NAIFA
National Association of Insurance
and Financial Advisors

February 21, 2017

VIA ELECTRONIC MAIL – Lloyd.karen@dol.gov (cc: e-oed@dol.gov)

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11926
U.S. Department of Labor
200 Constitution Ave., NW
Suite 400
Washington, DC 20210

RE: ZRIN 1210-ZA26
Proposed Best Interest Contract Exemption for Insurance Intermediaries

To Whom It May Concern:

The National Association of Insurance and Financial Advisors ("NAIFA") appreciates this opportunity to comment on the Department of Labor's ("Department" or "DOL") Proposed Best Interest Contract Exemption for Insurance Intermediaries ("proposal" or "Proposed Exemption").[1] As discussed in further detail below, NAIFA has two primary concerns with the proposal:

(1) The restrictive definition of "Financial Institution" would bar almost all operating insurance intermediaries dealing in annuities—and by extension, the independent insurance agents and brokers with whom they work—from utilizing the Proposed Exemption; and

(2) To the extent the proposal's requirements mirror or go beyond those of the Best Interest Contract ("BIC") Exemption finalized by the Department last year,[2] the same operational challenges and concerns expressed by NAIFA and other industry participants with respect to that exemption still apply.

BACKGROUND & EXECUTIVE SUMMARY

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations representing the interests of insurance professionals.

[1] 82 Fed. Reg. 7336 (Jan. 19, 2017).

[2] Department of Labor, Adoption of Class Exemption, *Best Interest Contract Exemption*, 81 Fed. Reg. 21002 (Apr. 8, 2016).

NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors[3] who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs. For small business owners, our advisors encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Most of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer, insurance company, or independent intermediary with whom they work, including the format and provision of client forms and disclosures. They also are subject to transaction-level oversight and review by their overseeing financial institutions.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Roughly one-third of NAIFA members work in the independent channel with independent marketing organizations or similar independent institutions. Accordingly, it is very important to our members that this Proposed Exemption present a feasible option under which common business practices and compensation arrangements/channels can be preserved.

All of our advisors, regardless of whether they are independent or affiliated, have been and/or will be significantly impacted by the Department's fiduciary duty rule for retirement investment advice ("fiduciary rule")[4] and related Prohibited Transaction Exemptions ("PTEs").[5] Virtually all NAIFA members working in the individual IRA space will have to rely on the BIC Exemption or this Proposed Exemption, both of which represent more onerous compliance

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[3] For purposes of this comment letter, the term "advisor" refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

[4] Department of Labor, Final Rule, *Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice*, 81 Fed. Reg. 20946 (Apr. 8, 2016).

[5] In particular, NAIFA members will be impacted by the BIC Exemption and PTE 84-24 (*Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters*, 81 Fed. Reg. 21147 (Apr. 8, 2016)).

regimes than any of our members (or their financial institutions) have previously faced. While NAIFA members do not oppose a best interest standard for advisors, any new standard (and related requirements) must be operationalized in a fashion that is workable for Main Street.

The Department's fiduciary rule and PTEs already have generated negative consequences in the marketplace,[6] which have and will result in fewer retirement products and services for low-dollar account holders and middle-market retirement savers, and/or a shift to more expensive fee-based arrangements for these individuals.[7] NAIFA urges the Department to refrain from exacerbating these harmful developments by perpetuating—or worse, compounding—an already complex and costly regime.

Notably, the Trump Administration has instructed the Department to prepare an updated economic and legal analysis of the fiduciary rule, and to determine whether it may have an adverse impact on, *inter alia*, consumers' access to retirement savings advice or products, the price of such products and services, and increased litigation risk.[8] To facilitate the President's directive and to gather additional public input on these issues, the Department has sent a proposal to the Office of Management and Budget to delay the fiduciary rule's applicability date.[9]

Because this Proposed Exemption is fundamentally linked to the fiduciary rule and the BIC Exemption, NAIFA urges the Department to halt further action on this proposal until its reexamination of the larger regime is complete. If the Department later determines that revision of the fiduciary rule and related PTEs is warranted, NAIFA urges the Department to adequately address the independent channel (for both institutions and advisors) within the new framework. To the extent the fiduciary rule/PTE structure remains in place, however, we urge the

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[6] *See* AdvisorHUB, *Merill to End Commission-Based Retirement Business on Retail Accounts* (Oct. 6, 2016) available at https://advisorhub.com/exclusive-merrill-end-commission-based-retirement-business-retail-accounts/ (Merrill Lynch announces, in response to the fiduciary rule, that its 14,000 brokers cannot receive commissions for advice on retirement accounts and will have to shift clients who remain with the firm to fee-based advisory accounts); Wall Street Journal, *Edward Jones Shakes up Retirement Offerings Ahead of Fiduciary Rule* (Aug. 17, 2016) (Edward Jones announces it will limit mutual fund access for retirement savers in accounts that charge commissions); Crain's, *Why State Farm agents are getting out of the investment game* (Sep. 3, 2016) (State Farm directs 12,000 securities-licensed agents to no longer provide their clients with mutual funds, variable annuities and other investment products).

[7] See the discussion in Section I.A. regarding the disadvantages of fee-based or wrap account arrangements for small account holders and first-time savers.

[8] Presidential Memorandum, *Fiduciary Duty Rule* (Feb. 3, 2017), available at https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule.

[9] Department of Labor, Proposed Rule, *Definition of the Term "Fiduciary" – Delay of Applicability Date*, RIN 1210-AB79 (received by OMB on Feb. 9, 2017; pending review).

Department to modify and reissue the Proposed Exemption at the conclusion of the pending delay period.

If the Department does move forward with this proposal, NAIFA recommends that the following changes be made to the Proposed Exemption:

(1) Modify the definition of "Financial Institution" by eliminating the $1.5 billion in fixed annuity premiums threshold so that more than a select few intermediaries can qualify for the Proposed Exemption;

(2) Eliminate the contract requirement for IRAs and non-ERISA plans;

(3) Eliminate superfluous warranty and disclosure requirements; and

(4) Extend the compliance deadline for the Proposed Exemption to at least thirty-six months after publication of a final exemption.

Below is a more detailed discussion of NAIFA's recommendations.

I. THE "FINANCIAL INSTITUTION" DEFINITION SHOULD BE REVISED TO ELIMINATE THE $1.5 BILLION PREMIUM THRESHOLD

A. <u>The $1.5 billion threshold bars the vast majority of current market participants from eligibility for the Proposed Exemption and will result in negative consequences for Main Street investors</u>.

To qualify as an eligible "Financial Institution" under the Proposed Exemption, the Department would require that an intermediary transact sales of Fixed Annuity Contracts[10] averaging at least $1.5 billion in premiums per fiscal year over the last three fiscal years. According to the Department, the requirement is "intended to identify insurance intermediaries that have the financial stability and operational capacity to implement the anti-conflict policies and procedures required by the exemption." The real impact of this arbitrary $1.5 billion threshold, however, will be to disqualify the vast majority of intermediaries (and their affiliated agents and brokers) from the Proposed Exemption's relief.

Indeed, of the approximately 350 independent marketing organizations ("IMOs") that distribute fixed annuity products, one public source estimates that *only 11* sell at least $1.5 billion in annual fixed annuity premiums.[11] Further, of the 22 intermediaries with individual exemption

[10] Defined under the proposal to include fixed rate annuity contracts and fixed indexed annuity contracts.

[11] Tuohy, Cyril, Insurancenewsnet.com, *Super-IMOs Get 16 Months to Comply with DOL Rule for Exemption* (Jan. 24, 2017) available at https://www.insurancenewsnet.com/innarticle/super-imos-get-16-months-comply-dol-rule (last visited Feb. 15, 2017); *see also* Thornton, Nick, BenefitsPro, *Under proposed exemption, IMOs will need $15M in cash reserves* (Jan. 20, 2017)

applications pending before the Department, only 7 would be eligible under the Proposed Exemption.[12]

The proposal, as drafted, dramatically limits the availability of its prohibited transaction relief for the vast majority of intermediaries and the independent insurance agents and brokers with whom they work. Without access to the Proposed Exemption's relief,[13] these intermediaries and advisors will have to (1) stop providing retirement investment advice, or (2) move to flat fee or wrap account compensation arrangements.

The first option leaves clients with no meaningful guidance whatsoever because investment "education" (which does not trigger fiduciary obligations or prohibited transaction rules) is defined very narrowly in the Department's fiduciary rule. Reduced access to advisors is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace.

Overall, advised investors are better off than non-advised investors. According to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.[14] Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with $100,000 or less in annual income, advised individuals have an average of 113% more assets that non-advised investors.[15]

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available at http://www.benefitspro.com/2017/01/20/under-proposed-exemption-imos-will-need-15m-in-cas?slreturn=1487174138 (last visited Feb. 15, 2017).

[12] *Id.*

[13] Other exemptions upon which these entities could rely are either unavailable or unworkable. The Department recognizes in the proposal's preamble that the BIC exemption does not cover insurance intermediaries because they do not satisfy the definition of "Financial Institution" under that exemption. Further, in addition to not covering indexed annuities, PTE 84-24 has other limitations that are material to insurance intermediaries' business models and revenue streams. For instance, the compensation relief under PTE 84-24 with respect to insurance products is limited to receipt of "insurance commissions," which are defined as sales commission paid by the insurance company (or an affiliate) to the insurance agent or broker (or an affiliate) for purchase of a fixed rate annuity, including renewal fees and trailers but not revenue sharing payments, administrative fees, or marketing payments.

[14] LIMRA Secure Retirement Institute 2015 Consumer Survey (May 2015), at 13.

[15] Oliver Wyman Study, *The Role of Financial Advisors in the US Retirement Market* (July 10, 2015), at 6.

The second option will harm consumers by increasing their costs. Traditional commission-based compensation models (which require some PTE relief) actually can *benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients.

First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.[16] The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.[17] Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Finally, the Department's exclusion from the Proposed Exemption of over 95% of current operators threatens to decrease competition in the independent distribution channel, which could very well impact consumers with higher prices, fewer product offerings, and less access to advice (i.e., from advisors working with the 300+ non-eligible intermediaries).

B. <u>The $1.5 billion threshold is unnecessary, given the extensive intermediary (and advisor) requirements contemplated under the Proposed Exemption</u>.

The Department, without adequate explanation, has determined that $1.5 billion in annual premium sales is the best (or only) proxy for gauging the stability and operational capacity of insurance intermediaries, as well as their ability to mitigate conflicts of interest with respect to investment advice. The remainder of the Proposed Exemption, however, sets forth numerous detailed consumer protection and anti-conflict of interest measures that intermediaries must implement to receive prohibited transaction relief. These requirements include, *inter alia*, disclosure of material conflicts of interest, implementation and warranties of policies and procedures to monitor and minimize conflicts, an enforceable "best interest" standard of care,

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[16] Oliver Wyman Study, at 6.

[17] *Id.*, at 7.

and direct contractual relationships with insurance companies, advisors and any sub-intermediaries in the distribution channel.

It is unclear why, if an intermediary is willing and able to implement (and take on related liability) for this multitude of requirements, it *also* is necessary to impose a strict monetary barrier to participation in the scheme. To the extent intermediaries do fail to fulfil the Proposed Exemption's requirements, they can be held liable under ERISA and the Code and they will not receive prohibited transaction relief. Fitness for eligibility under the Proposed Exemption should be judged on an intermediary's satisfaction of the substantive requirements, not on a pre-judgment of stability and/or capacity that automatically cuts out 95% or more of market players.

For the foregoing reasons, the Department should eliminate the $1.5 billion threshold requirement for Financial Institutions.

II. RECOMMENDATIONS REGARDING THE PROPOSED EXEMPTION'S REQUIREMENTS

In general, the Proposed Exemption—like the BIC Exemption—is overly prescriptive, complex and onerous. And in notable respects, the Proposed Exemption *exceeds* the burdens under the BIC. As discussed below, multiple requirements are duplicative and will result in significantly increased liability risk and cost for intermediaries and advisors. As risk and cost go up for these entities, more businesses and advisors are likely to exit the market, stop dealing with low-balance account holders, or limit service and product offerings for commission-based accounts (i.e., those that require compliance with an onerous PTE). NAIFA's specific recommendations regarding the Proposed Exemptions requirements are addressed below.

A. <u>Eliminate the contract requirement for IRAs and non-ERISA plans</u>.

The Proposed Exemption's contract requirement portends a substantial increase in litigation and penalty exposure for intermediaries and those advising IRA owners and non-ERISA plans. To the extent *any* of the proposal's requirements are unclear under the finalized exemption, litigation will likely ensue. For instance, the "best interest" standard and "reasonable compensation" are open to different interpretations even among industry professionals, and are therefore ripe for consumer lawsuits.

In addition to the increased threat of litigation, intermediaries and advisors also will face substantial risk of excise tax penalties under the Code as they navigate and implement a brand new compliance regime. A high level of litigation and penalty exposure will increase the cost of doing business for intermediaries and advisors, and in some cases, the amplified risk will cause services to disappear for middle market clients. As noted above, several large financial institutions already have pulled out of lines of business and compensation arrangements that would require reliance on the BIC Exemption with its identical contract requirement. This trend is likely to escalate as the true cost of litigation and penalty risk is realized.

Further, as a practical matter, it will take a substantial amount of time and resources for financial institutions and advisors to "paper" their clients (sometimes hundreds of clients for a single advisor) with contracts. NAIFA members estimate that getting new contracts in place will require, for 77% of clients, face-to-face conversations and explanations about the new requirement. In other words, any transition to a formal contract requirement will be very labor- and time-intensive for advisors, and therefore costly to implement.

B. Eliminate superfluous warranty and disclosure requirements.

1. *Remove warranty requirements (and corresponding business obligations) related to compensation arrangements/channels and annuity application approvals.*

Like the BIC Exemption, the proposal would require intermediaries to make several warranties with respect to their policies and procedures. For instance, they must warrant that they prohibit certain differential compensation arrangements (such as quotas, appraisals, performance or personnel actions, bonuses, contests, etc.) that would reasonably be expected to cause advisors to make recommendations not in the best interest of investors. This warranty requirement effectively undermines the compensation-related benefits an advisor purportedly receives for complying with the Proposed Exemption (i.e., receiving compensation like 12b-1 fees, revenue sharing, etc., which are ubiquitous in the marketplace).

Moreover, the differential compensation warranty is unnecessary. Under the terms of the Proposed Exemption, intermediaries and advisors *must* act in the best interest of their clients or be held accountable. The best interest standard is in place to address the very problem presumably targeted by this warranty. Thus, NAIFA urges the Department to remove this warranty requirement.

Even more troubling, the Proposed Exemption goes well beyond the BIC Exemption and requires additional warranties by intermediaries. The warranties in themselves increase burdens and liability risks for financial institutions. These particular warranties, however, also import significant compensation arrangement restrictions and personnel/oversight requirements into the Proposed Exemption.

For instance, the person(s) designated by the intermediary to address material conflicts of interest and monitor advisors' compliance with the Proposed Exemption's requirements must approve, in writing, recommended annuity applications involving retail retirement investors prior to transmitting them to the insurance company. This requirement is extremely onerous in terms of personnel hours, and it is unnecessary. Advisors, under the proposal, must act in the best interest of their clients, and intermediaries must implement policies and procedures designed to ensure that their advisors do in fact adhere to that standard. Further, the designated person referenced above is charged with ongoing monitoring of advisor compliance. Therefore, this additional written approval requirement for *all* annuity applications is, at best, a *fourth* layer of complexity and burden on these financial institutions, and it should be eliminated.

Next, the proposal imposes—via an additional warranty requirement—restrictions on how and by whom advisors are compensated. This warranty (and related interference with current business models), once again, is unnecessary and unduly prescriptive. The benefit of utilizing the Proposed Exemption is to continue commonplace compensation arrangements. As with the differential compensation warranty discussed above, these compensation restrictions undermine the benefit of the proposal and they are unnecessary in light of the Proposed Exemption's best interest standard, disclosure requirements, and other safeguards. This warranty (and its underlying compensation restrictions) also should be removed from the Proposed Exemption.

2. *Remove duplicative disclosure requirements following point-of-sale disclosures.*

The Proposed Exemption would require intermediaries—in addition to extensive point-of-sale disclosures—to provide additional written disclosures before transmitting a recommended annuity application to the insurance company. The advisor, furthermore, would have to orally review the disclosure with the investor, and both parties would have to sign the disclosure (indicating that the oral review has occurred).

Notably, the information required in the transmittal disclosure overlaps almost entirely with what is required in the point-of-sale transaction (i.e., disclosure of the best interest standard; any material conflicts of interest; that the investor has the right to obtain further information about the institution's policies and procedures, costs, fees, and compensation; and a link to the institution's website containing the more detailed information). The only unique information reported in the transmittal disclosure (vis-à-vis the point-of-sale disclosure) is the information required under the most recent Annuity Disclosure Model Regulation published by the National Association of Insurance Commissioners ("NAIC") (e.g., value reductions caused by withdrawals or surrenders, the guaranteed and non-guaranteed elements of the contract, etc.).

The transmittal disclosure requirements are problematic in multiple respects. First, most of the content simply repeats the required point-of-sale disclosure and is thus of no added benefit to the investor (and at the same time places more burden and cost on the intermediary and advisor). Second, with respect to the NAIC model information, it either (1) duplicates requirements in states that have adopted the NAIC's model,[18] or (2) imposes an insurance-related disclosure obligation that has *not* been approved by the state (in states that have not adopted the NAIC model). Under both scenarios, the Department is encroaching on a state regulatory issue that should be left to them to avoid any duplicative and/or conflicting requirements.

Based on the foregoing, the Department should remove the transmittal disclosure requirements entirely.

III. THE DEPARTMENT SHOULD EXTEND THE ENFORCEMENT TIMELINE TO AT LEAST THIRTY-SIX MONTHS

The proposed applicability dates (April 10, 2017 for partial compliance and August 15, 2018 for full compliance) clearly underestimate the complexity and administrative burden of the

[18] According to the NAIC, seven states (Alabama, Colorado, Iowa, Maine, Ohio, Rhode Island, and West Virginia) have adopted the 2011 version of the NAIC Annuity Disclosure Model Regulation (#245).

Department's proposal. By way of example, financial institutions and advisors that do qualify for the BIC Exemption have been preparing for partial compliance on April 10, 2017 for over ten months, and many of them still will have difficulty meeting that deadline. As with the BIC Exemption, the process will involve, at the very least: drafting and approving new client documents and business contracts between intermediaries, sub-intermediaries, and advisors; internal education and development of new procedures at the institution and advisor levels; and then actual implementation of the new requirements at all levels (e.g., web and transaction disclosures, policies and procedures, etc.). Accordingly, a turnaround time of mere weeks (following publication of a final Intermediary BIC Exemption) is unreasonable, even with the transition relief provided under the Proposed Exemption.

NAIFA therefore urges the Department to allow at least thirty-six months between the final exemption's publication and any enforcement or compliance deadlines.

Thank you for your consideration.

Sincerely,

Paul R. Dougherty, LUTCF, FSS, HIA
NAIFA President