AMERICANS FOR ANNUITY PROTECTION

Advocacy in Action. Prosperity for All.

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Vice Chairman & CEO
July 21, 2015

VIA ELECTRONIC DELIVERY

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

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32)

Dear Sir or Madam:

Annuities are unique among all financial instruments because they provide a guaranteed income for life – easing the anxiety virtually all seniors experience for -"outliving their money." Americans for Annuity Protection defends the rights of Americans to maintain their financial independence and represents all Americans who already own an annuity or would benefit from owning an annuity.

Americans for Annuity Protection is grateful for the opportunity to comment on the Department of Labor's (the Department's) proposed regulation defining the term "fiduciary," the two new prohibited transaction exemptions, and the related amendments to the four existing prohibited transaction exemptions that the Department released on April 14 (the "Proposed Rule"). This letter specifically addresses the Department's request for comments on whether to "leave in place relief for IRA transactions involving insurance and annuity contracts that are not securities [i.e., fixed annuities] strikes the appropriate balance and is protective of the interests of IRAs." ***Specifically, we are requesting that the class exemption be retained to cover transactions that include the purchase from plan assets of a non-securities insurance or annuity contract from any individual, insurance company, or other entity (including affiliates of any individual, insurance company, or other entity) licensed by the state to transact the sale of a non-securities insurance or annuity.***

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The annuity marketplace is the most underserved and, therefore, underutilized market for retirement savings. Today less than 1% of all employer-sponsored plans offer annuities[1]. So for many, the only option for employer-sponsored savings to provide security and lifetime income is an annuity IRA.

The U.S. Government Accountability Office (GAO), a non-partisan federal agency focused on reducing wasteful government spending, recognized the benefit of annuities in their 2011 report entitled "Ensuring Income throughout Retirement Requires Difficult Choices." The Report highlights the increasing income gap from lower and lower Social Security payments, which underscores the need for Americans to buy more annuities: "Even under the current generous benefit schedule, social security cannot be relied on to fully replace a person's preretirement salary." According to the GAO report, for low-wage earners (i.e., 45 percent of national average) social security replaces only 55.2 percent of pre-retirement income and for high-wage earners (i.e., 160 percent of national average) the replacement rate is only 33.9 percent. Five years later, those numbers are even more concerning.

Americans with employer-sponsored defined contribution plans face a number of difficult choices regarding their savings account balances, such as leaving money in the plan, purchasing an annuity, or rolling over their savings into an IRA. Based on 2014 sales of annuities, slightly more than 50 percent of all fixed annuity sales (the product offering guaranteed income AND protection from market losses) were IRA purchases, representing about $40 billion of American worker savings.

The GAO report recognizes the benefits of annuities: "An annuity is an insurance agreement or contract that comes in a number of different forms and can (1) help individuals accumulate money for retirement through tax-deferred savings, (2) provide them with monthly income that can be guaranteed to last for as long as they live, or (3) do both."

In addition, the GAO report recognizes the value of delaying guaranteed payments by suggesting that by delaying Social Security payments – the public version of commercial annuities – the payments recipients will receive will be higher. Likewise, with the growing longevity crisis and individuals living longer in retirement, a deferred annuity with lifetime income options allows individuals to defer taking that income until they want or need it – and those deferred payments remain guaranteed.

[1] A study for the U.S. Department of Labor, Employee Benefits Security Administration.

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A Fiduciary Standard on Fixed Annuities Will:

Further Erode America's Retirement Security

Americans for Annuity Protection believes that imposing a fiduciary standard on top of a suitability standard on the sale of annuities will even further erode their availability to Americans. We believe the only course is to maintain the Amendment to Prohibited Transaction Exemption 84-24 adopted in 2006. This exemption recognizes the unique role annuities play to insure retirement savings and provide guaranteed income for life.

Reduce Annuity Income Benefits, Interest Crediting and Americans Retirement Savings

The Department's assumptions of the cost of the paperwork burden for PTE 84-24 is woefully underestimated. In 2014, approximately $40 billion dollars of annuities were sold as IRAs. According to the US Census Bureau, the average IRA annuity premium is $40,000. That represents almost 1,000,000 policies in just the annuity IRA space and does not include any other financial products (e.g., variable annuities, mutual funds, etc.). The Department assumes just 645,000 "disclosures and notices" annually. The insurance industry and IRA agents and advisor will need to provide these 450,000 annuity policyholders not only notices and disclosures, but compliance guidelines and requirements to agents and advisors, notices to the independent fiduciary to request the exemption, as well as guidance on record keeping compliance – and that is just the tip of the iceberg. The entire annuity policyholder fulfillment systems and policyholder service platforms will need to be dismantled and rebuilt to comply with the requirements of the exemption. The burden of these excessive costs will impact the consumer's value proposition of the annuity contract. Without refiling the thousands of annuity products already available to Americans the likely impact will be lower interest crediting.

Cost Americans More to Obtain Annuity Advice and Limit their Access to Advice

Since the Proposed Rule is constructed to favor fee-only advisors, it is a major threat to the fixed annuity distribution model that is currently structured to fairly compensate agents who work with less affluent consumers. A change to the model would make it cost prohibitive to provide annuities to those who may need them the most.

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Cause Unintended Discrimination

Americans for Annuity Protection recently published a Study[2] finding that requiring a fiduciary-only standard unintentionally discriminates against minorities because a disproportionate percentage do not have sufficient assets to be accepted as clients by most fee-based fiduciary advisors.

The Department's Proposed Rule would cause undue hardship to over 88 million households. Since the median value of an IRA account is $34,000 and the median value of a 401(k) plan account is $30,000 a fiduciary-only standard for qualified accounts would effectively deny the vast majority of Americans access to professional financial advice [Source: U.S. Census Bureau, Survey of Income and Program Participation, 2011]. More than 80% of fee-based advisors define their core market as clients with a minimum of $250,000 [Franklin, 2011]. Many larger firms have a $500,000 minimum. A common practice for these firms to increase their "assets under management" and subsequently their revenue, is to advertise against annuities and recommend rolling annuity assets over to the firm to manage.[3] They even offer rebates on surrender charges as incentives. These same activities (investment advertising and rebates) are against the law for annuity agents and/or insurance companies.

African-Americans with an IRA have a mean account value of $39,423; if they participate in a 401(k) or thrift plan the mean value is $45,274. Americans of Hispanic origin participating in a 401(k) have a mean account value of $41,834 and those with IRAs have a $64, 978 average value. Even if fee-based advisors were encouraged to drop their minimum account size to $100,000, a statistically significant percentage of African-Americans and Americans of Hispanic origin would have insufficient assets to secure financial help from advisors with their qualified accounts when compared with white Americans. What the DOL fiduciary-only plan effectively does is create a bar that keeps the majority of minorities from getting professional financial advice.

Not every fee-based, fiduciary-only advisor has a minimum account size, but those that do not tend to have minimum fees. Doing a web search for fee-based advisor minimum account size Americans for Annuity Protection found minimum annual fees ranging from $1,875 to $6,500 [Marrion, 2013]. Consider a consumer with only $60,000 of additional financial assets; those first year fees would be equivalent to between 3.1 percent and 10.8 percent of assets. Even if the consumer decided on a do-it-yourself approach thereafter, those are still significant one-time hits.

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[2] **The Flawed Arguments of Department of Labor's Fiduciary-Only Rule,** Produced for Americans for Annuity Protection by Dr. Jack Marrion and Kim O'Brien, CFP, MBA, June 2015

[3] Ibid.

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By contrast, the typical minimum required to purchase a fixed annuity ranges from $5,000 to $25,000 and is often $1,000 for qualified accounts. Fixed annuity agents can and do provide the same professional service for consumers whether the annuity premium is $5,000 or $500,000. A fiduciary-only standard would effectively raise these minimums so that the use of the agent's time and expertise is justified. The net effect would be a dramatic increase in the minimum annuity premium required, with the result that millions of consumers would be unable to purchase an annuity and receive an income guaranteed for life.

The fiduciary-only standard effectively creates two classes – the affluent who have sufficient assets to justify the time and fees of the advisor - and the much larger mass market who will be unable to get professional financial advice. The fiduciary-only standard places an excessive burden on African-Americans and Americans of Hispanic origin because far fewer meet the minimum threshold for financial advice. In practice, requiring a fiduciary-only standard is, essentially, discrimination against certain minorities.

If a fiduciary-only standard were adopted by either the Department or the Securities and Exchange Commission, the effect would be catastrophic on all but the most affluent Americans. The suitability standards currently in place are effective and permit mass and middle market Americans to work with a financial professional, regardless of the modesty of their assets. The adoption of a fiduciary-only standard, especially by the Department, would effectively bar 80 percent to 90 percent of African-Americans and Americans of Hispanic origin from receiving professional financial advice.

The Client's Best Interest Is at the Core of the Suitability Standard and the Best Protector to the Consumer from Conflict of Interest.

The Department's desire for a fiduciary fee-based only standard is no doubt well-intended. However, the Department's analysis does not recognize that the suitability standard required by state law is already serving consumers' best interests. In 2014, consumer complaints involving securities and advisors represented over 97 percent of combined annuity and securities complaints. The reason that 99.97 percent of annuity owners have not complained – based on annual sales – is because the fixed annuity industry is already acting under a higher standard of conduct.

Insurance companies, **not individual brokers and advisors**, are liable under the standards imposed on state departments of insurance by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act and state suitability laws. The requirements are that:

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- All annuity recommendations must be reviewed by the carrier **before the annuity is even issued**.
- All annuity salespeople must be trained in every product they recommend before the recommendation and the insurance company is liable to oversee that product training and maintain records of compliance. This product-specific training is not required in any fiduciary standard of the sale of any other financial product.
- All annuity complaints must be logged and all actions taken to resolve must be kept in accordance with strict record-keeping requirements. Those records are subject to routine and frequent audit by state insurance department auditors whose sole purpose is to determine that customers' best interests are met through compliance with state laws.
- All suitability compliance, systems of supervision, and record-keeping are outlined by state market conduct rules and are subject to audit by state insurance department auditors whose sole purpose is to determine that customers' best interests are met through compliance with state laws.
- Suitability recommendation has empirical, measurable standards, unlike a more subjective fiduciary standard.

State Regulation Puts the "Client's Interest First" and Is the Best Protector of Consumers.

At minimum, and subject to state law, every annuity sold must offer the consumer:

- A product that is filed and approved by the state insurance department in the state the consumer resides and/or purchases the annuity.
- A product that meets stringent statutory non-forfeiture rules, with minimum guaranteed interest.
- A free look period, during which the consumer may decline the policy and receive a full refund of premium paid.
- The laws of agency require that agents maintain a valid license in every state in which they do business and maintain active appointments with every carrier for whom they sell annuity products.
- State insurance laws covering misleading and deceptive advertising, disclosure, annuity illustration, fraud and elder abuse have documented success of protecting consumers;

In addition to these specific protections, all annuity account values held by the insurance company are subject to strict reserving laws to ensure solvency and financial prudence.

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By contrast, state security regulators provide only “low net worth guidance ($10,000) and the SEC has no net worth requirement for investment advisors; that means if the fiduciary standard is breached there may not be money available with the advisor or firm to recover any losses.

Further, state guaranty fund laws protect annuity owners with substantial guarantee thresholds. The protections afforded through the guaranty system, the generally conservative nature of insurance company investments, and the effectiveness usually demonstrated by regulators in intervening promptly when life insurers face financial difficulties saw that between following the economic crisis and between 2008 and 2012 only four life/annuity companies failed. Most importantly, all policies were taken over by a solvent insurer and all contracts were honored.[4]

And finally, if a fiduciary duty is breached, a customer’s only recourse is through the courts which can be a lengthy and expensive process. Whereas, with the suitability standard the customer calls or visits their state insurance department and works with a state auditor who investigates the claim and determines the remedy based on the facts of the case. Furthermore, the state insurance department’s role is to enforce strict consumer protection laws; whereas the courts must remain impartial to either party.

The Fee-Only Model Can Generate Higher Compensation versus Commission-Based

The justification often used for a fiduciary-only, fee-based standard is that is it less expensive for the consumer than commission-based compensation. Although that may be true for consumers with substantial financial assets, it is not necessarily true for most consumers.

If a fee-only advisor accepts smaller accounts, the annual fee is often 2 percent of the assets in perpetuity [Franklin]. It is illustrative to compare that compensation paid with a consumer with $100,000 who wants preservation of principal. In one case the consumer will buy a fixed annuity, in the other an advisor has a 2 percent fee. In both cases, the yield is assumed at 3% and the timeframe is 5 years. Under the fee-based advisor method, the total advisor fees paid over five years would be $10,190. However, an examination of 37 multiple-year guarantee annuity policies with a 5-year rate guarantee shows the average agent commission would be a one-time payment of $2,400 (annuityratewatch.com, 06/26/14). Assuming the consumer could even find a fee-based, fiduciary-only advisor willing to take a client with only $100,000 the advisor earns $7,790 more than the fixed annuity agent in compensation over the five years.

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act makes clear that the *form* of the compensation does not, per se, prevent an advisor (or agent) from earning a commission. It is expected that those held to a fiduciary standard will fully disclose both the method and

[4] Source: https://www.nolhga.com/factsandfigures/main.cfm/location/insolvencies.

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amount of compensation from all sources, and Americans for Annuity Protection supports commission disclosure under any regulatory rubric.

Beyond considerations of "how I get paid", there is a mistaken belief that "*what* I get paid" is somehow adverse to the best interest of the client. Perhaps the assumption is that a "fee-only" advisor would have access to - or otherwise recommend - the deployment of a so-called "low-load" annuity, and for this there are two observations:

1. Anecdotally, Americans for Annuity Protection has found that pure fee-only planners (those who are not compensated for the placement/implementation of a financial product) are far less likely to recommend retirement annuities in spite of the specific and unique benefits such annuities provide. Among other reasons, the most credible is that a fee-only planner is not licensed to sell – and thus is neither educated (nor re-educated through periodic continuing education requirements) nor comfortable recommending annuities to their clients. Consumers inquiring about the benefit of retirement annuities will often be told: "… you don't need that. The fees are high - and in any case we can do much better for you through our investment management." This is a benign form of negligence; an investment portfolio in support of retirement has a very different risk profile than does a lifetime annuity.
2. Americans for Annuity Protection is conducting an informal solicitation of benefit quotations for immediate and deferred immediate annuities for males and females at ages 60, 65, 70 and 75 from both "low-load" (no agent/no commissions) and commercial carriers utilizing agents and paying commissions. While not yet complete, preliminary findings indicate that at some ages a straight life annuity providing monthly income may be somewhat higher for a given premium on a "low load" basis – and at others ages, the "commission paying" annuity provides the higher monthly income.

Conclusion

Today, every 9 seconds an American retires. That means every 9 seconds someone is relying on a prescribed income that she hopes will last until she takes her last breath. During the Great Recession, Americans lost over $5 trillion in their savings and pensions. While much of that has come back, can Americans relying on their investments and living on a fixed income afford another devastation? Where will the money come from? Even in a time of unprecedented stock market growth, more and more citizens are frightened about their financial future, yet have saved very little to secure it. This is a time crying out for more security and guarantees, not less.

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Americans need more access to professionals to help chart their later years, not fewer channels of advice.

Annuity rollovers to IRAs are an important option for those who make the transition to retirement. With advice from a licensed annuity agent, broker or advisor, they can consider the appropriate balance of immediate and/or deferred annuities to manage that portion of typically "core" monthly expenses with confidence that their critical ongoing living expenses will always be covered.

If this rule goes into effect as is, it will establish the conditions that will keep ordinary consumers from getting the advice and assistance they so desperately need. And instead, this will place more of Americans' money in risky investments, while sending more of this nation's wealth into the already-ample coffers of Wall Street investment firms.

With this rule and the precedent it sets, average Americans will be forced to choose between paying fees for advice, going it alone, or giving their personal financial information to an "online entity" with little comfort of its privacy and protection. In a time when middle-class consumers are struggling with college costs for their children, medical expenses for their families, and caring for infirm and underfunded parents, they will be told to spend even more money for advice or more time to research their options on their own.

Americans for Annuity Protection would like to work with the Department to change or add any reasonable requirements to the Rule that will work to ensure that fixed annuity consumers maintain their current protections under the state regulatory framework, do not add excessive costs and burdens that prohibit Americans from receiving annuity advice, and allow the qualified annuity professionals to continue to serve their clients without back-breaking compliance and liability costs that will drive them out of the annuity business.

We look forward to future conversations, respectfully,

Kim O'Brien, CEO
Americans for Annuity Protection