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February 17, 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: **ZRIN 1210-ZA26** – Proposed Best Interest Contract Exemption for Insurance Intermediaries

Dear Acting Secretary Hugler:

The National Association for Fixed Annuities ("NAFA")[1] writes to comment on the Department of Labor's proposed Best Interest Contract Exemption for Insurance Intermediaries (the "Proposed Exemption") creating a new class exemption under the Fiduciary Duty Rule ("the Rule") published April 8, 2016. (81 FR 20946).

We wish to begin with recognition that the new administration under President Donald Trump appears open and receptive to concerns of those in the financial services industry who work hard every day to provide quality products for the average retirement savers of America. The comments here – to the extent they are critical – are directed at the prior administration that developed the Rule and created this Proposed Exemption which perpetuates and exacerbates inherent flaws contained within the underlying Rule.

NAFA is the primary trade association representing Independent Marketing Organizations (IMOs). IMOS are the entities most directly impacted by this Proposed Exemption. Among NAFA's membership, there are about 80 IMOs ranging across the spectrum in business size and scope, from smaller boutique operations to large organizations facilitating distribution of fixed annuities on a nationwide basis. NAFA membership also includes insurance carriers that manufacture and underwrite fixed annuity products. The Proposed Exemption will adversely affect all NAFA membership segments and will have particularly devastating consequences on small and medium sized IMO members who,

[1] Founded in 1998, NAFA is a trade association dedicated to educating and informing state and federal regulators, legislators, industry personnel, media, and consumers about the value of fixed annuities and their benefits to Americans in financial and retirement planning. NAFA's membership includes insurance companies, independent marketing organizations, and individual producers, representing every aspect of the fixed annuity marketplace and covering 85% of fixed annuities sold by independent agents, advisors, and brokers.

indeed, would likely be put out of business based on how the Proposed Exemption is presently structured.

In many ways, the Proposed Exemption compounds problems with the underlying Rule and with the existing Best Interest Contract Exemption ("BICE") by making it impossible for fixed annuity distributers to conduct their business and serve their clients. Numerous provisions of the Proposed Exemption do not comport with realities of the existing fixed annuity marketplace and the timing of this exemption is completely unworkable given the Rule is scheduled to take effect in less than two months. The Proposed Exemption reflects misunderstandings regarding fixed annuity products and seeks to saddle fixed annuity providers with burdens that unfairly impact the fixed annuity industry relative to other segments of the financial services industry. We elaborate below on these concerns.

Recognizing there are several pending lawsuits challenging the Rule and a February 3, 2017 Presidential directive issued to the Secretary of Labor calling for possible rescission or revision of the Rule, NAFA believes the Department should delay the Proposed Exemption's notice of pendency and keep the comment period open indefinitely until there is clarity on the ultimate disposition of the Rule.[2] However, in light of the Department's published request for comment and lack of any official extension of the comment period, NAFA feels compelled to express its deep concerns and objections relating to the Proposed Exemption. In the event the Rule and/or Proposed Exemption are delayed and more time is allotted for review and comment, we reserve the right to submit additional commentary.

The concerns of NAFA with respect to this Proposed Exemption fall into three broad categories. First, the timing of the Proposed Exemption is unfair and unworkable. Second, the Proposed Exemption is flawed technically and imposes unrealistically heavy burdens on fixed annuity providers and distributors. Third, the Proposed Exemption opens up questions about fixed annuity products and the delivery of such products that reveal biases of the Department under the prior administration and go beyond the appropriate scope of this Proposed Exemption to the extent such questions are raised now for the first time, rather than during development of the Rule itself.

2 Nothing in this Comment Letter should be construed to suggest the underlying Rule and related exemptions pass legal muster. NAFA has sued the Department of Labor in the federal courts in the District of Columbia, objecting to the Rule and related exemptions on several grounds. That litigation is ongoing. Among other things, NAFA alleged in the lawsuit that the ten-month implementation period was inadequate; the Proposed Exemption only further compounds that concern. Nothing herein is intended to be inconsistent with the position NAFA has taken in the litigation.

The timing of the Proposed Exemption is unfair and unworkable.

NAFA believes it is patently unfair that the Department issued this Proposed Exemption at this late hour of the rulemaking process. The prior administration issued the Proposed Exemption in its waning days knowing full well it would be impossible for the fixed annuity industry to reshape itself quickly enough around these new requirements to meet the April 2017 compliance timeline for the new Rule. Thus, the obvious and immediate effect of this Proposed Exemption, which indeed is merely proposed and not yet even adopted, will be to handicap or paralyze the fixed annuity industry during the transitionary period in which the Rule first becomes applicable to the sizeable IRA marketplace. Even with its proposed "Transition Relief" and even if the exemption was put in force immediately, there is simply not enough time for the industry to pivot and make drastic changes to business models and practices to comply with these new requirements under the Proposed Exemption.

It is noteworthy that the first application by an IMO for exemptive relief was filed back in May 2016. Over eight months later and just 83 days before the Rule is to go into effect, the Department finally released this Proposed Exemption. Of course the Proposed Exemption must still go through this notice and comment period and the industry must wait even longer as the Department reviews and considers submitted comments – with a possible scheduled public hearing – before the final regulation is edited and finally published. As a practical matter, what this means is that the fixed annuity industry, which is largely organized around the IMO-based delivery system, is stymied and must await the unveiling of this Proposed Exemption before it can function fully under the Rule and its new regime relating to IRA sales.

It must be emphasized that when the Rule was adopted, it permitted for a ten month lead time between June 2016 and April 2017 for the financial services industry to prepare for the new Rule and its extensive requirements. One of the most impacted subcategories within the financial services industry is the fixed annuity sector which is organized around the IMO delivery system. The fact that this Proposed Exemption comes only now plainly means the fixed annuity sector is deeply disadvantaged compared to all the other competing sectors (i.e., securities firms, investment advisory firms, banks) in preparing for this Rule and being ready on "day one" to operate and thrive in this new environment. While the Department under the prior administration can try to downplay or deny the importance of this critical exemption in terms of its impact on the fixed annuity distribution system, the reality is that the delay in developing and introducing this Proposed Exemption deprived the fixed annuity industry of an equal opportunity to prepare for and compete on a level playing field with other financial services providers.

Given both the time constraints and the great uncertainties presented by this new proposal, it is frankly impossible for the fixed annuity industry to reshape itself to comply with this still evolving Rule. Over 60% of the estimated $60 billion indexed annuity market is distributed through IMOs. NAFA believes that there may be over 200 IMOs operating in the United States, with over 100 major IMOs potentially affected by the Proposed Exemption. Of the 22 IMOs that applied for this exemption, the onerous requirements will permit at most only five to eight of them to be granted "Financial Institution" status. Consequently, NAFA estimates that the Proposed Exemption will put hundreds of IMOs out of business, with each employing between 5 and 35 employees. Of course, many of these IMOs are NAFA members, and our Association will also be harmed as a result. We think fairness dictates that the new administration recognize this Proposed Exemption comes too late for the fixed annuity industry and therefore the Rule should be delayed -- if not repealed -- out of elementary fairness.

The Proposed Exemption is flawed technically and imposes unrealistically heavy burdens on fixed annuity distributors.

NAFA is equally concerned that this Proposed Exemption is unworkable and has significant technical flaws. While NAFA does not seek here to catalogue all the technical deficiencies in this Proposed Exemption, it will identify in this comment letter a few prominent examples that demonstrate the Proposed Exemption lacks reasonable clarity, its requirements are arbitrary and unrealistic, and the net result is this Proposed Exemption is unworkable for most, if not all, IMOs and for the fixed annuity industry. These examples also make clear that the prior administration failed to conduct an adequate business impact analysis as required by the Regulatory Flexibility Act.

One example, which goes to the heart of this Proposed Exemption, is that an IMO qualifies as a "Financial Institution" under the Proposed Exemption only if it "… transacts sales of Fixed Annuity Contracts averaging at least $1.5 billion in premiums per fiscal year over its prior three fiscal years." (82 FR 7372). Depending on what is meant exactly by these words, this would mean *only* five to eight IMOs out of about two hundred in the marketplace could meet this threshold and potentially qualify as Financial Institutions. This makes the Proposed Exemption facially unreasonable and self-defeating. It is impossible to fathom how an exemption which purports to facilitate sales through the IMO channel would be designed by definition to be inaccessible to the vast majority of IMOs.

Beyond that, the $1.5 billion premium requirement is unclear due to DOL's lack of familiarity with technical aspects of the insurance business. For example, it is unclear whether the requirement is based on premium *submitted* to carriers or premium *taken* by carriers. Those are two different measures which are tracked separately in the insurance industry but which are blurred by this Proposed Exemption. Premium accepted by carriers can be lower due to various situations where applications may be withdrawn or policies rejected prior to issuance. If the requirement is based on premiums taken and accepted by carriers, that would disqualify even more IMOs unable to attain the daunting $1.5 billion threshold. Additionally, it is unclear whether the requirement may be met by aggregating premiums across several IMOs within a consortium of IMOs or whether it must be met by a single IMO.

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Perhaps most significantly, this $1.5 billion premium requirement is arbitrary and lacks any rational basis. The creators of this Proposed Exemption concede it comes merely from the Department's limited review of premium sales of the top *insurance carriers* (82 FR 7360) as well as attributes of some of the 22 IMOs that applied for an individual exemption under BICE. (82 FR 7360). But there is no meaningful basis for this threshold which is disconnected to its basic purpose concerning compliance with fiduciary standards and is disproportionately restrictive compared to standards applicable to other segments of the financial services industry.

Aside from the problematic $1.5 billion premium requirement, another stark example of the Proposed Exemption's arbitrariness and detachment from realities of the IMO marketplace is the exemption's quasi-capital requirements. The Proposed Exemption imposes an impractical financial responsibility requirement based on a combination of liability insurance or unencumbered cash or cash equivalents. Under this test, in order for an IMO to qualify as a "Financial Institution," it must maintain, in aggregate, an amount of specialized insurance coverage and/or unencumbered cash or cash equivalents at least equal to "1% of the average annual amount of premium sales of Fixed Annuity Contracts sold …. pursuant to this exemption over its prior three fiscal years…" (82 FR 7372). This is not realistic and is beyond any comparable requirement for other financial service providers such as broker dealers and investment advisers.

As far as NAFA knows, the specialized fiduciary liability insurance contemplated by this Proposed Exemption does not even exist in the current marketplace. NAFA believes such coverage is unlikely to be available any time soon as liability insurers must assess the risk, price the coverage, and create policies and endorsements to cover this unique particularized insurance. If indeed the coverage is even found to be insurable, there is no way to tell how much such coverage will cost, or whether it will be affordable. And even if such coverage becomes available, and the cost established, no meaningful cost benefit analysis was conducted; instead, the Proposed Exemption attempts to extrapolate potential costs related only to the cash set aside alternative to the insurance requirement. (82 FR 7358-59).

While the availability and cost of the liability insurance is unknown, the alternative unencumbered cash or cash equivalent requirement is out of reach for most, if not all, IMOs. The $1.5 billion premium threshold requirement for IMOs dictates that the minimum cash reserve requirement of qualifying IMOs will be onerous. Depending on how it is interpreted, that could be $15 million if the requirement means 1% of all premiums, or could be $7 to 9 million if the 1% applies only to qualified premiums. But either way, this onerous insurance/reserve requirement is likely unattainable even for the largest of IMOs. At the very least, it unfairly hamstrings IMOs as compared to banks, broker dealers and registered investment advisory firms under BICE that are not subject to such steep requirements. Like the $1.5 billion premium requirement, this baseline multimillion dollar financial responsibility requirement is utterly arbitrary and without any ascertainable reasoned basis. Indeed, the Department provides no explanation whatsoever

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concerning how it arrived at the 1%-of-premiums figure, whether it considered alternatives, or what the impact of such steep requirements would be on IMO businesses.

Beyond these formidable threshold requirements to qualify for the Proposed Exemption, the exemption itself contains conditions and imposes uniquely burdensome requirements upon fixed annuity distributors including:

- advertising review requirements (Section II(d)(4) at 82 FR 7367);
- written and *oral* disclosure requirements (Section III(a)(1) and (5) at 82 FR 7368-69;
- website disclosure requirements (Section III(b)(1)(vi) and (vii) at 82 FR 7369);
- transaction review requirements (Section II(d)(5) at 82 FR 7367); and
- training requirements. (Section II(d)(8) at 82 FR 7367)

These are requirements that would apply only to IMOs based on an unfounded notion that greater protections are needed for IMOs compared to other segments of the financial services industries that distribute similar products, i.e., banks, broker dealers and registered investment advisory firms. NAFA submits these additional requirements are excessive, unnecessary, and unjustified, merely serving to create an unlevel playing field, based on a fiction that other financial product distributors are inherently superior and less susceptible to misconduct.

The preamble to the Proposed Exemption raises questions biased against fixed annuity products which are troubling because they show a predisposition against the insurance industry and foreshadow possible adoption of even more arbitrarily stringent requirements without proper notice or deliberation.

An alarming aspect of the Proposed Exemption is its series of questions raised in the preamble which reflect inherent biases against the insurance industry and demonstrate woeful lack of understanding of fixed annuity products. Many of the ill-informed questions in the preamble have no place in this Proposed Exemption and should be withdrawn or disregarded to the extent they seek to raise new issues about fixed annuity products which were never raised during development of the Rule itself. NAFA must take the questions seriously, however, because they open the door for the Department to adopt far-reaching modifications to the Proposed Exemption without proper advance notice and opportunity for comment which was the tactic used by the prior administration in shifting fixed indexed annuities from PTE 84-24 to BICE.

Perhaps most disturbing in this regard is commentary in the preamble calling into question whether insurers should be allowed to "…change the terms of a fixed indexed annuity contract during the life of the annuity..." (82 FR 7344). This question and surrounding narrative is deeply troubling. It reflects an abject misunderstanding of annuity products and represents what can only be described as a blatant attack by the Department on the

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indexed annuity industry, going so far as to say these products can "…place the customer in a lose-lose situation…" (82 FR 7344). That is an outrageous statement and irresponsible characterization of how fixed indexed annuity products are structured. To suggest the final exemption might even prohibit agents from selling any product containing what are known in the industry as "non-guaranteed elements" (described ominously but inaccurately in the preamble as the ability to change critical terms) shows there is likely a hidden agenda at play here that perhaps has been unfolding ever since the inception of this Rule and has now culminated in this overt attack on fixed annuity products.

Regarding the supposed ability of insurers to change critical terms of the annuity, this is a distortion of truth. While annuity contracts may contain nonguaranteed elements like caps, spreads or participation rates, the elements are limited by terms of the annuity contract. Specifically, the fixed annuity contract guarantees a floor or maximum for such parameters which is approved by state insurance regulators and disclosed upfront to the consumer. It is no different from how declared rate annuities - often considered traditional annuities - operate which permit annual changes in declared interest rates subject to certain minimums set forth in the annuity contract. The ultimate key feature to fixed annuities, whether indexed or declared rate, is that they are subject to minimum nonforfeiture requirements and thus provide principal guarantees backed by the general account (i.e., full faith and credit) of the insurance company.

The irony here is that fixed products do not contain the range of risk inherent in securities and other kinds of investments which the Department thinks are in need of less protection than fixed annuities which are far safer with their protections of principal. Not only are sale of these fixed annuity products subject to long-established, state-based insurance regulation including rigorous suitability rules, according to records by the National Association for Insurance Commissioners, in 2014, fixed indexed annuities had the lowest incidence of consumer complaints across all financial products. Moreover, to the extent a consumer is planning for retirement and could be adversely impacted by an unexpected downward market move at the wrong time (e.g., point of retirement), NAFA submits that a better question is: how can an advisor prudently recommend anything without a guaranteed floor such as a fixed annuity?

To be clear, NAFA is also concerned with many other questions contained in the preamble, many seemingly designed to stir up extraneous issues such as questioning whether additional disclosure is needed for fixed annuity products beyond the comprehensive disclosure already required of insurance agents under state insurance laws. NAFA strenuously opposes any attempt to use this Proposed Exemption as a backdoor means to create greater regulation of fixed annuity products and their distributors, in effect creating a new layer of federal regulation for insurance agents selling IRA products.

With this letter, NAFA wants to be on record identifying these concerns and opposing any attempt by the Department to regulate fixed annuity products and distributors in the manner intimated by questions in the preamble. At the same time, NAFA holds out hope the new administration will approach these matters more thoughtfully and reject the overreach of the prior administration evidenced by the questions in the preamble.

<u>NAFA's Legal Challenge to the Rule Necessitates Postponement and Further Consideration by the Department.</u>

In June 2016, NAFA brought a lawsuit in the United States District Court for the District of Columbia, challenging the Department's authority in expanding the definition of fiduciary, imposing ERISA fiduciary duties on parties to IRA transactions, and creating a private cause of action in the absence of Congressional authorization. NAFA's action also challenges the Rule's vague definition of "reasonable compensation" as violative of due process and thus constitutionally defective. And NAFA's action further asserts the Department acted in an arbitrary and capricious manner in adopting the Rule in contravention to the Administrative Procedure Act.

Relevant to this Proposed Exemption, NAFA's lawsuit challenges the failure of the Department to conduct an adequate business impact analysis as required by the Regulatory Flexibility Act. Similarly, NAFA's lawsuit challenges movement of fixed indexed annuities from PTE 84-24 to the BICE which swept sale of such products into the supervisory construct involving Financial Institutions, which does not work for independent insurance agents that operate within the IMO-based distribution model and sell products for multiple insurance carriers.

The Department's attempt to address the deficiencies of the Rule through this Proposed Exemption – through midnight rulemaking by the prior administration – serves to prove the very point asserted in NAFA's briefing in the lawsuit that the Department had not properly analyzed the impact of the proposed Rule on the fixed annuity distribution channel. Attempts by the Department through *post hac* explanations and "too little too late" pronouncements including its FAQs and this Proposed Exemption only underscore the original Rule was not adequately thought out and analyzed prior to adoption. In fact, none of the analysis or data of purported harm caused by the financial services industry used to justify the Rule had anything to do with fixed annuities, its sellers, or consumers, and thus the Department failed to account in any way for the true effects of the Rule on the annuity distribution channel.

NAFA believes the Proposed Exemption does not solve concerns about the Rule raised in the lawsuit, including but not limited to concerns BICE is unworkable and impossible to administer for independent insurance agents. That aside, it is still self-evident that the Proposed Exemption is put forward by the Department, in an attempt to compensate for its earlier oversights. The Proposed Exemption, designed now to "fix" a flaw in the Rule as it relates to insurance intermediaries in the annuity distribution channel shows the prior administration acted beyond its regulatory authority and expertise when it promulgated the Rule.

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Conclusion

As shown above, this Proposed Exemption is deeply flawed in many different ways. With fewer than 55 days remaining before the April 10, 2017 applicability date, this Proposed Exemption only illustrates why the Rule itself is not workable for the fixed insurance industry, because far from addressing or curing problems within the Rule the Proposed Exemption exacerbates those problems. Far from adding clarity, this Proposed Exemption engenders greater uncertainty for NAFA members and for the fixed annuity industry, especially those individuals and entities involved in the industry's distribution system.

Indeed the only thing that is certain is the Rule will cause large scale disruption to hundreds of small and medium-sized businesses across the country, and their employees, and will limit the ability of everyday Americans to access quality products and services that promote wealth and guaranteed retirement security. Disappointingly, the Proposed Exemption only compounds the ill effects of the Rule and will help contribute to the demise of scores of American businesses and the careers of thousands of independent insurance agents.

NAFA respectfully requests the Department delay indefinitely this Proposed Exemption while it undertakes the current White House directed review of the Rule. The Proposed Exemption is not well thought out, has too many flaws, prompts too many unanswered questions, and should not be rushed into effect following a mere 30 day comment period on an exemption that fundamentally alters the IMO-based delivery system which accounts for billions of dollars of sales every year.

NAFA appreciates the opportunity to submit these comments. Please do not hesitate contacting our organization if additional information or clarification is needed.

Sincerely,

Chip Anderson

Charles "Chip" Anderson
NAFA Executive Director