-expectancy distributions from an account holding mutual funds, when both are generated from the same initial investment. As shown in the illustration, the risk pooling benefit of a lifetime annuity provides superior income security throughout retirement:

Comparison of Lifetime Annuity Income and Periodic Sales of Mutual Fund Shares over Life Expectancy

Source: Jeffrey R. Brown, *The New Retirement Challenge* (September 2004). Doctor Brown is Professor of Finance and William G. Karnes Professor of Finance and Director of Center for Business and Public Policy. All calculations are based on a $100,000 initial investment. Investment returns under the annuity and account are both set equal to 4.58% (which was the yield on 10-year government securities in April 2004). Mortality rates and life expectancies are those for a 65 year-old man, based on the 1939 birth cohort life table from the 2004 Social Security Trustee’s Report. Withdrawals from the account are assumed to occur at the end of each year, after interest has been credited.

Other forms of life-contingent annuity income are available in addition to the traditional fixed life annuity payout illustrated above. For example, *variable life-contingent annuities* protect against longevity risk as well as inflation risk by providing lifelong income and access to equity returns. In addition, life annuity payouts are available under *longevity insurance* (“deferred income” annuity) products, which provide individuals an affordable way to protect against the risk of running out of income from their other retirement assets if they outlive their life expectancy. In general, a longevity insurance contract is an annuity that provides no cash value, provides a very limited death benefit (if any), and pays a stream of periodic payments for the individual’s life (or the joint lives of the individual and a beneficiary) commencing late in

---

5 Of course, a life annuity with a refund feature will provide lower payments than a life annuity with no refund feature because of the actuarial cost of the refund feature.
life. As the Treasury Department has recognized, “purchasing longevity annuity contracts could help participants hedge the risk of drawing down their benefits too quickly and thereby outliving their retirement savings.”

2. **Period Certain Annuity Payments**

Annuity contracts also typically offer annuity payees options that guarantee periodic payments will continue for a specified period, such as 10 or 20 years. These options may be elected as an independent benefit or in combination with a life annuity payout. For example, an annuitization option can provide for payments that will continue for the longer of an individual’s life or 10 years. If the individual lives for more than 10 years after payments have commenced, the payments will continue for the rest of his or her life. But if the individual dies before the 10-year period has expired, his or her heirs will receive the remaining payments, either in a lump sum or as continued installments. This provides the individual with comfort that an untimely death will not result in a “loss” of the annuity premium. Indeed, such assurances are critical to most annuity purchasers, because as discussed next many retirees are hesitant to purchase a life annuity.

C. **Annuity Industry Innovations to Meet Modern Consumer Demands**

Despite the substantial benefits of life annuitizations, individuals are often hesitant to choose that form of payout from their annuity contracts. Scholars have speculated that one reason for this could be a behavioral response to the risk-pooling nature of insurance – an individual’s fear of financially “losing” if early death prevents the payment of at least a significant amount of cash benefits under the contract. Another potential reason is the perceived loss of “control” over one’s savings, because converting a lump sum into a series of life annuity payments often involves a corresponding reduction in liquidity with respect to the annuitized sum. These responses may be economically irrational in light of the purpose and nature of life annuities, but they nonetheless contribute to the relative infrequency of life annuitization.

In response, annuity insurers have developed innovative products in the modern era that help address many of these perceived barriers to electing life-contingent forms of payout. Industry innovations also have addressed growing consumer demand for insurance protections against interest rate risk and investment risk. These types of advances in annuity product design are sometimes called “living benefits,” because they provide financial and insurance guarantees

---


8 See id.
throughout the individual’s life. The general types of living benefits can be categorized as accumulation benefits and distribution or payout benefits, as discussed below.

1. Accumulation Benefits

Many annuity products offered today include features that allow individuals to benefit from increases in the equity markets while limiting (either partially or completely) their downside risk to market losses. For example, deferred fixed indexed annuities provide a principal guarantee coupled with interest credits that are linked to an equity market index, such as the S&P 500. Likewise, many deferred variable annuities offer optional benefits that can protect against market risk while still providing access to equity markets. For example, guaranteed minimum accumulation benefits or GMABs guarantee a minimum rate of return before annuity payments commence, regardless of the performance of the mutual funds held under the variable annuity. Deferred registered index annuities provide exposure to an equity market index, such as the S&P 500, but include a buffer or floor. These and similar features encourage individuals to invest in assets that are more likely to provide higher returns, while reducing or eliminating the risk of investment losses. Such features contribute greatly to the overall retirement security of many annuity owners.

2. Distribution Benefits

Other important innovations in annuity product design focus on the decumulation or payout of accumulated savings. These include guaranteed minimum income benefits and guaranteed withdrawal benefits. Each of these provides protection against market risk and longevity risk.

a. Guaranteed Minimum Income Benefits

A guaranteed minimum income benefit or “GMIB” is designed to provide the annuity owner with a base amount of lifetime income when he or she retires regardless of how the account value within the contract has performed. This feature can be included within a fixed annuity or a variable annuity. The typical GMIB provides that if the individual annuitizes the contract on a life-contingent basis (with or without a period certain), the resulting annuity payments will be calculated using the greater of the contract’s account value or a “benefit base.” The benefit base is typically calculated by reference to the cumulative premiums paid plus notional interest calculated at a specified rate, such as 1-4%. Thus, the value applied to a life annuity option can exceed the value available if the contract is surrendered for a cash lump sum.

b. Guaranteed Withdrawal Benefits

Another important innovation in annuity product design is the guaranteed withdrawal benefit. These benefits, which are commonly available with fixed indexed and variable annuities, provide that each year during a specified duration a guaranteed minimum amount will be available to withdraw from the annuity’s account value, irrespective of the actual balance in the account at that time. The guarantee can be scheduled to last for a specified period (such as 10 years) or for the entire life of one or two individuals. The former iteration of the benefit is typically called a guaranteed minimum withdrawal benefit or GMWB, while the latter is typically
called a guaranteed lifetime withdrawal benefit or GLWB. In either design, the guaranteed minimum withdrawal amount is normally determined as a percentage of a specified “benefit base.” The percentages differ by product and insurer, but for GMWBs they typically range from 4-6% and for GLWBs they typically depend on the individual’s age and range from 3-5%, with some percentages as high as 7% if the individual waits until a later age (such as 70) before taking the first withdrawal.9

The benefit base is initially equal to the amount invested and is subject to adjustments thereafter. It is typically adjusted to equal the account value on the date of the first withdrawal. Other adjustments can include a “step-up,” where the benefit base is re-set periodically to equal the higher of the current account value or the account value on a specified prior date, such as the previous contract anniversary. Another type of adjustment is a “roll-up,” where the benefit base is re-set periodically to equal the higher of the current account balance or the cumulative premiums plus notional interest determined at a specified rate. Other benefit base adjustment features may be available. These additional features such as step-up and roll-up adjustments provide added protection against market loss, and in many cases they are offered as options that can be included with a basic GLWB for an additional cost.

In providing these types of guaranteed withdrawal benefits, the annuity insurer takes on significant and long-term risk including investment risk and, in the case of a GLWB, additional longevity risk. As a result, the insurer must take steps to hedge these risks. For example, the insurer must carefully select and manage complex derivatives and other investments that will provide economic protection against volatility and loss in the financial markets. This requires a significant outlay of capital on the insurer’s part. To reduce the cost of such hedging activity and otherwise reduce risk, the issuer of a variable annuity also will typically impose restrictions on how the individual may allocate his or her account value among the available investment options under the contract. For example, the insurer may require that the individual’s investment allocations produce a relatively balanced portfolio of equity and fixed income investments in order to reduce the chance of excessive volatility in the account value.

For the consumer, GMWBs and GLWBs facilitate equity returns while providing protection against investment risk and longevity risk. Equally important, they protect against these risks while preserving the liquidity of the individual’s account balance. In other words, the individual is protected against longevity risk without having to relinquish “control” over his or her savings. This greatly reduces the psychological barrier to electing a form of payout that protects the individual against outliving his or her assets in retirement. Of course, if the individual exercises his or her liquidity rights by withdrawing more than the guaranteed amount in any given year, the guaranteed amount is reduced proportionately for subsequent years. Nonetheless, the individual remains in control of his or her own savings, which is a key motivation of today’s retirees. A well-respected textbook on insurance summarizes all this as follows:

[T]he annuity industry is largely driven by buyers who elect investment guarantee options that prevent significant losses while retaining the opportunity for modest investment gains. These

include guarantees as to minimum withdrawal, income, and/or accumulation and as to life-time withdrawals. Equity-indexed and inflation-indexed annuities also provide guarantees.

Of course, guarantee options are not free. Insurers charge for them, thereby, reducing benefits. Savers may find guarantees more attractive than pure annuities, because they are perceived to be less as a gamble, reduce the possibility of regret, and/or maintain increased liquidity.\(^{10}\)

**D. Death Benefits**

Virtually all deferred annuities provide death benefits, and it is very common for those benefits to guarantee a return at least equal to the contributions made to the contract.\(^{11}\) This is often called a return of premium or “ROP” death benefit. Optional “enhanced” death benefits also are available to provide additional protection against the convergence of market loss and untimely death. Enhanced death benefits include “ratchet” or “high water mark” designs, where the minimum death benefit equals the greatest of the ROP death benefit, the contract’s account value on the date of death, or the highest account value on a specified previous date, such as the prior contract anniversary. Other enhanced death benefit designs include “roll-ups,” where the minimum death benefit equals the higher of the date-of-death account balance or the cumulative premiums paid plus interest at a specified notional rate.

These types of benefits indirectly facilitate a more financially secure retirement for annuity owners because they allow owners to invest in equity markets without fear of leaving dependents and other beneficiaries with inadequate assets should the owner die unexpectedly during a downturn in the financial markets. Nevertheless, a bequest motivation may not be the reason an ROP or enhanced benefit is desired; rather, it may be the more fundamental behavioral response described above – fear of having made a bad financial decision if early death prevents the payment of at least a significant amount under the contract.

**II. Annuity Product Pricing: Fees and Charges**

**A. In General**

Annuities provide a variety of guarantees that are critical to individuals assuring themselves a secure retirement. The guarantees often cover multiple risks and persist for long durations, such as 30 years or more for any given policyholder.

The specifics of these risks, the guarantees made by insurers with respect to these risks, and fees for these risks, are described in this section. We respectfully submit that when these risks and guarantees are properly understood, it is entirely appropriate that the “cost” of an annuity contract can in many instances be materially greater than the “cost” to an employee or

---

\(^{10}\) KENNETH BLACK, JR. ET AL., LIFE INSURANCE 602-603 (14th ed. 2013).

\(^{11}\) Longevity annuities often do not provide a death benefit, thereby maximizing the amount of lifetime income that can be purchased from a dollar of premium.
IRA owner of purchasing a simple and uninsured financial instrument such as shares in an index fund. Thus, the criticism sometimes lodged at annuity products for higher relative fees overlooks the fact that the fees pay for not only the costs associated with selling the product, but more importantly, the valuable insurance benefits that annuities offer by protecting individuals against a variety of risks they face in retirement, features that are not available with other investments.

The risks that annuity insurers assume in issuing annuity products include the following:

- **Longevity and mortality risk.** Annuity insurers also face longevity risk, which is based on mortality rates. Insurers project mortality rates using actuarial tables and making adjustments for the type of product, the demographics of the insurer’s customer base, and the market in which the product is sold. If actual mortality rates differ from those the company projects, the company could need to pay out more in benefits than the assets it holds in support of those benefits.

- **Adverse selection risk.** Long-term experience has shown that individuals who purchase annuities live longer than the population at large. In other words, individuals with poor health tend not to purchase annuities, so as a group those who voluntarily purchase annuities tend to live longer than non-purchasers. As a result, insurance premiums must be set high enough to compensate insurers for the relatively long period during which they will have to make annuity payments. Also, individual mortality rates are generally lower than group mortality rates, which means that annuities purchased in the individual market typically have higher costs for the insurer than those purchased in the group market, *i.e.*, as a group, individuals who purchase a life annuity live longer than the general population.

- **Investment risk.** Annuity insurers face investment risk in a variety of ways. They use the premiums they receive to make investments, which must retain sufficient principal and generate sufficient income to offset all of the insurer’s costs in issuing and servicing the contracts, paying the benefits promised thereunder, and providing an adequate profit or return on the capital the insurer dedicates to its annuity business lines.

  o Managing this investment risk is particularly challenging for benefits such as GLWBs, which require sophisticated hedging strategies using complex derivatives and extensive modeling of potential financial market outcomes over time, and can generate benefit obligations that fluctuate inversely with severe market downturns.

  o In addition, many of the guarantees that insurers provide are based on expectations of future interest rates, which can fluctuate greatly over the long durations that the insurer’s guarantees are in effect. For example, the issuer of a deferred annuity guarantees that the owner will have the right at any time throughout the life of the contract to convert at a specified price the savings accumulated in the annuity to a stream of periodic payments that will then continue for as long as the owner lives. The specified price reflects an assumption about future interest rates.
• **Disintermediation risk.** Annuity insurers face disintermediation risk, which is the risk that a large number of fixed deferred annuity policyholders will surrender their contracts during a period in which the insurer’s asset portfolio market values are depressed. Because the surrender values of the contracts could be greater than the market value of the insurer’s assets, the insurer would need to pay out more in cash than it obtained in premiums and investment income. (For this reason, some contracts contain “market value adjustments,” which allow the insurer to guarantee a higher rate of interest as long as the contract is held for a specified period.)

• **Expense risk.** Annuity insurers guarantee that the expenses they will charge under an annuity contract will not exceed a specified maximum level, regardless of the expenses the company actually incurs in administering the product and providing the benefits thereunder.

Premiums and other charges plus the investment returns on retained funds must be adequate to fund the current and future benefits that an annuity insurer promises under the contracts it issues, as well as related expenses, taxes, contingencies and profits. In other words, annuity products must be designed and priced so that the insurer can satisfy the guarantees for many years into the future. Indeed, state insurance laws mandate that insurers hold sufficient assets to ensure their claims-paying ability. Such state law requirements are intentionally conservative (to assure policyholders will receive their contractual benefits), requiring extensive capital outlays that insurers must generate from the premiums, charges, and investment returns they receive in connection with the contracts they issue.

The typical types of fees and charges that annuity insurers impose and for what purpose are discussed more specifically next.

B. **Deferred Fixed Annuities and Deferred Fixed Indexed Annuities**

In general, traditional fixed and fixed indexed annuities do not expressly impose periodic expense charges, although surrender charges may apply to withdrawals taken from the contract or on a full surrender of the contract, as discussed below. Insurers do not expressly impose periodic charges because the company expects to recoup its costs (and make a profit) through the “spread” between the interest rate it credits to the contract’s account value and the interest and earnings it receives on the premiums it invests through its general account. This is the same mechanism that banks and other financial institutions use to cover their expenses under interest-bearing accounts they maintain for their customers. Because the annuity insurer guarantees a minimum interest crediting rate under a fixed annuity over the duration of the contract, the insurer will suffer a loss if the interest and earnings it actually receives on the premiums it invests are insufficient to cover the promised benefit and direct expenses.

C. **Deferred Variable Annuities**

Unlike the case of fixed annuities, variable annuities expressly impose one or more types of fees. This is different than a fixed annuity because, in the case of a variable annuity, the

---

12 See Black *supra* note 10, at 378.
earnings (and losses, if any) on the premiums invested in the insurer’s separate account are directly passed through to the policyholder. Thus, there is no interest rate “spread” from which the insurer can recoup its expenses or make a profit. The fees and charges commonly associated with variable annuities include:

- Mortality and expense risk charges (“M&E fees”). In most contracts, the M&E fee is designed to compensate the insurer for three important insurance guarantees: (1) the guaranteed purchase rates at which the individual can elect a life-contingent annuity payout at any time, (2) a death benefit to protect the individual’s heirs in the event of an unexpected death, and (3) the guarantee that the charges the insurer imposes for contract expenses will never increase above a specified maximum level, even if the insurer’s actual expenses do. As discussed above, these guarantees persist for the duration of an annuity contract, which can span 30 years or more for any given policyholder. (Revenues from M&E fees, however, can also be used to help pay for distribution expenses and can be a source of profit to the insurer.)

- Administrative charges. These pay for all of the services associated with administering variable annuity contracts, such as the preparation of contract statements and mailings, and other customer services.

- Mutual fund fees and expenses. Variable annuities are supported by separate accounts that typically invest in mutual funds. Those mutual funds incur investment management fees and operating expenses, and in many cases, distribution charges known as “12b-1 fees.” The investment management fees for the types of mutual funds that insurers hold in their separate accounts can be lower than those charged for publicly-offered mutual funds. These lower fees have the effect of offsetting, to some extent, the insurance charges that are imposed under a variable annuity. The manner in which the distribution charges are paid varies. Some of the more common structures are:
  
  - A-share products. A-share variable annuities have up-front sales charges instead of surrender charges. The amount of the charge applied against each premium may decrease over time as more premiums are paid. A-share contracts often have lower M&E fees than those with surrender charges.
  
  - B-share products. B-share variable annuities have no up-front sales charge but do impose a surrender charge, either on complete surrender or as discussed below under surrender charges.
  
  - C-share products. C-share variable annuities do not impose surrender charges or up-front loads. Instead, selling costs are recouped through an upward adjustment to M&E fees.

D. Deferred Registered Indexed Annuities

In general, like traditional fixed and fixed indexed annuities, registered indexed annuities do not expressly impose expense charges, although surrender charges may apply to withdrawals and full surrenders, as discussed below. Insurers do not expressly impose periodic charges
because the company expects to recoup its costs (and make a profit) through the “spread” between the indexed performance adjustments it makes to the contract’s account value and the interest and earnings it receives on the premiums it invests and the hedges it uses to support the product.

E. Fees for Additional Insurance Benefits

As discussed above, some annuities permit the owner to add optional benefits to their contracts for an additional charge. These include benefits like GLWBs, which are often offered as riders to a more basic variable or fixed indexed annuity contract. Such additional benefits, whether provided through a rider or as part of the base contract itself, typically have separately-stated fees that are assessed periodically against the annuity contract’s account value. The fees compensate the annuity insurer for the significant additional risks it assumes under the benefit promises it makes.

The potential liabilities relating to benefits like a GLWB are significant. This is because such benefits insur against a catastrophic risk that, if realized, is likely to affect a large number of insured individuals. This is the opposite of most insurance risks that life insurers assume. For example, mortality risk involves an event (death) that is certain to occur, but which in any given time span will affect only a small number of insureds from a very large group. In contrast, while GLWBs include a longevity risk component, they also protect against severe market downturns, which, if they occur, can simultaneously affect virtually every individual who purchased the benefit, thereby requiring the insurer to pay out substantial benefits within a short time. This obviously presents additional risk to the insurer, and it must hold sufficient capital to cover that risk, if and when it materializes, and to cover the costs of the financial hedges the insurer enters into to manage the liabilities.

Unfortunately, the liabilities that insurers assume in providing GLWBs and similar benefits are often overlooked in discussions of their associated fees. Because such benefits protect against catastrophic events that, while potentially devastating to the retirement security of millions of Americans, are relatively rare in occurrence, critics tend to focus on how the fees affect returns under the contract during the “good times” in which the catastrophic event has not occurred. As one well-respected textbook on insurance has observed:

The fees associated with VAs in general and GLBs in particular have been characterized as excessive by some. Other criticisms are similar to those associated with index annuities; the amount of potential gain sacrificed in return for the guarantees is too great relative to their underlying value. Guarantee performance during the global equity market declines of 2008-2009 do not support this view.13

The same textbook observes that researchers who examined economic aspects of GMWBs found that the benefit of the guarantee is substantial in times of market distress. They

13 See Black supra note 10, at 139 (14th ed. 2013).
examined the hypothetical performance of variable annuities with a GMWB during the generally rising market for equities from 1979 through 1999 and during the falling markets of 2000 through 2008. The account balance and benefit base (the guaranteed withdrawal amount) grew at the same pace during the years of rising markets, but during the years of falling markets the benefit base was more than twice the account value. This highlights the substantial economic (and emotional) benefits that such guarantees provide in bad financial times.

In that regard, concern over such potentially catastrophic financial events is a driving motivation for many annuity owners. These individuals elect to purchase GLWBs and similar benefits to eliminate such concerns and to give them confidence to invest in the equity markets throughout retirement, thereby improving their chances for higher returns that can help sustain their financial security for the rest of their lives. Of course, this requires a trade-off between paying the fees necessary for the insurance protection and keeping those fees invested in the account value. For many, this trade-off is more than worthwhile; it is critical to their willingness to invest, rather than simply save.

In particular, individual annuity owners are overwhelmingly satisfied with their GLWB purchases. Almost nine in ten (87%) consider the GLWB a valuable product feature, and more than three in four (77%) who purchased a GLWB say it was important in their decision to purchase an annuity. More generally:

- 87% of individual annuity owners agree that annuities are “secure and safe;”
- 87% also agree that “[t]he investment and insurance guarantees available in annuities are a very important benefit of the product;”
- 85% agree that “[o]wning an annuity makes them feel more secure in times of financial uncertainty, such as during declines in the stock market;”
- 85% agree that “[a]nuities can help protect them against losing the money they invest;” and
- 82% agree that “[b]eing able to invest in the stock market through annuities and still get guaranteed income for life adds to the financial security of retirees.”

---

14 Id. at 601 (citing Chen, Peng and Milevsky, Merging Asset Allocation and Longevity Insurance: An Optimal Perspective on Payout Annuities, JOURNAL OF FINANCIAL PLANNING (Feb. 2010)).

15 The Committee of Annuity Insurers, Survey of Owners of Individual Annuity Contracts, at 11 (The Gallup Organization and Mathew Greenwald & Associates 2013) available at http://www.annuity-insurers.org/wp-content/uploads/2013/10/2013-Gallup-Survey.pdf. This survey is of the owners of non-qualified (after-tax) annuity contracts. However, there is no reason to believe that an employee or an IRA owner with a GLWB benefit would have any different views of a GLWB.

16 Id. at 31-32.
F. **Surrender Charges**

An insurance company incurs a variety of costs when it issues an annuity. These costs include commission and other distribution expenses. The amount of the commissions and expenses vary with the product and the distribution channel. However, all annuities are inherently long term products with a variety of protection features, as described above. This requires a sales agent to spend a considerable amount of time learning about the particular products they offer for sale and explaining the features (and alternatives) to customers. The insurer must compensate the sales agent for these efforts and recover the costs of doing so. This can be done in different ways, including by imposing a charge at the time the premium or premiums are paid. Indeed, for many years, this was exactly how distribution and other acquisition costs were recovered by life insurance companies. However, few consumers today are willing to pay an up-front charge. As a result, most insurers offer a class of annuity products with a surrender charge.

Surrender charges vary in amount and duration depending on the expenses, including commissions, the insurer incurs in issuing the contract. A key driver of both the amount and duration of surrender charges is that the insurer will invest the premiums it receives for the contracts and then recover its acquisition expenses through the earnings on those premiums. Expenses can be recovered in this manner, however, only if the insurer retains the assets long enough.

In that regard, annuities are marketed and intended to be used as long-term retirement savings and income vehicles, so issuers expect that purchasers will retain their contracts long enough for the company to recoup all of its up-front expenses. However, if an individual decides not to use the contract for its intended purpose and surrenders the contract (or takes a significant withdrawal) relatively soon after the contract was issued, the company will be unable to recoup all of its up-front costs. This is why companies impose surrender charges – absent a surrender charge insurers generally must either impose an up-front charge or run the risk of losing money if the contract is terminated earlier than the company expects when it prices the product.

III. **Annuity Products Are Highly Regulated**

The annuity business in the United States is highly regulated by state and federal governments. According to the National Association of Insurance Commissioners ("NAIC"), which serves as a vehicle for individual state regulators to coordinate their activities and share resources:

> The fundamental reason for government regulation of insurance is to protect American consumers. State systems are accessible and accountable to the public and sensitive to local social and economic conditions. State regulation has proven that it effectively protects consumers and ensures that promises made by insurers are kept. Insurance regulation is structured around several key functions, including company licensing, producer licensing,
product regulation, market conduct, financial regulation and consumer services.\textsuperscript{17}

A. **Annuity Contract Requirements**

An annuity contract form must be filed with the insurance department of every state in which the contract will be issued. This filing requirement also applies to accompanying materials, such as applications, endorsements, riders, and amendments. Most states also impose readability requirements under which annuity contracts must meet certain standards in form and content to ensure that the contract’s terms and benefits are understandable to consumers.

B. **State Licensing Requirements**

Only state-licensed insurance companies can issue commercial annuities. To become licensed, a company must, \textit{inter alia}, demonstrate that it has complied with the necessary capital and surplus and other financial requirements of state law. Some states also require special licenses for the sale of certain types of products, such as variable annuities. In addition, any person who solicits, sells, negotiates, or procures an annuity contract for another person must be licensed as an insurance agent or broker. An agent’s license can be revoked or suspended for a variety of reasons, including engaging in business practices that are fraudulent, dishonest, or demonstrate incompetence.

C. **State Marketing and Sales Requirements**

State insurance regulations also address how life insurance companies can advertise their annuity products. These rules generally are intended to ensure that the format and content of any advertising materials is not misleading, deceptive, or confusing. This is measured using the standard of what impression and effect the materials would reasonably have on a person not knowledgeable in insurance matters.

In addition, suitability requirements apply to sales of annuity products. Under the NAIC Suitability in Annuity Transactions Model Regulation (Model 275), which most states have adopted, there are express training obligations imposed on insurers and insurance producers with respect to annuity products. These are intended to ensure that licensed insurance producers understand annuity products generally and also understand the annuity products issued by a specific insurer. The insurer’s supervisory system also must include product-specific training that explains all the material features of its annuity product to its licensed insurance producers.

Many states also have adopted the NAIC’s Annuity Disclosure Model Regulation (Model 245), which requires the delivery of an appropriate “Buyer’s Guide” and disclosure document to the annuity purchaser to assist with understanding the annuity product. Finally, to the extent that the annuities being offered are variable annuities sold through a broker-dealer, FINRA imposes ongoing continuing education requirements.

State insurance laws also regulate transactions in which one annuity contract is replaced by another, such as in an exchange, direct transfer, or rollover. Many states require certain procedures be followed before the issuance of a replacement annuity contract. IRAs are subject to these requirements, although exemptions may apply for certain types of group annuities and annuities issued to qualified plans. In order to reduce the opportunity for misrepresentation or unfair practices, many states also require that a special notice be provided to a customer in a replacement transaction. The notice generally discusses important information that the customer should consider before replacing a contract. In some cases, the notice also will include a comparison of the values and costs of the contracts involved. In addition, customers who replace their annuity contracts generally are given a longer period in which to revoke their contracts after issuance.

D. Securities Law Requirements

In addition to state insurance regulatory requirements, variable annuities and certain other types of annuities that are securities (principally because they do not meet the requirements of state insurance standard non-forfeiture laws for individual deferred annuities) are subject to federal securities laws and regulations.

1. Securities Act of 1933

Variable annuities and certain other annuities that are securities and offered in the retail and IRA markets generally must be registered with the Securities and Exchange Commission (“SEC”) under the Securities Act of 1933, as amended. The SEC reviews registration statements (principally the prospectuses contained within them) and requires annual, or if necessary more frequent, amendments to them. For registered products, the issuer must provide the purchaser with a prospectus and update that prospectus regularly. Prospectuses also are required for the underlying mutual funds or other investment options offered under variable annuities. Exceptions to these registration and prospectus delivery requirements are available for annuity contracts that are securities but which are issued in connection with qualified plans or as “private placements.” However, these exceptions are not available for IRA annuities or individual section 403(b) annuities unless the purchasers are accredited investors as defined by the SEC.

Prospectuses for variable annuities and other registered annuities, such as registered index annuities and market value adjusted annuities, must disclose a variety of information intended to ensure that the customer fully understands the benefits, guarantees, risks, and costs associated with the contract. These include disclosure of the maximum charges for all contract fees and expenses. Variable annuities must show the range of total operating expenses for the underlying funds offered with the contract. In addition, prospectuses for variable and other registered annuities must provide numerical examples of applicable fees, based on specified assumptions.

2. Securities Exchange Act of 1934

The Securities Exchange Act of 1934 generally requires that variable annuities and other annuities that are securities be distributed through registered broker-dealer firms and their registered representatives, which themselves are subject to extensive regulation regarding capital
requirements, reporting, recordkeeping, supervision, advertising, and sales activities. Registered broker-dealer firms also must be members of FINRA, a self-regulatory organization overseen by the SEC. FINRA imposes additional layers of regulation, including supervisory, suitability, advertising, recordkeeping, and reporting rules.

3. **Investment Company Act of 1940**

The Investment Company Act of 1940 imposes an extensive federal regulatory regime on “investment companies,” which include variable annuity separate accounts and their underlying mutual fund or other investments. Exceptions apply to separate accounts used exclusively to fund annuity contracts issued in connection with qualified plans. The 1940 Act requirements govern how variable annuities are issued and redeemed, and the 1940 Act sets forth a specific standard applicable to variable annuity fees and charges. Variable annuities also are subject to 1940 Act requirements regarding voting rights, prohibitions on self-dealing, and recordkeeping and reporting requirements.

4. **Advertising and Customer Communications**

SEC rules also govern the advertising of annuities that are securities. For variable annuities, these rules generally focus on how past performance of a variable annuity or underlying fund is presented, requiring the reflection of certain standardized formulas and certain specified disclosures and legends. The annuity insurer also must provide updated performance information upon request.

FINRA rules govern broker-dealer communications with the public about variable annuities. Broker-dealer firms that disseminate retail communications about variable annuities must file these communications with FINRA and take into account comments provided by the FINRA advertising department staff.

5. **Suitability Requirements**

FINRA also imposes suitability, principal review, supervision, and training requirements with respect to annuities that are securities. For variable annuities, many of these requirements are set forth in a rule specifically designed for and applicable only to variable annuities. Under these requirements, a registered representative recommending a variable annuity purchase must have a reasonable basis to believe that (a) the customer has been informed in general terms of various features of a deferred variable annuity; (b) the customer would benefit from certain features of a deferred variable annuity, such as deferred growth, annuitization, or a death or living benefit; and (c) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated, and riders and product enhancements, if any, are suitable for the particular customer based on required customer information. Additional suitability requirements also apply.

6. **FINRA Compensation Requirements**

FINRA rules include comprehensive requirements with respect to the payment of compensation for securities transactions, including transactions in variable annuities. Certain
other FINRA rules provide requirements applying specifically to the payment of compensation in connection with the sale and distribution of variable insurance products.

Of particular relevance, FINRA Rule 2320 (“Variable Contracts of an Insurance Company”) prohibits a FINRA member or its associated person from receiving any non-cash compensation in connection with the sale or distribution of a variable contract, except in limited circumstances subject to very strict requirements. These exceptions may be categorized as either non-incentive based non-cash compensation arrangements or incentive based non-cash compensation arrangements.

The non-incentive based arrangements permit broker-dealer associated persons to receive certain small gifts and occasional meals or entertainment. Such payments may not be preconditioned on reaching any type of sales target. Also, meals and entertainment may not be frequent or extensive. Another non-incentive based exception – again subject to strict requirements – allows product offerors to pay expenses incurred in connection with training or educational seminars or meetings. Payments related to training or educational seminars or meetings may not be preconditioned on reaching any sales target.

Incentive non-cash compensation arrangements are permitted only based upon the total production of an associated person where credit for each variable contract is equally weighted, and the arrangement is between a member and its associated persons or an affiliate of the member and its associated persons.

IV. **Annuity Insurers Comply with Strict Financial Regulatory Requirements**

In addition to the regulatory requirements discussed above, as well as many others, annuity insurers are subject to strict financial regulatory requirements. The most important of these are the stringent reserve requirements that annuity insurers must satisfy with respect to their benefit liabilities to customers, which are measured using actuarial calculations prescribed by uniform state laws. These requirements, together with associated capital requirements, are designed to protect consumers by ensuring each company’s solvency and claims-paying ability, considering the long-term and important promises they make to their customers. While that is both necessary and desirable, the fact is that these reserve and capital requirements affect the cost of the benefits provided under annuity contracts.

Uniform state insurance laws require life insurance companies to determine reserves for their contracts pursuant to prescribed actuarial standards. For annuities, the standard valuation method is the Commissioners’ Annuity Reserve Valuation Method, or CARVM. The basic principle of CARVM is that all possible future guaranteed benefit streams must be valued at the end of each year, when the financial report (the annual statement) is filed with state regulators, with the reserves being set equal to the largest of the present values of those future guaranteed benefits. In addition, the reserve with respect to a contract cannot be less than its cash surrender value. The insurer must hold “admitted” assets (see below) at least equal to these reserves, over and above its capital requirements (also discussed below), to be considered solvent and thereby avoid increased solvency supervision by state regulators.
The basic benefits under most deferred annuities consist of an account or cash value and various annuitization benefits. Many deferred annuities, however, also provide additional benefits, all of which must be factored into the reserve calculations. For example, a benefit as simple as a “free withdrawal” benefit, which allows the annuity owner to withdraw a certain amount per year without imposition of a surrender charge, can increase the reserve required for the contract because it eliminates a potential source of funds (the surrender charge) from which the insurer could recoup its costs in issuing the contract, thereby potentially increasing its expenses. Likewise, ROP death benefits, enhanced death benefits, extended interest rate guarantee periods, GMWBs, GLWBs, GMABs, and every other form of guaranteed benefit under a contract must be reflected in the reserve calculations and can increase the required reserve and capital requirements.

The result is that in a number of cases the assets the company will be required to maintain in support of its liabilities can exceed the cash surrender values of the contracts. Also, in connection with their annual statement filings with state regulators, life insurance companies are required to conduct an asset adequacy analysis, i.e., to measure the adequacy of the assets to meet the company’s obligations under the annuity contracts it has issued. The process typically models the insurer’s assets and liabilities, including the expected behavior of policyholders under various economic scenarios. The resulting cash flows are compared to the cash flows projected to be needed to fund claims, surrenders, expenses, and other liabilities. If the projected cash flows are insufficient to meet the projected liability cash flows, the reserves are considered inadequate and must be strengthened by diverting part of the company’s surplus holdings to its contract reserves.

In addition, the types of assets life insurance companies can hold to fund their reserve and capital requirements are regulated under state laws, and certain types of assets – those not “admitted” because they do not meet certain conservative safety standards – cannot be counted in determining the adequacy of the assets backing insurers’ liabilities. In addition, most life insurers are required by state regulators to hold risk based capital that is six to seven times greater than the minimum capital they are required to hold for solvency alone. (Financial rating agencies also look to an insurer’s risk based capital to assess its claims-paying ability and its overall value.) Finally, the books and records of life insurers are reviewed by state regulators on a regular basis and subject to required annual independent audits, the costs of which are borne by the insurers.

All of this contributes to the fact that fees for annuity products can sometimes be higher than for other types of financial instruments, such as mutual funds, which do not provide insurance benefits and are not subject to state law reserve and capital requirements placed on insurers. In other words, life insurers’ reserve and capital requirements affect the cost of the benefits provided under annuity contracts. By way of example, a long-term interest rate guarantee embedded in an annuity contract will significantly increase the required reserve, meaning that the insurer will need to charge more for the product with such a guarantee in order to collect sufficient sums to fund its reserve liabilities. Likewise, other insurance benefits and guarantees provided under a contract can increase the insurer’s required reserve and capital and, hence, the cost of the product it provides. Life insurers’ reserve and capital requirements restrict their ability to use their resources for other purposes, such as funding new business, developing new products, making long term business investments in systems, making acquisitions, or paying...
policyholder or shareholder dividends. These requirements, in other words, have a real financial impact on insurers, a fact that significantly contributes to the cost (and availability) of annuity product offerings.
The Committee of Annuity Insurers was formed in 1981 to participate in the development of federal policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.
Northwestern Mutual

July 21, 2015

Filed By Email: e-ORI@dol.gov
e-OED@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule, Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW
Suite 400
Washington, DC 20210

Re: Department of Labor Proposed Investment Advice Regulation and Related Exemptions
RIN 1210-AB32/ZRIN 1210-ZA25

To Whom It May Concern:

The Northwestern Mutual Life Insurance Company ("Northwestern Mutual") appreciates the opportunity to comment on the Department of Labor's (the "Department") proposed rule and related prohibited transaction exemptions under the Employee Retirement Income Security Act of 1974 ("ERISA"), which would redefine the circumstances in which a person is considered a fiduciary when providing investment advice to employer-based qualified plans ("Plans"), Plan participants and owners of Individual Retirement Arrangements ("IRAs"), among others. Northwestern Mutual has long supported a uniform "best interest" standard of care when providing investment advice across its brokerage and investment advisory businesses (including for retirement account and Plan clients) so long as the standard is business-model neutral, preserves client choice, ensures continued access to investor education and affordable retirement options, and provides reasonable certainty for the adviser in its implementation.

While Northwestern Mutual supports the Department's objective of changing the standard of care that applies to persons giving retirement advice to clients, we believe the proposal significantly misses the mark on the criteria noted above and would lead to increased consumer cost, greater consumer confusion, and reduced consumer access to high-quality investment products. We submit this comment letter to help the Department achieve its goal of providing fiduciary protections for retirement investors, but in a manner that more fully incorporates existing regulatory structures, ensures continued access to products that provide guaranteed lifetime income, and empowers consumers with relevant information to make informed investment decisions regarding their retirement savings.
About Northwestern Mutual

Northwestern Mutual has been helping families and businesses achieve financial security for nearly 160 years. Our financial representatives build relationships with clients through a distinctive planning approach that integrates risk management with wealth accumulation, preservation and distribution. Northwestern Mutual delivers financial security to 4.3 million people who rely on us for insurance and investment solutions, including life, disability income and long-term care insurance; annuities; trust services; mutual funds; and investment advisory products and services. Our financial strength and ability to meet our clients' needs is demonstrated by $230 billion in assets, $27 billion in revenues, $87 billion in assets under management in investment products and services, and $1.5 trillion worth of life insurance protection in force. Northwestern Mutual was recognized by FORTUNE magazine as one of the "World's Most Admired" life insurance companies in 2015.

Northwestern Mutual meets client retirement savings needs through a comprehensive planning process that incorporates solutions primarily using unaffiliated mutual funds and proprietary insurance products such as fixed and variable annuities and life insurance. Our annuity products provide clients with guaranteed lifetime retirement income backed by a company that has the highest financial strength ratings awarded to any life insurer by all four of the major rating agencies. These products often serve as the foundation of our clients' retirement plans, by both helping to ensure clients will not outlive their assets and by supporting prudent decumulation strategies.

We have a sales force of more than 6,200 full-time financial representatives and 4,300 associate financial representatives, most of whom are also registered representatives of our broker-dealer, Northwestern Mutual Investment Services, LLC ("NMIS"), which is among the top 10 independent broker-dealers in the United States. NMIS has more than $46 billion of assets in brokerage accounts.

As our name indicates, Northwestern Mutual is organized as a mutual company, which allows us to manage the company in the best interests of our clients rather than splitting our focus between clients and shareholders. As a mutual, after setting aside a safe margin for reserves and surplus each year, Northwestern Mutual returns gains from its operations, which would otherwise be profits, to its participating policyowners in the form of dividends, which, in turn, lowers the net cost of products to our clients over time. In other words, our mutual advantage brings into alignment the interests of both clients and the company, which is amply demonstrated by our persistency rate for life insurance in force of more than 96 percent, a key indicator of client satisfaction.

We are providing you with this background on our company for the following reasons. First, to demonstrate that we know the retirement investor market well and care deeply that retirement savers continue to have access to quality investment advice, products and services at affordable prices. This market makes up a significant portion of our retail investment business.

Second, we believe that Northwestern Mutual's (and companies like ours) substantial investment in the training of financial representatives and the development of high-quality, guaranteed
lifetime income products allows us to deliver a combination of exceptional guidance and investment solutions to help the middle America retirement investor achieve financial security. Doing so while living by mutual values and delivering long-term product value (in the form of low net cost over time) is something that the Department should continue to foster, not hinder, in this rulemaking.

Summary of Our Observations and Recommendations

As described in detail below, our observations and recommendations on the rulemaking include the following:

- The Department needs to more fully consider existing regulatory protections
- The rulemaking places undue emphasis on the lowest cost products
- There should be clarification that investment advice and related definitions do not apply to welfare benefit plans
- Advisers should be permitted to define the investment advice reliance time period
- The investment education carve-out should be broadened
- The seller’s carve-out should be expanded
- The Best Interest Contract ("BIC") exemption contracting process should be reformulated
- Existing disclosure regimes should be leveraged rather than creating a new one under the BIC exemption
- The bias against proprietary or other limited range of product offerings should be eliminated
- The Department should use one definition of reasonable compensation and rely on compensation disclosure
- Reliance on the BIC exemption should not trigger registered investment adviser status
- The Department’s data request authority should be eliminated
- Variable annuities should be retained within the scope of PTE 84-24
- The definition of insurance commissions within 84-24 should be revised or eliminated
- The effective date of the rulemaking should be extended
- The Department should reconsider its cost-benefit analysis

Initial Observations

Before highlighting concerns with specific provisions of the rulemaking and our related recommendations, we wish to note a few contextual observations that bear on the entirety of the proposal. We respectfully suggest that these considerations be taken into account as the Department begins the process of finalizing the rule and exemptions in response to written comments and public hearing testimony.
Insufficient Consideration of Existing Regulatory Protections

The Department states that this fundamental change to ERISA brought forward by the proposed rulemaking is required because of the changes in the retirement markets over the last 40 years. However, what the proposal fails to take into account, or in places unjustifiably discredit in our view, is that the development of the retirement market has been supported by evolving regulatory oversight mechanisms of other authorities, both at the federal and state level. The SEC, FINRA, the Treasury Department, bank regulators, and state insurance regulators have all been very active in the retirement market since ERISA was enacted. There is already a very robust disclosure regime, enforcement mechanisms, required representative training, marketing material requirements, non-cash compensation restrictions, and heightened standards of care, to name just a few aspects of the existing regulatory structure. In response, firms have developed and continually enhance sophisticated compliance and supervisory structures to help ensure their sales forces meet these regulatory expectations.

The Department has indicated it consulted extensively with other federal regulators, but it appears the Department saw little value in leveraging or coordinating with existing approaches for investor protection. We think this is a serious mistake and one that will lead to consumer confusion as yet another set of standards, processes and disclosures will be applicable to one segment of a client’s investment accounts. It will also lead to increased costs and, in turn, less access to retirement solutions by consumers. Given this, a recurring theme in this comment letter is that the Department should work more closely with federal and state regulatory agencies to build upon investor protection structures that already exist and move toward a unified approach to retirement market regulation, rather than a fragmented one.

Existing FINRA rules provide one example of opportunity for the Department in this regard. Today, sales and exchanges of mutual funds and variable annuities are scrutinized under FINRA’s Suitability Rule 2111. It is an oft-perpetuated myth that somehow a transaction might be both suitable for a client under FINRA rules and not in the client’s best interests. The staffs of the SEC and FINRA have stated that a “central aspect of a broker-dealer’s duty of fair dealing is the suitability obligation, which requires a broker-dealer to make recommendations that are consistent with the best interests of his customer.”1 FINRA Rule 2330 requires that firms engage in a detailed analysis of a variable annuity’s costs and features in comparison to the needs of the client being sold the product and for the firm to conclude that the customer would benefit from the features of the product. As a result, sales of variable annuities are already highly scrutinized by FINRA, and brokerage firms subject variable annuity sales to an added level of review. An additional layer of regulation in this circumstance is neither good for clarity from the consumer’s perspective nor cost-effective from the industry’s perspective.

---

**Undue Emphasis on Lowest-Cost Products**

The Department’s proposal appears to unduly favor low-cost product options such as indexed mutual funds without considering other factors that may be important to retirement investors, as well as in their best interests (e.g., financial strength of the issuing company, flexibility of the product in the event of unforeseen circumstances, ability to lower net cost or enhance product features over time, etc.). Long-term retirement savers benefit from building enduring relationships with their advisers. Companies like Northwestern Mutual believe that a financial representative should have a very direct and positive impact on a client’s financial security over the course of the client’s lifetime. Our well-trained representatives – among the highest credentialed in the industry – are critical to achieving our clients’ goals.

That includes working with our clients to take action on their retirement planning by engaging in ongoing fact finding throughout their life stages to truly understand what goals and investment considerations are most important to them at any point in time. This benefit to our clients does not come without a substantial investment in our representatives’ education and training on sales and servicing of appropriate products, programs and strategies for retirement investors. That investment must be factored into the cost of investment products we manufacture.

Focusing too much on low-cost mutual fund investments also does not take into account the value derived from the certainty that a company will be around in 50 years to stand behind its promises. Over almost 160 years, Northwestern Mutual has had a disciplined focus on expertly managing fundamentals such as expenses, underwriting and investment performance in order to provide low net cost insurance products over the long-term. In doing so, we have been (and aim to be) well-positioned in all economic environments to meet our promises to clients, minimize client risks and help clients meet their financial goals. This disciplined management has consistently been rewarded with industry-leading financial strength and exceptional client loyalty – clear evidence of the great value it brings to our clients.

A 2014 study of Fortune 500 companies showed that by the end of 2013, only 24 percent of those companies offered any kind of defined benefit plan to their employees. In addition, less than 20 percent of savers in defined contribution plans are offered access to a product that can generate guaranteed lifetime retirement income. Thus, for the vast majority of Americans getting ready for retirement, annuities issued by insurance companies are the only means a retirement saver is able to have a guaranteed means of not outliving their savings other than Social Security. Northwestern Mutual provides its clients with deferred and immediate annuities that give them access to guaranteed lifetime retirement income backed by a company with the highest financial strength ratings awarded to any insurance company.

---

3 PSCA Annual Survey (2013) (only 17.1 percent of plans offer an annuity distribution).
To provide the features and insurance and other guarantees of its annuity contracts, Northwestern Mutual charges loads and expenses that would be higher than an S&P 500® index fund, for example. These charges enable Northwestern Mutual to provide the client with financial security by taking on risk associated with guaranteeing lifetime income. Northwestern Mutual must be able to continue to charge a reasonable premium to provide the benefits it promises over a potentially long duration, and as mentioned above, train its representatives, supervise the sale of its products, and compensate its sales force for their time and effort (which may extend over decades when servicing a client’s annuity contract).

Given the Department’s previous recognition of the importance of access to lifetime income options after retirement due to the trend away from traditional defined benefit plans, it is imperative that the Department not adopt regulations that could reduce access to and use of guaranteed income options offered by insurance companies to retirement investors. To this end, the Department should acknowledge that meeting a fiduciary standard is a process that involves evaluation of many factors, not just cost. Furthermore, as we point out in greater detail below, it should not treat variable annuities differently than fixed annuities for purposes of available prohibited transaction exemptions.

The Proposed Rule

Our specific comments on the provisions of proposed rule defining investment advice are as follows:

**Clarify that Investment Advice and Related Definitions Do Not Apply to Welfare Benefit Plans**

The definitions of “Investment Advice” as well as some of the terms used within such definitions (e.g., “Plan”) in the rule could be read broadly enough to potentially capture activities associated with the sale of long-term care, disability or life insurance products to welfare benefit plans. Northwestern Mutual believes that the Department should limit the extent of its rulemaking to advice regarding retirement investments rather than including products or services that are not properly characterized as investments. Sales of insurance products to welfare benefit plans are not traditionally considered an investment. These products do not have any expectation of return on investment and are usually purchased without any expectation of such. Rather, these products are purchased in order to obtain a specified welfare benefit.

Since there is little substantive discussion of welfare benefit plans in the rulemaking, we believe that the inclusion of welfare benefit plans has not been adequately analyzed by the Department and expect that if the Department were to act in this area, analyses would be done regarding the need for

---

4 The annual expense load for a front loaded Northwestern Mutual RR Series Select Variable Annuity is 1.29 percent, with a front load of 4.95 percent. By comparison, the average front load mutual fund had an annual expense of 1.3 percent and average maximum front load charge of 4.95 percent. Source: Morningstar® Direct for Mutual Funds and Morningstar® for Variable Annuities, based on review of 4,156 A share class funds.

5 See, e.g., Department of the Treasury and Department of Labor, Request for Information on Lifetime Income Options for Participants and Beneficiaries in Retirement Plans, 75 Fed. Reg. 5253 (February 2, 2010).
regulation in a separate rulemaking. The Department should make clear in its final rule that a recommendation to purchase an insurance product intended to provide welfare benefits will not be treated as fiduciary investment advice.

**Permit Advisers to Define the Investment Advice Reliance Time Period**

As proposed, the definition of Investment Advice puts no limits on the period of time during which a retirement investor could reasonably rely on such investment advice, meaning that an adviser could theoretically be liable for transactional activity occurring well after the advice is stale due to any number of factors including market conditions, interest rate changes, issuer developments, etc. When Congress authorized the SEC to adopt a uniform standard of care between broker-dealers and investment advisers in the Dodd-Frank Act, it made clear that such standard would not require a broker-dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing the personalized investment advice about securities.6 Further, Congress authorized the SEC to facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers-dealers.7

We suggest that the Department follow Congress’ lead here, as the Dodd-Frank Act provides recent perspective on Congressional expectations regarding fiduciary obligations in a financial services space that overlaps the retirement market. The revised regulation should clarify that it does not establish a continuing fiduciary obligation when discrete transactional advice has been provided to the retirement investor. The Department should also allow parties to define the period over which the advice applies. Absent such an understanding or agreement, we believe that the following presumption should be applied: In order to retain its fiduciary status, advice must be acted upon within a timeframe reasonably contemporaneous with the recommendation, taking into account the type of recommendation and any facts and circumstances to the contrary.

**Broaden the Investment Education Carve-out**

The investment education carve-out from the definition of Investment Advice as proposed specifically precludes providing investment education recommendations regarding specific investment products or specific Plan or IRA alternatives, or recommendations on investment, management, or the value of a particular security or other property. We believe that goes too far. The financial services industry has effectively used the Department’s current regulation under DOL Reg. § 2509.96-1 (“IB 96-1”) to help educate retirement clients on investment choices for many years and we believe the current flexibility afforded by IB 96-1 should be retained in the new rule.

There are many situations in which retirement clients need very limited information or examples of investment or retirement alternatives. The format described in IB 96-1 provides a way for a retirement saver to receive low cost and discrete investment education. Often, a retirement investor is

---

interested in obtaining an investment allocation based on their individual characteristics and wants information to help them implement the allocation. Providing examples of products or funds that would fit within the individual asset classes of their allocation, at the very least, gives the investor a good starting point from which to ultimately take action. We have seen that if examples are described as such, the average retirement saver understands the meaning of what is being presented to him or her. The Department’s proposed regulation essentially reduces the educational opportunities available to retirement savers. In our view, providing an investment allocation to prepare for retirement without any information on how to actually implement the strategy is useless if the goal is to ensure retirement investors save wisely.

If the Department believes, as Northwestern Mutual does, that many retirement savers could benefit from enhanced financial literacy, the Department should look for paths where retirement investors can receive more information, not less. By removing the ability to provide examples to a retirement investor, the Department puts that investor in an unfavorable position to make sound decisions regarding their investment allocation. In the final rule, the Department should embrace the approach to retirement investor education that was contained in its 2010 effort to modify the fiduciary definition, where it proposed to preserve IB 96-1 in its entirety without change.

*Expand the Seller’s Carve-out*

The proposed rule contains a seller’s exemption from fiduciary status for sales to plans with 100 or more participants or when dealing with fiduciaries managing at least $100 million in employee benefit plan assets if certain additional conditions are met, including that the plan fiduciary knows that they are not relying on impartial advice, no fee is being paid to the seller for the provision of investment advice, and the plan fiduciary is informed of the person’s financial interest in the transaction. This carve-out does not apply to IRAs. We believe that with the protections afforded by the carve-out’s conditions, it should be extended to IRA owners and small employer plans, consistent with the DOL’s original approach to this exemption in 2010.

Preserving flexibility to provide non-fiduciary advice to IRAs and small plans would preserve choice and reduce cost for the retirement investor. To do otherwise could cause providers to limit these types of sales due to an unwillingness to accept fiduciary responsibility or comply with an overly burdensome prohibited transaction exemption. We also believe that retail retirement investors and small employers would be capable of understanding the written information required under the conditions and the circumstances that would make clear (e.g., the sale of proprietary products by a representative that has an exclusive relationship with the issuing firm) that they are not being provided impartial advice. Moreover, IRA owners and small plans would still be protected under the federal securities and state annuity laws’ suitability standards and, as discussed more fully below, an extensive disclosure regime.

Failure to modify this provision for small employer plans means that there is virtually no way to provide them with valuable investment information. The Best Interest Contract ("BIC") exemption is inapplicable to participant-directed small plans and other carve-outs are too limiting to meet their
needs. Without a return to the 2010 approach to the seller’s exemption for IRAs, there will be a significant misalignment with the securities laws, which recognize that retail investors can be sufficiently protected in a brokerage transaction even when receiving “incidental advice” in connection with that non-fiduciary relationship. For all of these reasons, we urge the Department to reconsider the scope of this carve-out.

The BiC Exemption

We are concerned that the BiC exemption could result in more customer confusion, increased consumer costs, loss of investor access to high-quality investment products, and curtailment of well-accepted business practices. Without a significant recrafting of the exemption to make it reasonably feasible to implement, we believe that many firms in the financial services industry will not use it. As a result, small IRA accounts will be squeezed out of the retirement advice space as advisers choose not to support unprofitable accounts resulting from these substantial new regulatory burdens or migrate to a fee-based advisory business that will be out of reach or not suitable for many retirement savers.

We urge the Department to take the time necessary to fully consider existing regulatory structures that are familiar to advisers and consumers and which could be more readily leveraged for the benefit of retirement investors. Our specific comments on the provisions of the BiC exemption are as follows:

Reformulate the Contracting Process

One significant departure from common business practices in the Department’s proposal is that a contract be signed before the client receives any advice. When engaging in a binding agreement, normally the parties have had some opportunity to build a relationship that would warrant a consumer to want to contract with the service provider. This exemption doesn’t give the client time to evaluate the adviser, ascertain the quality of their products and services, assess the individual adviser’s knowledge and experience, and compare among different advisers. We expect many investors will be turned off by such an approach and walk away, frustrating the Department’s objective of ensuring every American has access to retirement advice. At a minimum, the Department should allow the contract to be entered into as part of an account opening process.

Seeking to apply the BiC exemption to pre-existing accounts where subsequent investment advice recommendations are made will be incredibly disruptive, costly and confusing for clients. If the Department proceeds with its treatment of pre-existing accounts, at a minimum the exemption should allow for the use of negative consent when seeking to effect the contract with existing clients of the advisory firm. While new client relationships afford an understood opportunity to obtain client signatures, obtaining contract signatures from existing clients during the term of relationships is challenging and made more difficult given the timing contemplated in the proposal. It is an accepted

---

8 Alternatively, and less preferable given the overly burdensome requirements of the BiC exemption as discussed below, would be to include small employer participant-directed plans within the scope of the BiC.
practice to use negative consent with existing clients for other purposes under the securities law and would strike a more appropriate balance than the exemption currently provides.\textsuperscript{9}

There should also not be a specific requirement that the individual adviser sign the contract. Most advisers are agents of the financial institution in their status as independent contractors or employees. Industry practice is for the firm, which has ultimate responsibility to the client, to enter into account agreements and other types of contracts with the client. This practice also prevents the client from having to re-enter into the contract any time an individual representative may depart the firm or the account becomes serviced by call center staff.

\textit{Leverage Existing Disclosure Regimes Rather than Create Entirely New Disclosure Requirements}

Northwestern Mutual believes that this exemption will be very difficult for financial services firms to use and comply with in a low-cost way for clients and in a manner that avoids customer confusion, in part due to the new proposed disclosure requirements. The Department has proposed new, very extensive and costly disclosures at the point of sale, annually and on an interactive website. Much of the information that would be required to be disclosed can only be obtained from third parties such as mutual fund families and advisers would have no way of verifying its accuracy. Further, entirely new systems would need to be created to capture all the information, individualize it to the client, update it periodically, and retain it over time. This will result in either a massive investment in systems (discussed below), the cost of which will undoubtedly have to be passed on to the retirement investor, or a determination by advice providers that they will either not support IRA account owners with small balances or transition to a fee-based advisory business, which is not an affordable option for many retirement investors.

Northwestern Mutual urges the Department to seriously examine ways to leverage existing disclosure requirements under other regulatory authorities before adopting a final rule. Many of the securities and insurance disclosure regimes currently serve to protect retirement investors when making investment decisions. Northwestern Mutual encourages the Department to work more closely with the SEC, FINRA and other federal and state regulators in order to incorporate the extensive body of client disclosures that already exist in this market.

For illustration of the extensive disclosures clients receive for securities products, we provide the following list for a variable annuity contract:

\begin{itemize}
  \item A prospectus detailing all the features, risks and expenses of the variable annuity contract in a standardized format that allows comparison to other products, as required by the Securities Exchange Act
\end{itemize}

\textsuperscript{9} See, e.g., Regulation of Investment Advisers §2:7 (2014) (permissibility of obtaining negative consent from clients in connection with a change of control of the investment adviser).
• Prospectuses for each underlying fund invested in or available for investment under the variable annuity contract containing the features, risks and expenses of each fund in standardized format that affords fund comparison

• A summary disclosure detailing the guarantees, sales charges, withdrawal charges, and annual contract fees, and explaining the costs of taking money out of the contract, as required by the National Association of Insurance Commissioners (NAIC) Annuity Disclosure Model Regulation

• A suitability supplement which requires the client to explain their reasons for purchasing the annuity, their investment objective, and their time horizon for owning the contract, among other things, and which shows the client a comparison of the expenses of the contract they are purchasing and any annuity or insurance contract they may be surrendering in exchange, as required by FINRA Rule 2330

The Department asserts that current regulatory protections are inadequate, but the fact that some investors have not received advice in their best interests should not serve to indict an entire system, developed and refined over 80 years, to protect investors and help them achieve their investment goals. At most, it argues for unifying or enhancing current disclosure practices rather than creating an entirely new regime.

One such existing enhanced disclosure process is that required of registered investment advisers under the Investment Advisers Act of 1940. Registered investment advisers must make available to the public, through the SEC website, information about their advisory business. This enables the public to easily compare and evaluate advisory firms. In addition, registered investment advisers must deliver a Form ADV disclosure brochure in plain English to each client at the outset of the relationship and update the brochure annually (or sooner for more material events). In 2010, the SEC amended the Form ADV to require the disclosure to clients of detailed information about the individual who is providing them with investment advice. In combination, these disclosure include:

• The services the firm provides and the fees charged for the services
• Other compensation the firm receives from the sale of securities
• Any material conflicts of interest the firm has in providing advice or services to the client and how conflicts are addressed
• Material disciplinary information about the firm
• Other financial services activities in which the firm or its affiliates are engaged
• A description of the firm’s Code of Ethics
• Information about the investment adviser representative’s education, experience, compensation, disciplinary history, supervision and conflicts of interest

The SEC has been successfully regulating investment advisers functioning as common law fiduciaries under this regime since the 1940s. We suggest that the DOL give serious consideration to leveraging this disclosure approach as it has the advantage of being familiar to many financial services
firms, provides more clarity as to expectations of the adviser, creates more consistency across the regulatory spectrum, and has a proven track record in this space.

The Department should also coordinate more with the Treasury Department regarding existing point of sale disclosures for IRAs. Treas. Reg. § 1.408-6 already requires disclosure of commissions, predictions of account growth and account expenses. In addition, it does not appear that the Department has analyzed the effectiveness of or duplication of disclosure caused by ERISA § 408(b)(2) and Forms 5500 schedules A and C. The latter disclosures are required at point of sale and annually. The financial services industry, including Northwestern Mutual, has spent considerable resources complying with these new disclosure requirements and seemingly without consideration, the proposed exemption creates completely new point of sale and annual disclosures without reference to the requirements that already exist.

Eliminate the Bias against Proprietary and Other Limited Ranges of Products

The BIC exemption requires that a financial institution face a higher standard of care than “best interest of the client” when presenting proprietary or other limited range of products to a retirement saver. The exemption requires that the financial service provider (i) make a specific written finding that the proprietary or limited range of products do not preclude it from providing advice in the client’s best interest, and (ii) adhere to a higher reasonable compensation standard based on the value of the specific service provided to the retirement investor and not be in excess of the service’s fair market value. We believe that the DOL’s approach to these products is fundamentally flawed.

Inherent in the premise that retirement investors need greater protections when it comes to proprietary or other limited-range products is that they are somehow bad for consumers. We could not disagree more. The reality is that no firm is completely open architecture (i.e., allowing all products on its platform). The Department clearly recognizes this, as it assumed in its disclosure estimate for the exemption that “nearly all financial institutions using the PTE will limit their investment menus in some way and provide the limited menu disclosure.”10 Creating some product limits through various considerations helps refine the appropriate options for the retirement investor, making it easier for the client to take action as opposed to pondering a limitless investment selection.

We believe that well-designed proprietary insurance products (such as annuities) combined with a career agency system to distribute those products (such as what we have at Northwestern Mutual) offers tremendous benefits and long-term value for retirement clients. As discussed above, our mutuality allows us to deliver long-term product value while our exclusive agents are able to focus on learning the benefits and expenses of Northwestern Mutual’s products and to match those products to clients’ needs. Our career agency system enables us to have one of the best-trained sales forces in the

---

United States. We are also able to compensate sales force management who supervise sales to ensure they meet clients' needs and are in clients' best interests.

There is no reason for the standard applied to Northwestern Mutual and its representatives to be higher when recommending Northwestern Mutual products. That only serves to limit consumer choice unnecessarily when the adviser already has to meet a best-interest standard of care. In fact, Congress considered this very point when authorizing a uniform standard of care between broker-dealers and investment advisers in the Dodd-Frank Act. It provided that the sale of proprietary or other limited range of products by a broker-dealer does not in and of itself result in a violation of the standard of care, choosing instead to authorize the SEC to promulgate a rule to require notice of such limitations and the acknowledgement or consent of the client. We think that is a sensible approach.

Rather than creating new requirements for these circumstances, we suggest that the Department refer to the SEC’s approach for registered investment advisers offering fiduciary advice on proprietary or other limited range of products. If an investment adviser only provides advice as to limited types of investments, it must disclose those investment types to the client and explain that its advice is limited in such regard. Additionally, registered investment advisers that recommend to clients securities in which it or a related person has a material financial interest must disclose such practice, the conflict it creates and how the conflict is addressed. There is no reason that the Department’s and SEC’s approaches could not be harmonized to create a uniform set of standards.

Use One Definition of Reasonable Compensation and Rely on Compensation Disclosure

The BIC exemption employs three different formulations of the “reasonable compensation” concept without defining it. At the same time, it does not account for the existing ERISA construct of “reasonable compensation.” ERISA § 408(b)(2) and (c)(2) require that compensation paid to a party in interest for providing something of value or a service be reasonable. This requirement applies to a party in interest regardless of whether the party is a fiduciary or not. The regulation under ERISA § 408(b)(2) makes clear that the examination of reasonableness is a facts and circumstances test.

There is no evident reason why the Department has chosen to advance different formulations of this concept, while apparently seeking to heighten the bar given their varied wording, when the existing term already on the books would work. Acknowledging that this ERISA provision does not currently extend to IRAs, the Department could consolidate its terminology, facilitate administrative ease, and ensure greater clarity in understanding by adopting the existing standard as the one applicable in all cases under the exemption.

---

11 Northwestern Mutual ranked 11th on Training Magazine’s Training Top 125 for 2015 (Training Magazine, Feb. 11, 2015), and had the #1 ranked internship in the financial services industry, and the No. 5 ranked internship among all industries according to Vault.com. (Vault.com October 28, 2014).
13 SEC Form ADV, Part 2A, Item 4 B.
14 SEC Form ADV, Part 2A, Item 11 B.
In authorizing the SEC to adopt a uniform standard of care under Dodd-Frank, Congress made clear that traditional forms of compensation arrangements used by broker-dealers, including transaction-based commissions, could not in and of themselves be considered a violation of that standard of care. While the Department proclaims that the exemption preserves traditional brokerage compensation practices, it has unlevelled the playing field by expressing a clear preference for fee leveling, creating new standards for defending differential compensation and requiring a warranty that the firm’s incentive compensation practices do not tend to encourage individual advisers to make recommendations not in the retirement investor’s best interest.

We believe this approach fails to take into account existing approaches to manage the conflicts associated with compensation. Broker-dealers currently abide by FINRA non-cash compensation rules applicable to sales of mutual funds and variable products which require equal weighting of proprietary and non-proprietary products and inclusion of total production when providing non-cash incentives. FINRA has also recently issued a conflicts report that has substantial recommendations for managing conflicts related to compensation. Firms provide website and written disclosure with respect to their revenue sharing partners and payments. Prospectuses contain various disclosures regarding compensation. Registered investment advisers and their investment adviser representatives provide detailed disclosure to clients in their respective ADV brochures of conflicts related to compensation.

If the Department believes that firms should make a representation to retirement investors regarding their compensation, then we believe that representation should go to the reasonableness of the compensation received under the facts and circumstances using the existing ERISA concept and not be limited to arrangements tied to the individual client. Further, the Department has not demonstrated that the disclosure model used by the SEC for registered investment advisers has failed retail investors. We believe upfront compensation disclosure to retirement investors following that model fully serves the interests of the Department in protecting retirement savers and should be incorporated into the final exemption language.

Reliance on the BIC Exemption Should Not Trigger Registered Investment Adviser Status

Another opportunity to further coordinate with other regulatory authorities concerns the requirement in the proposed exemption that any financial representative and firm that wishes to use the BIC exemption acknowledge that they are acting as a fiduciary in the client contract. Currently, broker-dealers navigate the line between that status and the fiduciary investment adviser status by only providing advice that is solely incidental to the conduct of the brokerage business and receiving no special compensation for that incidental advice, in accordance with an exclusion to the definition of investment adviser. Admission of fiduciary status in the BIC exemption contract calls into question whether the broker-dealer is now providing more than incidental advice and thus must register as a registered investment adviser with the SEC. This is not an issue that the Department can resolve on its own. We urge the Department to coordinate with the SEC on a resolution that does not trigger RIA

---

status—a contrary result would further diminish the utility of this exemption and prove more costly to the retirement investor.

**Eliminate the Data Request Authority**

The data request conditions of the exemption require that a financial institution provide the Department, upon request, various sets of quarterly data including inflows, outflows, holdings and performance returns over the previous six years. The Department states the purpose of this requirement is to determine the proposal’s effectiveness. Northwestern Mutual believes that the Department will not be able to determine the overall effectiveness of the exemption from the data required to be maintained. Instead, we believe the data request provision is intended to further the Department’s premise that low-cost solutions are the “best” for clients. As noted above, we believe that this premise is flawed, and therefore that the benefits associated with this burdensome series of requirements is questionable.

As noted above, advice in a client’s best interest should take into account many factors in addition to cost. Furthermore, working with an adviser can assist clients in ways that may not be adequately captured by measuring performance or costs such as (i) selecting the right asset allocation based on the client’s total wealth; (ii) making tax efficient decisions to improve the client’s net return, and (iii) withdrawing the right amount from an investment to make it sustainable over someone’s lifetime. These factors, according to Morningstar, can add as much as 22 percent to the retirement income a client can receive from their assets. Because these benefits that clients gain from their advisers cannot be captured in gathering masses of quantitative data about account performance and cost, we believe the Department should delete this data request provision from the final exemption. To the extent it wants to evaluate relevant data related to the exemption, the Department will know who is using it by virtue of the notice requirement and can obtain appropriate information upon examination.

PTE 84-24

Our comments on the PTE 84-24 amendments are as follows:

**Retain Variable Annuities within the Exemption**

In the proposed changes to Prohibited Transaction Exemption 84-24, the Department revokes the coverage of variable annuities and mutual funds sold to IRAs under the exemption with the intent of requiring those transactions use the BIC exemption. Fixed annuities that are not securities remain eligible to rely on the PTE 84-24. The Department’s basis for drawing a distinction between the two types of annuities is founded in its belief that variable annuities are more like mutual funds and other securities than like insurance products. We disagree with this conclusion and urge the Department to reconsider its treatment of variable annuities.

---

17 David Blanchett and Paul Kaplan, *Alpha, Beta, and Now... Gamma*, 1 Journal of Retirement 29 (Fall 2013).
Variable annuities and mutual funds are fundamentally different products when you consider the nature of the lifetime income guarantee and are most similar to fixed annuities in many respects. They both include fixed options with interest guarantees, mortality-based investment guarantees, and retirement income guarantees, features not offered by mutual funds or other securities. Both types of insurance contracts require the insurance company to bear the longevity risk that the investor will outlive the premium outlays and investment returns, another distinction from mutual funds and other securities. Consequently, these insurance products are far more similar to each other than to mutual funds.

It should also be noted that the Department has not demonstrated why the PTE, which has been in place for more than 30 years, as enhanced with the impartial conduct standards as proposed, would not sufficiently protect the investing public with respect to variable annuity sales. The current exemption has robust disclosure requirements, including clear disclosures regarding compensation. As previously discussed, those disclosures are supplemented by a whole host of other disclosure materials that a retirement investor receives today when purchasing a variable annuity. Accordingly, the Department should reverse course and preserve unfettered access by consumers to these beneficial products.

*Revise or Eliminate the Definition of "Insurance Commissions"

The term "insurance commissions" is newly defined and narrowed by the Department in this exemption to limit what traditionally has been viewed by the Department as a commission and generally has been used to compensate sales. It would include renewal fees and trails, but specifically exclude other common revenue sources including revenue sharing, administrative and marketing fees, and other payments from third parties. This restrictive definition of commissions would apply to both Plans and IRAs, diminishing the utility of the exemption substantially.

We believe that this new definition is an unwarranted retreat from the interpretation of that term for more than 30 years. The term should include all of the customary forms of compensation and revenue (including those it currently excludes) that it has historically been viewed to include absent any showing by the Department of substantial abuse. Alternatively, the Department could choose to withdraw the definition. Maintaining the long-established view of this term could be coupled with the type of compensation disclosure to clients discussed above. Taking that approach would ensure a fully informed consumer with continued access to high-quality guaranteed lifetime income products.

*Extend the Effective Date of the Rule and BIC Exemption*

The Department has proposed that the rule and the BIC exemption become effective eight months after publication in the *Federal Register*. Northwestern Mutual submits that eight months is not a realistic period of time to train employees and agents, build new computer systems, create additional disclosure documents, create new compliance programs and supervisory procedures, and establish new fiduciary processes, to name some of the actions that will be required. Under the two most recent new disclosure regimes promulgated by the Department, Form 5500 Schedule C and the regulations under
ERISA § 408(b)(2), two years was necessary for Northwestern Mutual to build and implement compliant systems. This proposal is significantly more expansive and burdensome and we believe it would realistically take three years to become compliant. We believe our expected timetable to implement this rulemaking is not unique when compared to firms of our size and urge the Department to adopt a manageable compliance period for the industry.

Reconsider the Cost/Benefit Analysis

We believe the Department has substantially underestimated the cost of people, processes and systems necessary for firms of our size to implement this rulemaking as proposed. Our current high-level estimate of costs to implement this rulemaking within our enterprise is in a range of $13-15 million. Our current high-level estimate of annual costs to comply with this rulemaking is $3-4 million. As the Department considers revisions to its rulemaking, it should reconsider its cost/benefit analysis in light of specific cost estimates provided during this comment period to ensure it remains justified in moving forward with this effort, and if so, revise its final rulemaking to more appropriately balance the increased costs to industry and consumers.

Once again, we appreciate the opportunity to provide input on this proposal. If you have any questions regarding our comments or if we can be of any assistance in your consideration of the issues summarized above, please contact the undersigned or John Dunn at 414-665-5443 or johndunn@northwesternmutual.com.

Very truly yours,

Raymond J. Manista
Senior Vice President, General Counsel
and Secretary

3777256-4

18 In the Department's Scenario B cost analysis, which it believed was a more reasonable but still overstated cost estimate as compared to its Scenario A cost analysis, the Department estimated that a large firm would incur $1.1 million of start-up costs and $436,000 of ongoing annual costs to implement and comply with this rulemaking. Fiduciary Investment Advice Regulatory Impact Analysis at 164-169 (April 14, 2015).
July 21, 2015

Addressed to: e-ORI@dol.gov

Re: Comments Regarding Department of Labor (DOL) Fiduciary Standard Proposal
    RIN 1210-AB32; Best Interest Contract Exemption, PTE 84-24, ZRIN:1210-ZA25

Dear Sir or Madam:

This letter is being provided to you on behalf of Allianz Life Insurance Company of North America (AZL) and its wholly owned subsidiaries (together, the AZL Group). The purpose of this letter is to comment on:

- recently proposed DOL regulations on the definition of the term fiduciary (the Fiduciary Proposal),
- a new proposed “best interest contract exemption” (the BIC Exemption), and
- proposed amendments to Prohibited Transaction Exemption (PTE) 84-24 (together, the Proposal).

We appreciate this opportunity to provide you with comments on the Proposal.

Very truly yours,

Gretchen Cepek,
Senior Vice President and General Counsel

---

1 The companies in the AZL Group are subsidiaries of Allianz SE, a holding company based in Munich, Germany.
Comments of
Allianz Life Insurance Company of North America and Subsidiaries

On the Fiduciary Proposal of the Department of Labor
RIN 1210-AB32

July 21, 2015
# Table of Contents

I. BACKGROUND ON THE AZL GROUP ........................................................................................................ 5

II. SUMMARY/OVERVIEW OF THE AZL GROUP’S COMMENTS ON THE DOL PROPOSAL .................. 6

III. AZL GROUP ANALYSIS OF THE DOL FIDUCIARY PROPOSAL ................................................. 9

A. Challenges In Modern Retirement Planning ......................................................................................... 9
   1. Troubling statistics from the retirement market ................................................................................ 9
   2. To be effective, retirement plans must address market risks, longevity risks, and payout risks.
      Annuities are one way of addressing these risks ........................................................................... 10

B. Insurance Agents Acting in a Selling Capacity Should Not Be Treated as Fiduciaries ...................... 10

C. The Proposal Should Include a Series of “Safe Harbors” .................................................................. 12

D. The Proposal Should Be Revised to Encourage “Merit” Protections Similar to Protections Found in
   State Insurance Laws ........................................................................................................................ 12

E. The Proposal Should Be Submitted for Additional Regulatory Review Outside the DOL ............... 13

F. The Proposal Will Lead to Expensive, Unnecessary Litigation. There Are Better Ways to Meet
   Regulatory Objectives ....................................................................................................................... 14

G. The Proposal Does Not Adequately Consider All of the Various Federal and State Laws that Already
   Provide Substantial Protections to Plan Participants ......................................................................... 15

H. Federal Law Recognizes the Primacy of State Insurance Law in the Regulation of the Business of
   Insurance. The Proposal Does Not Show Appropriate Deference to this Congressional Intent .......... 15

I. Purchasers of Annuities Are Already Provided Extensive Consumer Protections Pursuant to
   State Insurance Laws ........................................................................................................................ 17

J. All Annuity Products Should Be Subject to a Single Exemption and Conduct Standard .................... 17
   1. Products such as annuities, which involve significant “issuer risk”, are fundamentally different from
      traditional investment products such as mutual fund shares, and should be subject to a
      different fiduciary analysis .......................................................................................................... 18
   2. Annuity products contain numerous “insurance” features, and cannot be analyzed simply as
      “investments” .......................................................................................................................... 19
   3. Annuity commission, fee, and expense structures are fundamentally different from those for
      traditional investment products, and this must be considered in any analysis of annuities .......... 20
   4. Product design and distribution are converging for certain types of annuity products, with the result
      that diverse types of annuities are more similar to other types of annuities than to traditional
      investments .......................................................................................................................... 21

K. The Proposal Is Overly Complex ......................................................................................................... 22

L. The BIC Exemption in Its Current Form Will Lead to Inconsistent and Inaccurate Product Disclosures.. 23

M. “Reasonableness” of Compensation .................................................................................................. 25

N. The DOL Should Not Become Enmeshed in Determining What Sorts of Compensation Are Permissible,
   or What Sorts of Investments Are “Permitted Investments” for Plans or IRAs .................................. 25

O. The Proposal Should Clarify that “Principal Underwriters” that Are Non-Retail “Wholesalers”
   Are Not Fiduciaries ....................................................................................................................... 26

P. The Proposal Should Clarify that Salaried Back-Office Clerical Employees Such as Telephone Center
   Employees Who Are Employed by “Wholesalers” Are Not Fiduciaries .......................................... 27

Q. The BIC Exemption Should Clarify Responsibilities in Multi-Party Transactions ............................. 27

R. The Proposal Should Be Clarified as to the Definition of “Direct or Indirect Compensation” ............ 28

S. The Proposal Should Include Clarification and Guidance In the Form of Safe Harbor Protections ....... 29
1. Procedural prudence safe harbor
2. Reasonable compensation safe harbor
3. Safe harbor for certain limitations on the range of investment options
4. PTE 84-24 should include procedural prudence safe harbors based upon current insurance regulatory requirements

IV. CONCLUSION
I. BACKGROUND ON THE AZL GROUP

AZL is a Minnesota domiciled stock life insurance company. It has been in business since 1896. AZL currently issues fixed (non-SEC registered) annuities, fixed (non-SEC registered) index annuities, SEC registered variable annuities, SEC-registered index variable annuities, and fixed (non-SEC registered) index life insurance.

AZL is very familiar with both the life insurance industry and the securities industry. AZL (together with its subsidiaries) issues annuities on a 50-state basis. At December 31, 2014, it was the top writer of fixed index annuities in the United States, and the 15th largest writer of variable annuities, with a total of $12.4 billion in annuity premiums received in 2014. AZL was one of the earliest entrants to the fixed index annuity industry, where it began issuing contracts in the mid-1990s, and was also one of the earliest entrants to the variable annuity industry, where it began issuing contracts in the late 1980s.

In addition to its insurance business, AZL is the parent company of a series of securities-related businesses, including two registered broker-dealers and two registered investment advisers. One of the investment advisory subsidiaries acts as investment adviser to a group of mutual funds that are offered as investments through AZL Group variable annuities (the AZL Funds).

AZL is also very familiar with the retirement planning market, as an issuer of both individual retirement annuities (IRAs) and non-qualified retirement annuities. As of December 31, 2014, AZL held and administered $68 Billion in IRA assets for consumers.

AZL believes it has made a significant contribution to the retirement security of many thousands of consumers. In the five years from January 1, 2010 through December 31, 2014, AZL paid out $22 billion in benefits to IRA owners and beneficiaries.

AZL is keenly aware of its obligations to consumers in the retirement market, and places a high priority on maintaining financial strength, meeting its financial commitments, and providing products and services that help its customers achieve their retirement goals. As of December 31, 2014, AZL had total assets of $140 Billion and capital of $7.77 Billion.

2 The AZL Group is not currently active in the 401(k) market.
II. SUMMARY/OVERVIEW OF THE AZL GROUP’S COMMENTS ON THE DOL PROPOSAL

The AZL Group recognizes the importance of the goals intended to be addressed by the Proposal. We believe, however, that promulgation of the Proposal in its current form would lead to substantial market disruption, increased costs both to advisers and consumers, and reduced consumer choice. The Proposal would ultimately result in harm to the very persons it is intended to help. The following is a brief list of items that we believe must be reviewed and addressed as part of revising the Proposal.

- It is generally acknowledged that there is a rapidly approaching retirement crisis in the United States. The Proposal does not directly address this problem, and in fact may distract attention from a number of the critical steps that need to be taken in the near future to avert this problem.
- It is also generally acknowledged that there is a significant need to make lifetime income options available to plan participants and IRA owners. The United States Government Accountability Office (the GAO) has gone so far as to encourage the purchase of annuities for retirement planning. Significantly, as recently as last week, President Obama highlighted this issue, and encouraged the use of lifetime income options. The Proposal does not address this issue. Further, the Proposal may even interfere with and delay necessary reforms.
- The Proposal’s emphasis on disclosure and punitive litigation will prove inappropriate and inadequate to address the retirement crisis. Substantial consideration needs to be given to additional “merit” protections for plan participants and IRA owners in the form of principal value guarantees and lifetime income guarantees.
- The Proposal revises the term “fiduciary” to be largely synonymous with the term “sales person.” We believe that this revised definition is contrary to the Congressional intent expressed in ERISA, and that the definition, when applied to insurance agents and insurance companies, is contrary to interpretations of ERISA found in Federal case law. The revised definition of fiduciary in the Proposal, when applied to insurance agents and insurance companies, would appear to exceed the DOL’s authority.
- The Proposal does not adequately consider the already existing, substantial protections for annuity purchasers provided by state insurance law.

---

3 President Obama, in “Fact Sheet: The White House Conference on Aging (July 13, 2015)” stated:

“Retirement Security requires more than just accumulating savings—people also need protection against outliving assets. Lifetime income options like annuities provide a regular stream of income regardless of lifespan. Yet fewer than one in five defined contribution plans offer annuities, with the share falling sharply over time. The Treasury and Labor Departments have previously issued a series of guidance documents encouraging plan sponsors to offer responsible annuity options to help protect retirees from outliving their savings. However, some plan sponsors remain concerned that they could be held liable if the annuity provider fails.”

Similarly, in Field Assistance Bulletin No. 2015-02 (July 13, 2015), the DOL has stated:

“[A] recurring comment...is that employers remain unclear about the scope of their fiduciary obligations with respect to annuity selection under defined contribution plans.... Confusion or lack of clarity regarding the nature and scope of fiduciary responsibilities...could create or reinforce disincentives for plan sponsors to offer their employees an annuity as a lifetime income distribution.”
- The Proposal does not show appropriate deference to clear and repeated Congressional intent regarding the primary role of state insurance laws in the regulation of the business of insurance.
- The Proposal is highly complex. As a result, the Proposal will be very difficult for companies and advisors to administer, and extremely expensive. This will lead to significantly increased costs to industry and consumers, confusion, inadvertent errors, and disputes between advisors and their customers.
- Regulatory complexity, coupled with potentially punitive sanctions for inadvertent violations, is a significant concern for employers and other fiduciaries. Historically, complexity and unclear legal exposure have led to hesitancy on the part of plan sponsors in offering new plan designs, and an unwillingness to offer clearly beneficial products (e.g., lifetime income options). We believe that this harms consumers. As noted above, last week both the DOL and President Obama acknowledged this problem, and spoke in favor of clarifying guidance pertaining to lifetime income options. President Obama also mentioned the critical need for guidance to plan sponsors to allay their concerns about personal liability.
- As noted above, we believe the revised definition of “fiduciary” in the Proposal is beyond the authority of the DOL to adopt. However, assuming this definition is found valid, to address concerns about regulatory complexity and unclear liability, the Proposal should be supported by clear, succinct safe harbor protections. It is generally acknowledged that the lack of this sort of guidance has impeded retirement plan design in a number of areas, including specifically in the highly important area of retirement income solutions. Safe harbor guidance would be particularly important in the IRA area, since the Proposal would in effect subject IRA accounts to new ERISA requirements, and sales persons currently working with IRA accounts would have to become conversant with these ERISA concepts virtually overnight.
- Safe harbor protections should be based substantially upon compliance with state insurance law. There is significant, recent authority for interpreting Federal law by reference to state insurance laws.
- The Proposal should be submitted for additional legislative and regulatory review outside the DOL. We believe that the subject matter of the Proposal is too important to be rushed. Initially, a proposal of this magnitude, which in effect substantially overhauls ERISA, should be subject to significant Congressional input. Further, we believe that the SEC, FINRA, and the NAIC are pivotal parties in this broad initiative. Among other things, we are concerned that, if the DOL

---

4 See Vernon, Stanford Center on Longevity, The Next Evolution in Defined Contribution Retirement Plan Design, A Guide for DC Plan Sponsors To Implementing Retirement Income Programs at 8 (September 2013) ("Employers and plan sponsors may have a number of goals regarding implementation of a retirement income program, including minimizing fiduciary exposure and administrative complexities."
5 See footnote 3, supra.
6 One author has stated: “[There is] a significant barrier for employers and plan sponsors to implement retirement income solutions in their defined contribution (DC) retirement plans—the lack of comprehensive safe harbor guidance from the [DOL] and/or [IRS] on the design and implementation of retirement income solutions in tax-qualified retirement plans. This creates uncertainty and confusion for plan sponsors...Safe harbor guidance could be structured to reduce uncertainty and confusion.” Vernon, Stanford Center on Longevity, Foundations in Research for Regulatory Guidelines on the Design & Operation of Retirement Income Solutions in DC Plans at 3 (September 2014).
and the SEC adopt fiduciary regulations independently, product issuers may be subject to multiple, significantly different, and potentially conflicting regulatory standards.

- The effect of the Proposal, if adopted in its current form, will be to encourage litigation between plan participants and providers. We believe litigation is almost never in the best interest of consumers, because of cost, delay, and uncertainty—and that there are substantially better ways to achieve regulatory objectives. Further, improper sales of insurance products are already subject to private rights of action and regulatory sanction at both the Federal and the state level.

- From the perspective of the life insurance and annuity industry, the Proposal raises a number of interpretational questions. While certain insurance products are clearly intended to be covered by the Proposal, the Proposal does not attempt to address the unique product features and distribution structures found in the insurance industry. Insurance products are priced differently and sold differently than products in the traditional securities industry. In addition, they involve significant issuer risks that do not exist in other financial services industries. These differences must be addressed in any analysis of products.

- The Proposal specifically requests comment on which exemption, the BIC Exemption or a revised PTE 84-24, should apply to different types of annuity products. For the reasons set forth in this letter, we believe that annuities should be treated as a separate class of product subject to a single regulatory standard, the standard found in the “annuity exemption” of PTE 84-24.

- The Proposal appears to underestimate the disruptive effect it will have on sales persons who are not currently operating in an ERISA environment. We strongly believe that additional consideration should be given to these sales agents, and the enormous change that the Proposal would make to their business model. Either the Proposal should exclude IRAs until there has been substantially more review of this issue, or a clear, simple safe harbor should be generated for persons marketing to IRAs, to assist these sales persons in assuring their businesses remain compliant.
III. AZL GROUP ANALYSIS OF THE DOL FIDUCIARY PROPOSAL

Once again, the AZL Group appreciates the opportunity to comment on the Fiduciary Proposal. While we expect that the DOL will receive a number of insurance industry trade group comment letters, these letters by necessity address general industry concerns and cannot present every issue or position important to individual companies. The following comments reflect the AZL Group’s unique role as a leader in innovative index annuity and variable annuity solutions for the defined contribution retirement market.

We have also participated in discussing and drafting comment letters submitted by the American Council of Life Insurers; Committee of Annuity Insurers; Insured Retirement Institute; and several other trade groups, and we generally support the positions taken in those letters.

A. Challenges In Modern Retirement Planning

It is generally acknowledged that there is a rapidly approaching retirement crisis in the United States. This problem has been caused by consumer losses in the stock market, the financial fallout of the Great Recession, the substantial decrease in the number of defined benefit plans over the last several decades, increased longevity, and the risks associated with retirement plan payouts that may occur over 20 to 30 years. 

1. Troubling statistics from the retirement market

Increasingly, consumers are being asked to manage their own retirement. Companies that offer retirement plans to these consumers are increasingly shifting from defined benefit plans to defined contribution plans, such as 401(k)s. In 401(k) plans (and IRAs), consumers typically do not have the benefit of the principal protection and lifetime income that are provided by defined benefit plans. As a result, consumers increasingly have smaller retirement accounts and more risk and uncertainty. The following is a brief snapshot of the important trends:

- According to the LIMRA Secure Retirement Institute, “[t]he biggest risk to Americans’ retirement security is the lack of savings. Half of Baby Boomers have less than $100,000 saved for retirement, and more than a third have less than $25,000.”
  Source: Consumer Survey, LIMRA Secure Retirement Institute, 2014

- From 1990 to 2008, the number of active participants in private sector defined benefit plans fell by 27.6% from about 26 million to about 19 million.
  Source: GAO, Report to the Chairman, Special Committee on Aging, U.S. Senate, RETIREMENT INCOME Ensuring Income throughout Retirement Requires Difficult Choices, June 2011

- “Almost two thirds of pre-retirees do not expect to receive enough income from Social Security and employer pensions to cover their basic living expenses in retirement.”
  Source: LIMRA, The Facts of Life and Annuities, September 2014 Update

---

7 These problems are exacerbated by a significant decrease in purchases of individual life insurance, which can be expected to further weaken consumer finances. Over the last 50 years, individual life insurance ownership has decreased from 60% to 35% of the population. Group Life Insurance coverage has increased somewhat, from 25% to 35%. Source: LIMRA, The Facts of Life and Annuities, September 2014 Update.
• “Almost 75 percent of pre-retirees expect to work in retirement, but 75 percent of retirees do not work.”
Source: Quarterly Retirement Perspectives, LIMRA Secure Retirement Institute, Fourth Quarter 2013

2. To be effective, retirement plans must address market risks, longevity risks, and payout risks. Annuities are one way of addressing these risks
The GAO has recognized the important role of annuities for Americans’ retirement needs. In its June 2011 report on Retirement Income, submitted to the Chair of the U.S. Senate Special Committee on Aging, the GAO warned that “holding stocks and bonds leaves households exposed to the financial uncertainty in financial markets over an unknown number of retirement years” and noted the adverse impact for retirees if they need to begin taking income after the value of their investments has declined. The report further noted that experts recommended that retirees draw down their reserves at a systematic rate and that this process “should be a part of a larger strategy that includes a certain amount of lifetime retirement income (such as Social Security, defined benefit, and annuity income).” The report went on to say that experts generally recommended “income annuities, in conjunction with systematic drawdown of other savings, to provide a greater level of retirement income security.”

As discussed elsewhere in this letter, we believe that the Proposal, because of its complexity and considerable cost to implement, may raise a series of logistical roadblocks, and interfere with the adoption of the necessary types of reforms outlined in the GAO report.

B. Insurance Agents Acting in a Selling Capacity Should Not Be Treated as Fiduciaries
As noted above, the proposed re-definition of the term fiduciary would, in effect, turn the process of describing a product that is being sold into a “fiduciary recommendation,” and make the term “sales person” largely synonymous with the term “fiduciary.” We believe that this interpretation is well outside the historical understanding of the meaning of the term “fiduciary”, and that the interpretation is not in accordance with the language of ERISA.

ERISA defines an investment advisory fiduciary as a person who “renders investment advice for a fee or other compensation direct or indirect...” DOL regulations promulgated subsequent to the enactment of ERISA further define investment advisory fiduciary as a person who renders advice “on a regular basis pursuant to an agreement...that such advice will form the primary basis for investment decision making.” In other words, an advisory fiduciary is distinguishable from an insurance sales agent by the fact that the fiduciary provides advice on a “regular basis” and this advice is the basis for the investment decision, unlike the sales agent, who effects individual sales transactions, rather than providing overarching investment advice for multiple assets, and the fiduciary’s advice is the basis for the investment decision.

We believe that the proposed revised definition of fiduciary is not supported by the provisions of ERISA. A number of courts have rejected broad assertions that insurance agents are fiduciaries.
Most notably, in *Flacce v. Sun Life of Canada*, the Sixth Circuit, relying solely on statutory construction of ERISA without appearing to even consider the need to analyze the application of the five-part regulatory definition, concluded that:

“[S]elling...an annuity contract does not constitute investment advice.”

Similarly, the 5th Circuit has stated:

“Simply urging the purchase of its products does not make an insurance company an ERISA fiduciary with respect to those products.”

Similarly:

“To satisfy the authority or control element....the Plaintiffs must demonstrate” that the insurance agent caused the plan trustee to “relinquish his independent discretion....”

Based upon the language of these cases, we believe the revised definition of fiduciary in the Proposal is invalid as applied to insurance agents and insurers. While a governmental department or agency has authority to promulgate rules interpreting a statute, it does not have authority to promulgate rules contrary to the meaning of that statute, as interpreted by courts with appropriate jurisdiction.

However, if the DOL insists on applying this regulation to insurance agents and insurance products, the DOL should adopt safe harbor guidance or carve-outs to the proposed regulation outlining the types of sales activities that will not result in an insurance agent becoming a fiduciary. This safe harbor guidance should be based primarily on the provisions of state insurance law. As also outlined in this letter, we believe that there is substantial authority for using state insurance law to define the requirements of Federal law. For example, a safe harbor might provide that an insurance agent meeting the requirements of state disclosure, advertising, and suitability requirements is not a fiduciary unless he specifically acknowledges that he is acting as a fiduciary or otherwise engages in conduct that can reasonably be construed as the provision of fiduciary advice.

In the alternative, if the DOL determines that an insurance agent giving a product presentation is a fiduciary, the DOL should clarify by safe harbor when the agent is acting in accordance with applicable prohibited transaction exemptions. Again, compliance with the safe harbor would be based substantially on compliance with state insurance laws.

---

8 958 F.2d730, 734 (6th Cir. 1992)
9 American Federation of Unions Local 102 Health & Welfare Fund v. Equitable Life Assurance, 841 F.2d 658 (5th Cir. 1988)
11 See e.g., United States v. Home Concrete and Supply, LLC, 132 S. Ct. 1836, 1843 (2012) (holding that an agency is due no deference when it amends a regulation that a court previously found to be a reasonable interpretation of an unambiguous rule).
C. The Proposal Should Include a Series of “Safe Harbors”

The Proposal is voluminous and highly complex, and has required, and will continue to require, specialized legal, compliance and business experts to help understand and assure compliance. Many of the standards, such as that of “reasonable compensation” may be familiar to ERISA lawyers and regulators but would be foreign and unclear to individual advisers such as small independent broker-dealers and insurance agents. The challenge of the Proposal is in its premise: it seeks to apply common law trust principles, developed for trustees with discretionary asset management responsibility, to non-discretionary sales activities. While this may have theoretical appeal, in reality it amounts to a novel application of common law trust principles and therefore would create enormous compliance uncertainties and costs. This inevitably will lead to unintended consequences in the form of increased costs to individual investors and/or the exit of small independent brokers and agents from the market.

To the extent the Department determines to go forward with the Proposal in substantially the form presented, safe harbors should be provided to make it feasible for sales persons to determine that they are in compliance. Compliance certainty not only benefits the adviser but also benefits the retirement investor by ensuring consistent protective practices throughout the industry, without the need for the investor to initiate a lawsuit to determine whether conduct standards have been met. It could also be expected that compliance certainty would result in a more diverse plan choice and a higher level product innovation.

In addition to the safe harbor guidelines discussed in the preceding Section III.B, the DOL should consider the additional safe harbor protections set out in Section III.S.

D. The Proposal Should Be Revised to Encourage “Merit” Protections Similar to Protections Found in State Insurance Laws

The Proposal is not sufficiently forward looking. It propagates and expands the deficiencies in the current regulation of modern retirement plans. For example, the Proposal is, in significant part, premised on a form of “full disclosure.” While “disclosure regulation” does provide a significant consumer benefit, disclosure regulation by itself will ultimately prove inadequate when used with unsophisticated consumers. Many of the consumers in the qualified plan market are unsophisticated. 12 Other, supplementary forms of regulation should be adopted. Specifically, the sort of “merit regulation” found in state insurance laws may be better suited to protecting these

---

12 We believe that the regulatory issues that exist in a disclosure regime are compounded when a plan or IRA account only offers traditional securities products. As the DOL is aware, the availability of annuity products in defined contribution plans is highly restricted, in part because of regulatory uncertainty. Securities products, which generally do not provide principal guarantees, involve significant risks to principal. We believe there is some question whether a plan or IRA that only offers securities products, with their inherent risk to principal, could ever be “suitable” or “in the best interest” of consumers. As noted above, the insurance industry addresses this issue by applying a form of merit regulation to many insurance products, (e.g., through state “standard minimum nonforfeiture laws”, which assure that purchasers of fixed annuities receive a minimum principal value on surrender of their contract). We believe that the Proposal at a minimum should not discourage, and optimally should encourage, plans to offer at least some plan options that provide a principal guarantee. We similarly believe that, to further reduce participant risk, plans should be encouraged to offer 2-3 lifetime income options. Only through guaranteed features and lifetime income options can participants be assured they will not outlive their retirement savings.
unsophisticated consumers. To the extent that the Proposal usurps state merit regulation in favor of disclosure regulation, it may be conflicting with the goals it is attempting to achieve.

In analyzing annuities, many people focus almost exclusively on the “annuitization” feature of annuities. In effect, they think of annuities in terms of immediate payout streams. This approach is somewhat short-sighted, and understates substantially the benefits and protections of “merit review” products such as annuities in a retirement plan, both during accumulation and during payout. During the accumulation period, the participant and his/her spouse and heirs receive substantial protection in the form of an annuitization feature and a minimum death benefit. Depending on the contract, they may also receive principal protections, payout protections, target value protections, and increasing income protections. These benefits are described in more detail at page 19 of this letter. All of these benefits provide valuable account protections to annuity owners. Once the payout phase commences, these various benefits provide a variety of protected payout guarantees that substantially reduce the contract owner’s risk in payout.

As noted above, we agree with the DOL’s consumer protection goals. However, we believe that there are other, substantially larger threats to plan participant accounts that should be addressed. For example, as the DOL is aware, in the years 2008-2009, plan participants suffered massive losses in their retirement accounts as a result of market declines. Estimates put these losses at $3.4 Trillion, or 40% % of total value.13 The Proposal, even if adopted, would not have prevented these losses. In contrast, fixed and fixed index annuities, which are subject to state “merit” regulation in the form of standard minimum nonforfeiture laws, did not incur any market-related losses. We believe that plan investments should receive the benefit of various forms of “merit regulation”, such as exist in state insurance laws. For example, the Proposal could be drafted so as not to discourage the availability of investment options with minimum principal guarantee features. Or, the Proposal could be drafted so as not to discourage the availability of minimum lifetime income features.

In sum, we believe that to address the critical shortcomings in the current retirement plan market, the Proposal should be revised so as not to undermine the objectives of “merit protection” and to ensure the availability of a variety of products with guaranteed, insured values and guaranteed payout options.

E. The Proposal Should Be Submitted for Additional Regulatory Review Outside the DOL

The Proposal should be submitted for additional regulatory review outside the DOL. Specifically, it appears that input from other Federal financial services regulators, and the 50 state insurance departments, has been limited. These regulators should provide detailed input on the Proposal. Among others, the United States Securities and Exchange Commission (SEC), the principal Federal regulator for investment securities, should be actively involved in vetting the Proposal.14 Similarly, input from FINRA, the most significant broker-dealer self-regulatory authority in the United States,

---

13 Mauricio Soto, Urban Institute, “How is the Financial Crisis Affecting Retirement Savings?” (March 10, 2009)
14 We note that senior SEC officials have raised concerns publicly about the process for the Proposal. Investment News, SEC’s White: Fiduciary battle far from over (March 24, 2015).
should also be considered critically important. As noted above, comments should also be solicited from the NAIC.

One Federal regulator, FINRA, has raised specific concerns about the Proposal. These concerns include: (i) it is premature for the DOL to move forward on its Proposal until the SEC has completed its review of the fiduciary advisor issue, as instructed by Congress in the Dodd Frank Act; (ii) the Proposal is unnecessarily derogatory of financial services sales persons; and (iii) the Proposal may have the effect of seriously damaging the IRA industry, to the detriment of consumers. We agree with all of these concerns.

Among other things, we are concerned that, if the DOL and the SEC adopt fiduciary regulations independently, insurers may be subject to multiple, significantly different and conflicting regulatory standards.

F. The Proposal Will Lead to Expensive, Unnecessary Litigation. There Are Better Ways to Meet Regulatory Objectives

The effect of the Proposal if adopted in its current form, particularly the BIC Exemption, will be to encourage litigation between plan participants and providers. We believe litigation is almost never in the best interest of consumers, because of cost, delay, and uncertainty--and that there are substantially better ways to achieve regulatory objectives.

Litigation is also counterproductive from the perspective of the adviser. Not only would the adviser be subjected to significant costs, interference with the conduct of his/her business, and potential reputational damage, the adviser may have to defend him/herself from what at bottom may have been customer dissatisfaction that a recommendation “didn't work out.” We believe the Proposal, rather than relying almost entirely on an adversarial process, should contain a series of “safe harbors” so that legitimate insurance and annuity sales persons can be assured as to how they can conduct their businesses in a compliant manner.

---

15 We note that senior FINRA officials have raised concerns publicly about the process for the Proposal. See Think Advisor, FINRA’s Ketchum Criticizes DOL Fiduciary Plan (May 1, 2015); Ketchum, Remarks from the 2015 FINRA Annual Conference (May 27, 2015); and Investment News, FINRA’s Ketchum criticizes DOL fiduciary rule (May 27, 2015).

16 As reported in Investment News (May 27, 2015), Mr. Richard Ketchum, the CEO of FINRA, raised a series of concerns about the Proposal:

“Mr. Ketchum...criticized rhetoric surrounding the DOL proposal that portrays brokers preying on clients....

‘Depictions of the present environment as providing ‘caveat emptor’ freedom to broker-dealers to place investors in any investment that benefits the firm financially with no disclosure of their financial incentives or the risks of the product are simply not true....Nor are they an accurate starting point to justify a new standard of care.’

He warned that the primary mechanism in the DOL rule that would allow brokers flexibility in charging clients for their services – a legally binding contract requiring them to act in the clients’ best interest – would send disputes over fiduciary duty into legal and arbitration forums without instruction on how to rule on compensation practices.

‘I fear that the uncertainties stemming from contractual analysis and the shortage of useful guidance will lead many firms to close their IRA business entirely or substantially constrain the clients that they will serve....’”

See also Ignites, FINRA Calls on DOL to Scrap “Fractured” Fiduciary Standard (July 20, 2015).
It is important to note that improper sales of insurance products are already subject to private rights of action and regulatory sanction at both the Federal and state level. The effect of the Proposal would be to add one more layer of vague potential liability.

G. The Proposal Does Not Adequately Consider All of the Various Federal and State Laws that Already Provide Substantial Protections to Plan Participants
The Proposal does not adequately consider all of the existing, overlapping, and potentially conflicting insurance and securities laws that already exist to protect plan participants. The Proposal should be revised to more fully address these statutory and regulatory provisions that provide protections to qualified plans and IRAs. To be effective, the Proposal should be harmonized with these requirements.

Specifically, The Proposal makes several broad statements about the benefits of a fiduciary duty standard. However, as the DOL is aware, a “suitability” standard has existed in the securities laws for 80 years, and now also exists in the insurance laws of substantially all states. The Proposal does not adequately discuss these suitability protections, or explain what sorts of improper conduct, if any, are permissible under current suitability standards but would be prohibited under a new fiduciary standard. In other words, we question whether the Proposal in its current form makes the case for a new, overlapping consumer protection standard.

H. Federal Law Recognizes the Primacy of State Insurance Law in the Regulation of the Business of Insurance. The Proposal Does Not Show Appropriate Deference to this Congressional Intent
In a number of situations, Federal law has been drafted in a manner that defers to the comprehensive regulation of insurance found in state insurance laws. Further, Congress has also relied upon state insurance laws in tailoring the requirements of Federal law to insurance matters.

Initially, as the DOL is aware, Congress has specifically exempted state insurance laws from ERISA pre-emption. See 29 U.S.C. 1144(b)(2)(A). In doing so, Congress explicitly recognized the comprehensive regulation of insurance that exists at the state level, and evidenced an intent that insurance should be regulated primarily/exclusively by the states. The Proposal does not pay adequate deference to this Congressional intent. In fact, the Proposal, as currently drafted, could be viewed as attempting to regulate various aspects of the business of insurance.

More recently, there is significant authority for using state insurance law to interpret the requirements of Federal law. In the so-called “Harkin Amendment” to the Dodd Frank Act (Section 989 J), Congress provided that a fixed index annuity meeting certain requirements is not a security pursuant to Federal law, and is subject to regulation exclusively pursuant to state insurance laws. The principal requirement of the Harkin Amendment is that the annuity must meet the

---

17 49 states have adopted annuity suitability protections.
18 The DOL, in consultation with the National Association of Insurance Commissioners (NAIC), should review the Proposal to remove provisions that pertain to the business of insurance. Further, we believe that the “safe harbor” recommendations set out elsewhere in this letter should be based substantially upon compliance with state insurance law.

---
requirements of state insurance standard minimum nonforfeiture laws. The legislative history to this provision indicates that Congress’ purpose was to “[f]urther promot[e] the adoption of the NAIC model regulations that enhance protection of seniors and other consumers.” Nonforfeiture laws are discussed elsewhere in this letter.

As an historical matter, we believe it is important to point out that Federal law has for nearly a century shown a substantial deference to state insurance regulation. When Congress began enacting regulation of the financial services industry in the 1930s, it enacted sweeping regulation of the securities industry, but did not enact laws to regulate the business of insurance. Further, to the extent that certain insurance products might potentially be subject to Federal regulation as “securities”, Congress enacted a series of “carve outs” for the insurance industry.

- Pursuant to Section 3(a)(8) of the Securities Act of 1933, a fixed “annuity” is expressly excluded from the definition of the term “security.”
- Pursuant to Section 3(a)(2) of the Securities Act, a group variable annuity contract sold to a qualified plan is expressly exempted.
- Pursuant to Section 3(c)(3) of the Investment Company Act of 1940, an insurance company is expressly excluded from the definition of the term “investment company.”
- More recently, the SEC has adopted a rule, based in large part upon the extensive protections contained in state insurance laws, that broadly exempts insurance company issuers from the status of “public company.” Rule 12h-7 pursuant to the Securities Exchange Act of 1934 provides that an insurance company issuing an insurance product that is a registered security is not required to file periodic reports on Forms 10-K, 10-Q, or 8-K unless it also issues other, non-insurance registered securities.

Put simply, for a variety of historical reasons, Federal law has for many years and in many contexts shown substantial deference to state law as the primary regulator of insurance.

This Federal deference to state insurance laws has extended to ERISA. As noted above, state insurance laws have been specifically exempted from ERISA pre-emption of state law.

As is evident from the foregoing points, annuities are subject to comprehensive regulation at the state level, and the primacy of state insurance regulation has been repeatedly sanctioned by Congress. As such, there is a significant question as to whether other, additional regulatory regimes should be applied to these products. This is particularly the case where the additional regulatory regimes are very dissimilar from insurance regulation. In the context of the Proposal, insurers could become subject to uncoordinated and highly dissimilar laws in the form of insurance laws, securities laws, and ERISA/tax laws. This would be highly burdensome, and could result in significant additional costs to consumers.
I. Purchasers of Annuities Are Already Provided Extensive Consumer Protections Pursuant to State Insurance Laws

In analyzing whether the Proposal should be applied to annuity products, and if so how, it is important to recognize that annuities are already subject to comprehensive consumer-protection laws at the state level. Among other things, state insurance laws require:

- Insurers must be licensed in, and are subject to examination by, each state in which they operate.
- Insurers must file all contracts in all applicable states.
- Annuity contracts typically cannot be changed without the consent of the contract owner.
- Annuity guarantees are not simply a promise to pay. Rather, guarantees are supported by extensive and rigorous regulation by state insurance departments. In a number of respects, state insurance regulation resembles bank “safety and soundness” regulation. For example, to assure that an insurer is capable of meeting all of its financial obligations, it must maintain substantial excess net capital, typically 5-7% of assets or more.
- Investment risk in the insurer’s general account is controlled by requirements that insurers can invest only in specific “permitted investments.” Investment in derivative securities is typically permitted only for hedging purposes, and not for speculation.
- Advertisements for annuity products are subject to comprehensive state advertising regulations.
- Annuity contracts must meet specific state-law readability requirements.
- Insurers or their delegates must determine that all annuity transactions are “suitable.”
- Annuity purchasers are given a “cooling off period” of 10 or more days, which allows the purchaser to review the contract and cancel it if he/she no longer wants it. These cooling off periods are called “free looks.”
- In the context of all annuities other than SEC-registered products, state law mandates that annuity purchasers must be given minimum contract value guarantees. Pursuant to state “standard minimum nonforfeiture” laws, upon a surrender of a contract, after the effect of all fees, charges, and surrender charges, the owner must receive at least 87.5% of premiums paid, increased by a stated minimum rate of interest annually. Other types of contract value guarantees are provided by insurers as a matter of contract, rather than pursuant to law. These contract value guarantees are discussed elsewhere in this letter.

J. All Annuity Products Should Be Subject to a Single Exemption and Conduct Standard

The Proposal specifically requests comment on which exemption — PTE 84-24 or the BIC Exemption — should apply to which types of annuity.

The current draft of the Proposal would bifurcate the regulation of different types of insurance products, so that variable annuities and other registered annuities would be subject to a new Best Interest Contract Exemption, but fixed annuities and fixed index annuities would be subject to a revised PTE 84-24. Sales persons defined as fiduciaries by the Proposal would be fiduciaries regardless of which exemption they rely upon.
For the reasons set forth in this letter, we believe that insurance products should be subject to a single regulatory standard. Many insurance companies offer both variable annuities and fixed index annuities—often to the same—customers—and it would be confusing and counterproductive to customers to have these different types of insurance products subject to significantly different disclosures and regulatory regimes. We believe that, because insurance products share many product features, and differ so substantially from traditional securities products, insurance products as a group should be treated as a separate class of products, subject to a single exemption and conduct standard. Annuities should be subject to the historical annuity exemption found in PTE 84-24. Attempting to create a single exemption that would apply to both annuities and general securities would be an exercise in combining “apples and oranges.”

In addition, as set out elsewhere in this letter, we believe that insurance products subject to 84-24 should be provided with “safe harbors” that are based substantially on state insurance law.

1. Products such as annuities, which involve significant “issuer risk”, are fundamentally different from traditional investment products such as mutual fund shares, and should be subject to a different fiduciary analysis

Annuities are a form of “issuer risk product.” We do not believe that issuer risk products can be analyzed alongside traditional investment products such as mutual funds. Insurance companies incur significant financial, portfolio management, and longevity risks in issuing annuities, and these must be addressed through annuity cost structures. There is no corollary to these risks and costs in the traditional securities industry.

A brief summary of annuity issuer risk features, and the types of risks involved, is as follows:

<table>
<thead>
<tr>
<th>Product Feature</th>
<th>Types of Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annuity</td>
<td>Asset/liability management risk assumed by insurer; annuitant longevity risk</td>
</tr>
<tr>
<td>Traditional minimum death benefit</td>
<td>Mortality risk; market risk in variable annuities; utilization risk; investment duration risk</td>
</tr>
<tr>
<td>Market-based product guarantees</td>
<td>Hedging risks; volatility risks; interest rate risks; utilization risk; investment duration risk</td>
</tr>
<tr>
<td>Guaranteed minimum income benefit</td>
<td>Longevity risk; asset/liability management risk; interest rate risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk</td>
</tr>
<tr>
<td>Guaranteed minimum withdrawal benefit</td>
<td>Longevity risk; asset/liability management risk; interest rate risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk</td>
</tr>
<tr>
<td>Guaranteed minimum asset benefit</td>
<td>Asset/liability management risk; interest rate risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk</td>
</tr>
<tr>
<td>Product Feature</td>
<td>Types of Risk</td>
</tr>
<tr>
<td>-----------------------------------------------------</td>
<td>-------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Guaranteed target date benefit</td>
<td>Asset/liability management risk; interest rate risks; volatility risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk</td>
</tr>
<tr>
<td>Guaranteed Increasing Payout Benefit (e.g.</td>
<td>Inflation risk; longevity risk; asset/liability management risk; interest rate risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk</td>
</tr>
<tr>
<td>inflation-linked increasing income benefits,</td>
<td></td>
</tr>
<tr>
<td>performance-linked increasing income benefits)</td>
<td></td>
</tr>
<tr>
<td>Enhanced liquidity benefits (e.g. Unemployment</td>
<td>Morbidity risk; health risk; employment risk; utilization risk; investment duration risk; asset/liability management risk</td>
</tr>
<tr>
<td>benefits or confinement benefits)</td>
<td></td>
</tr>
</tbody>
</table>

2. **Annuity products contain numerous “insurance” features, and cannot be analyzed simply as “investments”**

Annuity products offer a wide range of insurance features that do not exist in the context of traditional securities products such as mutual funds. Two or more of these features may be included in a single product. In some instances, the features and associated fees may be “bundled” in a contract, and in some instances features may be selected and paid for separately.

The insurance benefits of an annuity contract are not “collateral” or “tangential.” They are often the primary reason for buying an annuity.\(^{19}\)

Insurance features that may be included in an annuity may include:

- **Annuitization**
  Substantially all annuities offer multiple annuitization payout options, such as lifetime payout, joint lifetime, and lifetime with 10 year period certain.

- **Traditional or enhanced death benefit**
  Annuities offer traditional and enhanced death benefits. The traditional benefit would guarantee a minimum death benefit, even in the event of a market decline.

- **Guaranteed Minimum Withdrawal Benefit**
  These benefits provide a level periodic payout (e.g., $1,000 per month) for a specific period (e.g., 20 years) regardless of contract performance, even if the accumulation value goes to zero. At the end of the payout period, if accumulation value is positive, this value can be withdrawn or annuitized.

\(^{19}\) As one example of this, a 2014 survey by LIMRA indicates that “[s]eventy-seven percent of new variable annuity business is sold with a guaranteed living benefit (when available).” Source: Finding the Right Mix, Retirement Income Attitudes and Preferences, LIMRA Secure Retirement Institute, 2014. In other words, for the vast majority of variable annuity purchasers, the GLB was apparently the primary reason for purchasing a contract.
• **Guaranteed Minimum Income Benefit**
  These benefits provide a guaranteed minimum “rollup” of the premium value (e.g., premium compounded at 5% per year) which can be annuitized after some specified period (e.g., 7 years) at a relatively low fixed rate of the interest (e.g., 1%). This annuitization right will be honored by the issuer regardless of contract (separate account) performance.

• **Guaranteed Lifetime Withdrawal Benefit**
  These benefits provide a guaranteed level lifetime payout (e.g., $1,000 per month) regardless of the performance, even if accumulation value goes to zero.

• **Guaranteed Minimum Accumulation Benefit**
  These benefits provide a guaranteed withdrawal value at a specific future date. For example, a contract might guarantee a withdrawal value in contract year ten that is equal to the higher of premium paid or the highest contract anniversary accumulation value.

• **Guaranteed Target Date Benefit**
  These benefits are designed to provide a guaranteed account value at a date in the future. Unlike mutual fund target date funds, annuity target date benefits guarantee and minimum account value, and do not simply have a “goal” of reaching some value.

• **Guaranteed Increasing Payout Benefit**
  These benefits provide income that can increase over time which may be based on a fixed amount, or a variable amount tied to increases in inflation, index values, or contract investment performance.

• **Enhanced Liquidity Benefits**
  Annuities offer benefits which may increase liquidity based on specific life events including unemployment, entering nursing home facilities, or disability.

• **Product Diversification and Volatility Management**
  Because insurance is a form of risk management product, many variable annuity contracts have embedded in them multiple layers of risk management that protects contract purchasers. For example, many variable annuities offer “funds of funds”, which provide professional diversification and comprehensive asset allocation, thereby reducing risk. Some contracts also offer funds with “volatility risk management”, which reduces contract volatility and risk.

3. **Annuity commission, fee, and expense structures are fundamentally different from those for traditional investment products, and this must be considered in any analysis of annuities**

Commissions and fees for annuity products work in a substantially different manner than commissions and fees for traditional investment products. As a result, any analysis of annuities, including an analysis of the “reasonableness” of annuity commissions and fees, must consider the unique design features of annuities. These include:

• Insurance product commissions are typically paid up front by the insurance company, and then earned back by the insurance company over the expected lifetime of the product
through the spread on its investments. The insurance company is “at risk” as to when, and whether, it will be able to earn back the commission.\textsuperscript{20} This commission structure benefits contract purchasers, since they receive an account value equal to premium paid, without any deduction for commissions, and this entire value begins earning on day 1. This is in contrast to traditional securities products, where the commission is typically paid up-front by the consumer, and the consumer’s account value is immediately reduced by the amount of the commission.\textsuperscript{21}

- Insurance sales charges are typically “deferred” and “contingent.” This is in contrast to traditional securities products such as the commonly offered A Class mutual fund shares, where the charge is typically immediate and is not subject to contingency. With an insurance product, the sales charge typically is not assessed unless the purchaser surrenders his/her contract early.

- In determining the “value” of a product or the “reasonableness” of commissions, we believe that many consumers would prefer a sales commission paid by the insurer and that those consumers would also prefer a “contingent deferred” charge to an up-front charge taken “off the top.”

4. **Product design and distribution are converging for certain types of annuity products, with the result that diverse types of annuities are more similar to other types of annuities than to traditional investments**

Product design and distribution for different types of annuities are converging in many respects, so that, increasingly, different types of annuities look more similar to other types of annuities than to traditional investment products. In analyzing annuities for purposes of the Proposal, we believe that the relevant consideration is whether the product is an “insurance product” or a “non-insurance product.”

For example, the AZL Group has for many years issued unregistered fixed index annuities. These annuities offer multiple index crediting options, and regulate income crediting primarily by means of a performance “cap.” These annuities offer a minimum death benefit and various annuitization options. Recently, the AZL Group has commenced offering registered index products. These products offer multiple index investing and crediting options, regulate income crediting by means of a performance “cap”, and offer a minimum death benefit and various annuitization options. The principal difference between the registered product and the unregistered product is that the registered product has a higher level of risk and offers higher return potential. (The registered product is not required to comply with standard minimum nonforfeiture laws, but is subject to review and regulation by state insurance departments.)

\textsuperscript{20} While the insurer expects to earn back commission costs through a combination of investment spread and surrender charges, total acquisition costs may exceed spread plus surrender charge and the insurer may incur a loss as a result of the commission. \textsuperscript{21} We note that the DOL is aware of this issue, and in the Proposal it appears to express some ambivalence about traditional investment commissions that are “taken off the top fee” Fiduciary proposal at 9.
This registered AZL Group product blends annuity types in other ways. The annuity offers mutual fund investment options in addition to index investment options, and so it is referred to as “a variable annuity with index investment options.”

The AZL Group has also offered variable annuities with a fixed (unregistered) investment option. The fixed (unregistered) investment option provides benefits which comply with standard minimum nonforfeiture laws required by state insurance regulations.

Other companies are also blending multiple different types of annuity product. One issuer offers a variable annuity with a fixed index (unregistered) investment option. Other companies offer other combinations of registered/unregistered and fixed/index/variable products.

The distribution of different types of annuity products is also converging. As one example, over the last 5 years, many broker-dealers have begun offering unregistered fixed index annuities based on the annuities’ “low risk profile.” From 2010 to 2014, sales of FIAs through regional and wirehouse broker-dealers increased from 2% to 13% of total FIA production. The Allianz Group saw an increase in FIA sales through broker-dealers from $1.49 Billion to $5.62 Billion. More recently, broker-dealer firms have also begun offering unregistered fixed index life insurance products.

Based on the foregoing factors, we believe that annuities should be regarded as a separate asset class.

K. The Proposal Is Overly Complex

The Proposal is highly complex. As a result, the Proposal will be difficult for insurers, marketers, and advisors to administer, which will lead to significant costs and confusion, and inadvertent errors. Many well-intentioned, experienced sales persons could find themselves unintentionally violating various provisions of the Proposal. This sort of regulatory complexity, coupled with potentially punitive sanctions for inadvertent violations, is a significant concern for employers and other fiduciaries. 22 Historically, complexity and unclear legal exposure have led to hesitancy on the part of plan sponsors in offering new plan designs, and an unwillingness to offer clearly beneficial products (e.g., lifetime income options). We believe that this harms consumers. Put simply, while the Proposal is designed to “cast a wide net”, it should not be drafted so broadly as to constitute a “trap for the unwary.” The Proposal should be made as simple, clear, and easy to implement as possible, so as to reduce unnecessary disputes and facilitate innovation in the retirement plan market.

To address concerns about regulatory complexity and unclear liability, the Proposal should be supported by clear, succinct safe harbor protections. Sales persons who are diligently structuring their businesses to meet regulatory requirements should have the benefit of implementable safe harbor guidance. It is generally acknowledged that the lack of this sort of guidance has impeded

22 See notes 3 and 5 of this letter.
We believe that safe harbor guidance would be particularly important in the IRA area, since the Proposal would now in effect subject IRA accounts to ERISA’s fiduciary conflict of interest prohibitions, and sales persons currently working with IRA accounts have little background in these ERISA requirements.

L. The BIC Exemption in Its Current Form Will Lead to Inconsistent and Inaccurate Product Disclosures

The BIC Exemption as currently drafted appears to contemplate that in many instances product and commission disclosures will be prepared and communicated by the adviser, rather than the issuer. This is contrary to current practice in the insurance industry, and we believe it would lead to substantial inconsistent and incorrect information being provided to consumers.

Put simply, we believe that having thousands of sales persons generating “one-off” disclosure materials would be highly counterproductive.

In the insurance industry, product disclosures are typically controlled by the product issuer, and not the individual adviser. This has the benefit of increased uniformity of disclosure, in that hundreds of sales persons selling for an issuer can use the same consistent, carefully reviewed sales materials. Further, if the issuer prepares all sales materials, it can be assumed that the materials will be accurately prepared and thoroughly reviewed by internal compliance departments, and as a result could be expected to be clearer and more accurate than materials prepared by a sales person. If disclosure materials are prepared by a sales person in the form of individualized disclosures, it could be expected that the disclosures would be inconsistent among sales persons, even when the materials describe the same product, and may occasionally be inaccurate.

---

23 See note 7, supra.
In the AZL Group, sales persons are flatly prohibited from independently generating sales materials.  

In the context of SEC-registered investment products, the SEC views consistency and comparability of disclosure to be critical. All issuers must use a standard prospectus disclosure format. SEC requirements even go so far as to require that certain disclosures are subject to “ordering requirements”, so that disclosure A must come before disclosure B, and disclosure B must come before disclosure C.

It should be noted that any disclosure for an insurance product created by a sales person or marketing organization would not exist in a vacuum. That disclosure would likely constitute an “advertisement” for purposes of state insurance laws, and would have to comply with state insurance model advertising regulations. In the context of variable annuities, the materials also would likely constitute a “prospectus” for purposes of Federal securities laws. Any materials constituting a prospectus would have to be reviewed by a Series 24 or 26 “registered securities principal.” Most sales persons are not “registered principals.” The sales materials would also have to be filed with FINRA pursuant to Rule 482. Overall, the preparation and review of the sales materials would be subject to highly detailed laws and regulations. Sales agents may not have the experience or training to deal with these complex requirements.

We believe that the creation of individualized disclosures by sales persons would lead to disruptions of product distribution and numerous errors. Rather than permitting sales person disclosures, the Proposal should facilitate template disclosures by the issuer.

The National Association of Insurance Commissioners (NAIC), following three years of study and debate, has recently promulgated a comprehensive Model Regulation addressing annuity disclosure. We believe that any provision of the Proposal pertaining to fee disclosure should be implemented

---

24 The AZL Insurance Compliance Guide states that

“[A]ll materials promoting an Allianz product must be pre-approved by Allianz. You must first obtain written approval from the Allianz Review department if you wish to promote an Allianz product or service using materials that were not created by Allianz.”

• Similarly, the AZL Advertising Manual, which is used for both fixed and variable business by the AZL Advertising Compliance group, states that

“Each individual developing or submitting materials for review and approval is responsible for...ensuring that the material is not used, distributed, mailed, or shown in any form until the required reviews have been conducted and the piece has Supervisory or [Registered Principal] approval prior to use.”

• Similarly, the standard form “selling agreement” entered into between the AZL Group and third-party broker-dealer firms selling AZL annuities states that

“[the selling firm] and all persons associated with [the selling firm] shall use only those sales, advertising and promotional materials which have been approved in writing by Allianz. Any sales materials created by [the selling firm] or its associated persons that refer to [AZL]...or [AZL] products must be submitted to the AZL Group for prior review and approval. This applies to sales material in paper, electronic, or any other form.”
through the NAIC Model Regulation or, for securities products, through the statutory prospectus, following consultation by the DOL with the SEC and FINRA.

M. “Reasonableness” of Compensation

The Proposal requires, basically, that advisers and financial institutions must determine that compensation received by the adviser is “reasonable.” However, in the context of insurance products, the analysis of “reasonableness” is often substantially different from, and more complex than, the analysis for traditional securities products. Additional guidance should be given on the determination of “reasonableness” of compensation in the context of annuity products.

- A single annuity may offer dozens of “investment” and “insurance” features, and not just a single “investment.” The sales person must be able to advise the investor on all of these features. For example, a modern variable annuity typically offers 50 or more variable investment options, managed by 10-20 different portfolio managers and/or sub-advisers. Similarly, index annuities may offer 3-5 different equity and/or fixed income index crediting options. In addition, an annuity typically will offer various “insurance features.” A variable annuity may offer a traditional death benefit, a guaranteed minimum income benefit, and/or a guaranteed minimum asset benefit.

- In addition to advising on annuity “investment” and “insurance” features a sales person must also be cognizant of all of the laws that affect annuity products, including tax laws.

- Further, as noted above, commission and fee structures work differently for annuities than for traditional investment products, in that the issuer, and not the consumer, is paying the sales commission. Some consumers may find a product benefit in this structure. Guidance should be given as to the situations in which beneficial commission payment structures may result in a higher level of fee being “reasonable.” Put another way, in what situations would a 5% sales commission be unreasonable if paid by the consumer, but reasonable if paid by the insurer?

In sum, we believe that in assessing the reasonableness of annuity compensation, the value of all of the various embedded and separate annuity features and benefits must be carefully reviewed. An annuity cannot simply be analyzed as a traditional “investment.”

N. The DOL Should Not Become Enmeshed in Determining What Sorts of Compensation Are Permissible, or What Sorts of Investments Are “Permitted Investments” for Plans or IRAs

The Proposal attempts to both restrict the sorts of compensation that are permissible, and to restrict the sorts of investments that are “permitted investments” for qualified plans. Both of these actions appear to exceed the DOL’s authority. We do not believe that the DOL should become involved in what resembles a rate setting activity.

In the proposed exemptions, the DOL attempts to manage compensation practices by prohibiting, certain types of compensation — in an unprecedented level of detail — when products are sold pursuant to the exemptions. For example, any company relying on Exemption 84-24 would apparently be prohibited from paying “marketing support payments.” The proposal also seeks to make distinctions between “permitted” and “non-permitted” investments for plans and IRAs. For
example, interests in publicly traded REITs would be considered permitted “assets”, whereas interests in non-publicly traded REITs would not. We believe this sort of involvement in the regulation of commissions and permitted investments is well outside the DOL’s mission and function.

In analyzing this issue, it is important to again review historical Congressional intent. Prior to 1996, the SEC was permitted to approve fees and charges for variable annuity products through the exemptive order process. However, in 1996, Congress enacted the National Securities Market Improvement Act of 1996 (NSMIA). Pursuant to NSMIA, the SEC was taken out of this “rate setting” function, and responsibility for determining “reasonableness of fees and charges” was allocated to the product issuer. See Investment Company Act Section 26(f). The issuer met its obligations primarily pursuant to an actuarial “reasonableness” memorandum. While NSMIA deals with all contract fees and charges, and not simply sales compensation, we believe that the Act indicates a Congressional intent that commissions, fees, charges, rates, and “permitted investments” should not be set by Federal Departments or Agencies. The DOL should not take on the role of a sort of “rate setting agency.”

O. The Proposal Should Clarify that “Principal Underwriters” that Are Non-Retail “Wholesalers” Are Not Fiduciaries

The Proposal should clarify that principal underwriters that act as a “wholesale” broker-dealer are not fiduciaries. In the insurance industry, products are frequently sold on a “wholesaling” basis. In a wholesaling structure, the insurer establishes a subsidiary broker-dealer to meet regulatory requirements. The broker-dealer does not, however, function on a retail basis or make recommendations. Rather, the wholesaling broker-dealer enters into selling agreements with third-party, largely unaffiliated broker-dealers, and these third party firms conduct all product sales, make all recommendations, and determine suitability. The wholesale broker-dealer does not make recommendations, determine suitability, or receive sales commissions. The wholesale broker-dealer is operated on a breakeven basis, and all sales commissions are paid to the third-party selling firm.

For example, Allianz Life Financial Services, LLC (ALFS), a wholly owned subsidiary of AZL, is the wholesaling broker-dealer for the AZL Group. While ALFS acts as principal underwriter and distributor for the AZL Group, it does not provide individualized investment advice, make recommendations, determine suitability, or receive sales commissions. ALFS’ Written Policies and Procedures, Section 9.1, expressly prohibit ALFS personnel from engaging in retail selling activity:

“ALFS [registered representatives] are prohibited from engaging in any retail securities activities, as its business is limited to wholesaling variable annuities to other [registered representatives] and [broker-dealers].”

Regulatory filings by AZL clearly disclose how ALFS operates, and that all commissions are paid out to retail firms, and that ALFS does not receive transaction-based compensation. See Post-effective Amendment to SEC Registration Statement No. 333-182987; 811-05618; Statement of Additional Information at pages 2-3.
We believe that it should be clarified that principal underwriters that are wholesalers and that do not make specific recommendations and/or receive transactional compensation are not fiduciaries.

P. The Proposal Should Clarify that Salaried Back-Office Clerical Employees Such as Telephone Center Employees Who Are Employed by “Wholesalers” Are Not Fiduciaries

As discussed above, many insurance companies and their affiliated principal distributors operate on a wholesale basis, and do not make specific product recommendations to consumers. Further, they do not receive transaction-based compensation. These companies do, however, maintain internal customer service and phone center personnel, who may assist prospective and current contract owners with product information. These people are not paid transaction-based compensation.

The Proposal should clarify that these telephone center employees are not fiduciaries. Initially, internal personnel of wholesalers are compensated by salary, and not transaction-based compensation, and so do not receive “variable compensation” within the meaning of the Proposal. Further, because these internal personnel work for wholesale broker-dealers that do not provide personalized advice and do not receive transaction-based compensation, we believe it is clear that they are not receiving “direct or indirect” compensation and therefore are not fiduciaries. However, we are concerned that the proposed regulation, and the preamble thereto, could be read otherwise.

Q. The BIC Exemption Should Clarify Responsibilities in Multi-Party Transactions

The Proposal “casts a very wide net”, in an attempt to identify all persons who may have a responsibility for a product recommendation. We believe that this may lead to a lack of clarity as to which party is responsible for a transaction, particularly in multi-party transactions where the transaction involves multiple affiliated and unaffiliated providers. We believe it should be clearer who responsibility attaches to in a particular transaction, and in what situations and when the responsibility attaches.

Currently, the BIC Exemption provides for the concept of a “financial institution”, and assumes that the advisor is employed by, or is a sales agent or registered representative of, that financial institution. The financial institution must sign the contract with the consumer that is required by the BIC Exemption. This responsibility will be very difficult to administer in the context of a multi-party transaction.

Initially, it is important to identify the various parties that may be involved in an insurance transaction.

- An insurance product must be issued by a licensed insurance company.
- The sales person must be a licensed insurance agent, who is “appointed by” the insurance company. The insurance agent is permitted by applicable law to be appointed to multiple affiliated and unaffiliated insurance companies. To offer a broad product mix, the sales person is often licensed to sell multiple types of insurance and non-insurance products, and is appointed to 5-6 insurance companies. Suitability review for a traditional (non-securities) insurance product is typically performed by the insurer.
If the product being sold is a security, such as a variable annuity, the product must be sold by an appointed agent through a registered broker-dealer, the sales person must be “licensed to” the registered broker-dealer, and the sales person must be a “registered representative” with a Series 6 or Series 7 securities license. The broker-dealer is often unaffiliated with the insurer. Unlike in the traditional insurance industry, where an agent can be “appointed to” multiple insurance companies, a registered representative can only be “licensed to” one broker-dealer. If the product being sold is a security, the suitability review is performed by the broker-dealer.

The sales person may also be an “investment advisory representative” (IAR) who is licensed to provide investment advice regarding securities for a fee. As an IAR, he/she must have a Series 65 securities license. The sales person may either be an individual investment adviser, or may be “licensed to” an investment advisory firm. The IAR typically does not perform a classic “suitability” review, but is subject to an investment advisory fiduciary duty standard. The IAR and investment adviser may be unaffiliated with the insurer.

Initially, this sort of structure would raise a question, in the context of the sale of a variable annuity, as to whether the “financial institution” is the insurer, the unaffiliated broker-dealer, or both. This issue is largely resolved in the securities industry, where it is assumed that the broker-dealer, and not the insurer, is responsible for selling activities involving securities. However, the Proposal should give guidance on this point.

A second question would come up as to which party is responsible if the product being sold is a fixed annuity. The answer to this question is less clear in the securities industry. With a variable annuity, the broker-dealer is clearly subject to FINRA suitability requirements. With a fixed annuity, however, responsibility is less clear, and as a practical matter, responsibility for sales practice review is typically negotiated between the parties.

A third type of question might arise where multiple product presentations are involved, and the products are offered by different insurers, are of different types, and are sold through different parties. For example, a sales person may present 2-3 different variable annuities, two types of mutual fund shares, and a fixed index annuity. Certain of these products may be “sold through” a broker-dealer, whereas others are not. One of the products may be a no-charge/no-commission “investment adviser variable annuity”, which is offered by the sales person in his capacity as an investment advisory representative who is licensed to an independent registered investment adviser. The type of product being recommended may change repeatedly during the presentation. In this scenario, the financial institution would change repeatedly over the course of the product presentation.

Substantial guidance should be given as to the allocation of responsibility in this sort of transaction.

R. The Proposal Should Be Clarified as to the Definition of “Direct or Indirect Compensation”

As discussed in Section III.B above, the Proposal in various places uses the term “direct or indirect compensation.” This terminology is very broad, is of unclear applicability, and could lead to a wide
range of disputes. We believe this terminology should be focused considerably. We recommend that:

- The term “direct or indirect compensation” should be clarified to refer to “direct or indirect transaction-based compensation.”
- “Indirect compensation” should exclude salaries, which are not “variable compensation” within the meaning of the Proposal. It should be clarified that “indirect compensation” only applies to variable compensation and not salaries, and then only if the compensation relates to specific investment advice.

S. The Proposal Should Include Clarification and Guidance In the Form of Safe Harbor Protections

To the extent the Department determines to go forward with the Proposal in substantially the form presented, safe harbors should be provided to make it easier for advisers to determine that they are in compliance. Compliance certainty not only benefits the adviser but also benefits the retirement investor by ensuring consistent protective practices throughout the industry, without the need for the investor to initiate a lawsuit to determine whether conduct standards have been met. It could also be expected that compliance certainty would also result in a more diverse plan choice and a higher level product innovation.

1. Procedural prudence safe harbor

For a variety of reasons, advisers, particularly insurance agents and independent broker dealers, may have difficulty understanding and ensuring that “Best Interest Standards,” as they have been articulated in the BIC Exemption have been met. As recognized in the preamble to the proposed BIC Exemption, a proper analysis of fiduciary behavior focuses on the process that a fiduciary uses to investigate the merits of an investment. The Proposal, however, particularly the BIC Exemption, is not process-driven but instead takes a punitive stance. The BIC Exemption, with its emphasis on enforcement through a private right of action, would require the IRA owner or participant, the very individual the regulation is designed to protect, to have the resources and wherewithal to take it upon himself to enforce the law. While the Department seems to contemplate enforcement through class action lawsuits, these are expensive and can drag on for years before plaintiffs receive recovery, if any. There could also be a significant question as to whether individual IRA claims would ever meet the class action requirements for commonality.

The Proposal could more efficiently and effectively meet its consumer protection goals by setting forth procedural exemption conditions designed to safeguard participants and IRA owners. This would both provide immediate benefits to the advice recipients and provide certainty to advisers trying to comply with the new standards. Rule-making through litigation

---

25 It is unclear that the Department has the authority to create a private right of action to enforce ERISA and/or the Internal Revenue Code. See Alexander v. Sandoval 532 U.S. 275, 286 (2001) (“[P]rivate rights of action to enforce Federal law must be created by Congress.”) See also Massachusetts Mutual Insurance Co. v. Russell, 473 U.S. 134, 147 (1985) (“We are reluctant to tamper with an enforcement scheme crafted with such evident care as the one in ERISA.”)
is fraught with unnecessary costs and uncertainties. This result can be mitigated by well-designed safe harbors that would establish, absent evidence to the contrary, that the parties have followed prudent procedures with regard to investment recommendations and thus have satisfied the requirement that the investment recommendation be in the best interest of the retirement investor.

Safeguards that could be considered in developing procedural prudence safe harbors include the following:

- Adherence to state and, if applicable, Federal suitability standards;
- Sales in accordance with state standard minimum nonforfeiture laws, which both protect principal values and act as a “cap” on sales charges;
- For annuity contracts, disclosure of general considerations for the purchase of annuities (based on the Department’s existing safe harbor guidance for selection of annuity provider);
- Demonstrated compliance with relevant policies and procedures the Financial Institution is required to develop;
- For insurance products, demonstrated compliance with state insurance law consumer protection and merit regulations described in Section III.I above.
- A clear (perhaps written) indication to the consumer that the agent is describing the features and benefits of the product he/she is selling, not acting as an independent fiduciary.

As an alternative to a safe harbor, the preamble to the final exemption could provide examples that illustrate typical scenarios that involve a prudent process by the adviser and therefore would not generally violate best interest standards.

2. Reasonable compensation safe harbor
Advisers and financial institutions do not have the ability to engage in the sort of evaluative processes that plan-level fiduciaries follow when analyzing and selecting investment providers. Unlike plan-level fiduciaries, advisers are constrained from being able to, e.g., embark on an RFP process or compare pricing of a variety of available annuity products with different benefits, rights and features. In fact, antitrust laws may restrict them from even attempting to do so. The Department has not indicated that it has consulted with the Federal Trade Commission regarding the extent to which attempts to comply with this requirement might be construed as illegal price-fixing, or that it has even considered antitrust laws in developing a rule that would require advisers and financial institutions to warrant that their total compensation is reasonable.

This problem is exacerbated in the context of determining reasonable compensation for effecting the sale of multi-faceted annuity contracts. As described in more detail above, insurance contract costs, including sales compensation, may vary substantially depending on the number and type of optional riders selected. Optional benefits can vary widely among products. Further, the cost of product features is often built into the contract or rider, and is not a separate cost. Perhaps most problematic, there are many features included in annuity
contracts that require substantial actuarial and financial expertise to value. A comparison of annuity products involves more than simply comparing dollar amounts. Insurance companies typically employ staffs of actuaries, accountants, and investment experts to determine pricing. These pricing processes are often considered proprietary in nature.

For these reasons, among many others, AZL does not believe that insurance sales agents, whether or not they become advisers, or even most financial institutions, are able to properly evaluate, ensure and warrant that reasonable compensation standards are met. In the event that the Department moves forward with shifting the reasonable compensation determination responsibility from the plan-level fiduciaries to the adviser and financial institution, it should be done through process-driven compliance standards that take into account the realities of legal and marketplace constraints. These standards could take the form of reasonable compensation safe harbors, which could be incorporated as part of the conditions for exemptive relief.

For annuities and other insurance products, this safe harbor could include the following conditions:

- The product complies with state standard minimum nonforfeiture laws (if applicable), and with all other Federal and state laws addressing insurance pricing;
- The adviser provides disclosure similar to that required under current PTE 84-24, plus additional explanations for annuity sales. The additional disclosure would be in the nature of a general explanation of the factors that should be considered in selecting an annuity product and could be based on the Department’s existing safe harbor guidance for selection of annuity providers.
- Any recommendation meets the suitability requirements of state insurance law.

As an alternative to a safe harbor, the preambles to the final exemptions could provide examples illustrating situations where reasonable compensation standards have been met. These examples would expressly reference the various considerations in pricing an annuity contract, including number and type of investment options available; value of embedded and optional insurance features; whether the commission is paid by the customer or the insurer; and whether the sales charge is automatic or is deferred and contingent upon holding the annuity for the period specified in the contract.

3. **Safe harbor for certain limitations on the range of investment options**

The BIC Exemption imposes conditions related to limitations on adviser recommendations which appear to be based on a misperception that it is the financial institution that places limitations on the range of products that advisers may recommend. In reality, there are a number of other reasons why an adviser may be limited in what he/she can recommend. As the Department is aware, advisers must be licensed to sell either securities or insurance products, and the particular products that the adviser may sell will be limited by the type of licenses that the adviser holds. An insurance agent, if licensed solely under state insurance
law, would not be able to recommend securities, including a variable annuity, because he or she does not have a series 6 or 7 securities license. Similarly, a securities broker-dealer or registered representative would not be able to recommend annuities unless they also hold an insurance license.

In addition, AZL objects to, as unworkable, the BIC Exemption requirement that a financial institution conduct a specific written finding that any limitations on recommendations will not prevent an adviser from providing best interest advice. AZL’s products are distributed through over 129,904 independent agents, and it would be impossible for AZL to continually update its analysis in this regard. Moreover, if the subject of this regulation is truly individual investment advice, this sort of finding would need to be specific to each individual and thus, in addition to being enormously impracticable and costly, would be impossible to accomplish because the BIC Exemption requires that the contract be entered into before the sales recommendation process begins.

AZL agrees that it is important for an investment advice recipient to be aware of any limitations on the range of investments that the adviser may recommend. AZL proposes that the range of investment options condition be condensed to a requirement of a written disclosure describing any limitations and the reason for the limitation (e.g., license restrictions, employment restrictions, excessive risks of certain types of products). At a minimum, providing this disclosure should serve as a safe harbor where the adviser’s limitations on the range of investments is driven by factors other than his own potential for personal gain.

In the alternative, AZL requests that the Department create a safe harbor to clarify that in connection with the sale of an insurance product, Section IV (b)(2) of the BIC Exemption requiring that compensation be reasonable in relation to the value of specific services, will be deemed to have been met in cases where the insurance contract has been approved by applicable state insurance departments and the product is in compliance with Federal and state requirements as to commissions and suitability.

4. **PTE 84-24 should include procedural prudence safe harbors based upon current insurance regulatory requirements**

When ERISA was enacted, Congress made clear its intention that state insurance law should continue to govern the business of insurance by saving those laws from ERISA preemption. The current version of PTE 84-24 is a disclosure-based exemption and therefore might not be considered to directly impose upon state insurance regulations. The proposed addition of the impartial conduct standards to 84-24, however, goes further because it potentially usurps state insurance regulations governing the sale and pricing of insurance products. This would subject insurance agents and companies to two sets of conflicting regulatory structures, one at the state level and another at the federal level. This is precisely what Congress sought to prevent through ERISA’s preemption and insurance savings clauses.
If impartial conduct standards are added as a condition to PTE 84-24, the exemption needs to also include safe harbors for reasonable compensation and procedural prudence in the context of the sale of insurance contracts. As noted above in the discussion on safe harbors for the BIC Exemption, these safe harbors should make clear that compliance with applicable state insurance laws will be deemed to constitute compliance with the impartial conduct standards for purposes of the exemption.

IV. CONCLUSION
The Allianz Group appreciates the opportunity to comment on this important proposal.

As outlined in this letter, we do not believe that ERISA and relevant case law authorize the promulgation of the Proposal in its current form. Specifically, ERISA does not support the treatment of insurance sales agents as “fiduciaries.”

To the extent the Proposal is adopted, the analysis in the Proposal should place substantially more focus on the unique aspects of annuity products, including principal protection, product guarantees, lifetime income options, and the protections of merit regulation.

To the maximum extent possible, any revised Proposal should attempt to significantly reduce the complexity of the Proposal, and provide a series of safe harbor protections, to assure that sales persons have clear, implementable guidance on how to assure their businesses remain compliant. We believe this is in the best interest of both consumers and sales agents.