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Submitted Electronically

September 24, 2015

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

**Subject: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32);**
**Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters (RIN 1210-ZA25); and**
**Proposed Best Interest Contract Exemption (RIN 1210-ZA25)**

Greetings:

On behalf of the American Council of Life Insurers ("ACLI")[1], we offer additional comments on the Department of Labor's ("Department") proposed rule and prohibited transaction exemptions promulgated under Sections 3(21)(A)(ii) and 2510.3-21 of the Employee Retirement Income Security Act ("ERISA")(collectively, the "Proposal"). In addition to this letter, please see the comments provided in our letter of July 21, 2015 ("Letter") as well as the testimony delivered by ACLI staff at the Department's public hearing on August 11th and 12th.

We reiterate our concern that, absent the significant changes identified in our Letter, the Proposal would cause irreparable harm to small balance retirement plan investors, including many middle and lower income investors. More specifically, the Proposal would effectively limit or deny access to guaranteed

[1] The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with 284 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. ACLI member companies offer insurance contracts and other investment products and services to qualified retirement plans, including defined benefit pension and 401(k) arrangements, and to individuals through individual retirement arrangements (IRAs) or on a non-qualified basis. ACLI member companies also are employer sponsors of retirement plans for their own employees.

income products that are increasingly important to millions of Americans who no longer have access to a traditional pension.

Section I of this letter provides suggested revisions to the "Definition of the Term Fiduciary." Section II provides suggested simplifications and revisions to the proposed "Best Interest Contract Exemption." Section III provides post-hearing observations on the Regulatory Impact Analysis, responds to questions posed by the Department during the hearings relating to arbitration, and provides observations about the four additional research papers posted by the Department on its website subsequent to the close of the prior comment period and public hearings.

## I. Revise the Fiduciary Definition

### *A. Provide Clarification Regarding Coverage of Welfare Benefit Plans*

Under the Proposal, a person is a fiduciary if the person provides a "Recommendation" for a fee to a "Plan" on the advisability of acquiring "property." The Proposal defines "Plan" to include any employee benefit plan as defined in ERISA §3(3). This definition includes welfare benefit plans. A disability income insurance contract issued to an employer-sponsored welfare benefit plan is "property." Thus, the Proposal arguably would include recommendations regarding the acquisition of a disability income insurance contract by a welfare benefit plan. At the hearing, we heard DOL staff note that the Proposal was not drafted with the intent to cover all welfare benefit plans, but only instances in which advice is provided regarding the investments of assets held in a welfare benefit plan trust or with respect to the investment of certain welfare benefit products that include variable investment features. Our letter offered revisions to refine the proposed definition of fiduciary to clearly focus on advice regarding retirement plan assets when there is a mutual relationship of trust and an expectation of impartiality. More specifically, our Letter includes recommended changes to the rule that would narrow the language of the rule to address advice regarding investments and a recommendation that, given the lack of analysis and explanation regarding the Proposal and its impact on welfare benefit plans, the Department exclude these plans from this rulemaking effort.

### *B. Broaden the Seller's Exception to Cover Wholesale Activities*

We seek a seller's exception that provides a clear path for sales/marketing activities with all investors. The Proposal broadly includes routine sales "suggestions" that naturally include a "call to action" as it were. Thus, it was necessary for the Department to include a counter-party carve out or sales exception, which, as we noted in our Letter, is far too narrow.

At the hearing, concerns were raised regarding the scope of the definition and its application to wholesale marketing activities. In response, DOL staff acknowledged wholesaling was "kind of a new concept that maybe we haven't explored."

Under the terms of the Proposal, it is not unreasonable to conclude that efforts on the part of an insurer to make arrangements with a wholesaler for the sale of its insurance products to plans and IRAs would be considered fiduciary advice when the wholesale intermediary is a fiduciary to plans and IRAs by reason of the application of the Proposal or otherwise. This must be addressed. Any final rule should clearly exclude from the definition of fiduciary an insurer's arm length sales activities with an intermediary to a plan or IRA, even if such intermediary is a fiduciary by reason of the Proposal.

### *C. Revise the definition of "Recommendation"*

At the hearing, the Department reiterated its query in the Executive Summary of the Proposal as to whether it should adopt some or all of the standards developed by FINRA in defining the term

"Recommendation" under the proposal. The Investment Advisers Act predates ERISA by more than three decades. As there was existing law in place, it is not surprising that Congress included no more than a single phrase regarding "investment advice" in ERISA. A uniform definition of the term "recommendation" would provide investors certainty, simplify the administration of the rule, and be consistent with the application of law. Thus, we recommend the Department incorporate by reference FINRA guidance as the basis for the definition of the term "Recommendation."

### *D. Retain All Current Elements of Interpretive Bulletin 96-1 in the Investment Education Carve-out*

We reiterate our concerns regarding the Department's proposed restrictions within the Proposal's investment education carve-out. Our Letter offered specific suggestions for improving this carve-out, including elimination of the requirement to avoid specificity regarding investments in asset allocation models and interactive materials as well as specificity regarding distribution options and annuity features in interactive materials. The Department's proposed replacement of Interpretive Bulletin ("IB") 96-1 with a more restrictive carve-out renders it only marginally useful.

It is clear from the written comments and hearing testimony of financial service providers and organizations representing plan sponsors that IB 96-1 serves a crucial and significant role to ensure participants have access to meaningful investment-related educational materials and programs. The Department has not established a basis for the proposed more restriction regulation. The Regulatory Impact Analysis does not discuss or describe any empirical evidence to support such a change. We seek a broad investment education carve-out that would preserve IB 96-1 in its entirety, expand the availability of distribution guidance, include education regarding features inherent in previously purchased products, and include "anti-cashout" intervention education.

## II. Exemptive Relief for Fiduciaries

We seek workable, administrable compensation exemptions that support the variety of annuity distribution models in place today, permit reasonable and customary compensation to be paid to agents and brokers for the sale of annuity products, leverage existing disclosures, and permit insurers and other product manufacturers to engage in commerce and freely receive revenue in a competitive marketplace. We seek exemptive relief for fiduciaries that is sufficiently flexible to accommodate the wide range of business practices and compensation structures that currently exist to support the sale of annuity products. We seek workable, administrable exemptions that provide fiduciaries and their affiliates certainty and clearly permit the receipt of reasonable and customary compensation paid for the sale of annuity products. Exemptive relief should be both protective of plan participants, beneficiaries and IRA owners, and administrable. In our Letter, we offered comments seeking to improve on the proposed amendments to Prohibited Transaction Exemption ("PTE") 84-24. This important exemption has provided support for the sale of annuities for over three decades and should continue to be available to support the commissioned sale of any and all annuities to plans, plan participants, beneficiaries and IRA owners.

The Department should be mindful of the fact that the cost of doing business is borne by a firm's customers. To keep the cost of operationalizing an exemption low, the Department should consider existing laws and regulations. For example, in our Letter, we noted that the Department could minimize the cost to administer the Best Interest Contract Exemption by requiring disclosures based on the disclosure elements included within ERISA §2550.404a-5 (Fiduciary requirements for disclosure in participant-directed individual account plans) and ERISA §2550.408b-2(c) (Reasonable contract or arrangement) rather than establishing a new disclosure regime. We also described the robust regime of state laws that is protective of plans, plan participants, beneficiaries and IRA owners who are purchasing or have purchased insurance contracts.

In our Letter, we stressed the need for the Department to revise the proposed BICE to eliminate a phrase in Section 11(c)(2) which requires compensation to be tied directly to the cost of providing a service. This could be read to prohibit a fiduciary from receiving a commission or fee based on a percentage of assets - as such amount would lead to overcharging those with greater amounts involved over those with less. We noted that setting compensation based on a percentage of the transaction or assets of the account leads to a subsidization by those with more of those with less. For example, a fiduciary that receives a 1% commission on a sale or receives 1% for all assets under management will earn three times more compensation on a $75,000 transaction or account than a $25,000 transaction or account, although the fiduciary may have provided the same services to both accounts

Recently, the Department posted on its website a document entitled “Q&A on Small Savers.” On page 3, in answer to the question “will the new rule prevent advisers from providing financial advice to small savers,” the document notes that “advisers will still be able to deliver advice to all savers and charge for the costs of the advice delivered…”

This indicates that the Department intends for the BICE to permit only compensation arrangements that result in a uniform charge for cost of advice services. Thus, using as an example the two transactions described above which generate total compensation to the fiduciary of $1,000 (1% of $25,000 plus 1% of $75,000) to comply with the final rule and earn the same total compensation, the fiduciary would need to change its compensation approach and charge each customer a flat $500 fee. This would result in the retirement investor purchasing the $25,000 product paying more than she would under a commission-based arrangement, and the investor purchasing the $75,000 product paying less than she would under a commission-based arrangement. Of course, such a flat fee arrangement would not give rise to a prohibited transaction and thus there would be no need for an exemption.

If we misunderstand the intent of the proposal and the meaning of this Q&A, we urge the Department to accept our recommended change to Section 11(c)(2) and revise the Q&A. If not, the Department should reconsider the implication of such a policy on small savers and the fact that such position would render the BICE useless to fiduciaries.

### *A. A Simplified Best Interest Exemption*

The proposed Best Interest Contract Exemption (“BICE”) requires that there be a contract between the fiduciary, the financial institution and the investor that is enforceable in state court. The exemption is contingent on the fact that no misleading statements are made to the investor.

Insurers are familiar with the idea of an enforceable contract between a financial institution and its customer. All annuity owners have contractual rights enforceable against the insurer and recourse to state insurance departments and state courts. State laws provide annuity owners with important consumer protections. These include state unfair trade practice laws that protect annuity owners from false claims and misleading statements. State insurance departments have the authority to enforce these protections. For example, all insurance agents and insurance companies must have valid licenses to engage consumers. State insurance departments have the authority to revoke these licenses and deny an agent the right to sell insurance products and deny an insurance company the right to do business in the state.

During the recent hearings, Deputy Assistant Secretary Hauser asked several witnesses questions regarding the potential for revising and simplifying the proposed BICE. As detailed in our Letter on the Proposal, the BICE must be revised and re-proposed since, absent substantial changes, it has no utility for the insured retirement industry.

ACLI and its members recommend the Department revise and simplify the BICE, utilizing a true "principles-based" approach that allows for savers to have continued access to guaranteed lifetime income products and (1) ensures that advisers act in the best interest of retirement savers; (2) simplifies the "Best Interest Standard; (3) preserves reasonable and customary commission-based compensation practices; and (4) provides for a simplified disclosure regime. Such an exemption should include the following key elements:

1. **A Simplified and Enforceable Commitment to Act in the Retirement Saver's Best Interest.** ACLI and its members support a simplified exemption that would require a fiduciary and/or the fiduciary's employer or an affiliate (as defined in the Proposal) to provide retirement savers with a written enforceable commitment that, in providing investment guidance and advice, the financial professional will act in the saver's best interest.

    a. Timing. The simplified exemption should provide that the written commitment is required to be provided to the retirement saver prior to the commencement of any trading or transaction activity. In order to protect any prior recommendations, the written agreement should contain a provision that applies the best interest standard to any recommendations made prior to the provision of the written commitment to the retirement saver.

       As discussed in our Letter, the proposal's pre-recommendation requirement is impractical and incompatible with customary business practices in the financial services industry. It is illogical for an adviser to provide a retirement saver with a written commitment to act in the retirement saver's best interest before the parties determine whether to enter into a business relationship. Financial professionals often begin their discussions with customers with an initial general consultation during which a customer's needs – and the products and services provided by the financial professional - are discussed. This is especially true with respect to lifetime income products. Financial professionals often introduce savers to annuities and explain the various types of lifetime income options available and the value proposition associated with each. In such circumstances, neither the financial professional nor the retirement saver would reasonably have an understanding that such discussions included a "recommendation" or "call to action."

    b. Parties. As discussed in detail in Section IV(B)(3) of our Letter, it should be sufficient that the fiduciary, the fiduciary's employer or an affiliate (as defined in the Proposal) make the binding commitment. Accordingly, the simplified exemption should require only that such an employer or affiliate make the best interest commitment, so long as in making such commitment, the employer or affiliate assumes responsibility for the actions of the fiduciary adviser. A best interest commitment that is enforceable under state law without the signature of the retirement saver should satisfy the simplified exemption.

    c. Delivery. As discussed above, with respect to new arrangements, we recommend that the written best interest commitment be furnished to the retirement saver prior to the commencement of any trading or transaction activity. With respect to existing arrangements, the simplified exemption should permit the best interest commitment to be furnished contemporaneous with any change in the terms of the arrangement between the fiduciary advisor and the retirement saver, again without the need for retirement saver to consent to the best interest commitment, when such commitment is enforceable under state law without such consent. It is simply impractical to require financial professionals to obtain signatures to amend existing IRA and other retirement plan agreements. Financial professionals should be able to provide their existing customers with written materials acknowledging acceptance of their duty and responsibility to act in the best interest of the retirement saver.

d. Enforceability. The simplified exemption should require that the retirement saver have an unequivocal right to enforce the terms of the written commitment. Simply put, if the retirement saver believes that, in providing financial advice, the fiduciary did not act in her best interest, the retirement saver should be able to take legal steps to enforce her rights. Although several witnesses during the hearing recommended that the Department not allow, as proposed, a fiduciary adviser and a retirement saver to enter into a pre-dispute binding arbitration agreement, we continue to support inclusion of this provision in a simplified exemption.

2. **A Simplified Best Interest Standard.** During the hearing, several witnesses provided testimony on the interpretive problems associated with the language in the proposed BICE definition of "Best Interest" requiring the financial professional to act "without regard to the financial interests of the Adviser, Financial Institution, or any Affiliate, Related Entity, or other party." As discussed on our previous comment letter, this provision could easily be interpreted to imply that if an adviser has any financial interest in the transaction – including receiving a commission associated with the transaction – the advisor will have violated the Best Interest Standard.

   We believe a simplified definition of "Best Interest Standard" would serve to both protect retirement investors and clarify that a financial professional may be compensated. We recommended that the simplified exemption include the following definition of "Best Interest:"

   > *Investment Advice is in the "Best Interest" of the Retirement Investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence and diligence that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, placing the needs of the Retirement Investor before the financial or other interests of the Advisor, Financial Institution, or any Affiliate, Related Entity, or other party.*

3. **A Revised "Reasonable and Customary Compensation" Requirement.** As discussed in our Letter, the Department uses three different formulations of the concept of "reasonable compensation" within the proposed BICE, creating unnecessary and harmful confusion. The revised BICE should require that, in order to obtain relief under the exemption, compensation paid in connection with the transaction must be "reasonable and customary." We recommend that the revised exemption be clarified as follows with regard to the definition of "reasonable compensation:"

   > *When providing investment advice to the Retirement Investor regarding the Asset, the Adviser and Financial Institution will not recommend an Asset if the total amount of compensation anticipated to be received by the Advisor, Financial Institution, and Affiliates in connection with the purchase, sale or holding of the Asset by the Plan, participant or beneficiary account or IRA, will exceed that which is reasonable and customary for the products and services provided to the Retirement Investor, within the contemplation of ERISA Sections 408(b)(2) and 408(c)(2) and Internal Revenue Code Sections 4975(d)(2) and 4975(d)(10).*

   Further, as confirmed by Department officials during the hearings, we recommend that the simplified BICE clarify that the marketplace serves as a "governor" with respect to the determination of reasonable compensation.

4. **A Simplified Disclosure Regime.** The final key element that should be included in a simplified exemption is a useful and meaningful simple point-of-sale disclosure which is based on elements found in the ERISA section 404(a)(5) and 408(b)(2) disclosures and other disclosure required by federal securities and state insurance law. Many of the elements found in these disclosures overlap with the disclosure information required by the Proposal. It is essential that the required disclosure

be meaningful and actionable for retirement investors without overwhelming them with information they don't need – or want – in making investment decisions. It is also important to find a regulatory solution that minimizes the cost of compliance.

### *B. Re-Propose the Revised Exemptions*

In light of the issues raised here and in our Letter, we asked that the Department issue the exemptions via a Notice of Proposed Rulemaking. The changes needed to be made to the exemptions are clearly material. If the Department intends to make these or other material changes, the public must be afforded an opportunity to review and comment on the exemptions before they are issued as final. While we have not asked the Department to re-propose the regulation defining fiduciary, we do ask that any final regulation be effective no earlier than the effective date of the final prohibited transaction class exemptions.

### *C. Transitional Good Faith Compliance/Grandfathering Provisions*

As proposed, there will be a short 8-month period from the date the final rule and exemptions are issued to the time they are applicable. Our Letter stressed the need for additional time to get processes and procedures in place to comply with the requirements of the proposed exemptive relief. If the Department is not persuaded by our Letter and the comments and testimony of others to provide additional time for the effective date of the rule and the applicable exemptions, we ask that the Department delay strict compliance with the requirements of final exemptive relief and provide fiduciaries and affected financial institutions a sufficient period of time during which compliance can be done on a good faith basis. If the requirements for exemptive relief in the final prohibited transaction exemptions are materially similar to that of the proposed exemptions, we ask that such transitional good faith period be no less than 3 years. For example, to the extent the final exemptions would require disclosures not currently required by ERISA §2550.404a-5 (Fiduciary requirements for disclosure in participant-directed individual account plans) and ERISA §2550.408b-2(c) (Reasonable contract or arrangement), the Department should provide for a delayed compliance date for such disclosures that offers sufficient time to work. Again, absent material changes to the disclosure requirements, we ask that such transitional good faith compliance date be no less than 3 years from the issuance of the final exemptions.

Additionally, as discussed in our Letter, we urge the Department to make application of a final regulation, including changes to existing prohibited transaction exemptions, prospective only to apply to fiduciary advice with respect to retirement accounts opened or insurance contracts issued after the regulation's compliance date. An effective grandfathering provision is especially important for commission-based annuity contracts, as retirement investors may have already paid for services – and application of the regulation retroactively would likely result in such investors incurring additional expenses to transition to a fee-based arrangement.

## III. Post-Hearing Observations on the Regulatory Impact Analysis

### *A. Annuities Missing in RIA Calculus*

One thing is uniformly consistent in the Proposal's preamble, the Regulatory Impact Analysis ("RIA"), the economic studies supporting the RIA and the hearing transcript: they all ignore the comprehensive scope of consumer-protective regulation governing the sale of annuities, and fail to translate the unique impact of the initiative on annuities.

ACLI noted during the hearing that, although the initiative mention annuities a total of 172 times and acknowledge that "31 percent of IRAs include investments in annuities" and that "insurance companies

[will] be significantly affected by the proposal," the cost-benefit analysis makes no attempt to examine the impact of the proposed rule on annuities, advisers, insurers, or retirement savers using them. Neither the hearing transcript nor four economic studies posted after the hearing reveal any additional analysis or information about the proposed rule's impact on retirement savers using annuities, on advisers recommending annuities, or on annuities' role in retirement security. The RIA, therefore, continues to fail the statutory, administrative and judicial requirements that federal agency rulemaking conduct a meaningful cost-benefit analysis. Collectively, these rulemaking standards ensure that federal agencies "strike the right balance," and develop "more affordable, less intrusive rules to achieve the same ends--giving careful consideration to benefits and costs."[2]

### *B. The Proposal's Unsubstantiated Bias Toward Fee-Based Advice*

During the hearing, ACLI emphasized that the proposal was built on two false premises: (i) all commissioned advice is conflicted and (ii) all fee-based advice is unconflicted and always serves retirement savers' best interest. The RIA failed to properly support these assumptions and nothing in the hearing transcript bolstered them further. As we noted during the hearing, formidable and independent regulators have observed that fee based advice is not always in the customer's best interest. Rather, the appropriateness of commissioned advice and fee-based advice should be evaluated based on the unique facts and circumstances of each retirement saver. Commissioned advice should not, therefore, be effectively barred through the Department's Proposal.

In a very relevant point of reference, FINRA issued guidance about fee-based arrangements, recognizing that while fee-based programs are beneficial for some customers, "they are not appropriate in all circumstances."[3] FINRA instructs that

> Firms must consider the overall needs and objectives of the customer when determining the benefits of a fee-based account for that customer, including the anticipated level of trading activity in the account and non-price factors such as the importance that a customer places on aligning his or her interests with the broker. Additionally, firms must take into account the nature of the services provided, the benefits of other available fee structures, and the customer's fee structure preferences.[4]

As FINRA aptly observes, depending upon customer circumstances, compensation through commission arrangements may be more appropriate than fee-based arrangements. Quite correctly, FINRA explained that the appropriateness of fee-only financial arrangements should be evaluated on the unique circumstances of each customer and their financial needs. The same is true with evaluations of commissioned recommendations to purchase annuities. Assets under management on which the annual, recurrent fees are assessed under fee-only financial arrangements may not always serve customers' best interest.

On this point, Elisse B. Walters, who served as acting SEC chair, SEC Commissioner, and FINRA Senior Executive Vice President, critically noted:

> In a nutshell, while fee based accounts can be a good thing, they are not always the right thing, or the best thing. We need you to look at each customer and determine what kind of fee works best for him or her. The Tully Report itself recognized that investors with low trading activity

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[2] Op-Ed, President Barak Obama, *Toward a 21st Century Regulatory System*, Wall Street Journal (Jan. 18, 2011). The President's Op-Ed coincided with his issuance of Executive Order 13,563, which set strict standards for cost-benefit analysis in federal agency rulemaking.

[3] *See* Notice to Members 03-68, *Fee-Based Compensation-NASD Reminds Members That Fee-Based Compensation Programs Must Be Appropriate*, http://www.finra.org/sites/default/files/NoticeDocument/p003079.pdf .

[4] *See Fee-Based Questions and Answers*, http://www.finra.org/industry/fee-based-account-questions-answers .

> would probably be better off with a commission-based program that charges only when trades are made.
>
> So how do you decide what is the best fee structure for your customers? NASD [now called FINRA] states that it is inconsistent with just and equitable principles of trade to put your customer in a fee structure that can reasonably be expected to result in a greater cost than alternative account that provides the same services and benefits to the customer. We believe that cost is an important factor, but not the only one. Other factors include the objectives of the customer, including the anticipated trading and non-price factors such as aligning their interests with those of the broker.
>
> You need to determine that such an account is appropriate by making reasonable efforts to get information about the customer that will allow you to gauge the right kind of fee, based on the services provided, the cost, the alternatives, and the customer's preferences. You also need to tell the customer about the fee based structure and what it means. And you need to set up supervisory procedures to review those fees - we recommend annually - to make sure that they stay appropriate over time.[5]

Ms. Walter's statement objectively concludes that, depending upon customer circumstances, fee-only investment advice is not advisable or worthwhile. Quite correctly, she explained that the appropriateness of fee-only financial arrangements should be evaluated on the unique circumstances of each customer and their financial needs. The same is true with evaluations of commissioned recommendations to purchase annuities in a retirement context.

Importantly, regulators have provided strict guidance on managing conflicts in recommendations to customers. In 2013, FINRA published a Report on Conflicts of Interest[6] in the broker-dealer industry to highlight effective conflicts management practices. In this endeavor, FINRA published examples of how some broker-dealers address conflicts to help broker-dealers analyze the conflicts they face and implement a conflicts management framework appropriate to the size and scope of their business. The report highlights approaches to managing conflicts that firms can apply across their business, and explained that there is no one-size-fits-all framework for conflict management.

Interestingly, in 2008 the RAND Corporation issued a report[7] following a study conducted for the SEC on the services and functions of broker-dealers and investment advisers. The study followed judicial rejection of Rule 202(a)(11)-1 under the Investment Advisers Act, a rule that sought to delineate the regulatory status of these securities professionals in a contemporary marketplace. On the relative presence of fee-based advice compared to commissioned advice, the 2008 Rand Report observed:

> Not surprisingly, the primary form of compensation is based on a percentage of assets under management. More than 97 percent receive such compensation, and the share is even higher among the 98 percent of firms that report providing "continuous and regular supervisory or management services to securities" (language from SEC, 2006). The second-leading form of compensation is "fixed fees (other than subscription)" (language from SEC, 2006), which are reported by 50 percent of advisers with individual clients, followed by hourly fees (44 percent). Only 13 percent of these advisers reported receiving commissions. In fact, more of these advisers (20 percent) reported receiving performance-based fees than reported receiving commissions.[8]

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[5] *See* Elisse Walters, *Current NASD Regulatory Issues on Sales and Marketing* (Sept. 28, 2004) http://www.finra.org/newsroom/speeches/092804-remarks-27th-annual-sia-sales-and-marketing-conference.

[6] *See* http://www.finra.org/industry/2013-report-conflicts-interest .

[7] *See* https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf .

[8] *Id.* at 40.

This report was authored by Dr. Hung, who was also an author of three of the four economic studies commissioned by the Department and posted after the hearing, and was an author of two of the documents identified by the Department as supporting the RIA. Significantly, the 2008 RAND Report concludes that most advisory compensation is fee based and that only 13% of advisers reported receiving commissions. These conclusions suggest that the Department's concerns about the presence of commissioned advice to retirement savers may be overstated and of disproportionate concern.
In sum, the RIA fails to properly quantify and balance the different approaches to providing advice under the proposal. Consequently, the RIA does not fulfill the explicit judicial, statutory and administrative requirements to conduct a complete and balanced cost-benefit analysis.

### *C. Harm to Small and Moderate Retirement Savers*

ACLI explained during the hearing that the RIA fully overlooked the proposal's harm to small businesses and small to moderate balance retirement savers. We noted that the RIA extoled a parallel 2013 initiative in the UK and cited a significant reduction in commissioned advice, glaringly failed to acknowledge an even greater drop in advice to retirement savers following the UK experiment. In 2014, Morningstar UK reported that eleven million investors have fallen through an 'advice gap' following industry regulation. The week before the hearings on the proposal, the UK launched a comprehensive review of its regulations and its abandoned retirement savers in response to this severe problem. During the hearing, none of the economists or the Department staff acknowledged the rather shocking reversal of position in the UK program that the Department had highlighted to justify the proposal. The Department's silence on the sinking status of the UK proposal that was a linchpin in the proposal is deafening. Failure to discuss the negative implications of the proposal in light of the documented advice gap to UK retirement savers undermines the integrity of the RIA.

### *D. The Disregard of Comprehensive Patterns of Regulatory Protection*

The proposal's preamble asserted that current regulatory protections are inadequate to address its concerns about advice to retirement plan participants. During the hearing, ACLI disagreed with the preamble's wholesale disregard of detailed systems of significant protection from the RIA or the preamble. Nothing in the studies supporting the RIA or the four studies posted after the hearing consider the unique and comprehensive regulations governing the sale of annuities.

As one example of this significant oversight, our testimony highlighted the fact that recently enhanced FINRA regulations governing variable annuity suitability, supervision and non-cash compensation were outside the scope of the RIA's assessment of need. Likewise, parallel regulations under state insurance laws were fully omitted. Our submission provided 269 pages highlighting the comprehensive scope of state and federal regulation of annuities. We emphasized the NAIC Annuity Buyers Guide as an excellent source of plain-English, streamlined disclosure about the mechanics of fixed, index and variable annuities that includes full discussion of fees and charges and provides a series of detailed questions for consumers to ask salespersons. Nothing further appeared about these matters in the hearing from the Department staff, other witnesses or in the economic studies posted after the hearing. The RIA continues to be deficient through its dismissal of significant patterns of regulatory protection for retirement savers in purchasing annuities.

### *E. Surrender Charges are Misrepresented.*

ACLI explained during the hearing that, with respect to surrender charges associated with insurance products like annuities, the Department's public statements assumed that:

- all annuities have surrender charges;
- full surrender charges are applied 100% of the time;
- all surrenders are for the full amount of the annuity; and,

- annuity contracts never waive surrender charges in cases of hardship.

We emphasized that none of these presumptions were correct.  Surrender charges are contingent deferred sales charges, meaning that if the customer holds the contract for the surrender period, which is usually 7 years, then there is no surrender charge.

Since the Department's discussion of surrender charges was based on anecdotal information, ACLI commissioned NERA to examine the incidence of surrender charges in a sample of 237,000 variable annuity contracts representing 30% of variable annuity reserves. NERA's report[9] was published August 8 and found:

- 76% of those firms surveyed offer contracts with no surrender fee;

- The average surrender charge on any surrender (partial or full) is 0.8% or .008 in decimal notation.

- Of the accounts with surrenders, approximately 23,000, or 70%, are IRA accounts.

    - For IRA variable annuities only, the average surrender fee paid on any partial withdrawal or full surrender is even lower, at 0.6% or .006;

    - 78.6% of withdrawals in IRA accounts paid 0% in fees.

Nothing about this type of data was considered in the four economic studies posted after the hearing or in the economic studies the Department identified as supporting the RIA.  A proper understanding of surrender fees needs to be part of the conversation on the Proposal and the RIA.

### *F. The Department Questions about Arbitration*

During the first day of the hearings on the proposal, the Department staff asked several witnesses whether annuities would be subject to pre-dispute arbitration agreements. None of the witnesses had specific expertise about annuities and, therefore, were unresponsive to the question. Ironically, the same Department staff did not raise this question with ACLI witnesses on other days of the hearings or with other witnesses with insurance product expertise.

The answer to the Department's question is that individual variable annuity contracts can only be sold by a registered representative of a broker-dealer subject to FINRA regulation. Typically, most broker-dealers' customer account agreements provide that both parties remedy in the event of dispute is binding arbitration under the FINRA arbitration process. The drift of the Department's questions about arbitration suggested that it was an insufficient consumer remedy. The U.S. Supreme Court upheld the validity of binding arbitration in broker-dealer customer account agreements in the case of *Shearson American Express v. McMahon*, 482 U.S. 220 (1987)[10]. The tone of the Department staff's comments reflects a potential misunderstanding of the FINRA arbitration process, which is designed to provide a quick, low-cost forum for the resolution of customer disputes. Customers are not required to have a lawyer for representation in FINRA arbitrations, and FINRA arbitrators do not impose the rules of evidence on customers representing themselves.[11]

[9] *See* https://www.acli.com/Newsroom/News%20Releases/Pages/NR15-043.aspx .
[10] *See* https://supreme.justia.com/cases/federal/us/482/220/case.html
[11] FINRA operates the largest securities dispute resolution forum in the United States, and has extensive experience in providing a fair, efficient and effective venue to handle a securities-related dispute. The resolution of problems and disputes is accomplished through two non-judicial proceedings: arbitration and mediation. Arbitration and mediation are two distinct ways of resolving securities and business disputes between and among investors, brokerage firms and individual brokers, and offer a prompt and inexpensive means of resolving issues.

Typically, FINRA has a panel of one to three arbitrators in disputes between customers and broker-dealers depending on the size of the dispute.[12] FINRA uses the Neutral List Selection System (NLSS) to generate random lists of arbitrators from FINRA's arbitrator rosters to appoint a panel. Generally, the arbitrator selection process begins after the answer is due, regardless of whether the respondent answers a claim. After the answer is due, FINRA will use the NLSS to generate list(s) of arbitrators, which will include their background information, called arbitrator disclosure reports. FINRA will send the lists and arbitrator disclosure reports to the parties for their review. Parties will review the information, strike any arbitrators from the lists that they do not want on their panel, and rank the remaining choices. After parties have ranked their choices, they submit their ranked lists to FINRA. FINRA combines the parties' ranked lists and appoints the highest ranked available arbitrator from each list to serve on the panel. Consumers can also appeal the arbitration under certain circumstances. The SEC exerts careful oversight regarding the integrity and fairness of the FINRA arbitration process. FINRA arbitration, therefore, is designed to be an impartial forum for customer disputes that is faster and cheaper to utilize than the judicial system. The Department staff's questions about the merits and fairness of the arbitration process during the first day of the hearing implicitly conveyed misinformed regulatory concern.

Customers of a broker-dealer may also file a written complaint through FINRA's complaint program.[13] FINRA investigates complaints against brokerage firms and their employees. FINRA is empowered to take disciplinary actions against brokers and their firms. Sanctions may include fines, suspensions, a barring from the securities industry or other appropriate sanctions.

Additionally, it is important to note that an integral part of a state insurance department's role is to protect consumers from illegal insurance practices by ensuring that insurance companies and producers act in accordance with state insurance laws. All states have Consumer Complaint Departments to investigate consumer complaints. In each case, the state will review the information obtained in the case to make sure that the company or agent has complied with statutes, regulations and the terms of policy contracts. If the Insurance Department determines that the actions of the insurance company or agent are in violation of a statute, regulation or policy the Department may take or order corrective action which includes restitution and revocation of agents' and insurers' licenses, among other things. Action against an insurance company can trigger a for cause market conduct examination to rectify systemic problems. Consumers can appeal the department's decision to the courts. The laws supporting the complaint process include: unfair trade practices acts, market conduct and licensure, among others.

### *G. Observations about the "Four Additional Research Papers"*

On August 26, 2015, the Department posted three "additional research papers" on a segment of it website, entitled "conflict of interest proposed rule." On September 8, 2015, the Department posted another -"additional research paper" there.[14] The Department announced the posting of these four additional papers on September 8, 2015. The status of those additional research papers on the proposal is unclear. In choosing to post the four papers on the proposal's web space, the Department apparently thought the papers were integral to its overall regulatory package. However, nothing explains the exact role of the four additional research papers on the proposal. It is unequivocally confusing whether these documents are part of the proposal or its regulatory impact analysis. That is unacceptable under federal agency rulemaking.

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[12] Generally, for claims of more than $50,000 up to $100,000, the parties will select and FINRA will appoint one arbitrator, unless the parties agree in writing to three arbitrators. For claims of more than $100,000, the parties will select and FINRA will appoint three arbitrators. *See* http://www.finra.org/arbitration-and-mediation/arbitrator-selection

[13] *See* http://www.finra.org/investors/file-complaint#sthash.RZY3KcaR.dpuf.

[14] *See* http://www.the Department.gov/ebsa/regs/conflictsofinterest.html

As a matter of administrative process, the four additional research papers create troubling challenges. When the Department posted the hearing transcripts on September 8, 2015, it set a supplemental comment period of 16 days expiring September 24, 2015. The first time the Department publicly announced the posting of the "additional research papers" occurred on September 8, 2014, when it published its hearing transcripts. Collectively, the four added papers total 118 pages of highly technical material. The 16-day review period for analyzing the research papers is fundamentally inadequate. Moreover, this overlaps with the 16-day review period of the 1305 page hearing transcript. In short, this significantly abbreviated period to review the four "additional research papers" with uncertain administrative status offends reasonable practices for federal agency rulemaking.

Neither the Administrative Procedure Act ("APA")[15] nor the Department's administrative procedures establish a "standard" period of comment on rulemakings. Rather, the goal of robust public comment on administrative rulemakings is best served by selecting a time period based on the unique factors and complexity of the individual initiative, and not "routine" practices. Some proposals should properly have longer comment periods than others.

The special time burdens confronting regulated industries and large organizations in digesting regulatory proposals were explicitly recognized by the Administrative Conference of the United States in its publication entitled *A Guide to Federal Agency Rulemaking*[16] ("*Guide*"), which notes that:

> [i]nterested persons often are large organizations, which may need time to coordinate an organizational response, or to authorize expenditure of funds to do the research needed to produce informed comments.[17]

The *Guide* reviews the legislative history of the APA and emphasizes that the notice of proposed rulemaking "must be sufficient to fairly apprise interested parties of the issues involved, so that they may present responsive data or argument." [18] The *Guide* further explains that rules developed through notice and comment procedures must be rational, and that notice and opportunity for comment under §553 of the APA should properly "give interested persons a chance to submit available information to an agency to enhance the agency's knowledge of the subject matter of the rulemaking."[19] The *Guide* also points out that "informal rulemaking procedures should provide interested persons an opportunity to challenge the factual assumptions on which the agency is proceeding and to show in what respect such assumptions are erroneous."[20]

The Department's late-circulated economic studies are relevant to the proposal's Regulatory Impact Analysis. The short period to review the economic studies is inadequate for such a complex rulemaking and conflicts with APA rulemaking standards requiring reasonable opportunity for comment, especially concerning regulated industries and large organizations as emphasized in the *Guide to Federal Agency Rulemaking*.[21] The Department's deficient process regarding the belated economic studies exposes the initiative to legal challenge under the APA.

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[15] *See* Guide at 196.
[16] *See, A Guide to Federal Agency Rulemaking* (1983) at 124. The American Bar Association updated and republished this *Guide* in 1998. *See* Lubbers, *A Guide to Federal Agency Rulemaking*, Third Edition (1998), American Bar Association, Government and Public Lawyers Division and Section of Administrative Law and Regulatory Practice. Subsequent citations to the Guide are to the updated and revised ABA publication.
[17] *See* Guide at 196.
[18] Administrative Procedure Act: Legislative History, S. Doc. No. 24879-258 (1946) [hereinafter legislative history of the APA].
[19] *See* Guide at 197.
[20] *Id.* at 182 and 196.
[21] Curiously, although the RAND study conducted for the Department entitled *Effective Disclosures in Financial Decision-Making* has a publication date of July 2015, it was not posted on the Department website until August 26, 2015. Through this delay, the posting of the report has a disturbingly stealth-like character.

Industry groups like our trade association circulate regulatory proposals, elicit membership input, develop a consensus, and circulate draft letters of comment before submission. This worthwhile, but time intensive, process is exceptionally difficult to execute in the short time window of 16 days, particularly given the scope and depth of the studies and their interconnection with the proposals' Regulatory Impact Analysis. The belated posting of the studies to the Department website thwarts meaningful analysis of those studies and burdens further review of the initiative's RIA.

Given the substantive depth of the economic studies and the unacceptable short comment period, ACLI was denied the opportunity to conduct extensive analysis. Accordingly, we can only offer our initial, preliminary observations. The "four additional research studies" were produced by the Rand Corporation (Burke and Hung (2015); Hung, Gong and Burke (2015); and, Burke and Hung (2015b)) and one by the Advanced Analytical Consulting Group (Panis (2015)).[22, 23] The four reports present literature reviews, commentary on the work of another consulting firm (NERA), and a comparison of the regulatory environment and market for financial advice in five countries (the U.S., the U.K., Australia, Germany, and Singapore) and the E.U. It is important to note that none of the studies were peer reviewed. All simply reflect the independent and unverified research of the authors.

As pointed out in our Letter, the Proposal would lead to a substantial decline in the number of financial advisers and an increase in the cost of advice. Lower and middle income investors would be most affected and would be forced to rely on robo-advisors or manage their own investments. As mentioned earlier, automated financial advice is not a sufficient substitute for a human being and cannot offer benefits such as encouraging greater savings, dissuading emotional investing (particularly the liquidation of assets in a market downturn), or addressing client-specific questions and concerns. [24, 25]

The Department's RIA entirely failed to examine the various benefits of using a financial adviser and how the loss of these benefits would impact retirement security. Burke and Hung (2015) attempt to fill this gap by investigating whether financial advisers actually offer such benefits, focusing primarily on saving.[26] They examine nine studies, eight of which found a strong correlation between the use of an adviser and saving. Some of the more compelling results include:

- Martin and Finke (2014) found that "those who had calculated retirement needs and used a financial planner generated more than 50 percent greater savings than those who estimated retirement needs on their own without the help of a planner (p. 52)".[27]

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[22] Burke, Jeremy; Hung, Angela A., "Do Financial Advisers Influence Savings Behavior?", *RAND Labor and Population*, RR-1289-DOL, prepared for the U.S. Department of Labor, August 2015; Hung, Angela A.; Gong, Min; Burke, Jeremy, "Effective Disclosures in Financial Decision-Making", *RAND Labor and Population*, RR-1270-DOL, prepared for the U.S. Department of Labor, July 2015; Burke, Jeremy; Hung, Angela A., "Financial Advice Markets: A Cross Country Comparison", *RAND Labor and Population*, RR-1269-DOL, prepared for the U.S. Department of Labor, April 21, 2015; Panis, Constantijn W.A., "Comments on a Review of a White House Report on Conflicted Investment Advice", *Advanced Analytical Consulting Group*, August 21, 2015.
[23] Panis (2015), Burke and Hung (2015b), and Hung et al. (2015) were posted on August 26, 2015; Burke and Hung (2015) was posted on September 8, 2015.
[24] *See* ACLI comment letter, July 21, 2015, at 47.
[25] In fact, the most common client questions human advisors deal with are those regarding market downturns. If financially sophisticated investors need to be reassured by their adviser when facing market downturns, how well will a computer program fare with poorer, lower income, less educated, younger, and/or less financially sophisticated investors?
[26] It should be noted that the authors make several contradictory statements in their analysis. For example, in their introduction they state that "[f]inancial advisers can play an important role by helping individuals make better financial decision and improving their financial situations. However, there is limited and mixed evidence about the benefits to using a financial adviser". If, in their opinion, there is limited and mixed evidence about the benefits to using a financial adviser, how can financial advisers play an important role in improving a client's financial situation?
[27] Martin, Terrance K., Jr; Finke, Michael, "A Comparison of Retirement Strategies and Financial Planner Value", *Journal of Financial Planning*, vol. 27, no. 11, pp 46-53, 2014.

- Using 2010 Survey of Consumer Finances data, Hudson and Palmer (2014) found "a significant and positive relationship between the use of information from formal advisors and the acceptable savings behaviors of low-income employees, and a significant and positive relationship between the use of information from formal advisors and the cash-flow management behaviors of low-income employees (p. 41)".[28]

- Using 2004, 2007, and 2010 Survey of Consumer Finance data, Smith and Griesdorn (2014) find that "seeking the advice and knowledge of a financial planner can help self-employed families navigate the complexity of tax-deferred retirement vehicles and establish the best savings plan for their unique situation (p. 58)".[29]

- Based on a survey of 1,003 randomly sampled households with a median income of $75,000 or more, Leonard-Chambers and Bogdan (2007) found that those respondents with ongoing advisory relationships received the following services from their advisers: regular portfolio review and investment recommendations (85 percent); review of allocation of investor's employer-sponsored retirement plan assets (61 percent); periodic discussion of financial goals (83 percent); planning to achieve specific goals, such as saving for college (75 percent); comprehensive financial planning (75 percent); managing assets in retirement (60 percent); access to specialists in areas such as tax planning (51 percent; five or more services (63 percent).[30]

- Winchester and Huston (2014) found that individuals who felt they did not have control of their finances were considerably more likely to achieve their financial goals when using a financial adviser.[31]

- Chatterjee, Salter, and Harness (2011) found that using the services of a financial planner increased the likelihood of retirement confidence by 136 percent among the lower income individuals and by 56 percent among higher income individuals.[32]

Despite these findings, Burke and Hung (2015) imply that using an adviser may not result in greater saving since "the same underlying characteristics make an individual more likely to seek out financial advice *and* more likely to save" (Burke and Hung (2015, p. 12)). If this were indeed the case, then the value of using a financial adviser may be questionable. However, the authors identified only one study, Mardsen, Zick, and Mayer (2011), to support their claim. Marsden, Zick, and Mayer (2011) do find that using a financial adviser does not increase savings, however, their study is based on a survey of 2,191 employees of a "large mountain west university", which is clearly not representative of the entire U.S.[33] This study should be discounted.

Burke and Hung (2015) also overlook the obvious fact that financial advisers encouraging their clients to save more is in the best interest of both parties. The studies listed above suggest that this is indeed the case. Both the Department's RIA and Burke and Hung (2015) missed that point.

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[28] Hudson, Crystal R.; Palmer, Lance, "Low-Income Employees: The Relationship Between Information from Formal Advisors and Financial Behaviors", *Financial Services Review*, vol. 23, no. 1, pp. 25-43, 2014.
[29] Smith, Hyrum L.; Griesdorn, Tim, "Do Savings Rules Influence Self-Employed Households' Participation in Tax-Deferred Retirement Plans?" *Family and Consumer Sciences Research Journal*, vol. 43, no. 1, pp. 47-60, 2014.
[30] Leonard-Chambers, Victoria; Bogdan, Michael, "Why Do Mutual Fund Investors Use Professional Financial Advisors?" Investment Company Institute, *Research Fundamentals*, vol. 16, no. 1, April 2007.
[31] Winchester, Danielle; Huston, Sandra J., "Does a Relationship with a Financial Service Professional Overcome a Client's Sense of Not Being in Control of Achieving Their Goals?", *Financial Services Review*, vol. 23, no. 1, 2014.
[32] Chatterjee, Swarnankur; Slater, John R.; Harness, Nathaniel J., "Financial Confidence Among Retirees: The Role of Financial Advice and Planning Duration", *Economics Bulletin*, vol. 31, no. 1, pp. 315-323, 2011.
[33] Marsden, Mitchell; Zick, Cathleen D.; Mayer, Robert, "The Value of Seeking Financial Advice", *Journal of Family and Economic Issues*, vol. 32, no. 4, pp. 625-643, 2011.

Based on their literature review, Burke and Hung (2015) conclude that wealthier, higher income, more educated, older, and/or more financially literate individuals are more likely to seek and receive financial advice. If these findings are valid, they call into question the validity of the Department's RIA. As mentioned in our Letter at page 43, the Department's RIA hinges on the implicit assumption that an investor will hold a poorly performing mutual fund for an extended period of time. If investors who use financial advisers are more knowledgeable, experienced, and sophisticated than those who merely own indexed funds, there is no reason to believe they would hold sub-optimal investments for an extended period of time or maintain a working relationship with an adviser who charges excessive fees or continually steers them toward poorly performing investments. Market forces quickly correct such inefficiencies and promptly drive such advisers out of business, negating the need for the Department's Proposal.

In sum, the information in the four economic studies posted after the hearing are unpersuasive on the issues under study and particularly with regard to advice about annuity purchases in a retirement context.

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On behalf of the ACLI member companies, thank you for consideration of these comments. We welcome the opportunity to discuss these comments and engage in a productive dialogue with the Department on this Proposal.

Respectfully,

James H. Szostek | Howard M. Bard