Allianz Life Insurance Company of North America

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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).[1] 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

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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.[2] 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.[3] 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.

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[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.[4] 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.[5]
- 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.[6] 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

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[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 Plan*s 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.[7]

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]the 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."[8]

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." [9]

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…."[10]

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.[11]

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.

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[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 (5h Cir 1988)

[10] *Schloegel v. Boswell, 994F.2d 266 (5th Cir. 1993) cert. denied, 510 U.S. 964 (1993).*

[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.[15] 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.[16] 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.

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[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.[17] 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.[18]

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:

Product Feature	Types of Risk
Annuitization	Asset/liability management risk assumed by insurer; annuitant longevity risk
Traditional minimum death benefit	Mortality risk; market risk in variable annuities; utilization risk; investment duration risk
Market-based product guarantees	Hedging risks; volatility risks; interest rate risks; utilization risk; investment duration risk
Guaranteed minimum income benefit	Longevity risk; asset/liability management risk; interest rate risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk
Guaranteed minimum withdrawal benefit	Longevity risk; asset/liability management risk; interest rate risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk
Guaranteed minimum asset benefit	Asset/liability management risk; interest rate risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk

Product Feature	Types of Risk
Guaranteed target date benefit	Asset/liability management risk; interest rate risks; volatility risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk
Guaranteed Increasing Payout Benefit (e.g. inflation-linked increasing income benefits, performance-linked increasing income benefits)	Inflation risk; longevity risk; asset/liability management risk; interest rate risks; hedging risks; market risk in variable annuities; utilization risk; investment duration risk
Enhanced liquidity benefits (e.g. Unemployment benefits or confinement benefits)	Morbidity risk; health risk; employment risk; utilization risk; investment duration risk; asset/liability management risk

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.[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.[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.)

[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.
[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.

retirement plan design in a number of areas, including specifically in the highly important area of retirement income solutions.[23]

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.[24]

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 distributers 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.[25] 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.