SUBMITTED ELECTRONICALLY: EBSA.FiduciaryRuleExamination@dol.gov

August 7, 2017

Office of Exemption Determinations, EBSA
Attention: D-11933
U.S. Department of Labor
200 Constitution Avenue NW, Suite 400
Washington, DC 20210

RE: **RIN 1210-AB82**
Request for Information Relating to Changes/Revisions to the Fiduciary Rule and Prohibited Transactions Exemptions

To Whom it May Concern:

NAFA, the National Association for Fixed Annuities,[1] appreciates the opportunity to comment on the Department of Labor's Request for Information ("RFI")[2] relating to changes and revisions to the Fiduciary Rule and Prohibited Transaction Exemptions ("the Rule") in connection with the Department's examination of the final rule as directed by President Trump in his February 3, 2017 White House Memorandum.

NAFA believes that the final rule must be revised in order to align with the President's priority to empower Americans to make the kinds of financial decisions that will allow them to save for retirement and build the individual wealth necessary to pay for typical lifetime expenses.[3] NAFA's membership is comprised of businesses and individuals that manufacture, distribute, market, and sell a retirement savings product that is integral in facilitating the President's interest in this regard: fixed annuities, which are insurance contracts that allow the contract owner to safely and predictably plan for a guaranteed retirement income stream that the owner cannot outlive.

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[1] NAFA, the National Association for Fixed Annuities, is the premier trade association exclusively dedicated to fixed annuities. Our mission is to promote the awareness and understanding of fixed annuities. We educate annuity salespeople, regulators, legislators, journalists, and industry personnel about the value of fixed annuities and their benefits to consumers. NAFA's membership represents every aspect of the fixed annuity marketplace covering 85% of fixed annuities sold by independent agents, advisors and brokers. NAFA was founded in 1998. For more information, visit www.nafa.com.

[2] 82 FR 31278, July 6, 2017.

[3] White House Memorandum for the Secretary of Labor, dated February 3, 2017. See 82 FR 9675, February 7, 2017.

But the Rule in its current form is, in fact, an obstacle to the President's priority. In particular, the last-minute decision to unfairly and unnecessarily bifurcate the two general types of fixed annuities under two separate prohibited transactions exemptions – the Best Interest Contract ("BIC") Exemption for fixed *indexed* annuities and PTE 84-24 for fixed *rate* annuities – will adversely affect retirement savers for all the reasons cautioned in the President's Memorandum: it will reduce Americans' access to retirement savings offerings, information, and advice; it will create unrecoverable dislocations in the retirement services industry, which will, in turn, adversely affect retirement consumers; and it will most certainly cause an increase in litigation, the costs of which will be borne by investors and retirees.

The essential change that NAFA believes is necessary to further the goals set forth in the President's memorandum is to return fixed indexed annuities to PTE 84-24, as was the case in the Department's proposed rule issued in April 2015.[4] NAFA has maintained throughout the rulemaking process that *both* fixed rate and fixed indexed annuities should be subject to PTE 84-24 under the Rule, and we have argued that the decision to switch fixed indexed annuities to the BICE reflected a fundamental misunderstanding by the Department regarding the features and similarities of these two types of fixed annuities.[5]

NAFA submitted a comment on July 21, 2017 in response to the Department's RFI in which we urged a minimum 12-month delay of the January 1, 2018 applicability date so that the Department could take the time it needs to complete its comprehensive examination pursuant to the President's directive. In our comments here, we respond more generally to the RFI and discuss the problems inherent in the Rule. In particular, we address the Question 17 of the RFI[6] with the intent of providing the Department with the rationale for expanding the scope of PTE 84-24 to cover fixed indexed annuities.

In order to understand why fixed indexed annuities belong under PTE 84-24, it is critical to understand that these products are not securities investments but are, instead, guaranteed insurance contracts that protect the contract holder's principal and earned interest from market risk. It is also essential to distinguish between the market distribution channels for securities products and insurance products in order to appreciate why the Best Interest Contract ("BIC") Exemption simply does not work for sales of fixed indexed annuities – and why the proposed IMO Exemption does not cure the industry compliance problems associated with the BIC.

[4] 80 FR 21928, April 20, 2015.

[5] NAFA submitted comment letters to the Department on June 21, 2015, September 24, 2015, February 17, 2017, March 14, 2017, April 17, 2017, and July 21, 2017 and has had several meetings with Department personnel regarding the appropriate exemption for all fixed annuities.

[6] We incorporate here responses to questions posed in the RFI that implicate the Department's interest in gathering information related to expanding the scope of PTE 84-24, such as Questions 4, 5, 6, and 8.

1. **PTE 84-24 is the Appropriate Regulatory Exemption for both Fixed Rate Annuities and Fixed Indexed Annuities**

A. ***FIAs do not possess 'complexities' that expose consumers to investment risk and therefore do not require the more stringent conditions of the BICE***

Fixed rate annuities ("FRAs") and fixed indexed annuities ("FIAs") are different types of fixed annuities, but both are intended to be long-term retirement savings vehicles. They are insurance contracts with a guaranteed minimum rate of interest credited on premiums paid and with the contract owner's principal and credited interest gains protected against stock market loss. They are not investments, and they are not securities.

The only difference between FRAs and FIAs is how the contractual interest is determined and calculated. For a fixed rate annuity, the insurance company determines the interest rate that is to be paid based on the interest rate environment; with a fixed indexed annuity, the credited interest is based on an external market index. However, the FIA contract account does not participate in the market, and the annuity owner does not directly or indirectly take on any market risk.

For both FRAs and FIAs, the rate of interest that is credited to the account is guaranteed to be never less than zero, even if the market goes down. People who purchase FIAs want the guarantees provided under both FRAs and FIAs but want the potential to increase their contract account value based upon increases in an external market index that might be better than the set interest rate offered with an FRA.

NAFA believes the Department properly categorized both fixed rate annuities and fixed indexed annuities as "non-security" annuities in the proposed rule and correctly placed them both under PTE 84-24.[7] This of course changed with the publication of the final Rule, when the Department switched FIAs from their original inclusion under PTE 84-24 into the BICE. The Department maintains that the reason for the switch was because of the "complexities" associated with FIAs.[8]

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[7] 80 FR 21928.

[8] 81 FR 21147, 21152 – 21153, April 8, 2016, Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84–24. In the preamble to the amended PTE 84-24, the Department conflated fixed indexed annuities and variable annuities, stating that the exemption would not cover any annuity registered as a security under federal securities law. Fixed indexed annuities are not registered as securities under federal securities law under the Harken Amendment to the Dodd-Frank Act. The Department goes on to state that "[t]hese investments typically require the customer to shoulder significant investment risk…[and] are often quite complex…", and, therefore, should be sold under the more stringent conditions of the Best Interest Contrast Exemption. Deputy Assistant Secretary Hauser continues to refer to the "complexities" associated with FIAs – while allowing that "everything is on the table" as far as reconsidering the exemption placement for FIAs: "DOL Official: Help Me

Clearly the Department felt that these FIA "complexities" exposed consumers to risks that are not present with an FRA. But the Department's own Appendix to the published final Rule[9] makes clear that the features of FIAs are the "same as" FRAs in terms of surrender charges, partial withdrawals, guaranteed surrender/nonforfeiture amounts, free-look requirements, MVAs, express fees and charges, and death benefits. Moreover, FRAs and FIAs share the same general fee structure, whereby neither is subject to contract fees, transaction fees, mortality and expense risk fees, nor underlying fund fees.

Most importantly, however, and relating directly to the Department's concern regarding consumer risk, the Department correctly recognizes that an owner of an FIA does not bear investment risk. The Appendix states that for variable annuities, the "Investment Risk is borne by the contract owner." It does not state this for fixed indexed annuities, which is correct because for FIAs the investment risk is *not* borne by the contract owner.

Nevertheless, there remains confusion and misunderstanding regarding the features of FRAs and FIAs and their essential similarity in providing protection from investment and market risk. In the table below, NAFA has reproduced the Rule's Appendix I for Fixed Rate Annuities and Fixed Indexed Annuities and corrects the Department's misconceptions regarding these two products. (NAFA's corrections and clarifications are in red.)

Appendix I Comparing Different Types of Deferred Annuities – *Corrected*

	Fixed Rate Annuity	Fixed Indexed Annuity
Overview	• A contract providing *for the crediting of interest based on the interest rate environment that provides a minimum,* guaranteed, specific rate of interest on premiums paid.	• A contract providing for the crediting of interest based on changes in a market interest *that provides a minimum guaranteed, specific rate of interest on premiums paid, plus the opportunity to earn additional interest.*
	Returns	
Allocation of Investment Risk	• Premiums are guaranteed to earn at least a minimum specified interest rate. The insurance company may in its discretion credit interest rates higher than the minimum.	• ~~Returns are less predictable because the interest credited at the end of each index period depends on changes in the market index.~~ *Premiums are guaranteed to earn at least a minimum, specified interest rate. The insurance company may, in its discretion, credit interest rates higher than the minimum.* • *Returns for FIAs are no less predictable than for FRAs because the interest credited in a*

Improve Fiduciary Rule," Insurance News Net, July 27, 2017, available at https://insurancenewsnet.com/innarticle/dol-official-help-make-better-fiduciary-rule.

[9] 81 FR 21002, 21086 – 21088, April 8, 2016, Appendix I – Comparing Different Types of Deferred Annuities.

	Fixed Rate Annuity	Fixed Indexed Annuity
		fixed rate annuity at the end of each interest period depend on changes in the interest rate environment and the net investment income earned by the insurer. However, FIAs have proven to provide higher fixed interest earnings than fixed rate annuities. Indeed, the 'less predictable' aspect is how much more interest FIAs will earn over FRAs.
	• Under most current state laws, upon surrender of the contract the buyer is guaranteed to always receive at least 87.5% of premiums paid, credited with a minimum interest rate such as 1%. This is known as the nonforfeiture amount.	• The surrender value must always equal at least the nonforfeiture amount and the interest rate is guaranteed to never be less than zero during each index period. • In general, returns depend on what index is linked and how the index-linked gains are calculated. Many current product designs offer alternatives to traditional indexes such as the S&P 500 and allow owners to allocate premiums among different indexes. These alternative indexes may include precious commodities, international and emerging markets, and proprietary indexes developed by insurance companies. • Changes in the index can be determined by several methods, such as annual reset, high water mark, low water mark, point-to-point, and index averaging. • Indexed-linked gains are not always fully credited. *This is incorrect. The interest determined by the crediting methods of the index-linked gain are ALWAYS fully credited.* How much of the gain in the index will be credited depends on the particular features of the annuity, such as participation rates, interest rate caps, and spread/margin/asset fees.
	• *The insurer generally reserves the right to change its interest crediting formula of its fixed rate annuities.*	• The insurer generally reserves the right to change participation rates, interest rate caps, and spread/margin/asset fees, subject to minimums and maximums specified in the contract.

	Fixed Rate Annuity	Fixed Indexed Annuity
Fees	Surrender Charges & Surrender Periods	
	• If the owner withdraws all or part of the value out of the annuity within a specified period, a surrender charge will be applied.	• Same as fixed rate.
	• The buyer can often receive a partial withdrawal (usually up to 10%) without paying surrender charges, and the charge may be waived in certain circumstances, such as confinement in a nursing home	• Same as fixed rate.
	• State laws generally require "free-look" provisions under which the owner can return the contract free of charge within a stated number of days after purchase.	• Same as fixed rate.
	• Some annuities have a market value adjustment (MVA). If at the time of surrender, interest rates are higher than at the time of purchase, the MVA could reduce the amount paid on surrender; conversely, if interest rates have fallen, the MVA could increase the surrender value.	• Same as fixed rate.
	Other Fees & Charges	
	• Generally no express fees.	• Generally no express fees.
	• *Fixed rate annuities are sometimes also sold with a guaranteed lifetime withdrawal benefit, which requires a rider fee.*	• Often sold with a guaranteed lifetime withdrawal benefit, which requires a rider fee.
Guaranteed Optional Benefits	Guaranteed Living Benefit Riders	
	• Seldom offered. *In fact, guaranteed living withdrawal benefits are being offered by a swiftly increasing number of FRAs. To the extent that GLWBs are offered for both FRAs and FIAs, which is increasingly the case, this is the "same as" fixed rate.*	• The most popular benefit, the guaranteed lifetime withdrawal benefit, is offered with 84% of all new fixed indexed annuity sales in 2014.
	Death Benefit	
	• Annuities pay a death benefit to the beneficiary upon death of the owner or annuitant during the accumulation phase. Benefit is typically the greater of the accumulated account value or the nonforfeiture amount. Different rules govern death benefits during the payout phase.	• Same as fixed rate.

As demonstrated by the table above, fixed indexed annuities are not appreciably different than fixed rate annuities – and this is especially true in terms of investment risk to the annuity owner. Contrary to what the Department contends, FIAs, just like FRAs, do not "require the customer to shoulder significant investment risk"[10] since they are neither investments nor securities. For some retirement consumers, FIAs offer the opportunity to earn more interest. Once the interest rate for an FIA is determined and credited, fixed indexed annuities function in all ways like fixed rate annuities, including the predictable stream of lifetime income that is contractually guaranteed by the insurance company.

Accordingly, there is no justification or rationale to treat these two *types* of fixed annuities differently under the Rule. NAFA urges the Department to put fixed indexed annuities back into PTE 84-24.

B. ***The BICE is designed for the securities industry and simply does not work for the fixed annuity industry marketplace***

Since June 9, 2017 the fixed annuity industry has been operating under the Impartial Conduct standards for all qualified-sales, but this changes dramatically on January 1, 2018 when the sale of fixed indexed annuities to IRA holders will be subject to the contract requirement of the BICE. The Department asks if the costs of that additional requirement exceed the associated benefits.[11] We believe the costs associated with complying with the BICE will greatly exceed any alleged consumer benefits because, simply put, a best interest contract does not work for the distribution network that exists for fixed annuity sales. It will have a devastating effect on NAFA members, especially the small and medium-sized insurance marketing organizations who will likely be put out of business. This will, of course, have a negative ripple effect on many thousands of affiliated independent agents – and the end result will be to harm every day Americans who are trying to save for their retirement.

<u>Under the independent agency system, no single carrier or IMO can serve as the Financial Institution without greatly increased and gratuitous litigation risk</u>

Total fixed annuity sales for 2016 were approximately $118 million, with sales of fixed indexed annuities making up over $60 billion of that total.[12] Independent insurance agents, working with insurance intermediaries (Independent Marketing Organizations, or IMOs), account for over 60% of those sales: in other words, $36 billion in FIA sales last

[10] 81 FR 21147, 21152.
[11] 82 FR 31278, 31279 (Question 4).
[12] ThinkAdvisor, "Fixed Annuity Sales Hit Record $117.4 Billion in 2016, February 21, 2017, http://www.thinkadvisor.com/2017/02/21/fixed-annuity-sales-hit-record-1174-billion-in-201, according to LIMRA Secure Retirement Institute's *Fourth Quarter U.S. Annuity Sales* survey.

year were made by independent insurance agents working with both IMOs and carriers in the distribution channel.[13]

Independent agents are just that: independent. The agent's activity is not directed by any single insurance company, and no single insurance company relationship dominates his or her practice. In fact, the agent may have appointments with a dozen different insurance companies, all offering an array of different annuity products. Given this very common situation of an agent representing many carriers and their products, there is no insurance company that would be in a position to sign the BIC as a financial institution under the Rule, warranting that the independent agent's recommendation adhered to the Impartial Conduct Standards and was made "without regard" to his or her financial interests.

It is not unusual for an independent agent to discuss with a client several different annuity products, each one offered by a different insurance carrier. This is a positive feature of independent agency: being able to sell products from multiple carriers allows the agent to help the client identify the annuity product that best suits his or her financial needs and objectives. However, not knowing the exact features of all of the product offerings, nor the agent's compensation arrangements with the different, competing carriers, it is impossible for a carrier to warrant in a contract that the agent recommended the product that was in the "best interest" of the client and that the compensation paid to the agent is, in fact, "reasonable." The litigation risk is too great for the carrier to act as the Financial Institution under the BICE.

The other entity in the independent agency system, the IMOs, might ostensibly serve as financial institutions. However, IMOs are not compliance or supervisory organizations, nor are they permitted to be financial institutions under the BICE. The role of the insurance intermediary is integral to the independent agent distribution network, which is the heart of the fixed annuity market. Independent agents contract with IMOs, which in turn provide the agent with training, marketing support and product distribution assistance.

Accordingly, an independent agent cannot sell a fixed indexed annuity under the BICE because there is no financial institution – neither the carrier nor the IMO – willing or able to enter into a contract with an IRA owner who purchases an FIA, warranting that it and the agent acted in the owner's best interests and that the advice provided was without regard to the agent's financial or other interests.

The BICE was clearly designed for the securities industry, which operates under a distribution arrangement whereby securities-licensed registered representatives and investment advisory representatives are allowed to work for only one broker dealer or

[13] *Id.* Note that independent agents accounted for 80% of all fixed annuity sales between 2011 and 2014.

registered investment advisor. Thus, these agents operate under the exclusive control and management of a single supervising authority. In the securities world, the B-D or the RIA can readily assume the role of the financial institution under the BICE.

This disparity in the sales and distribution arrangement of the independent agent system versus the B-D/RIA system saddles fixed annuity providers and distributors with unfair and unjust burdens relative to the other segments of the retirement services industry. The result of applying the BICE to the sales of fixed indexed annuities would be to place as much as 60% all annuity sales in jeopardy:[14] the independent agency system would be upended and likely dismantled, leaving millions of American retirement savers without access to the trusted resources provided by their personal insurance agents.

The Litigation Remedy under the BICE disfavors Fixed Annuities

Another aspect of the BICE that creates an unfair playing field for sellers of FIAs is that the primary enforcement action for the BIC – litigation – disfavors the fixed annuity marketplace. The fixed annuity industry is at a distinct economic disadvantage because it does not have the option to resolve disputes through arbitration, as does the securities industry. The securities industry, through FINRA, can avail itself of the well-established and effective system of arbitration when disputes arise with consumers. Typically the stream-lined process of arbitration is faster, significantly less costly than traditional litigation, and produces results that are often more beneficial for the consumer.

The insurance industry, on the other hand, does not have this advantage in dispute resolution. Insurance is regulated at the state level by state Departments of Insurance, and the contractual relationship between insurance companies and consumers is subject to the strict review and approval of the insurance regulators in each state. While there is considerable coordination and effort to enact similar regulations across the states – especially through the adoption of model regulations developed by the National Association of Insurance Commissioners – there is currently no uniform regulatory framework for the review and approval of contractual arbitration agreements between annuity providers and consumers.

As a result, the sale of fixed indexed annuities will be disadvantaged as compared with securities products, such as mutual funds. For consumer disputes involving FIAs, conflict resolution means litigation – perhaps even class action lawsuits. This increased litigation risk and the ensuing regulatory costs required to mitigate that risk means, in essence, that the BICE picks winners and losers in the retirement services marketplace.

[14] It is noted that a certain percentage of FIA sales are in the non-qualified market.

C. *The ambiguous definition of "reasonable compensation" exposes agents, IMOs, and carriers to IRS enforcement actions and private litigation under the BIC*

As we have noted previously, under the BIC a financial institution must warrant that the compensation received for the recommended transaction is "reasonable."[15] The "reasonable compensation" warranty applies to both plan sales and retail investment sales; accordingly, insurance companies could be subject to private litigation or excise tax penalties if the compensation is determined *at some later date* to have been unreasonable. (In the fixed annuity distribution channel, currently only insurance carriers can assume the role of the financial institution, as discussed more fully in Section 1.D, below. Of course, should IMOs be eligible to become financial institutions under the BIC, they would be exposed to the same litigation risk or excise tax enforcement action.)

Despite industry requests for elucidation and clarity on what might be defined as "reasonable," the Department has offered no meaningful guidance. The Department issued a FAQ related to this inquiry, but opined only that "the reasonableness of the fees depends on the particular facts and circumstances at the time of the investment advice," and, further, that the "essential question is whether the charges are reasonable in relation to the what investor stands to receive for his or her money."[16] What are those "particular facts and circumstances"? Is the relationship between what the investor stands to receive and the compensation received based upon some objective standard, such as a ratio or percentage? Is the reasonableness of the selling agent's compensation based only on the array of products that agent is authorized to recommend? How is the ultimate "compensation" to the issuing insurance company determined?

In other words, the Department cannot (or will not) define upfront what is reasonable in terms of compensation, but, to paraphrase Justice Stewart, they will know it after they see it. And woe to the financial institution and/or advisor who can only guess at what might later be determined to be unreasonable.

Of course, the reasonable compensation requirement is also part of PTE 84-24 through the Impartial Conduct Standards. But, while the definition of reasonableness under 84-24 is no less vague and ambiguous, it is the *post hoc* enforcement through a private cause of action under the BIC that is most troubling for financial institutions and agents and advisors who must warrant such reasonableness *ex ante*.

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[15] 29 C.F.R. §2550, Best Interest Contract Exemption, Section II(c)(2), 81 FR 21002, 21077, April 8, 2016.
[16] CONFLICT OF INTEREST FAQS (PART I- EXEMPTIONS), U.S. Department of Labor - Employee Benefits Security Administration, October 27, 2016, https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf.

D. ***The proposed insurance intermediary exemption does not cure the underlying defects of the BICE as it relates to the fixed annuity marketplace***

The Department recognized that the BICE was completely incompatible with the independent insurance market and attempted to fix the problem by creating a new exemption to the BICE so that insurance intermediaries *could* become eligible to be financial institutions. Proposed in January 2017 (over eight months after the publication of the final Rule, but as yet not finalized and adopted), the Best Interest Contract Exemption for Insurance Intermediaries (the "proposed exemption") would not cure the problems associated with placing FIA sales in the IRA market under the BICE, which requires a financial institution to contractually warrant the terms and conditions required by the BIC.

The proposed exemption places unrealistic and unworkable burdens on the fixed annuity industry, which is organized in large part around the IMO-based distribution and delivery system, as discussed in greater detail above. The threshold requirements for an IMO to be eligible to be granted financial institution status are so onerous and unreasonable that NAFA estimates that perhaps only 5 – 8 of the 100 major IMOs affected by this proposed exemption would be eligible to qualify.[17]

NAFA's membership includes most of the IMOs that would be affected by the Rule, and these businesses range across the entire spectrum in size and scale – but many are small and medium-sized companies that would not qualify under the proposed exemption. They would not be able to meet the impractical $1.5 billion minimum premium requirement, nor could they meet the exemption's "quasi-capital" insurance liability/cash reserve requirements. Moreover, even if these thresholds were modified, most IMOs are not set up to operate as compliance organizations or "financial institutions" as intended by the Rule. For the same reasons explained above, IMOs must be allowed to operate under PTE 84-24, as the vast majority of NAFA-member IMOs will be harmed by the BICE, and a great many will be put out of business.

The proposed exemption actually makes the Rule worse, making the facilitation of fixed indexed annuity sales inaccessible to the majority of IMOs. This outcome is especially unfair when compared to the other sectors of the financial services industry that distribute similar products – i.e., banks, broker dealers, and registered investment advisory firms – that, under the BICE, can operate as financial institutions. Here again, the decision to place FIAs under the BICE, which, in turn, necessitated this proposed exemption, has created compliance requirements that disproportionately and unjustifiably restrict the

[17] NAFA Comment Letter, ZRIN 1210-ZA26 Regarding the Proposed Best Interest Contract Exemption for Insurance Intermediaries, February 17, 2017.

economic vitality of fixed annuity providers as compared to other providers of retirement financial services.

E. ***Sales for both FRAs and FIAs are now operating under the Impartial Conduct Standards, militating against the need for a best interest contract***

In the short time since the Department implemented the new fiduciary definition and the Impartial Conduct Standards ("ICS") on June 9, 2017, NAFA can report that the fixed annuity industry has already brought on line new compliance protocols, including new annuity sale disclosure forms that comport with the requirements of PTE 84-24 and the ICS. These new mandatory disclosures originate with the agent and go in two directions: first, from the selling agent to the prospective IRA owner/annuity purchaser, disclosing, *inter alia*, the agent's commission and other possible compensation, limitations on the array of products that the agent is able to recommend, possible charges and rider fees that might affect the annuitant's account value, and other material conflicts of interest the agent may have, and, second, from the agent to the insurance carrier, acknowledging and certifying the agent's compliance with the best interest protocols embodied in the ICS.

In addition, NAFA-member carriers and insurance marketing organizations have developed a broad range of agent training modules, webcasts, and seminars, focusing on the various aspects of the Rule, including the identification of material conflicts of interest, documentation requirements and document retention retirements, the impartial conduct standard (including best interest), and all of the disclosure requirements associated with these new standards. And, the industry has seen a robust expansion of technology and marketing tools that support all of the requirements of these new standards. Carriers and IMOs are using new software programs to more thoroughly analyze the fixed annuity sales process to ensure that the entire transaction complies with the ICS.

It is clear that industry is already adhering to the underlying principles of the Rule as reflected in the ICS – which is the heart of the fiduciary rule and required by both the BICE and PTE 84-24. In other words, all fixed annuity sales and advice to IRA clients are being delivered under a "best interest" standard. These new protocols will continue to be in place throughout the transition period, even if that period were to be extended beyond January 1, 2018.

Robust and thorough consumer disclosures and the development of the best interest process address the foundational concerns of the Department in promulgating the Rule. However, the new standards have been in place for less than two months, which is not nearly time enough to evaluate their impact on the entire fixed annuity market and its customers. NAFA believes it is essential to allow fixed indexed annuities to continue to be sold under PTE 84-24 in the absence of any evidence to suggest they need to be placed under the ambiguous, unfair, and unduly burdensome requirements of the BICE.

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2. **A fee-based compensation model for fixed annuities is rarely in the best interest of the consumer**

An underlying assumption of the Rule is that a fee-based compensation model is better for the consumer. Here again, the Department demonstrates a fundamental misunderstanding of the distinguishing features of non-security annuity products versus securities investments. In truth, fee-based compensation on an insurance annuity product is very likely to cost the customer more money over the long term than would a commission-based product purchase. Over time—and, again, these products are intended to be long-term retirement savings vehicles – an upfront commission paid by the insurance company to the agent is less costly to the consumer than would be the payment of ongoing, annual, cumulative fees based on the value of the account.

As is the case with almost all retail consumer products where payments are made to the individual who transacts the sale, commissions on fixed annuities are factored into the price of the product. The current average commission paid on a fixed indexed annuity is less than 5%.[18] The consumer does not pay the commission directly, nor are any funds deducted from the purchase price of the annuity contract to pay the agent's commission. The insurance company pays the agent's commission, and the entire premium paid to the insurance company for the contract goes to work for the annuitant in earning interest.

The sale of a fixed annuity is a one-time sales transaction between the client and the agent. At no time does the agent control or direct or manage the money in the annuity contract. In fact, the agent cannot alter any of the terms of the annuity contract. And, while insurance agents often have a long-term relationship with their clients, it is not, in any meaningful or traditional understanding of the term, an investment advisory relationship.

In stark contrast, in an investment advisory relationship the consumer pays the investment advisor to manage his or her money on an ongoing basis. Advisory fees are calculated on the assets under management: advisors create an investment plan and, based on that plan, provide ongoing investment advice to the client regarding the assets – allocating and reallocating the assets into different securities and investment instruments, such as stocks and bonds and mutual funds.

Accordingly investment advice generally costs more than any commission-based compensation, which, as noted earlier, is factored into the product pricing. Paying more for investment advice is arguably justifiable because an investment advisory relationship is, by its nature, a longer-term and more active relationship between the advisor and the

[18] First Quarter 2017 Non-Variable Deferred Annuity Sales, May 23, 2017, Sheryl J. Moore, available at https://www.looktowink.com/2017/05/firstquarterannuitysales/.

consumer. However, the advisory fee is not the only expense that the consumer pays to his or her investment advisor to manage the portfolio: the "all-in" cost includes underlying product costs, transaction costs, and various platform fees.[19] While the typical consumer pays a 1% annual advisory fee,[20] with these additional costs factored in the all-in annual cost for the financial advisory services is actually around 1.65%.[21] Comparing a 1.65% annual investment advisory fee to one-time commission paid on a fixed annuity, the average percentage cost to the investment advisory client for the financial service is, in just a few short years, double that of the commission.

The justification for the Rule is to eliminate "conflicted advice," and the Department believes that a fee-based approach to compensation will help realize that goal.[22] But the Department never measured the (controversial and contested[23]) estimated $17 billion in annual consumer costs allegedly attributed to conflicted advice against the much higher cost of investment advisory fees. Additionally, the Department never attempted to factor in the subsequent higher costs to consumers resulting from converting commission sales to advisory fees. The predictable result of this is that low- and middle-income investors and retirement savers will suffer the most because they will not be able to afford the higher costs associated with a fee-based approach and will lose access to personalized retirement advice because firms and individuals don't want to take the risk and liability for smaller account balances.[24]

Moreover, applying a fee-based compensation structure on the sale of fixed annuities in the IRA space would disadvantage the sale of these products as compared to securities sales: investment advisors typically gather their fees from retirement portfolio withdrawals and the withdrawals for investment management expenses are not taxable distributions. On the other hand, a withdrawal made from an IRA annuity to pay the advisory fee would be a taxable distribution and would be subject to an additional 10% penalty if the annuity owner is not age 59½ or older.

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[19] "Financial Advisor Fees Comparison – All-In Costs for the Typical Financial Advisor?," Michael Kitces, available at https://www.kitces.com/blog/independent-financial-advisor-fees-comparison-typical-aum-wealth-management-fee/, July 31, 2017.

[20] The "typical" 1% annual advisory fee is actually often higher for clients with smaller account balances. "Those [advisors] who work with smaller clients tend to charge more, and those who work with larger clients tend to charge less." *Id.*

[21] *Id.*

[22] See Question 8 of the RFI: the Department seeks input regarding whether a streamlined fee-based compensation exemption might mitigate or eliminate some kinds of potential advisory conflicts that are otherwise present with commission-based compensation.

[23] A Majority Staff Report of the Committee on Homeland Security and Governmental Affairs, "The Labor Department's Fiduciary Rule: How a Flawed Process Could Hurt Retirement Savers," February 24, 2016, pp. 27 – 28 (internal citation omitted), available at https://www.hsgac.senate.gov/media/majority-media/chairman-johnson-releases-report-on-flawed-department-of-labor-process-that-could-hurt-retirement-savers.

[24] "A Fiduciary Rule Reckoning," The Wall Street Journal, July 30, 2017, available at https://www.wsj.com/articles/a-fiduciary-rule-reckoning-1501448022.

For these reasons, the insurance industry is not moving with great alacrity toward the development of fee-based annuities. While some carriers have recently introduced fee-based fixed annuities,[25] most of this advancement has been in the variable annuity sphere, where there already exists a securities-based sales distribution network. In the fixed annuity market, experts have estimated that current sales of fee-based fixed indexed annuities are negligible, perhaps less than 1/10th of 1% of sales. Moreover, fee-based FIAs are designed to fit the needs and business models of fee-based advisors, such as securities-licensed Registered Investment Advisors (RIAs), further disadvantaging the tens of thousands of insurance-licensed only agents whose businesses depend on the sale of FIAs.

Commissions for financial savings and investment products need not be a one-size-fits-all prospect, nor is it accurate to assume that a commission-based insurance sale creates an inherent conflict of interest. The typical fixed annuity sale is a one-time transaction, wherein the client intends to "buy and hold" the product and does not wish to pay annual, ongoing fees to the financial advisor for the lifetime of the product. However, it is obvious that the retirement financial services market is trying various approaches in terms of new product features and alternative commission models. NAFA believes that, with the appropriate consumer disclosures connected to all sales transactions, the market itself will best determine consumer preference.

Conclusion

Putting fixed indexed annuities under the BICE will create profound dislocations in the insurance annuity marketplace and will severely disadvantage the fixed indexed annuity industry and will favor the securities industry. As we have commented here, the BICE, which is modeled after the securities distribution and supervisory system, was never designed for the sale of non-securities annuities – which FIAs unmistakably are – and is unworkable for both the independent agents and the insurance intermediaries in the fixed annuity distribution system.

The result of treating FIAs as "quasi" securities and placing them under the BICE will have devastating consequences, resulting in the loss of thousands of independent insurance agents and the majority of small and medium-sized IMOs. The real-world effect of that entirely avoidable market dislocation will be to limit consumer access to crucial retirement savings options and the related personal retirement financial services now available to *all* American retirees, but it will especially limit the product choice and advice available to low and middle-income retirement savers.

[25] See, e.g., http://www.lifehealth.com/symetra-introduces-new-fee-based-fixed-indexed-annuities/ .

President Trump has directed the Department to review the Rule and to revise the Rule as necessary in order to advance the Administration's priority "to empower Americans to make their own financial decisions [and] to facilitate their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses…."[26] This is a serious mandate, and NAFA believes that the Rule requires substantive revisions to effect his directive. On behalf on an industry that serves American retirees and pre-retirees with products that provide a guaranteed, lifetime stream of income, NAFA urges the Department to, at a minimum, correct the Rule's flawed placement of fixed indexed annuities under the BIC Exemption and return them to the more appropriate exemption, PTE 84-24.

Again, NAFA appreciates the opportunity to share our concerns with the Department. Please do not hesitate to contact me if you would require any additional information.

Sincerely,

Chip Anderson

Charles "Chip" Anderson
NAFA Executive Director

[26] 82 FR 9675, February 7, 2017.