THE GOLDWATER ★ TAPLIN GROUP

Submitted electronically: e-OED@dol.gov

February 21, 2017

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

RE: Comments on Proposed Best Interest Contract Exemption for Insurance Intermediaries

Dear Acting Secretary Hugler:

Thank you for the opportunity to provide comment to the January 19, 2017, Department of Labor ("Department") published proposed class exemption (the "Proposed Exemption") providing relief for certain insurance intermediaries ("Intermediaries", and each individually, an "Intermediary") that commit to act as Financial Institutions, and as applicable to recommendations of Fixed Annuity Contracts[1] ("FACs"), generally defined as fixed rate annuities and fixed index annuities. Capitalized terms not defined herein shall have the same meaning as set forth in the Proposed Exemption.

In brief summary, and further detailed below, although we have numerous concerns with the published proposed class exemption we believe the two most critical issues are as follows:

- The Department is considering limiting the exemption to FACs that do not permit insurance companies to change contract terms (e.g., crediting rates and caps) during periods in which the client is subject to a surrender charge or penalty. Such a limitation would effectively disqualify sales of fixed indexed annuity products ("FIAs") by Intermediaries relying on the exemption.
- To qualify for the exemption, Intermediaries must have an established sales record averaging $1.5 billion in annual sales over the preceding three-year period. This, in effect, establishes a three-year seasoning requirement that erects a significant barrier to entry for all but the largest of Intermediaries.

[1] Defined in the Proposed Exemption as "an annuity contract that satisfies applicable state standard nonforfeiture laws at the time of issue and the benefits of which do not vary, in whole or in part, on the basis of the investment experience of a separate account or accounts maintained by the insurer. Fixed Annuity Contracts includes fixed rate annuity contracts and fixed indexed annuity contracts." (82 FR 7372 (January 19, 2017)).

I. Concerns with the Proposed Exemption

a. Definition of Fixed Annuity Contract

Of paramount concern is the Department's discussion and request for comment regarding an insurance company's ability to change certain terms applicable to a FIA during the life of the contract. The most troubling statement is:

> The Department asks for comment on these issues and features, with the intent of providing additional guidance on them in the final exemption, if it is granted, or potentially limiting the exemption to annuity contracts that do not permit insurers to change critical terms during periods in which the customer is subject to a surrender charge or penalty. 82 FR 7345 (January 19, 2017).

Examples of critical terms referenced by the Department include the participation rate, indexing method, interest rate cap, or relevant fees and charges. However, virtually all, if not all, FIAs in the marketplace today have granted the insurer the discretion to adjust certain contract features. This is reasonable because FIA contract forms are heavily regulated and approved by state insurance regulators. State insurance laws, rules and regulations expressly permit insurance companies to change certain critical terms within certain parameters, which reduces volatility to the insurance companies and allows them to offer consumers a product with principal protection and potentially higher income than available from fixed-rate products. Consumers receive up-front, detailed contract disclosures about these product features and typically may select a fixed rate account in addition to one or more index-based crediting methods offered by the insurance company. Therefore, limiting the Proposed Exemption to FIAs that do not permit insurers to change critical terms would both undermine state-based insurance regulation and render the Proposed Exemption illusory for FIA sales by an Intermediary. In addition, such a limitation on the types of products that Intermediaries can sell under the Proposed Exemption would place an unjustified restriction on Intermediaries that would not apply to the other types of Financial Institutions (i.e., banks, broker dealers, registered investment advisers and insurance companies) that can sell FIAs under the Best Interest Contract Exemption ("BICE"). The Department has not, nor can it, articulate a rationale for such an arbitrary, unduly burdensome and discriminatory restriction on Intermediaries that cannot rely on the BICE.

b. Qualifying FAC Premium Sales/Seasoning Requirement

Having an established sales record averaging $1.5 billion in annual FAC premiums over the last three years presents a significant hurdle for qualification. This proposed seasoning requirement gives rise to several problems. First, from a barrier to entry perspective, it will be difficult for new or smaller Intermediaries to accumulate sufficient sales to qualify for the Proposed Exemption. This barrier is not effectively alleviated by the fact that a new or smaller Intermediary could rely on a larger exempted Intermediary in their "distribution hierarchy." There are many smaller Intermediaries that do not work with or rely on larger Intermediaries.

Second, this proposed seasoning requirement is extremely anti-consumer and anti-competitive because it will create a distribution bottleneck – the ability to distribute FACs through the insurance marketing organization ("IMO") channel will be left to a very small, concentrated group of larger exempted IMOs. With such a dearth of exempted IMOs, there will most likely be a severe contraction in IMO distribution, and, subject to the previous concern regarding FIAs, there could also be severe competition among insurers for shelf space at the larger exempted IMOs, leading to an overall reduction in the availability of FACs for consumers to choose.

The Proposed Exemption also requires that the Intermediary maintain fiduciary liability insurance or possess unencumbered liquid assets, or some combination of the two, or at least one percent of the average annual amount of FAC premium sales of the Intermediary over the preceding three years.[2] However, tying the liability-reserving amount to a three-year average of sales is inappropriate because it is both arbitrary and bears no rational relationship to the potential liability that it is intended to backstop. In addition, an Intermediary does not retain any of the premium used to fund the FAC, and more often than not the commission is paid in a lump sum when the FAC is issued. If a liability arises many years after the sale, which may be the case because FIAs are long-term contracts, the Intermediary may no longer have the liquid assets (or liability insurance) on hand to satisfy the claim. For example, the Intermediary may have drastically reduced its production numbers between the time the sale occurred and the time the claim is made, thus reducing its reserving requirement.

II. Suggested Changes to the Proposed Exemption

a. Maintaining the Current Definition of FIAs

In order to continue to make FIAs and the important benefits and guarantees that they provide available to Retirement Investors, insurance companies need to be able to adjust certain critical terms. Otherwise, insurance companies may no longer offer these products. Accordingly, the Department should not include a provision limiting the Proposed Exemption to the sale of annuity contracts that do not permit insurers to change critical terms during periods in which the customer is subject to a surrender charge or penalty.

---

[2] 82 FR 7372 (January 19, 2017).

b. Qualifying FAC Premium Sales

As discussed above, requiring an established sales record averaging $1.5 billion in average FAC premiums over the preceding three years is an impractical and potentially anti-competitive and anti-consumer standard, which could lead to fewer consumer options. The proposed exemption for Intermediaries, by its stated language, does not preclude the establishment of new Intermediaries, but simultaneously it fails to adequately provide specific criteria or procedures for new or smaller Intermediaries to qualify as Financial Institutions. Potential enhancements to the current proposed draft could provide limited relief for new or smaller Intermediaries through such mechanisms as (i) an appropriate level of minimum capitalization in lieu of an established sales record (as discussed further below), (ii) a minimum number of employees, possibly within specific functions, or (iii) the expertise of seasoned industry professionals as officers or directors of the Intermediary. Another possibility for mitigating the damaging effects of this requirement could be to incorporate the Department's suggestion to include a provision that allows Intermediaries with a "reasonable expectation" of reaching the threshold over the next three years to qualify; however, we would request that the Department couple this reasonable expectation with annual revenue thresholds and subject organizations to revocation of the use of this exemption if such thresholds are not in fact met.

To further expand on the above, the proposed exemption contains a requirement to maintain either liquid assets or fiduciary liability insurance to satisfy potential liability equal to at least one percent of the average of such sales. (i.e., a minimum of $15 million). It is our understanding that the type of fiduciary liability insurance described in the proposed exemption is not currently available, nor would it provide adequate protections. Instead, it would be more prudent to increase the capitalization requirements to maintain a higher level of liquid assets. One such approach would be to have Intermediaries with average FAC premium sales of under $1 billion over each of the previous three years to be capitalized with $10 million in unencumbered liquid assets, with capital requirements increasing if the Intermediary made, in any one or more of the preceding five years, FAC premium sales in excess of $1 billion. The capital requirement would increase by an additional $1 million for each $100 million of FAC premium sales over $1 billion in the year with the highest FAC premium sales over the five-year lookback period, subject to a maximum capital requirement of $30 million.

Furthermore, we strongly request that the Department allow well-capitalized affiliates of insurance companies serving as Intermediaries to be excluded from any minimum FAC premium sales requirements. Such insurance company affiliates, capitalized in an amount equal to or exceeding $15 million in unencumbered liquid assets, would have the benefit of the related insurance company's experienced management team and sufficient capital to support potential liability as a fiduciary under the Proposed Exemption, at the same time not directly exposing the related insurance company to potential adverse rating agency or insurance regulatory action on account of the insurance company being directly exposed to increased litigation risk as the Financial Institution. Due to the close relationship with the affiliate insurance company, we would propose that this kind of Intermediary be required to supervise only the recommendations of products offered through the Intermediary and not for any incentives or compensation the insurance producer may receive from other sources, as per the Department's FAQ 22 published on October 27, 2016, "[the insurance company's] responsibility [under the BICE] is to oversee the recommendation and sale of its products, not the recommendations and transactions involving other insurers."

Thank you for the opportunity to submit these comments. Please do not hesitate to contact us if you would like additional information or further clarification.

Sincerely,

Holly J. Kinnamon
202.294.9536

###