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Submitted Electronically to EBSA.FiduciaryRuleExamination@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
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**Subject: RIN 1210-AB79 – Definition of the Term "Fiduciary"; Conflict of Interest Regulation – Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited Transaction Exemption 2016-02); Prohibited Transaction Exemptions 75-1, 77-4, 80-83, 83-1, 84-24, and 86-128.**

Greetings:

On March 2, 2017, the Department of Labor (the "Department") requested comments regarding the examination of the Fiduciary Regulation (the "Regulation") described in the President's February 3, 2017 memorandum ("Presidential Memorandum") to the Secretary of Labor. On behalf of the American Council of Life Insurers ("ACLI")[1], we provide comments in answer to the questions raised in the Presidential Memorandum and generally, on questions of law and policy concerning the Regulation and associated exemptions.[2] Our comments clearly demonstrate that the Regulation

[1] The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with 290 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 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. 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.

[2] ACLI incorporates by reference its comment letters dated July 21, 2015 and September 24, 2015, as well as pleadings filed by ACLI/NAIFA in *ACLI/NAIFA et. al v. Perez,* United States District Court, N.D. Texas, Civil Action Number 1:16-cv-1530, including the ACLI/NAIFA Complaint (filed June 8, 2016), the ACLI/NAIFA Memorandum of Law in Support of their Motion for Summary Judgement (filed July 18, 2016), and the ACLI/NAIFA Reply in

adversely affects the ability of Americans to gain access to retirement information, financial advice and longevity risk protection through annuities.

The Secretary of Labor must delay the applicability date of the Regulation until the Department has completed its examination to the satisfaction of the President. Based on both the observed and anticipated effects of this Regulation on consumers as described in this letter, the Secretary of Labor should conclude the examination with a determination that the Regulation must be revoked and replaced. ACLI would strongly support such action. ACLI supports the application of the Employee Retirement Income Security Act's ("ERISA's") sole interest standard to those engaged as fiduciaries. ACLI supports reasonable and appropriately tailored rules that require all sales professionals to act in the best interest of their customers regardless of whether they serve as fiduciaries under ERISA. But this Regulation does not accomplish these goals.

## Executive Summary

As further described below, we have serious concerns with the Department's approach to the examination required by the Presidential Memorandum. The Regulation must be delayed until the Department has completed its examination to the satisfaction of the President. The Regulation will have a harmful impact on investors due to a reduction in access to retirement product structures, retirement savings information, and related financial advice, because it: inappropriately sweeps in guidance and advice that is not fiduciary in nature; fails to distinguish between sales activity and fiduciary activity; abridges consumers' rights to receive truthful, non-misleading information about annuities; maintains a bias against commission-based arrangements, thereby harming "buy and hold" investors; continues to require exemptions unworkable for the insurance industry; and seriously disrupts the small-retirement plan and IRA marketplace.

The Regulation dislocates and disrupts consumer access to retirement products and services. It has begun to create an advice gap with the abandonment by service providers of small and medium retirement account holders while, without substantiation, the Department relies on computer generated asset allocation platforms (a.k.a. Robo-Advisers) as the option for small investors who lose access to financial assistance.

The Regulation will result in an increase in litigation. Thus, there will be higher industry costs and consumer prices due to the Best Interest Contract Exemption's ("BICE") ambiguous impartial conduct standards, rendering compliance uncertain and unworkable; a significant increase in litigation that will result from the BICE's private right of action; and the increase in class -action litigation brought against ERISA fiduciaries given the Department's promotion of such litigation as a BICE enforcement tool.

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Support of Their Motion for Summary Judgment and Response to Defendant's Cross-Motion for Summary Judgment (filed September 16, 2016).

The final Regulatory Impact Analysis' ("Final RIA") is deficient and flawed. The Department used unsubstantiated estimates of investor benefits. The Department incorrectly and inappropriately used stale front-end loaded mutual fund information as a basis for the Department's calculation of the Regulation's benefits. The Department failed to meaningfully address the impact of the Regulation on lifetime income products. The Department failed to meaningfully address and resolve comments received on the proposed Final RIA.

For these reasons, the Regulation should be revoked and replaced with a rule that is consistent with the Department's statutory and constitutional authority, accommodates the Department's interest in minimizing the impact of conflicts of interest on plans, participants and IRA owners, and avoids significant disruptions in access to saving and retirement products and services. At a minimum, a rule that defines "fiduciary" under ERISA and applies ERISA's sole interest standard to fiduciaries that provide investment advice for a fee should ensure that service providers, financial professionals, plan sponsors, plan fiduciaries, plan participants and IRA owners retain the freedom to define the nature and scope of their relationships. This includes the freedom to sell, purchase, negotiate and contract without a regulatory presumption of a fiduciary relationship and without codifying assumptions regarding the assumed competence – or lack thereof – of any group of plan fiduciaries or the general public. Finally, given the Regulation's chilling effect on consumers' rights to receive truthful and non-misleading information about retirement products and services, as part of its review of law and policy, the Department must ensure the Regulation conforms with the Administration's policy and applicable precedent on constitutionally protected commercial speech.

## I. <u>The Department's Approach to its Mandated Re-examination of the Regulation is Inconsistent with the Letter and Spirit of the Presidential Memorandum</u>

### A. The President's Directive

The Presidential Memorandum states that one of the priorities of his Administration is to empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses, such as buying a home and paying for college, and to withstand unexpected financial emergencies. The Memorandum further states that the Department's Final Fiduciary Regulation[3] may significantly alter the manner in which Americans can receive financial advice, and may not be consistent with the policies of the current Administration.

Accordingly, the Presidential Memorandum directs the Secretary of Labor to examine the Fiduciary Regulation to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice. As part of this examination, the Department is to prepare an updated economic and legal analysis concerning the likely impact of the Fiduciary Regulation, which shall consider, among other things, the following:

> (i) Whether the anticipated applicability of the Fiduciary Regulation has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings

[3] 81 Fed. Reg. 20946 (Apr. 8, 2016).

offerings, retirement product structures, retirement savings information, or related financial advice;

(ii) Whether the anticipated applicability of the Fiduciary Regulation has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees; and

(iii) Whether the Fiduciary Regulation is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services.

If the Department makes an affirmative determination as to any of the considerations identified in the Presidential Memorandum, or if it concludes for any other reason after appropriate review that the Fiduciary Regulation is inconsistent with the priority identified earlier in the Presidential Memorandum - then the Department is to publish for notice and comment a proposed Regulation rescinding or revising the Regulation, as appropriate and as consistent with law.

The Regulation is inconsistent with the stated policy and, therefore, per the Memorandum, the Regulation must be rescinded or revised. <u>The fact is that the Regulation - through a highly burdensome and paternalistic approach to regulation - effectively substitutes the judgment (and bias) of an administrative agency for the judgment of individual investors. The Regulation, rather than empowering plan fiduciaries, plan participants and beneficiaries, and IRA investors, limits sales engagements (e.g., small plan limits); constrains education; constrains roll over conversations; and limits the choices of products and services, especially for IRA investors</u>.

The Regulation in inconsistent with the Administration's stated policies; and, further, represents government overreach and interference in the financial markets in a way that is detrimental to the very population the Department stated it intended to benefit. Moreover, the Regulation’s deliberate heavy reliance on enforcement through the plaintiffs' bar and private litigation cannot possibly be viewed as consistent with this Administration’s principles. As explained further below, the Regulation will result in an explosion of costly class-action litigation that will inflict needless and substantial costs on insurance companies and, ultimately, consumers.

Not only is the Regulation inconsistent with the Administration’s stated policies, in conducting this important and essential examination, as discussed further below,[4] it will be abundantly clear that the Department completely ignored existing Executive Branch rulemaking requirements. These requirements, contained in Executive Orders 12866[5] and 13563[6] are in place to ensure appropriate oversight of agency rulemaking, and require that a federal agency, in deciding whether and how to regulate, conduct a full cost-benefit analysis, and assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating. The Department, in promulgating the Fiduciary Regulation, completely disregarded these requirements by factoring in its new or perceived benefits and discounting or completely ignoring the associated costs.

[4] *See infra* notes 156-164 and accompanying text.
[5] 58 Fed. Reg. 51735 (Sep. 30, 1993).
[6] 76 Fed. Reg. 3821 (Jan 21, 2011).

### B. The Department's Troubling Approach to the Re-examination

The Regulation must be delayed until the Department has completed its examination to the satisfaction of the President. In response to the Presidential Memorandum, the Department issued a Notice of Proposed rulemaking ("NPRM") seeking comment on (1) the Department's proposal to extend the Regulation's April 10, 2017 applicability date for 60 days, and (2) the questions raised in the Presidential Memorandum, and generally on questions of law and policy concerning the Regulation and associated exemptions.[7]

On March 13, 2017, ACLI filed a comment letter in response to the Department's proposed 60-day applicability date delay. Our comment letter strongly supported a delay in the Regulation's April 10, 2017 applicability date, but noted that the proposed 60-day delay would not provide sufficient time for the Department to complete the examination required by the Presidential Memorandum, and therefore an applicability date delay of longer than 60 days would be warranted.

On April 7, 2017, the Department published a final regulation implementing a 60-day applicability date delay, through June 9, 2017.[8] In implementing the 60-day applicability date delay, the Department concluded that "some delay in the full implementation of the Fiduciary Regulation and PTEs is necessary to conduct and careful and thoughtful review process pursuant to the Presidential Memorandum, and that any such review is likely to take more time to complete than a 60-day extension would afford, as many commenters suggested." Nonetheless, the final delay regulation, while not fully ruling out further delays, implements a June 9, 2017 date for compliance with the Impartial Conduct Standards required by the BICE and Principal Transaction Exemption. In support of this conclusion, the Department states that Impartial Conduct Standards are "among the least controversial aspects of the rulemaking project (although not free from controversy or unchallenged by litigation).[9]

The process being undertaken by the Department is significantly problematic and deeply flawed. ACLI is concerned that, by implementing a bifurcated approach to the required examination, the Department is not demonstrating a clear and concentrated effort to comply with the Presidential Memorandum, and indeed, appears to be acting inconsistently with its directives. By implementing a June 9, 2017 compliance date for the BICE's and Principal Transaction Exemption's Impartial Conduct Standards, it appears the Department has already concluded that maintaining these standards is consistent with the Presidential Memorandum. Further, we disagree with the Department's unsubstantiated conclusion that the Impartial Conduct Standards are among the "least controversial" aspects of the rulemaking project. Significant and meaningful challenges to aspects of the Impartial Conduct Standards have been raised in comment letters, in testimony during the Department's hearings on the proposed Regulation and exemptions, and in litigation challenging the Regulation. We fail to understand how the Department can believe it is consistent with the Presidential Memorandum to on the one hand undertake a review of the Regulation and exemptions and entertain a revocation or revision of the Regulation while on the other declaring aspects of the Regulation to be in effect.

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[7] 82 Fed. Reg. 12319 (March 2, 2017).
[8] 82 Fed. Reg. 16902 (April 7, 2017).
[9] *Id.* at 16906.

Moreover, the Department attempts to justify the length of the delay on the results of the flawed Final RIA it issued in support of the Final Fiduciary Regulation. In response to concerns raised in comment letters regarding the flaws in the Department's Final RIA, and the application of the Final RIA's conclusions to the proposed delay Regulation, the Department is wholly dismissive - simply stating that such comments "largely echo comments made in response to the Fiduciary Regulation when it was proposed in 2015, and that were addressed in considerable detail in the 2016 Final RIA."[10] This statement is half-true; while concerns were indeed raised by many regarding the regulatory impact analysis prepared for the proposal, most were not addressed in the Final RIA. The sole basis for the Final RIA's estimated investor gains was the Department's inappropriate and flawed examination and analysis of mutual fund retain class shares and its application of this analysis across the retirement product market as a whole. Although raised by ACLI in both comment letters and testimony, the Final RIA fails to adequately or meaningfully address the impact of the Regulation on retirement investor access to lifetime income products. Complicating this issue further is the fact that the Presidential Memorandum <u>specifically directs</u> the Department to prepare an updated economic analysis, and the Department acknowledges such, stating that it will "review the 2016 Final RIA's conclusions as part of its review of the Fiduciary Regulation and PTEs directed by the Presidential Memorandum."[11]

Further, although the Department projected investor losses associated with an applicability date delay based on its flawed Final RIA, it has inexplicably determined that investor losses associated with a 60-day delay will be "relatively small" because many firms have already taken steps toward honoring fiduciary standards, resulting in realized investor gains, while, on the other hand, because many other firms are not immediately prepared to satisfy new requirements beginning April 10, and need additional time to comply, the 60-day delay is unlikely to deprive investors of additional gains. This thinking is completely illogical. While ACLI continues to question the benefits to investors associated with the Regulation, assuming arguendo, that the Final RIA supports the investor losses and gains asserted by the Department, the Department now appears to be offering the non-substantiated conclusion that a non-compliance for a short period results in no investor losses, because some gains are also expected to occur during such a short delay. As it did in issuance of the Regulation and exemptions, the Department continues to base its conclusions on unsupported and unsubstantiated statements – which is exactly why the President correctly directed the Department to conduct a full and complete re-examination of the Regulation.

It is disingenuous to seek comments while drawing definitive conclusions before the comments are received, and it is wholly inconsistent with the Department's conclusion, in proposing the delay, that "rigid adherence to the April 10, applicability date could result in an unduly chaotic transition to the new standards as firms rush to prepare required disclosure documents and finalize compliance structures that are not yet ready, resulting in investor confusion , excessive costs, and needlessly restricted or reduced advisory services.[12] The Department's decision to require compliance with the Impartial Conduct Standards while it reviews the propriety of those standards will do just that. Further, it is not neither appropriate nor consistent with the President's directive to put any parts of this Regulation into effect before the President's appointed Secretary of Labor is in

[10] *Id.* at 16909.
[11] *Id.*
[12] *See* 82 Fed. Reg. at 16905.

place to review these and other comments, and make a determination whether the Regulation itself is consistent with the Administration's priorities, as contained in the Presidential Memorandum.

## II. The Regulation Will Harm Investors and Result in a Reduction of Americans' Access to Certain Retirement Savings Offerings, Retirement Product Structures, Retirement Savings Information and Related Financial Advice

### A. The Regulation Will Seriously Interfere with Consumer Access to Lifetime Income Products, As Developments Since the Regulation Was Finalized Confirm

#### 1. Importance and Benefits of Lifetime Income Products to Investors

Annuities play a significant part in today's retirement savings marketplace, particularly with respect to the retail IRA market. Indeed, the Department itself has found that thirty-one percent of IRAs include investments in annuities.[13] The widespread use of annuities reflects the significant value that retirement investors attach to annuity products as a means to help save for retirement while also managing and balancing different retirement risks.

First and foremost, an annuity is the only form of longevity protection in the market. It allows investors to convert retirement savings into a stream of monthly guaranteed income for life—a process known as "annuitization." With the shift away from defined-benefit plans, without an annuity, a retiree now bears the risk of outliving his or her retirement savings. That risk is becoming only more significant as Americans live longer. An annuity enables the retirement saver to transfer that longevity risk—the risk they will live longer than expected—to the insurer.

The peace of mind that annuities provide in the face of that longevity risk demonstrably improves retirees' overall well-being and mental health. A study commissioned by the Department itself "found that beneficiaries of lifelong-guaranteed income—such as from a privately-purchased annuity…were more satisfied in retirement and suffered from fewer depression symptoms than those without such income."[14] The "boost in well-being became stronger" the longer the person was retired—a finding "consistent with the notion that retirees who rely on finite savings and [defined-contribution] plan assets grow increasingly worried about funding retirement expenses as they grow older and deplete their assets, whereas recipients of lifelong-guaranteed income, other than from Social Security, are less concerned with outliving their resources."[15]

The record before the Department contained additional and concrete evidence supporting the unique and substantial value of annuity products to retirement investors. A 2012 report found that, among retirees with similar wealth and health, those with annuitized income are happiest.[16] A

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[13] *See, e.g.,* Fiduciary Investment Advice, Regulatory Impact Analysis 54 (Apr. 2015) ("Proposed RIA").
[14] Michael J. Brien & Constantijn W.A. Panis, *Annuities in the Context of Defined Contribution Plans: A Study for the U.S. Department of Labor, Employee Benefits Security Administration* (Nov. 2011).
[15] *Id.*
[16] See Steve Nyce & Billie Jean Quade, Annuities and Retirement Happiness, Towers Watson Insider 1 (Sept. 2012); *see also* ACLI Comment Letter dated July 21, 2005.

2014 study found that four out of five annuity owners agree that annuities are a good fit for their financial needs and a substantial majority would recommend an annuity to their family and friends.[17]

Other studies in the administrative record are to the same effect. A survey of "Boomers" (aged 50 to 65) conducted by the Insured Retirement Institute ("IRI") found that annuity owners "are far more optimistic about reaching their retirement income goals" than the general population, with 92% of annuity owners believing they have done a good job preparing for retirement, compared to 75% of the general population, and 86% of annuity owners expecting to have enough money to live comfortably during retirement, versus 73% of the general population.[18] And, according to a 2013 Gallup survey, 87% of annuity owners expect to use their annuity as a financial cushion in case they live beyond their life expectancy; 82% of annuity owners value "being able to invest in the stock market through annuities and still get guaranteed income for life"; and 85% of annuity owners appreciate the protection annuities provide "against losing the money they invest."[19]

Recognizing the importance of guaranteed lifetime income products to planning for a secure retirement, the Obama Administration previously sought to expand, not discourage, the purchase of annuity products. In 2010, for example, the White House Task Force on the Middle Class explained the need to "promot[e] the availability of annuities and other forms of guaranteed lifetime income, which transform savings into guaranteed future income, reducing the risks that retirees will outlive their savings."[20] Likewise, the Department of Labor and the Department of the Treasury jointly issued a request for information in 2010 to determine how they could "facilitate access to, and use of, lifetime income or other arrangements designed to provide a stream of income after retirement."[21] Further, in 2014, the Internal Revenue Service issued guidance designed to expand the use of annuities in 401(k) plans to help retirees protect themselves from outliving their savings.[22]

Given that consumers have different needs and varying risk profiles, it is important that consumers have a range of annuity options available to them. The current marketplace reflects that choice. For example, annuities can help protect consumers against longevity risk. Moreover, the different types of annuities provide individual retirement investors with differing risk preferences with the tools to address additional retirement risks, including the risks that their assets will decline in value ("investment risk") and that rising consumer prices will diminish their purchasing power ("inflation risk").

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[17] See LIMRA International, LIMRA Secure Retirement Study: Knowledge of Annuities Boosts Ownership 6, 8 (Oct. 2014); see also ACLI Comment Letter (citing LIMRA study)

[18] See IRI, Boomer Expectations for Retirement 12 (Apr. 2011); IRI Comments 12 (July 21, 2015) (citing IRI study), https://www.dol.gov/ebsa/pdf/1210-AB32-2-00626.pdf

[19] Gallup Org. et al., 2013 Survey of Owners of Individual Annuity Contracts 10, 31 (2013); Comm. of Annuity Insurers Comments 13 (July 21, 2015) (citing Gallup Org. et al.), https://www.dol.gov/ebsa/pdf/1210-AB32-2-00650.pdf

[20] White House Fact Sheet: Supporting Middle Class Families, available at www.whitehouse.gov/sites/default/files/Fact_Sheet-Middle_Class_Task_Force.pdf.

[21] 75 Fed. Reg. at 5254.

[22] *See* IRS Notice 2014-66, available at www.irs.gov/pub/irs-drop/n-14-66.pdf.

In particular, variable and fixed indexed annuities allow retirement investors to take advantage of the potentially larger rates of return of rising capital markets. In that way, they serve as an effective hedge against inflation risk. Historically, returns from investing in the stock market have consistently exceeded returns from investing in bonds (and far exceeded holding savings in cash), so long as the investment is held long enough. With retirement savers accumulating savings long before they retire and retirees increasingly living 20 or 30 or more years after they retire, the opportunity to have retirement savings in variable and fixed indexed annuities that grow along with the investment markets is vital to retirement security for many savers. In a recent, nationally representative survey of about 4,500 U.S. households conducted by Strategic Benefit Insights, among households with IRA balances of less than $100,000, 86% viewed providing a reliable income during retirement as either "important" or "extremely important." Additionally, 82% were concerned about the impact inflation will have on their retirement assets.[23] Such consumer concerns can be addressed through the use of annuities as retirement savings planning tools.

The guaranteed death benefit option available for many annuities provides insurance against yet another risk—namely, the risk that a spouse or other dependent will outlive the annuity owner and be left without sufficient assets on which to live. American retirement investors are often as concerned about managing this risk—continuing to provide for those who depend on them after they die—as they are about managing their own longevity, investment, and inflation risks.

Retirement investors can even further refine their annuity contract to balance longevity, investment, and inflation risks through the use of optional riders. A guaranteed minimum income benefit, for example, allows the retirement investor to adjust exposure to investment risk by guaranteeing a certain minimum level of payments, even if the annuitant's investments perform poorly. Other riders permit access to funds without penalty in the event of catastrophic illness or other devastating life events.

It would be extremely difficult for individual retirement investors to obtain variable and fixed indexed annuities' unique combination of benefits using other investment tools. Theoretically, an investor might be able to do so by combining mutual funds, hedging instruments, and phased purchases of fixed immediate annuities and term life insurance. But maintaining an appropriate balance of such investments would require active, financially sophisticated management that would not be practicable or cost-effective for many individual investors planning for retirement. As a practical matter, few individual investors could obtain this package of benefits without purchasing a variable or fixed indexed annuity.

Today's annuity marketplace thus provides retirement investors a wide array of products suited to different life situations and varied risk-tolerance levels. For some retirement investors, a fixed annuity's protection against investment risk is worth sacrificing potentially greater returns. Other retirement investors are willing to tolerate the greater investment risk of a variable annuity to obtain potentially greater upside and protection against inflation risk. And still others prefer a fixed indexed annuity's mix of protections against both investment and inflation risk. This range of options

[23] Strategic Business Insights 2016-2017 MacroMonitor Consumer Financial Decisions Survey.

available in the marketplace ensures guaranteed lifetime income products meet the retirement planning needs of a wide range of Americans.

As explained further below, despite the important benefits of variable annuities and fixed indexed annuities, the Department's Fiduciary Regulation will have the inevitable effect of interfering with consumers' access to these products and to truthful, non-misleading information about these products. Indeed, these effects are already manifesting themselves in the marketplace. Remarkably, the Department to date has wholly failed to account for the harm to consumers that will result from decreased choice of annuities and decreased access to variable and fixed indexed annuities and information about them.

### 2. The Regulation Inappropriately Sweeps In Guidance and Communication That is Not Fiduciary in Nature

Under the Regulation, a person is a "fiduciary" if he or she receives compensation, directly or indirectly, for making a recommendation regarding securities or other investment property held in an ERISA plan or IRA. Such a recommendation triggers fiduciary status if: (1) it is made under a written or verbal agreement, arrangement, or understanding that it is based on the particular investment needs of the retirement investor; or (2) it is directed to a specific person or persons regarding the advisability of a particular retirement investment or investment management decision. Actions that may not constitute a recommendation when viewed individually may amount to a recommendation when considered in the aggregate.

In addition to financial professionals long understood as providing fiduciary advice—namely, professionals paid to provide impartial investment advice and thereby deemed "investment advisers" under the Investment Advisers Act—the Regulation sweeps into its definition of fiduciaries, and subjects to a similar set of onerous obligations and prohibitions, every broker-dealer or insurance agent who directs information or recommendations about retirement products to a particular person or set of persons.[24] That latter group has never been considered to be a fiduciary or have fiduciary obligations.

The Department recognized in the preamble to the Regulation that its "broad test [for fiduciary investment advice] could sweep in some relationships that are not appropriately regarded as fiduciary in nature and that the Department does not believe Congress intended to cover as fiduciary relationships."[25]

Given that recognition, the Department should have carved out from the Regulation's regulatory ambit ordinary sales conversations where both parties understand that they are acting at arms' length and are not in a fiduciary relationship. Instead, the Department adopted only a narrow

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[24] Given its sweeping and overbroad definition of fiduciary advice, the Regulation contains an exception for general "investment education." *See, e.g.*, 81 Fed. Reg. at 20975-20979 (discussing investment education carve-out); *id*. at 20998-20999. Notably, however, that exception is inapplicable if there is any mention of "specific investment products," and thus - despite the exception - the Regulation applies with full force to the provision of virtually any information about specific products provided to a customer by a broker-dealer or insurance agent. *Id.* at 20998.
[25] 81 Fed. Reg. at 20948.

"seller's exclusion" limited to sales communications with large group ERISA plans—those with $50 million or more in assets - and itself conditioned on a variety of new requirements. The Regulation subjects all other sales conversations—with smaller plan sponsors, plan participants, and retail IRA consumers—to the fiduciary duties imposed by ERISA and the Internal Revenue Code ("IRC", whether or not those buyers expect or even want to pay for fiduciary investment advice.

The Department defended its narrow seller's exclusion on its claim that small plan sponsors and individual retirement savers are simply incapable of distinguishing between fiduciary advice and truthful, non-misleading sales speech. The Department maintains that no amount of explanation can dispel this disability: even "simple and clear" disclosures "could be ineffective – or even harmful."[26] An interesting conclusion given the fact that the entire structure of the federal securities laws is predicated on the utility of full and fair disclosure. "[M]ore fundamentally," the Department "reject[ed] the purported dichotomy between a mere 'sales' recommendation, on the one hand, and advice, on the other in the context of the retail market for investment products."[27] According to the Department, "sales and advice go hand in hand in the retail market."[28] "When plan participants, IRA owners, and small businesses talk to financial service professionals about the investments they should make, they typically pay for, and receive, advice."[29] The Regulation thereby effectively bans non-fiduciary commercial speech in the covered retirement savings marketplace: an insurance agent or broker-dealer may offer sales recommendations and provide specific product information *only* as a fiduciary. That sweeping expansion of the definition exceeds the Department's statutory authority and, as explained further below, raises serious constitutional concerns.

### 3. The Regulation Unreasonably and Arbitrarily Fails to Distinguish Sales Activities and Fiduciary Advice

The effect of the Regulation is to impose fiduciary obligations on non-fiduciary relationships. In that way, the Regulation banishes non-fiduciary commercial information from the retail IRA marketplace. The Department based this extraordinary expansion of the scope of fiduciary status on an express and categorical rejection of "the purported dichotomy between a mere 'sales' recommendation … and advice."[30]

Congress has long codified a distinction between sales communications and fiduciary advice. The Investment Advisers Act imposes fiduciary obligations only on an "investment adviser" who is paid specifically for investment advice, and exempts from those obligations a "broker or dealer" who provides advice "solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor."[31] In imposing fiduciary obligations on those who "render[] investment advice for a fee or other compensation" with respect to ERISA plans or IRAs,[32] Congress likewise intended to regulate those who are hired for their trusted investment advice, not

[26] 81 Fed. Reg. at 20951.
[27] *Id.* at 20981.
[28] *Id.*
[29] *Id.*
[30] 81 Fed. Reg. at 20981.
[31] 15 U.S.C. § 80b-2(a)(11)(C).
[32] 29 U.S.C. § 1002(21)(A); 26 U.S.C. § 4975(e)(3)(B).

to over-regulate or interfere with ordinary sales relationships and the valuable information that might be communicated in such relationships.

The recent enactment of the Dodd-Frank Act further confirms Congress's intent that ERISA's fiduciary duties should impose obligations only on those hired specifically to provide impartial investment advice, and not on broker-dealers engaged in ordinary sales conversations. In the Dodd-Frank Act, Congress "direct[ed] the *SEC*" (not the Department) to assess whether "the standards of care applicable to broker-dealers and investment advisers" are adequate, and "authorize[d], but [did] not require, the *SEC*" (not the Department) "to issue Regulations addressing [those] standards of care."[33] Congress thus understood that existing statutes (such as ERISA) did not already impose a fiduciary-like standard of care for ordinary sales conversations by broker-dealers. And Congress tasked the SEC, as the expert agency responsible for regulating investment products (not the Department), with studying and then deciding whether to impose new, higher obligations on broker-dealers.

The Department exempted certain sales conversations from fiduciary status—such as conversations with sponsors of ERISA plans with $50 million or more in assets. In that context, the Department recognized that a sales relationship—because it is not based on "trust or impartiality"—is not a fiduciary relationship.

But outside these narrow confines, despite its recognition of the statute's limits, the Department deemed all other information conveyed in commercial sales relationships in the retirement savings marketplace to be fiduciary in nature. Under the Regulation, any sales conversation (or series of sales conversations) by definition conveys a "recommendation" that gives rise to fiduciary obligations. That is contrary to Congress's intent, historical practice, and common understanding, as even the Department itself has recognized.

In doing so, the Department rejected a "dichotomy" that Congress expressly implemented in the Investment Advisers Act; that had for decades animated the Department's own regulations; and that accords with common sense. In fact, the Department's reasoning violates the federal Administrative Procedure Act's ("APA") command of reasoned decision making and is contrary to law in at least two respects.

*First*, the Department failed to identify sufficient record evidence to support its unqualified conclusion that all sales conversations involving ERISA plans or retirement investors are made in a context consumers expect to be one of "trust and confidence." That is an empirical proposition, and the Department failed to marshal evidence of consumer expectations to support it. That consumers may sometimes be *confused* about when an insurance agent or broker-dealer is providing impartial advice or making a sales pitch is different than evidence establishing that *all* consumers *expect* those relationships to be ones of fiduciary trust and confidence and all recommendations to be impartial.

[33] 81 Fed. Reg. at 20,990 (emphases added).

*Second*, and in any event, the Department unreasonably rejected requests to expand the seller's exclusion to cover additional if not all arm's-length commercial relationships in the ERISA plan and retail IRA context. The rationales offered by the Department for refusing to do so do not withstand scrutiny. The Department repeatedly emphasized that small ERISA plans and retail IRA investors are often confused about whether they are receiving sales information or impartial advice. But any such confusion does not justify defining fiduciary investment advice to encompass garden-variety sales conversations in which both seller and buyer fully understand that the seller is offering a product, and that the buyer and seller may have different financial interests.

At most, the Department's finding about role confusion might justify imposing fiduciary obligations when confusion actually exists, or requiring simple and effective disclosures to dispel that confusion. Imposing a disclosure requirement to establish a sales relationship—rather than deeming non-fiduciary speech fiduciary speech without regard to the particular facts—would have been consistent with Congress's substitution, under the Investment Advisers Act and elsewhere, of "a philosophy of full disclosure for the philosophy of caveat emptor" in order to "achieve a high standard of business ethics in the securities industry."[34] It would also have been consistent with the limits the Department recognized Congress imposed on the scope of fiduciary obligations under the statute.

The Department's rejection of these disclosure alternatives is unfounded. To support its claim that clear, simple disclosures would be ineffective or counterproductive, the Department relied primarily on a five-page theoretical paper that is supported, not by real-world, empirical evidence, but by limited experimental evidence from a few stylized role-playing experiments involving, for example, dice games offering the chance to earn $5 coffee-shop gift cards.[35] Moreover, the Department's sweeping conclusions about the inadequacies of disclosure are undermined by the Department's own extensive reliance on disclosure to protect retirement investors in a range of other contexts.[36]

Equally important, the Department failed to justify its critical assumption that ERISA plan sponsors, plan participants, and IRA owners are incapable of deciding which financial products to purchase without the benefit of a fiduciary adviser. To the contrary, the administrative record supported the commonsense recognition that many consumers, when provided with truthful information about suitable retirement products, will make choices that serve their own interests, as the high degree of satisfaction demonstrated by holders of variable and fixed indexed annuities plainly attests. And even if the Department could have marshaled empirical support for its deeply paternalistic view—and it did not—that would provide no basis for the Department's indiscriminate application of the fiduciary label. ERISA and the IRC give the Department authority to regulate fiduciary investment advice, not to transform non-fiduciary commercial communications into fiduciary conversations by fiat. <u>Put simply: The statute prohibits imposition of fiduciary duties unless the relationship is one of trust and confidence; it does not permit the Department to impose them because it wishes to alter the choices consumers make without the benefit of such a relationship</u>.

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[34] *Capital Gains*, 375 U.S. at 186.
[35] *See* George Loewenstein et al., *The Limits of Transparency: Pitfalls and Potential of Disclosing Conflicts of Interest*, 101 Am. Econ. Rev., No. 3, 2011, at 423-428; Proposed Regulation, 80 Fed. Reg. at 21,942 n. 19 (citing Loewenstein et al.).
[36] *See, e.g.,* 81 Fed. Reg. at 20974, 20983, 81 Fed. Reg. at 21046-21049.

In failing to limit the Regulation to communications and relationships that possess the fiduciary characteristics the Department itself knew to be required by Congress, the Department acted contrary to law and engaged in arbitrary and capricious decision making. Its overbroad and inconsistent application of the fiduciary standard is particularly damaging to ACLI's members and American consumers. Annuity products have long been distributed as part of commercial sales relationships. Under the Regulation, those non-fiduciary communications are by executive fiat deemed fiduciary—even when a customer is fully aware of the sales relationship, even when there are clear disclosures, and even when a customer desires that relationship—contrary to the limits Congress imposed and the Department itself has acknowledged.

### 4. The Regulation Unconstitutionally Abridges Consumer's Rights to Receive Truthful, Non-misleading Information About Retirement Products and Services

Consumers depend on access to truthful, non-misleading information about their suitable retirement options. The Regulation's application to truthful, non-misleading speech violates the First Amendment of the U.S. Constitution. As part of its review of the law and policy, the Department must ensure the Regulation conforms with the Administration's policy and applicable precedent on protected commercial speech.

The application of the Regulation to ordinary sales conversations about retirement products—conversations that are not made in a "fiduciary" capacity but that, day in and day out, provide consumers with a critical source of information about retirement products and retirement savings—abridges the freedom of speech guaranteed by the First Amendment. All commercial speech proposes a commercial transaction, and thus recommends that a customer engage in that transaction. The Regulation directly regulates such commercial speech by imposing fiduciary obligations on all recommendations about retirement products. In fact, the Regulation effectively outlaws non-fiduciary commercial speech about variable and fixed indexed annuities. The Regulation is presumptively unconstitutional because it restricts and burdens that commercial speech based on its content, and it restricts the ability of ACLI members and their agents to communicate truthful, commercial information to consumers based on the subject matter of those communications. The Regulation piles unreasonable, unworkable, and unnecessary burdens on truthful, non-misleading speech recommending selected retirement products—recommendations that are already required by law to be suitable for the customer in question—and thus is unconstitutional under either strict scrutiny or intermediate scrutiny applicable to content-neutral commercial speech regulation.

The Regulation raises especially serious First Amendment concerns because it abridges *consumers'* right to receive truthful, non-misleading information about retirement products—information that is important to their personal life decisions. Record evidence before the Department demonstrated what should have been obvious: by forcing all retirement speech to be provided in fiduciary relationships – and effectively prohibiting the provision of information about such services in a customary sales context - the Regulation will raise the cost of, and deny many retirement savers access to, information about retirement options—information they now receive from broker-dealers, insurance agents, and others. The Department's apparent belief that government-mandated silence is a preferable alternative to non-fiduciary sales conversations, and the Department's position that no set of clear or simple disclosures could ever enable consumers to make informed choices about retirement products, countermand core First Amendment principles and precedent. The Regulation will deprive American consumers of vital access to truthful retirement information.

For those reasons and others, the Regulation will work harmful changes on the retirement savings marketplace and will disserve American consumers. The Regulation should be repealed and replaced with a rule that avoids application to ACLI members and their agents who wish to engage in sales conversations with retirement investors that convey truthful commercial speech regarding annuity products.

As explained in our July 21, 2015 comment letter on the proposal, ACLI members and their agents are already subject to comprehensive regulation that ensures that only truthful and non-misleading information is conveyed to consumers about their retirement options and that consumers are given recommendations that are suitable for them. Those regulations, by and large, reflect regulation that has been traditionally permitted of commercial speech. The Regulation, however, goes far beyond that traditional regulation, imposing burdens far greater than needed to achieve any important government objective, by, among other things, requiring that all speech in the affected retirement savings marketplace be spoken only by a fiduciary.

ACLI members offer consumers a range of annuity products, which are marketed and sold to consumers, often through affiliated sales forces of broker-dealers and insurance agents or independent marketing organizations ("IMOs"). The Regulation, however, restricts such communications, defining the terms and conditions on which they can be made, and imposing liability as well as differential burdens based on the content of that speech. And the Regulation outright bans truthful commercial information unless such information is conveyed in the context of a heavily regulated fiduciary relationship.

When a Regulation "imposes a restriction on the content of protected speech, it is invalid unless [the government] can demonstrate that it passes strict scrutiny—that is, unless it is justified by a compelling government interest and is narrowly drawn to serve that interest."[37]. The Regulation restricts speech "'propos[ing] a commercial transaction,'" or speech incident thereto.[38] But that does not give the government license to suppress messages with which it disagrees.[39] "A 'consumer's concern for the free flow of commercial speech often may be far keener than his concern for urgent political dialogue,'"[40] —a proposition certainly true where information about retirement options is at issue—and regardless of the status of the speech as political or commercial, "the State cannot engage in content-based discrimination to advance its own side of a debate,"[41]

[37] *Brown v. Entm't Merchants Ass'n*, 564 U.S. 786, 799 (2011).
[38] Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 762 (1976).
[39] *See* Sorrell, 564 U.S. at 566.
[40] *Id.*
[41] *Id.* at 580.

Government regulation of speech is content-based either (1) if it draws facial distinctions based on a message, defining the regulated speech by particular subject matter or by the function or purpose of the speech; or (2) if the regulation cannot be justified without reference to the content.[42]

The Regulation draws numerous facial distinctions. It regulates a particular subject matter: "investment advice," or investment "recommendations," broadly defined to encompass any "suggestion" to take or not take some action. The Regulation then curbs speech with this content by imposing fiduciary status on the speaker, thereby triggering liability under ERISA and the Tax Code for violations of the prohibited-transaction Regulations ("The statute … disfavors marketing, that is, speech with a particular content.").[43] As the Department's own definition of "recommendation" makes clear, whether a given communication subjects the speaker to fiduciary regulation depends, in substantial part, "on [the communication's] content."[44]

The complex of exemptions built into the Regulation further discriminates among "recommendations" according to the speaker, the product being discussed, the listener, and the purpose or function of the speech. For example, to be exempt from the blanket liability imposed on those offering investment "recommendations," an insurance agent discussing a *certain fixed* annuity need only comply with PTE 84-24, whereas a broker-dealer or others discussing a *variable* or *fixed indexed* annuity must comply with the more onerous requirements of the BICE. In addition, the exception for "transactions with independent fiduciaries with financial expertise" (also known as the "seller's exclusion") provides specific listener-based relief from fiduciary status by creating less burdensome conditions on sales conversations to certain types of counterparties.[45] The Department's decision not to subject computer generated assets allocation platform providers (a.k.a. robo-advisers) to the BICE favors a privileged class of speakers. Indeed, the Department forthrightly acknowledged that it kept robo-advisers out of the BICE to avoid "adversely affect[ing] the incentives currently shaping the market for robo-advice."[46]

The Regulation likewise excludes from the definition of investment advice the provision of specific categories of information as "investment education," so long as they do not contain a recommendation "with respect to specific investment products."[47] The Regulation thus not only disfavors speech that falls within the Department's expansive definition of "investment advice"; it heaps special disfavor on commercial speakers communicating truthful information about suitable variable and fixed indexed annuity products to mid-sized plans and retail investors.

Beyond that, the Regulation's multiple facial distinctions cannot be justified without reference to the content of the speech itself. In justifying the regulation, the Department treated investment "recommendations"—presumptively truthful speech about suitable products—as a source of pervasive risk to consumers, citing "dangers posed by conflicts of interest and by the asymmetries

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[42] *See Reed v. Town of Gilbert, Ariz.*, 135 S. Ct. 2218, 2227 (2015).
[43] Cf. Sorrell, 264 U.S. at 564.
[44] 81 Fed. Reg. at 20997.
[45] *See* 81 Fed. Reg. at 20999-21000.
[46] 81 Fed. Reg. at 21058.
[47] *See* 81 Fed. Reg. at 20998.

of information" in the investment market.[48] The Department's solution of imposing blanket fiduciary status for such speech and then creating limited conditional relief has no content-neutral justification. Nor did the Department proffer any such justification. The Department simply deemed some types of recommendations, and the truthful, non-misleading information supporting them, worse than others and adjusted its restrictions on speech to retirement savers according to its preferences.

Because the Regulation restricts ACLI's members and their agents from communicating truthful, non-misleading commercial information about insurance products on the basis of the speech's content, the regulation is "presumptively unconstitutional and may be justified only if the [Department] proves that [it is] narrowly tailored to serve compelling state interests."[49] To withstand strict scrutiny, the Department "must specifically identify an 'actual problem' in need of solving, and the curtailment of free speech must be actually necessary to the solution."[50] The availability of a less restrictive alternative is fatal under this standard of review.[51] The Department has not identified a problem that justifies a content-based speech restriction on all recommendations, let alone restrictions specifically disfavoring certain products like variable and fixed indexed annuities. And several less restrictive alternatives, including more effective disclosure, could advance any legitimate aims the Department has in preventing marketplace confusion between advisory and sales relationships and helping investors to act in their own best interest.

The Constitution protects commercial speech because of both consumers' and society's strong interests "in the free flow of commercial information."[52] Given these profound consumer and societal interests in the dissemination of commercial information, the Supreme Court has firmly "rejected the 'highly paternalistic' view that government has complete power to suppress or regulate commercial speech."[53]

The Regulation assumes that consumers are better off with no information, as opposed to information they learn during a sales conversation. Contrary to the Department's position, "the First Amendment presumes that some accurate information is better than no information at all."[54] Indeed, the Department's position that making more information available to retirement savers is ineffective—and may even be harmful—flies in the face of well-established First Amendment principles.[55]

A typical "sales conversation" in which a person engages with prospective buyers may impart valuable information to help consumers make important investment and retirement decisions. The Regulation bars ACLI's members and their agents from engaging in such truthful commercial speech in a non-fiduciary capacity absent an exemption.

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[48] 81 Fed. Reg. at 20950.
[49] Reed, 135 S. Ct. at 2226.
[50] Brown, 564 U.S. at 799.
[51] See United States v. Playboy Entm't Grp., Inc., 529 U.S. 803, 813 (2000)
[52] Virginia State Board of Pharmacy, 425 U.S. at 763-764; accord Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York, 447 U.S. 557, 561 (1980).
[53] Cent. Hudson, 447 U.S. at 564.
[54] Cent. Hudson, 447 U.S. at 562.
[55] *See, e.g.,* Sorrell, 564 U.S. at 576.

The Department intended this impingement on the commercial speech rights of ACLI members and their agents and the First Amendment right of consumers to receive such information. The Department contemplated that the Regulation would reach commercial speech in all but the limited circumstance of transactions involving so-called "independent fiduciaries with financial expertise"—that is, counterparties deemed by the Department as capable of distinguishing between a sales conversation and fiduciary advice.[56] With respect to this limited set of presumptively sophisticated consumers, a seller can avoid being a fiduciary by making disclosures and not receiving a fee for advisory services. In contrast, commercial speech directed to all IRA owners, all plan participants and beneficiaries, and smaller plan fiduciaries automatically exposes a speaker to liability for violating the prohibited-transaction Regulations governing fiduciaries under ERISA and the Tax Code.

To restrict speakers' exercise of their commercial speech rights, the government must demonstrate that the regulation of speech directly advances a substantial government interest and is not more extensive than necessary to serve that interest.[57] The government has a substantial interest in helping retirement savers make wise investment decisions. But the Department cannot show that the Regulation either directly advances this interest or is narrowly tailored to serve this interest. To the contrary, as ample evidence in the administrative record demonstrated, and developments since the Regulation's effective date have made clear, the Regulation will create a serious deficit in access to investment information that will hit hardest small plans and retail investors, who need this information most.

To withstand scrutiny, the Department must show that the curtailment of First Amendment freedoms is no more extensive than necessary to effectuate the Department's legitimate aims. The Regulation is not narrowly tailored. The Regulation is the opposite of "narrow tailoring" because it in fact bans commercial speech in the first instance. In addition, the Department unreasonably rejected less restrictive alternatives. With respect to disclosure, for example, the Department concluded that the dangers of so-called conflicted "investment advice" cannot be cured and may even be exacerbated by more disclosure.[58] That reasoning fails on its own terms, but it also runs contrary to the First Amendment's premise that consumers can and must be allowed to make informed choices.

In short, Americans have a protected constitutional right to communicate truthful, non-misleading commercial information about retirement products (including making recommendations about those products), and the Department may not restrict this right without justifying both the direct effectiveness and narrow fit of the regulation chosen. The Regulation, however, unconstitutionally overreaches by outlawing protected commercial speech in the retirement savings market. By assuming that even fully informed consumers cannot act in their own interest, and that government-mandated silence is better than truthful commercial speech imparted in non-fiduciary sales relationships, the Department impermissibly rejected not only ample, narrower alternatives but also fundamental premises of the First Amendment. The substantial First Amendment concerns with the Regulation are reason enough for the Department to repeal it.

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[56] *See* 81 Fed. Reg. at 20982, 20999.
[57] Cent. Hudson, 447 U.S. at 564.
[58] 81 Fed. Reg. at 20950-20951.

5. **The Regulation's Inherent Bias Against Commission-Based Sales Causes A Harmful Impact on Retirement Investors**

Most investment advisers charge their clients fees for advisory services based on the percentage of assets under management—that is, consumers pay investment advisers for their ongoing advice. Few investment advisers receive commission-based compensation. By contrast, and reflecting the fact that broker-dealers sell investment *products* (not *advice*), the compensation in a broker-dealer relationship is typically transaction-based and earned primarily through commissions or similar fees on specific transactions.

The administrative record demonstrated the potentially crippling effects of the Regulation on consumers' access to guaranteed lifetime income products. The record before the Department made clear that: (1) the sale of annuity products takes more time and effort on the part of insurance agents or broker-dealers; (2) commissions are an efficient means of compensating agents and broker-dealers sufficiently for the sale of annuity products; and (3) because the ambiguous and uncertain relief available under the BICE, the Regulation will seriously impair consumers' access to annuity products and information about annuity products.

The need to provide so much information to prospective annuity purchasers means that selling annuities is not inexpensive. These challenges are well recognized, and they were explained directly to the Department in the rulemaking process. Lack of familiarity with and undervaluation of annuities are among the major reasons why fewer retirement investors purchase annuities "than would be anticipated by economic theory" or by research showing the great benefits of annuitization.[59] Policymakers, including the Department, and academic researchers have long expressed concern about this "annuity puzzle."[60]

To educate consumers effectively about annuities, insurance agents and broker-dealers must devote substantial time to learning how annuities work, the different types of annuities, and the optional features offered. Given the extensive training required, some insurers use so-called "captive" or "affiliated" insurance agents and broker-dealers to sell annuity products. Such agents and broker-dealers devote all or substantially all of their sales efforts to the insurer's own products. In this model, salespersons receive benefits as employees directly from the issuer, such as health and retirement plan coverage and contributions, office allowances, travel expense reimbursements, and other benefits customary in the industry. Insurers may also rely on third-party IMOs to distribute annuities to independent insurance agents, who then interface directly with customers.[61] IMOs—which are used most often to distribute fixed annuities, including fixed indexed annuities—offer on-hand sales support, product recommendations, and training for individual agents. The use of IMOs and affiliated insurance agents and broker-dealers are two ways that life insurers ensure that highly trained, professional salespeople sell their annuity products to consumers.

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[59] *See* Brien & Panis, at 2.
[60] *See* 75 Fed. Reg. at 5253, 5254; Brien & Panis at 1-3.
[61] Independent insurance agents must be state-licensed and complete an annuity-specific training course, as well as training about each specific product the agent wishes to sell. NAIC 2010 Suitability Model §§ 6(F)(1)(b)-(c), 7(A) (2010).

Life insurers have long sought to structure compensation in a way that encourages insurance agents and broker-dealers to devote the necessary time and attention to the sale of annuities. For that reason, insurers typically pay a sales commission upon the completion of an annuity sale to compensate agents and broker-dealers for the significant effort involved in learning about and marketing and selling annuity products. The vast majority of annuities today are sold on a commission-based compensation structure.

The use of commissions to sell annuities also reflects the "buy and hold" nature of annuity products.[62] In a fee-for-advice arrangement, a consumer pays an adviser to manage his or her money on an ongoing basis pursuant to a pre-determined investment strategy. A fee-based arrangement therefore makes little sense for broker-dealers and insurance agents who market and sell annuities, as these products do not typically necessitate continual advice and investment management.[63] In addition, fee-based models typically carry account balance minimums (typically between $100,000 and $250,000), and are used with customers that maintain high balances and are engaged in active trading.[64] They are therefore more expensive and may be inappropriate for many investors with small or mid-sized accounts who trade infrequently. Citing a study[65] finding that advisors earn .54 percent on commission based accounts versus 1.18 percent on fee-based accounts, the American Action Forum recently estimated that the Regulation has the potential to increase consumer costs by $46.6 billion, or $813 per IRA account holder.[66] Indeed, the SEC and FINRA recognize that transitioning clients to fee-based arrangements is suitable only under certain circumstances. In recent years, those regulators have increasingly scrutinized broker-dealers' placement of investors into accounts that require payment of a fixed fee but generate little or no activity to justify that fee. The Department's presumptive preference for such arrangements in all circumstances is therefore inconsistent with other expert regulators' concerns.

For these reasons, the use of sales commissions—both to compensate fairly insurance agents and broker-dealers for marketing annuity products and to keep costs lower for consumers—has been the common practice in the insurance industry for decades.

### 6. The Fiduciary Regulation's Exemptive Relief Conditions are Both Unwarranted and Unworkable for the Insurance Industry

The regulatory package includes two exemptions applicable to the sale of insurance products, the BICE for securities (including variable annuities), and fixed indexed annuities and an amended PTE 84-24 for all other annuities and insurance products, both of which provide little certainty as they include vague and open-ended standards and, for the BICE, enforcement by the plaintiff's bar. For example, the exemptions require compliance with the Impartial Conduct Standards under which advice is to be provided "without regard to the financial or other interest of the insurance agent, broker-dealer, or financial institution, yet offer no meaningful content to this standard. These exemptions require the insurance agent, broker-dealer, or financial institution to

[62] *See, e.g.*, ACLI Comment letter dated July 21, 2015.
[63] See National Association of Insurance and Financial Advisors ("NAIFA") July 21, 2015.
[64] *Id.*
[65] PriceMetrix: *Transitioning to Fee,* Insights Volume 6, August 2012.
[66] Meghan Milloy, American Action Forum, *The Consequences of the Fiduciary Rule for Consumers*, April 10, 2017.

warrant that the compensation to be received is not in excess of reasonable compensation, again with no meaningful content to this standard. Insurers must adopt and comply with written policies and procedures designed to ensure that insurance agents and broker-dealers adhere to the Impartial Conduct Standards, thus subjecting insurers to potential liability for compliance violations by others over whom they may currently exercise little supervisory control. The BICE is enforced by a private right of action, leaving state courts and the plaintiff's bar to enforce the meaning of the vague and open-ended standards.

To continue to receive variable compensation (including commissions), the Department through the BICE requires that financial institutions, such as life insurance companies, enter into written contracts with retirement investors that contain a host of open-ended and ill-defined standards to be enforced not by federal agencies but through litigation brought by private parties represented by plaintiffs' lawyers, and interpreted and applied by non-expert state and federal judges and local juries, with the certainty that this will result in conflicting and unforeseen interpretation of those standards across the country. In promulgating the BICE, the Department disregarded substantial record evidence making clear that the lack of predictability and inconsistent application engendered by this enforcement approach would radically increase the cost and risk or destroy the value of the exemption for many if not most sellers of annuities, and thus would lead to a marked increase in cost and reduction in availability and information about variable (and now fixed indexed) annuity products.

The Regulation, and the Final RIA make clear that the Department knew, if not intended, that the Regulation would interfere with consumer access to variable and fixed indexed annuities. According to the Final RIA, the Regulation is "expected to create benefits in the annuity market ... through better matches between consumers and the annuity product,"[67] and is "intended and expected ... to move markets toward a more optimal mix of ... financial products."[68] In the Final RIA, the Department acknowledges that it anticipates market share gains for those products that the Department has determined are "consumer-friendly."[69]

Indeed, throughout the rulemaking, the Department acknowledged that placing a product or practice in the BICE, rather than in PTE 84-24, would materially alter the market for that product or practice. For example, the Department explained that placing fixed rated annuities "under the terms of PTE 84-24 will promote access to these [fixed rate] annuity contracts."[70] It also asserted that moving fixed indexed annuities from PTE 84-24 to the BICE was necessary to "avoid[] creating a regulatory incentive to preferentially recommend indexed annuities" over variable annuities or mutual funds.[71] Finally, the Department specifically declined to subject robo-advisers to the BICE precisely to avoid "adversely affect[ing] the incentives currently shaping the market for robo-advice."[72] Accordingly, it is clear that the Department plainly understood that placing a class of

[67] *See* Regulating Advice Markets Definition of the Term "Fiduciary" Conflicts of Interest – Retirement Investment Advice, Regulatory Impact Analysis for Final Rule and Exemptions ("Final RIA") April 2016, at 168.
[68] *See* Final RIA at 308.
[69] *Id.* at 311.
[70] 81 Fed. Reg. at 21152.
[71] *Id.* at 21018, 21157,21158.
[72] *Id.* at 21058.

products or services in the BICE would decrease consumer access to and change the costs of those products or services, and on that basis placed products or services into or left them out of the BICE.

The Regulation adopts a highly prescriptive regulatory regime to govern the sale of "proprietary products" under the BICE, for example, sales by a career life insurance agent who sells primarily products of the life insurance company for whom the agent works. In order to sell a menu of proprietary products, the financial institution must reasonably conclude that the limitations on the universe of recommended investments and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation. In addition, the financial institution must reasonably determine that these limitations and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to recommend imprudent investments and document that conclusion in writing. Finally, any recommendation made by an insurance agent or broker-dealer with respect to a proprietary product cannot be based on the financial or other interests of the Adviser or on the Adviser's consideration of any factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the retirement adviser. The Department failed to explain how that standard could be satisfied in the common and important circumstance in which an insurance agent is authorized to sell primarily the proprietary products of the financial institution for which the agent works, again, leaving this to state courts and the plaintiff's bar to sort out.

### B. The Regulation Negatively Impacts Small Business Retirement Plan Formation and Improvement

Workplace saving programs play a critical role in retirement preparedness. As leading providers in the small plan formation marketplace, life insurers are particularly concerned that this Regulation impedes the important policy goal of expanding small plan coverage. The Regulation negatively impacts small plan formation by restricting sales activities that encourage small business owners (those with less than 100 employees) to start, maintain, or improve their employee benefit plans. The "sales exception" is limited to certain large plans, impeding the sale of products and services to small businesses. Only 50 percent of workers employed in small businesses have access to a workplace retirement plan. There needs to be greater incentives for these small businesses to start and maintain retirement plans—not new barriers.

With no pertinent economic or other analytical support, the Department opted to treat all selling and marketing activities as fiduciary investment advice when that activity is directed to small plans and IRA accounts without regard to any understanding or agreement of the parties to the contrary.

The Department's efforts went far beyond the statute in its interference with practices that are clearly recognized as the sales and marketing of products and services. The Regulation's framework is arbitrary, supposing that plan size is a proxy for one's level of understanding regarding responsibilities under ERISA, even when a plan sponsor is otherwise held accountable for understanding and compliance with the reporting, disclosure, fiduciary, and prohibited transaction Regulations. Under the Regulation, there is a new second-class plan fiduciary for small plans. This calls into question whether the Department would support a lower standard of care for small plan fiduciaries generally given this assumption that these employers lack sophistication. The Department assumes that IRA owners generally are not sufficiently sophisticated to distinguish advice from sales and marketing. The Regulation effectively eliminates for all plan sponsors, participants, IRA owners, the ability to acknowledge and define the parameters of their engagements with third parties. This, and other aspects of the Regulation, go far beyond what Congress intended and far beyond what can be construed as a reasonable reading of the statute.

The Regulation unnecessarily complicates interactions with all plans, as well as increases operational and compliance costs for providers and their customers. Further, the inability to conduct traditional sales and marketing efforts to small plans significantly impedes, if not preclude, efforts to close the retirement coverage gap, which is particularly acute among small employers. Millions of working Americans do not currently have retirement savings opportunities through their workplace. The Regulation significantly increase costs and risks attendant to reaching out to the small employer community and further exacerbates private-sector efforts to bring retirement savings opportunities to all working Americans. The Department's limits on sales and marketing to new and existing IRA owners increases the risk of leakage, thereby reducing retirement savings. Marketing and sales activities serve to educate consumers about their choices and ensure competitive pricing of products and services. As is evidence by changes in the marketplace post promulgation, the Regulation leaves potential and existing IRA owners on their own to gather information and materials about their options, while being subject to potentially competing demands from family and others to use accumulated savings for non-retirement purposes.

A key element of a fiduciary definition must be that absent a mutual understanding or agreement that person is serving in a fiduciary capacity, marketing and sales activities are not covered by the definition. Plan fiduciaries are, by law – and without regard to the size of their plan or the amount of assets within the plan -, required to act prudently and in the interest of the plan's participants and beneficiaries. Such standard imposes an obligation – and not a particularly difficult one – to ascertain the nature of the relationships in which they engage, including distinguishing a sales activity from a fiduciary activity (with respect to which they may have co-fiduciary liability). In the case of a plan participant considering a rollover or IRA owners generally, they too are expected to be cognizant of the Regulation and tax considerations governing IRAs and, in many cases, have reviewed the IRA marketplace in conjunction with the selection of an IRA with investments and fees that meet their criteria. Unlike plan participants, IRA owners have the flexibility – and therefore an inherent protection – to transfer their assets to a competing IRA if and when they become dissatisfied with investments and/or services. The knowledge and understanding of IRA owners should not be discounted by the Department in the absence of an empirical assessment of IRA owners' capabilities and the impacts on the Department's regulations on those owners.

As we suggested in our July 21, 2015 comment letter, the Department could have prescribed a simplified disclosure describing the sales function rather than forcing financial professionals to abandon the small balance investors. For example, a seller could fairly inform the investor that: (A) such person is not undertaking to provide impartial financial advice (i.e., not acting as a fiduciary for purposes of ERISA); and (B) such person has a financial interest in the matter. This approach would have achieved the Department's stated goals without codifying assumptions regarding the assumed competence – or lack thereof – of any group of plan fiduciaries or the general public.

## III. The Regulation Has Already, and Will Continue To, Result in Dislocations or Disruptions Within the Retirement Services Industry that Will Adversely Affect Investors and Retirees Resulting in an Advice-Gap

The Department's efforts to explain its rejection of "advice-gap" concerns were wholly deficient in multiple respects and developments since the Department promulgated the Regulation only confirm that conclusion. To a significant degree, the Department's rejection of the advice gap concern rested not on the proposition that retirement investors would retain comparable access to information as at present, but instead on the notion that information provided by non-fiduciaries—including truthful, factual, non-misleading information regarding the types, features, and benefits of guaranteed lifetime income products—was not of value, and may even be harmful. The Department seemed to believe that loss of access to that kind of truthful commercial speech was not a loss at all; indeed, at times, it seems that shutting down such information is one of the Department's central goals. In addition, the Department unreasonably dismissed as merely "correlati[ve]" record evidence demonstrating the relationship between access to retirement information and increased retirement savings,[73] despite contrary evidence. The Department also illogically discounted the vital role financial professionals play in helping consumers understand the variety of annuity products available and how best to utilize them to manage their ongoing living expenses.

The Department's subsequent acknowledgment that it does not understand the retirement savings marketplace renders its emphatic assurances about the advice gap suspect. Well after the Department issued the proposed regulation and conducted its purported analysis of costs and benefits, the Department issued a proposed information collection request to investigate how retirement planning strategies and decisions evolve over time. In that proposal, the Department conceded that "[r]elatively little is known about how people make planning and financial decisions before and during retirement" due to "lack of data."[74] The Regulation cuts off retirement savers from truthful, non-misleading information about retirement options without a data-based understanding about the role of such information in retirement savers' planning and decision making.

### A. The UK's Similar Regulatory Scheme Has Harmed UK Retirement Investors

The Regulation is largely patterned after, and reflects the previous Administration's admiration for, an approach to regulating the delivery of investment advice already piloted by the United Kingdom. In 2013, the U.K.'s primary securities regulator, the Financial Conduct Authority, adopted new standards governing the delivery of financial advice to retail investors known as the Retail Distribution Review.[75]

The Retail Distribution Review sought to reduce conflicts of interest by banning the use of commission-based compensation models by financial services firms when providing advice to retail

[73] Final RIA 315.
[74] Proposed Information Collection Request, 81 Fed. Reg. at 10281.
[75] *See* Fin. Servs. Auth., Principles for Businesses, https://www.handbook.fca.org.U.K./handbook/PRIN.pdf

investors.[76] Investment advisors were permitted to provide only fee-based advice. Fees for advice could be assessed as a stated amount (*i.e.*, a stated fee for the provision of investment advice on a one-time basis, a fee based on an hourly rate, a fee based on total assets, or any combination of the three). The objective of the Retail Distribution Review was to ensure that consumers would receive investment advice that was largely un-conflicted, delivered for a price that was easily understood, and directly paid for by the investor.[77]

Despite the U.K. regulators' good intentions, the Retail Distribution Review's implementation, which is now in its fourth year, is widely reported to have –

- widened the "advice gap" (*i.e.*, the availability of financial advice to less affluent investors);
- led to dramatic investor concentration in a limited number of funds;
- dramatically reduced the number of advisors serving in the financial services industry;
- had minimal impact on the fees paid by t those who can still afford advice.

Some of these harmful effects have worsened over time. For example, in the first year following the adoption of the Retail Distribution Review standard, 18% of advisors "orphaned" large number of clients by formally asking them to leave. Of that orphaned group, roughly two-thirds of customers maintained account balances of less than $60,000.[78] Over time, that minimum dollar threshold has steadily increased. Today, U.K. based advisors generally no longer compete for the business of individuals with less than $120,000 in investments.[79]

The legacy of the Retail Distribution Review thus far includes the abandonment of 16 million British retail investors who no longer have access to affordable investment advice.[80] (Adjusting for population size, this would be the equivalent of 78 million American customers.) This loss of access has harmed investors. Prior to the Retail Distribution Review, only 40% of retail financial products were purchased without the customer obtaining professional advice; according to the most recent estimates, 67% of products are now purchased without professional advice.[81] As a result, more than two-thirds are largely left to their own devices when considering whether and how to invest their retirement savings. To the extent orphaned investors have been able to determine how to invest at

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[76] See, generally, Gerard McMeel, *International Issues in the Regulation of Financial Advice: A United Kingdom Perspective – The Retail Distribution Review and the Ban on Commission Payments to Financial Intermediaries,* 87 St. John's L. Rev. 595 (2013).
[77] *Id.*
[78] *You don't need to be rich to receive advice*, THE TELEGRAPH: MONEY SERVICES (Oct. 6, 2015), www.telegraph.co.U.K./financialservices/investing/investment-and-pensions/11912950/You-dont-need-to-be-rich-to-receive-advice.html.
[79] Naomi Rovnick & Emma Dunkley, *FCA proposes reforms to close 'advice gap'*, FINANCIAL TIMES: PENSIONS INDUSTRY (Mar. 14, 2016), www.ft.com/content/4324f4dc-e9c8-11e5-888e-2eadd5fbc4a4.
[80] Caroline Binham, Naomi Rovnick, & Claer Barrett, *'Abandoned' financial consumers await review findings*, FINANCIAL TIMES: FINANCIAL CONDUCT AUTHORITY U.K. (Mar. 3, 2016) www.ft.com/content/93db3d16-e92b-11e5-bb79-2303682345c8 .
[81] *Id*.

all, they have largely concentrated their investment holdings by buying into the U.K.'s 10 largest funds.[82]

The harm experienced by investors is reflective of the U.K.'s approach to regulating the delivery of advice, which has significantly disrupted the financial services industry. In the first year following adoption of the Retail Distribution Review, the number of advisors working in the industry declined by 16%. Certain categories of advisor experienced much higher attrition rates.[83]

Finally, the benefits that were expected to materialize never appeared. A recent Grant Thornton study concluded that nearly four years after the Retail Distribution Review, the average investor who entrusts an adviser with $120,000 for a decade would pay on average 2.56% of their total investments every year for financial planning and the costs of holding financial products.[84] The affordable investment advice delivery model envisioned by the Financial Services Review's architects simply never materialized. [85]

In its public statements, Department officials have occasionally sought to distinguish the Regulation from the U.K.'s approach by pointing out that the Regulation does not ultimately render commission-based compensation arrangements illegal *per se*, but merely subjects those arrangements to the conditions of the Department's Best Interest Contract, or "BIC" Exemption.[86] Many in the financial services industry have expressed and continue to express grave concerns that the conditions of the BIC Exemption, when applied to a transaction-based distribution model, are so challenging to comply with and carry with them so great an exposure to class action claims, as to effectively albeit indirectly arrive at the same place.

### B. The UK Experience Will Be Replicated In the United States

Substantial evidence demonstrates that in anticipation of the Regulation's applicability, the United States financial services industry is beginning to experience the same disruptions and dislocations that have already taken place in the U.K. Distribution models are shifting away from commission-based models in favor of fee-based models. In anticipation of the Regulation's applicability, substantial segments of retail investors have been orphaned, or are slated to be orphaned, by major providers of financial advice. The size of the minimum account balance needed to procure fee-based advice, with the possible exception of "robo-advice," is rising. These developments strongly suggest that unless the Regulation is substantially modified or revoked the same disastrous results that have befallen the U.K. retirement investor community will be replicated in the United States. Indeed, a recent research paper found that based on a minimum balance requirement of $30,000, the Regulation could force 28 million Americans out of a managed

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[82] Tim Steer, *The financial services world has changed and not for the better*, THE TELEGRAPH: BUSINESS OPINION (Aug. 24, 2013), www.telegraph.co.U.K./finance/comment/10264089/The-financial-services-world-has-changed-and-not-for-the-better.html.
[83] *Id.*
[84] Naomi Rovnick & Aime Williams, *How much do you really pay your money manager?*, FINANCIAL TIMES: PENSIONS INDUSTRY (Aug. 20, 2016), www.ft.com/content/56243606-6614-11e6-a08a-c7ac04ef00aa .
[85] Naomi Rovnick, *U.K. retail investing fees stay above 2.5% annually*, FINANCIAL TIMES: FUND MANAGEMENT (Aug. 26, 2016), www.ft.com/content/ba0ae18c-6a98-11e6-a0b1-d87a9fea034f.
[86] PTE 2016-01.

retirement accounts completely, and even with a minimum balance of $5,000, over 13 million Americans would lose access to managed retirement accounts.[87]

The Regulation will result in more "orphaned" accounts. A number of ACLI member companies have already been notified by certain of their distribution partners of the distributors' intention to resign as agent of record to IRA and ERISA plan annuity holders in anticipation of the Regulation's applicability. Our members anticipate that this trend is likely to continue and to accelerate as the applicability date approaches, resulting in a significant increase in the number of "orphaned" accounts. The existence of orphan accounts is not, in and of itself, a new phenomenon. Insurance companies often have a number of orphan, or unassigned, accounts on their books. In the past, these were typically smaller customer accounts that are transferred to the home office in the event of an agent departing the business and leaving the client behind or the death or incapacity of an agent. As the Fiduciary Regulation's applicability date approaches, the numbers of orphaned accounts and the average size of those accounts have both increased dramatically. Member companies report that resigning distribution firms typically cite an unwillingness to assume the litigation risks inherent in the BIC Exemption as the primary basis for their resignation. While member companies will provide basic services to orphaned account holders, including the provision of factual responses to customer information requests, most companies are not equipped to replace the levels of personal advisory support formerly provided by the resigning agents. Moreover, it appears unlikely, given the liabilities associated with the Regulation, other agents or advisors would be willing to take on large blocks of orphan accounts, leaving the account holder with no financial advice or guidance.

First, it is clear that, as in the U.K, American investors are gradually losing access to advice. One need only read the daily financial headlines over the past 6 months to have observed this concerning trend. For example, it has recently been reported that JPMorgan Chase wealth management clients with individual retirement accounts were moved from advised to self-directed products on April 7, 2017.[88] That shift in approach appears to have been precipitated entirely by the Regulation's anticipated applicability. Similarly, Merrill Lynch is reportedly requiring retirement investors who are currently served by the firm through commission-based accounts to either go without any advice or enter into an agreement where the investor pays a fee to receive investment advice.[89]

Even for those firms that have chosen to adhere to a commission-based model, smaller balance accounts are being abandoned as firms are required to concentrate their attention on more affluent investors; the costs and legal compliance risks associated with the Fiduciary Regulation have driven many firms to conclude that smaller balance accounts are simply not worth the risks and

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[87] Milloy, *supra,* note 65.

[88] Crystal Kim, *BofA, JPMorgan, and the Regulation: Will they or Won't They*, BARRON'S (March 15, 2017), www.barrons.com/articles/bofa-jpmorgan-and-the-fiduciary-regulation-will-they-or-wont-they-1489588442. However, JP Morgan recently stated that it is delaying this move pending final action by the Department, resulting in even more investor confusion.

[89] Mason Braswell, *Merrill Early Mover Gaffe? DOL Policy Prompts 11 NY-Area Departures*, ADVISORHUB (March 6, 2017), www.investmentnews.com/article/20150624/FREE/150629958/perez-calls-out-variable-annuities-in-argument-for-dol-fiduciary-regulation.

associated costs of serving. For example, Edward Jones has reportedly concluded that it will only serve those investors who are able to maintain an account minimum of at least $100,000.[90] Clearly, the same advice gap that developed in the U.K. in the Retail Distribution Review's aftermath is now being replicated here in the United States in anticipation of the Regulation. The shift to an environment where only wealthy investors will have access to investment advice and where all others will be left to fend for themselves in self-directed brokerage accounts, if they choose to invest at all, directly contravenes the Presidential Memorandum's stated policy objectives. It should also properly alarm the Department, since these developments are clear indicators that the Regulation does not promote the interests of American workers who are seeking a secure retirement.

Second, as in the U.K., the diminution in access to skilled financial advisors for working Americans is being reflected in reduced take-up rates of non-vanilla products, including products that require explanation of their guaranteed lifetime income features. In the last year, variable annuity sales of the six largest annuity providers reportedly fell by 26% to 45%.[91] The Regulation's anticipated applicability is clearly a major driver of this result – and ACLI and others anticipated and warned the Department of this potential result prior to the promulgation of the Regulation. As further discussed below, the sharp drop-off in the sale of variable annuity products does not bode well for the retirement outcomes of investors who are uninsured against longevity risk and the risk associated with sharp and prolonged declines in financial markets. A recent consumer financial decisions survey. representative of 136,390,000 U.S. economic households, found that, among households with IRA balances of $100,000 or less, 74 percent are concerned about having adequate savings for retirement, and almost 60 percent are worried about outliving their retirement savings.[92] Only the insurance and annuity industry is able to offer the products that offer real guarantees against these risks. Since fee-based advisors have historically not offered annuity products to their retail clients, and since the Regulation is so clearly in the process of disrupting the insurance industry's traditional, commission-based distribution models, investors facing retirement are not learning about and are not choosing to purchase the insurance products that can secure their retirement income for a lifetime. Given the vital role that access to variable and fixed indexed annuities can have for retirement savers (as discussed above), this result is particularly problematic.

Third, it is clear that the disruption and dislocation due to the Regulation is particularly concentrated in the retail advisor community. Retail advisors are losing their jobs and are shuttering their businesses in anticipation of the Regulation. As the Department has acknowledged, the majority of fixed index annuities are sold by independent insurance agents.[93] Many are supported by independent marketing organizations ("IMOs"), specialized marketing organizations that lend assistance to distributors of life insurance company products, including fixed indexed annuities,

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[90] Michael Wursthorn, *Edward Jones Shakes Up Retirement Offerings Ahead of Regulation*, THE WALL STREET JOURNAL: MARKETS (Aug. 17, 2016), www.wsj.com/articles/edward-jones-shakes-up-retirement-offerings-ahead-of-fiduciary-rule-1471469692.
[91] Greg Iacurci, *Department of Labor's Regulation blamed for insurers' massive hit on variable annuity sales*, INVESTMENTNEWS (Mar. 28, 2017). www.investmentnews.com/article/20150624/FREE/150629958/perez-calls-out-variable-annuities-in-argument-for-dol-fiduciary-regulation.
[92] Strategic Business Insights 2016-2017 MacroMonitor Consumer Financial Decisions Survey.
[93] *See Proposed Best Interest Contract Exemption for Insurance Intermediaries*, 82 Fed. Reg. 7335, 7354 (Jan. 19, 2017). "In 2015, approximately 63% of FIAs, $34.1 billion, were sold through the independent agent distribution channel."

through independent agents. As a result of the Regulation, IMOs and the independent agents that work with IMOs will in most cases no longer be able to distribute fixed indexed annuity products. In fact, the recently-proposed exemption to cover the sale of fixed indexed products imposes financial barriers to entry that are simply too steep and too costly for most IMOs to take advantage of.

Finally, it is foreseeable that, unless substantially modified, the legacy of the Regulation will increase the cost of advice to most investors. Smaller retirement savers will be particularly disadvantaged since in many cases the commission-based account models used today by many "buy and hold" investors will be unavailable. For all of the foregoing reasons, it is imperative that the Department reform the Regulation quickly and before the interests of retirement investors are irreparably damaged by a dramatic reduction in the availability of much needed advice.

### C. The Department Inappropriately Relies on Computer Generated Asset Allocation Platforms (a.k.a. "Robo-Advisers") as the Option for Retirement Investors With Small Account Balances

In the Final RIA, the Department relied on the existence of so-called robo-advisers as an option for small investors who lose access to financial assistance from broker-dealers and insurance agents.[94] Robo-advisers are essentially interactive online tools that use algorithms to generate asset allocation recommendations based on data input by the user. But the Department did not cite any evidence establishing that robo-advisers either effectively substitute for in-person sales conversations or that such services would be readily available to retirement savers with small account balances. Commenters pointed to reports by the SEC and FINRA discussing the limits of robo-advice, including their reliance on incorrect assumptions; failure to react to shifts in the marketplace; consideration of limited options; and access to limited information about particular investors. Indeed, the Department conceded that automated advice likely does *not* offer the same benefits financial professionals do—benefits that include encouraging greater savings, responding to client-specific questions, and dissuading emotional investing, such as liquidating assets during a downturn like the 2008 market crash.[95] Thus, the Department failed to explain how robo-advisers, which are limited to offering computer generated asset allocations, could serve as adequate substitutes given those crucial limitations.

Nonetheless, in the Regulation, while interfering with information disseminated by human sales people, the Department actually attempted to encourage the growth of robo-advisers. The Department stated, without evidentiary support or any basis in logic, that robo-advice is less prone to conflicts of interest, and the Department therefore elected to exclude robo-advice from the BICE so as not to interfere with the development of that market.[96] The Department's favoritism toward robo-advise is particularly suspect given recent reports by FINRA and the SEC cited in the record that express concerns that automated investment tools rely on incorrect assumptions, neglect to react to

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[94] Final RIA 319-320.
[95] *See id.* at 320-321
[96] 81 Fed. Reg. at 21058

shifts in the market, present consumers with limited options, and may be prone to conflicts of interest in the form of revenue sharing or the sale of proprietary and affiliated products.[97]

### D. The Regulation Will Result in Many Households Experiencing Lower Living Standards in Retirement

U.S. retirement income policy is a complex, interdependent system of statutory law, administrative regulations and tax incentives that have been adopted with the goal of ensuring that U.S. households have sufficient retirement assets to avoid a significant decline in living standards upon retirement. Any proposed modification to regulation that may impact retirement savings by households must be judged by whether the modification serves this goal. In conducting the RIA, the Department has focused on the wrong measure of success – a potential increase in investment return – and has ignored the Regulation's impact on the true objective – ensuring that workers will have sufficient retirement income.

The Department acknowledges that the Regulation is likely to cause a significant disruption to the current retirement advice market. Preliminary evidence from the few firms that have announced how they intend to conform with the Regulation indicates that the likely outcome of this disruption is that only those with $100,000 or more in assets will have access to an adviser while households with less than $100,000 in assets will either be left to fend for themselves or pointed towards computer-generated asset allocation platforms. This lack of access to advisers will have a significant negative impact on retirement living standards.

The Department states that it "…takes seriously the risk that banning adviser conflicts could reduce access to advice for some IRA investors, and that not only their investing but also their saving might suffer as a result."[98] Yet, it did not evaluate this risk.

A recent study has found that investors utilizing an adviser for as short as four to six years will have 58% more assets than those who did not utilize an adviser. The benefit of utilizing an adviser increases over time also. After seven to fourteen years, advised households will have 99% more assets than non-advised households and after fifteen years, advised households will have 173% more in assets than non-advised households. [99] Furthermore, households with advisers earn a median return 3% greater than non-advised returns. This is insufficient to account for the full differences in asset values and the authors conclude that the higher asset values are due to increased rates of saving, better diversification and the adviser inducing better investment discipline on the investor.

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[97] *See* FINRA, *Report on Digital Investment Advice* 6, 13 (Mar. 2016), https://www.finra.org/sites/default/files/digital-investment-advice-report.pdf;; SEC, *Investor Alert: Automated Investment Tools* (May 8, 2015), http://www.sec.gov/oiea/investor-alerts-bulletins/autolistingtoolshtm.html; *see also* Mass. Sec. Div., *Policy Statement, Robo-Advisers and State Investment Adviser Registration* 1 (Apr. 1, 2016), www.sec.state.ma.us/sct/sctpdf/policy-statement--robo-advisers-and-state-investment-adviser-registration.pdf.

[98] Final RIA at 179.

[99] Montmarquette, Claude and N. Viennot-Briot, *The Value of Financial Advice*, Annals of Economics and Finance (16-1), 2015, pp 69-94.

Market changes that limit advice to those with $100,000 or more in assets will reduce retirement living standards by as much as two-thirds for some households. First, the over two-thirds of households that currently do not have an IRA[100] will be impacted heavily as there will be neither advisers who seek to encourage them to save nor advisers to assist them should they decide to save. Second, the nearly one-third of households that have an IRA will be impacted as well as almost two-thirds of these households (over 22 million households) have less than $100,000 in combined IRA assets[101] and over one-half of these households currently work with an adviser.[102] Thus, the Regulation will significantly lower, by as much as two-thirds, the retirement living standards of over 22 million U.S. households.

## IV. <u>The Regulation Will Cause an Increase in Litigation, and Accordingly, An Increase in the Prices That Investors and Retirees Must Pay to Gain Access to Retirement Services</u>

The Department recognized that its proposed Regulation would create unreasonable barriers to the sale of retirement products and it proposed a series of carve-outs and exemptions to attempt to remedy that problem. The Department explained that the carve-outs were designed to exclude communications that "Congress did not intend to cover as 'fiduciary advice' and that parties would not ordinarily view as … characterized by a relationship of trust or impartiality."[103] Creation of the carve-outs thus was an express recognition that the new definition was not fully consonant with congressional intent and swept too broadly.

The Department concluded that certain types of fees and compensation common in the retail marketplace, such as brokerage or insurance commissions, would be considered "prohibited compensation" under the Final regulation. Further, the Department arbitrarily determined that Prohibited Transaction Exemption 84-24 would no longer be available for the sale of variable or fixed indexed annuities, as it had been for decades. Accordingly, given the Department's severely restricted "carve-outs" and its conclusion regarding "prohibited compensation," sellers of annuity products are, in reality, left with one alternative – use of the Department's BICE.

According to the Department, the BICE is "designed to cover a wide variety of current compensation practices, which would otherwise be prohibited as a result of the Department's Regulation extending fiduciary status to many investment professionals who were formerly not treated as fiduciaries."[104] To receive "otherwise prohibited compensation" under the BICE for selling a retirement product—such as a sales commission for the sale of an annuity product—a financial institution must enter into a written contract with a retirement investor that governs the conduct of the insurance agent or broker-dealer as well as the financial institution (that is, the life insurance company).

In the preamble to the Final BICE, the Department states that "rather than create a set of highly prescriptive transaction-specific exemptions, which has been the Department's usual

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[100] *The Role of IRAs in U.S. Households' Saving for Retirement, 2015*, ICI RESEARCH PERSPECTIVE, February 2016, Vol. 22, No. 1.
[101] ACLI analysis of 2013 Federal Reserve Survey of Consumer Finances data.
[102] Strategic Business Insights 2016-2017 MacroMonitor Consumer Financial Decisions Survey.
[103] 80 Fed. Reg. 21928, 21941 (Apr. 20, 2015).
[104] 81 Fed. Reg. at 21003.

approach, the exemption flexibly accommodates a wide range of compensation practices, while minimizing the harmful impact of conflicts of interest on the quality of advice."[105] In reality, the BICE is the most prescriptive exemption ever issued by the Department and its requirements are so ambiguous as to render compliance, at best, uncertain and even impossible.

### A. The BICE's Impartial Conduct Standards are Unacceptably Ambiguous, Rendering Compliance Uncertain and Unworkable

Under ERISA and the Code, the Department may create exemptions, such as the BICE, only if they are "administratively feasible."[106] The BICE violates this requirement because it is unworkable for the insurers, agents, and broker-dealers that issue or sell annuities. Indeed, the BICE's impartial conduct standards include two separate requirements that create unacceptable ambiguity as to whether the customary compensation practices would be permitted going forward. First, the BICE requires financial institutions to warrant that they do not pay their advisers differential compensation intended to incent the adviser to make recommendations that are not in the sole interest of the investor. Second, financial institutions are required to represent that the compensation received by the financial institution, the adviser, affiliates and related parties is "reasonable" for the services provided to the retirement investor. Furthermore, if the financial institution places limits on the investments it offers, under the exemption, the Department sets forth an even higher standard that requires the financial institution to justify each payment stream with separate and distinct services.

These requirements are over and above the basic requirement that the adviser only make recommendations that are in the investor's sole interest. While the Department states in the preamble to the exemption that the BICE is designed to allow continued receipt of commissions, the text of the BICE does not create a clear, operational standard that accounts for the insurance industry's diverse business models. Under the BICE, the financial institution, as a party to the contract with the retirement investor, assumes responsibility – and liability - for the actions of the advisor. This requirement completely ignores common insurance industry distribution systems. For example, the common distribution system for independent agents who sell fixed index annuities and are not registered representatives under the Investment Advisors Act does not contemplate that the insurance company, which monitors the sale of its product, is able to determine if the sale of its product by an unrelated advisor is in the "best interest" of the customer.

The BICE ambiguity as to permissible compensation structures results in the courts or the Department, rather than the retirement investor or the market, deciding the manner in which a retirement investor can pay for services. Allowing a court or a regulator to decide after the fact whether differential compensation in the form of commissions satisfies this standard is plainly unworkable.

Further, the Department has refused to provide specific examples of "reasonable compensation" despite the fact that a number of commenters requested greater specificity as to the

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[105] 81 Fed. Reg. at 21002.
[106] *See* 29 U.S.C. §1108(a0, 26 U.S.C. §4975(c)(2).

meaning of the reasonable compensation standard.[107] In response, the Department clarified the term by tying the concept of "reasonable compensation," as required by the BICE, to "the well-established reasonable compensation standard as set out in ERISA section 408(b)(2) and Code section 4975(d)(2)."[108] This "clarification" by the Department is misguided. According to ERISA regulations, whether compensation is "reasonable … depends on the particular facts and circumstances of each case."[109] In over 200 advisory opinions dealing with reasonable compensation under ERISA § 408(b)(2), the Department has consistently said that such questions are "inherently factual" and declined to opine on them.[110]

Moreover, the BICE's standards for the sale of proprietary products are onerous and ill-defined. Many insurers deploy an affiliated sales force with expertise in the multiple features of variable annuities. Although the BICE purports to allow for the sale of proprietary products, the conditions imposed by the Regulation make doing so fraught with litigation risk, especially given the Department's professed "deep and continuing concern" regarding proprietary sales.[111] In particular, the Department's position that an adviser "may not, consistent with the Best Interest obligation, recommend a product from its limited menu" "if another type of investment" would be in the investor's best interest,[112] imposes an unworkable standard on insurance companies that sell proprietary products, such as a menu of variable annuity products, because those life insurers will be subject to lawsuits claiming that other products would have better satisfied a retail investor's needs.

The principles-based nature of the BICE creates considerable exposure for advisers seeking the protection of the exemption, rendering it unusable from a compliance standpoint. In order to meet the requirements of the BICE and avoid a prohibited transaction, fiduciaries would not only be required to contractually obligate themselves to act in the client's best interest but would also have to comply with the best interest standard to avoid a prohibited transaction. This formulation makes it impossible for financial institutions to have confidence that they have ever met the conditions of the BICE and is unnecessary to protect retirement investors. By requiring a contractual obligation, the retirement investor will have a legally enforceable cause of action against a financial institution for breach of contract if the client is harmed by recommendations that were not in his or her best interest. This legal cause of action is what the Department claimed was necessary to protect retirement investors. However, the Department also makes compliance with the best interest standard a condition of the exemption itself. Because such compliance is purely subjective, financial institutions will never be certain whether the conditions have been met and that no excise taxes are owed. Furthermore, the penalty for breach of contract will be to compensate the retirement investor for any harm suffered. The penalty for a prohibited transaction is an excise tax that is due regardless of whether any harm occurred.

In addition, financial institutions are also required to warrant, or guarantee, certain conditions that are likely to be determined only in retrospect, e.g., that each "material" conflict has

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[107] 81 Federal Register at 21030.
[108] *Id.*
[109] 29 C.F.R. § 2550.408c-2(b)(1).
[110] *See, e.g.*, Advisory Opinion Procedure, 41 Fed. Reg. 36281, 36282 (Aug. 27 1976).
[111] 81 Fed. Reg. at 21052.
[112] *Id.* at 21055.

been identified and disclosed, that they have personnel policies appropriately align with the Best Interest standard.

If a court determines that a fiduciary breached any of these warranties, or even if a court determined that a fiduciary's fees were "unreasonable", the fiduciary could be subject to undeterminable monetary damages based on a state-law contract right of action. Allowing courts to determine ERISA fiduciary compliance in hindsight without any clear mitigation strategy is simply not an acceptable business model for any responsible ERISA fiduciary or service provider, and many advisers will strongly consider exiting the retirement market due to the inability to properly assess the risks.

Even in the absence of litigation, it is not clear that an adviser would be able to determine whether an excise tax is due. A fiduciary that takes reasonable measures to maintain reasonable fees may find that as market conditions shift, those fees may be deemed 'unreasonable' under the very same standard. As the law develops in this area, a fiduciary may find that her firms' compensation practices may be deemed to inappropriately promote proprietary products over non-proprietary products. It is unclear, under the BICE, whether this knowledge alone triggers an excise tax under Code section 4975, and an attendant duty to self-report.

### B. The BICE's Private Right of Action for IRAs Will Significantly Increase Litigation

There is no dispute that the Department lacks authority to enforce the ERISA's prohibited transaction and fiduciary duty provisions with respect to IRAs.[113] As a result, the Department, in a decision wholly inconsistent with Congressional intent, inappropriately delegated enforcement authority to the private sector. Congress chose to confer on the Internal Revenue Service the authority to enforce Regulations against certain prohibited transactions in the statute governing IRAs and specifically elected not to authorize enforcement through a private right of action. The Department, however, disagreed with Congress's judgment, and concluded such enforcement mechanisms were insufficient. Accordingly, the Department created a private right of action, with enforcement by class action lawsuits and state courts.

Further, the BICE, specifically affirmatively prohibits a contract from containing "[e]xculpatory provisions disclaiming or otherwise limiting liability … for a violation of the contract's terms."[114] In issuing the Regulation, the Department explained that, in purpose and design, "[t]he contract [requirement] creates a mechanism for IRA investors to enforce their rights and ensures that they will have a remedy," including "class litigation."[115]

Thus, to continue to receive variable compensation (including commissions), the Department, through the BICE, requires that financial institutions, such as life insurance companies,

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[113] *See* 80 Fed. Reg. 21972 "The Department would be able to enforce ERISA's prohibited transaction and fiduciary duty provisions with respect to employee benefit plans, but not IRAs, in the event that the Adviser or Financial Institution received compensation in a prohibited transaction but failed to comply with the Exemption or the Impartial Conduct Standards."
[114] 81 Fed. Reg. at 21077.
[115] *Id.* at 20947.

enter into written contracts with retirement investors that contain a host of open-ended and ill-defined standards to be enforced not by federal agencies but through litigation brought by private parties represented by plaintiffs' lawyers, and interpreted and applied by non-expert state and federal judges and local juries, with the certainty that this will result in conflicting and unforeseen interpretation of those standards across the country. Further, in promulgating the Final BICE, the Department disregarded substantial record evidence making clear that the lack of predictability and inconsistent application engendered by this enforcement approach would radically increase the cost and risk or destroy the value of the BICE for many if not most sellers of annuities, and thus would lead to a marked increase in cost and reduction in availability of information about variable and fixed indexed annuity products.

The Department's Final RIA did not even attempt to quantify the potential litigation costs associated with the BICE. Indeed, although Section 5.3 of the Final RIA states that "the costs of litigation are discussed separately in Section 5.4"[116] Yet, section 5.4 focuses solely on increased insurance premiums and wholly fails to address or consider increased litigation costs associated with the BICE.[117] Apparently, the Department simplistically assumes that all of the compliance and litigation costs associated with the BICE will be addressed by liability insurance. This ignores several facts. First, many current errors and omissions policies contain an exclusion for ERISA-related claims. Second, our members have informed us that such policies and/or policy riders on existing policies are not yet available in the marketplace. Third, it is impossible to know the cost of the insurance coverage alone, and this is only one measure of the additional costs that the Regulation will trigger.

The Department's complete failure to understand and address litigation costs is glaring and fatal, given the substantial legal risk associated with attempted compliance with an exemption with vague and undefined terms - and enforcement by the private litigation bar. Indeed, a recent analysis by Morningstar, completed after promulgation of the Regulation, estimated a long-term annual range for the industry from class-action settlements of $70 to $150 million – and the analysis stated that Morningstar would not be surprised if near-term class-action lawsuit settlements exceed this by a multiple "as firms figure out how to determine, demonstrate, and document best interest." Morningstar concluded that, in a bearish scenario, the cost of class-action settlements alone could decrease the operating margin on the advised, commission-based IRA assets of affected firms by 24% to 36%.[118] This was only an estimate of settlements and not the cost of defending against class actions. These are precisely the types of serious costs that the Department all but ignored before – and that the President's Memorandum now requires the Department to confront.

### C. The BICE Will Lead to an Increase in Class Actions Litigation Brought Against ERISA Fiduciaries

Class action litigation brought against ERISA fiduciaries will undoubtedly increase, given that the Department deliberately promotes class action litigation as a BICE enforcement tool. In

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[116] *See* Final RIA at 222.
[117] *Id*. pages 239-243.
[118] See Wong, Michael, *Costs of Fiduciary Regulation Underestimated*, Morningstar Stock Analyst Update, February 9, 2017.

discussing the Department's decision to allow BICE contracts with investors to require pre-dispute binding arbitration of individual disputes with the financial institution or adviser, but prohibiting provisions that would limit the investor's right to bring or participate in class action litigation, the Department praises the benefits of class action litigation. Specifically, in the preamble to the Final BICE, the Department states that "the option to pursue class actions in court is an important enforcement mechanism for Retirement Investors" and further that "exposure to class claims creates a powerful incentive for Financial Institutions to carefully supervise individual Advisers, and ensure adherence to the Impartial Conduct Standards."[119]

Class action plaintiff law firms continue to be active in the ERISA space. Between November 2015 and November 2016, nine law firms filed 102 ERISA class action lawsuits.[120] In August 2016 alone, 12 benefit plan cases were brought against Universities. Given the uptick in ERISA class action litigation, the BICE ambiguity as to permissible compensation structures and reasonable compensation requirements, and the Department's stated reliance on class action litigation as an enforcement tool, it is impossible to conclude that the BICE will not lead to an increase in such litigation. Indeed, in an *Amicus Curiae* brief filed in litigation challenging the Fiduciary Regulation and BICE, the American Association for Justice (formerly known as the American Trial Lawyers Association) urges the court to uphold the Department's requirement that participants continue to be able to participate in class action litigation as a BICE enforcement tool.

### D. The Increased Costs to Financial Service Providers Associated with Increased Litigation Will Likely Be Borne by Consumers

At their core, Insurance companies are manufacturers. They produce products (insurance policies and annuities) to sell to consumers, including retirement savers. Insurers are in the business of managing risk. Unlike other financial product manufacturers, insurance companies must satisfy capital and reserve requirements - given the long-term future financial guarantees they provide to policyholders. The price of any product includes the cost of producing it. It is reasonable to expect that, in an attempt to quantify the unknown liability risks resulting from the Department's decision to enforce the BICE through the private plaintiffs' bar and class action litigation, there will be resulting upward pressure on product pricing. '

Further, we understand from our members that insurance product distributors are also likely to increase the fees they will require from product manufacturers to maintain products on their distribution platforms. Our members inform us that these cost increases, which will likely be built into the cost of insurance products (and passed onto consumers) are a direct result of distributors being required to act as a "financial institution" under the BICE, and the unknown increased liability risk associated with doing so.

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[119] 81 Fed. Reg. at 21043.
[120] Bloomberg BNA *Top Plaintiffs Law Firms Fling ERISA Class Actions,* November 7, 2016.

## V. <u>The Department's Regulatory Impact Analysis Supporting the Regulation Was Deficient and Flawed</u>

### A. The Department's Regulatory Action is Based on Conjecture

A review of the Department's Final RIA supporting the Regulation shows that, while the Department has undertaken great effort to estimate the benefits of the Regulation, these efforts are for naught and the benefit estimate is nothing more than a conjecture without academic or empirical support. A regulatory impact analysis supporting regulatory action should not be based upon conjecture, and the deficiencies with the Final RIA that ACLI and others have documented through comment letter, testimony, and litigation filings provide a powerful reason for the Department to rescind the Regulation.

The entire Final RIA attempts to demonstrate that the benefits to mutual fund investors exceeds the compliance costs of the Regulation. In determining the benefits of the Regulation, the Final RIA relies on seven critical assumptions that can be succinctly described as follows.

1. The pool of front-load mutual funds (P) is an appropriate measure of conflicted advice in the IRA-mutual fund market.
2. Front-load funds both persistently and consistently underperform similar funds that do not have front-loads.
3. Prohibiting conflicted advice will eliminate the differences (R) in investment returns that the Department asserts is present between those who receive conflicted and those who receive unconflicted advice.
4. Gains to mutual fund investors (MFG) is the product of PxR. MFG = PxR
5. There is uncertainty surrounding the accuracy of the first three assumptions and to account for these inaccuracies, the gain to mutual funds investors, MFG, should be adjusted by an "effectiveness rate" (E).[121] MFG = PxRxE.
6. The benefit accruing to investors in non-mutual fund investments are positive. (Other), where Other > 0.
7. Excluding price increases, the Regulation will not cause harm (H) to investors. H = 0. [122]

If the above assumptions are correct, then if the gain to only mutual fund investors exceed the Department's estimate of the cost of the Regulation (C), the Regulation results in a net benefit to investors, i.e., if PxRxE + Other + Harm > Cost, there are net benefits to the Regulation. Restated, if all of the following are true, then benefits exceed cost:

- Pool x Increased Return x Effectiveness rate > Costs (PxRxE > C);
- Benefit to investors in non-mutual funds ≥ 0 (Other ≥ 0);
- No investors are harmed. (Harm = 0);

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[121] The Department describes this effectiveness ratio as the amount that the Regulation reduces conflicts of interest. To be most favorable to the Department, we have assumed this efficiency ratio incorporates all adjustments that need to be made to prior variables.
[122] *See, generally,* Final RIA.

If any one of the above statements is false, it cannot be determined whether the Regulation results in a positive net benefit or harm to consumers.

The Department presents only one numerical benefit estimate, the benefit to mutual fund investors. A careful review of this estimate utilizing an economic model and the work presented by the Department indicates that this estimate is nothing more than pure unsubstantiated and unsupported conjecture. The Department failed to provide any empirical basis for determining its effectiveness rate. Without an attempt, even an imperfect attempt, to guide the value assigned to the effectiveness rate, the effectiveness rate becomes nothing more than a guess.

The Department has no basis upon which to assign a value to the effectiveness rate. The benefit that the Final RIA estimates will accrue to investors depends entirely on what amount of compensation will pass the reasonableness standard. This is clear when we consider how the Department estimated the benefit to consumers.

$$P \times R \times E$$

A pool of assets (P) times the difference in investment returns between conflicted and unconflicted advice (R) times <u>an effectiveness rate</u> (E) that accounts for how much of the increase in investment returns that the Department *believes* will occur will actually occur. To establish the product of these three terms as anything beyond a guess, one must have some empirical or theoretical foundation on which to base their assigned values. It does not matter if one can determine with absolute accuracy two out of three of the values; if the last is a guess, the entire estimate becomes a guess.

This ratio incorporates not only all measurement errors in selecting the pool of assets and the potential change to investor returns from the Regulation, but also must reflect the difference between the commissions currently received by advisors and what constitutes reasonable compensation.

The Department has defined the effectiveness rate as the ability of the Regulation to reduce the difference between conflicted advice returns and unconflicted advice returns. The Department is incorrect. This is not what the effectiveness rate represents. The effectiveness rate represents whether investors will achieve returns in excess of what the Department believes is the maximum increase.

It appears that the Department believes that the upper-bound is 100% (i.e. the maximum gain is the difference between what the Department considers to be unconflicted advice and conflicted advice). This is not correct. The Regulation does not require that commission-based advice be delivered at the commission currently applicable to unconflicted advice. The Regulation requires that commission-based advice must be reasonable and reasonable is not defined. Consequently, the lower bound of the effectiveness rate is 0%, the upper-bound is unknown, but is greater than 100%, i.e. in excess of what the Department claims is the maximum.

The Department has produced no evidence that supports using any specific effectiveness rate nor has it produced evidence that it even attempted such a study. Without evidence, the Department presumed that "reasonable compensation" equates to "unconflicted advice." Under the Regulation, "reasonable compensation" is a matter to be settled by litigation and case law. Investors seeking advice cannot know if the price they pay for advice conforms with the Regulation while advisors face enormous litigation risk under the Regulation for providing any form of advice. Without a clear understanding of the Regulation's impact, including the ramifications due to the uncertainty inherent in the reasonable compensation requirement, the Department cannot estimate the benefit of the Regulation.

ACLI has not undertaken a formal impact analysis of what this substantial uncertainty will do to the IRA market. However, it is reasonable to assume that this uncertainty will cause enormous market turmoil and hardship for a considerable length of time and that this uncertainty may not be reduced until the courts have developed a clear view on what is reasonable compensation. The Department's Final RIA ignores this uncertainty entirely.

### B. Front-Loaded Mutual Funds are an Imperfect Proxy for Other Assets, Including Annuities.

The Department has assumed that all investment in products with front-load fees is due to conflicted advice. It has presented no basis for making this assumption. The Department has declared this the pool of conflicted advice assets. Yet, the pool is "contaminated." For example, an investor utilizing self-advice may have self-selected into these funds. An investor may have acquired the fund through an advisor who charges fees on assets under management (AUM).[123] If the Department wanted to use this pool as the foundation of their benefit calculation, it should have first attempted to decontaminate the pool or at the very least acknowledged that it did not do so. We can find no evidence that the Department did either. Because this pool of potential assets is too large, the Department's estimate is biased and will automatically overestimate the benefits accruing to mutual fund IRA investors.

### C. The Department Failed to Respond to Comments on the Regulatory Impact Analysis

The President's February 3, 2017, memorandum[124] directed the Department to reexamine the scope, mechanics, benefits and burdens of the Regulation. To that end, examination of how the Department addressed ACLI's testimony and comments on the proposed regulation's regulatory impact analysis ("Proposed RIA") provides a constructive yardstick on the Department's responsiveness and the integrity of the Regulation.

ACLI offered four core observations in its testimony and comments on the proposal's regulatory impact analysis:

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[123] Provided that the advisor returns any compensation from the fund to the investor, there is no *a-priori* reason to assume that no AUM assets are invested in high-load funds nor has the Department provided justification for making this assumption.
[124] www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule.

1. The Proposed RIA overstated benefits, understated costs, and disregarded harm to small retirement plans;
2. Several of the academic studies cited in the Proposed RIA were misinterpreted, misapplied or used stale data;
3. In calculating the proposal's need, the Proposed RIA fully ignored comprehensive federal and state laws that directly protect retirement savers against the very abuses it sought to rectify; and,
4. The 2015 proposal mentioned annuities 172 times, but the Proposed RIA contained nothing estimating the its impact on retirement savers using annuities, on advisers recommending annuities, or on annuities' role in retirement security.

On these four categories of input, the Department was largely unresponsive or deflected comments with meretricious misdirection and unsubstantiated conclusions, as explained below.

### 1. The Many Defects in the Final RIA's Statement of Benefits and Costs

ACLI noted that the Proposed RIA cited six academic studies and three working papers to quantify the proposed regulation's benefits with data that was sometimes 15 to 20 years old, about one type of mutual fund, at one point in time. ACLI explained that fees and charges have fallen significantly since the time the data in the studies was measured. Moreover, our submission explained that mutual fund data is not germane to advice about annuities. Even the Department admitted that none of these papers tried to detect asset underperformance due to conflicted advice. The studies served as a poor measure of the proposal's supposed benefits. Additionally, the Proposed RIA did not consider the benefits for retirement savers of annuities, which can ensure financial security for life, or the benefits of in-person advice.

The Final RIA continues to reference data and studies with dubious relevance to annuities. The Final RIA is replete with unsubstantiated observations, invalid comparisons, and "back of the envelope" estimates inaptly extrapolated to annuities. By way of examples, the Final RIA:

**i.** References studies of conflicted "contingent commissions," but admits *the studies that closely examined contingent commissions mostly focused on <u>commercial property-casualty insurance.</u>*[125] Nevertheless, the Final RIA draws the conclusion that *the incentive structures that were the focus of the studies parallel practices in the annuity market*.[126] The Final RIA abjectly fails to explain the nexus between annuities market practices and the commercial property-casualty insurance market. This apples and oranges comparison is symptomatic of the Department's frequent absence of analytical rigor and misuse of information to justify the Regulation.

**ii.** Asserts that *the decision to purchase an annuity product can be costly to reverse due to contractual surrender charges*.[127] The Department's Proposed RIA made numerous incorrect statements about surrender charges in annuities. To better inform the rulemaking,

[125] *See* Final RIA at 132 (emphasis added).
[126] *Id.*
[127] *See* Final RIA at 131.

ACLI commissioned NERA, an independent economic analysis firm, 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[128] was published August 8, 2015, 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; and,
    - 78.6% of withdrawals in IRA accounts paid 0% in surrender fees.

ACLI shared these findings and a link to the NERA report in our September 24, 2015 comment letter to the Department regarding the 2015 proposed regulation. ACLI emphasized that this type of data needed to be part of the conversation on the proposed regulation and the Proposed RIA. Regrettably, in the Final RIA, the Department conveniently chose to ignore information contrary to its objective and continued to misrepresent surrender charges to bootstrap its Regulation.

**iii.** Cites an unidentified study about consumer's ability to understand conflicts of interest, and concedes that *the [unnamed] study examined the mortgage brokerage industry, not the financial advice industry*.[129] Nonetheless, the Final RIA concludes that *the findings of the study are relevant to the IRA market because it sheds light on the dangers posed by conflicts of interest.*[130] The unsubstantiated nexus between mortgage industry and IRA advice stretches credulity.

**iv.** Admits that "[t]he Department's quantitative estimate of investor gains from the Regulation and exemptions takes into account only one type of adviser conflict: the conflict that arises from variation in the share of front-end-loads that advisers receive when selling different mutual funds that charge such loads to IRA investors."[131] As ACLI noted in its testimony and comments on the Proposed RIA, mutual fund data applies poorly, if at all, to annuities. Most annuity sales do not contain a front-end sales charges. Further, unlike mutual fund purchases where customers pay commissions, life insurers, not annuity customers, pay commissions.[132] The Department's extrapolation of mutual fund front-end sales loads to annuity purchases in the IRA market is unsustainably inapposite.

**v.** Acknowledges that "the Department has quantified estimated gains associated with only one subset of the market - front-end-load mutual funds - and only with respect to one category of

[128] https://www.acli.com/Posting/NR15-043
[129] *See* Final RIA at 142.
[130] *Id.*
[131] *See* Final RIA at 10.
[132] To the extent surrender charges are viewed to recoup the commissions paid by life insurers, the average surrender charge on any surrender (partial or full) is 0.8% or .008 in decimal notation, as noted above in the NERA report, which DOL conveniently failed to address.

conflicts associated with those funds."[133] With such limited sources of data to support its conclusion, the Final RIA suffers equivalent defects with the Proposed RIA's use of data that was 15 to 20 years old, about one type of mutual fund, at one point in time. The Final RIA's continued importation of inapt data is akin to junk science.[134] The extrapolation of front-loaded mutual fund data to annuities is simply wrong and a poor foundation for rulemaking.

vi. Asserts that concerns about conflicts of interest in annuity sales are underscored by various media reports.[135] The Final RIA also quotes statistics about problems in equity index and variable annuities from a trade group comment letter.[136] Neither four "media reports" nor unsubstantiated and self-interested claims from a trade association comment letter have objective weight worthy of consideration in the Final RIA. They represent hearsay at best and misinformation at worst.

vii. Employs a leap of logic in citing research examining the effects of the <u>mortgage broker compensation disclosure</u> to suggest that "disclosing conflicts of interest can make consumers worse off."[137] This non-sequitur involving mortgage broker compensation is an apples and oranges comparison unworthy of consideration in the Final RIA. Moreover, disclosure of conflicts of interest has been the hallmark of the regulation of investment advisers under the Federal securities laws.

viii. Asserts that "passively managed mutual funds consistently outperform actively managed funds, <u>largely due to their low fees</u>."[138] In truth, differences in performance are related to differences in stock selection between managed and passive mutual funds. Low fees have little to do with performance. Some of the studies the Department cites for this proposition date from 1996[139], long before even the Department acknowledges that there has been a significant reduction in mutual fund fees over the past five years. As with the Proposed RIA, the Final RIA relies upon stale mutual fund data to buttress its objective. This is unacceptable. Likewise, the Final RIA continues to use mutual fund cost data in numerous reports that were 15 or more years old.[140]

ix. Admits that "<u>despite the estimates' limitations</u>," the Department found importation of broker-dealer data from an SEC Request for Information on hypothetical approaches to standards of care useful in quantifying the costs of the Regulation.[141] The construction of cost estimates on the Regulation from borrowed data in another regulator's uniquely different initiative is a weak substitute for rigorous, original cost information. Further, the Final RIA acknowledges the "<u>potential weaknesses</u>" of borrowing survey data that included only 18 participants in

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[133] *See* Final RIA at 167 (emphasis added).
[134] "Junk science" is faulty scientific data and analysis used to further a special agenda; *See* Steven Milloy, *Junk Science Judo: Self Defense Against Health Scams* (Cato Institute, 2001).
[135] *See* Final RIA at 131.
[136] *Id.*
[137] *See* Final RIA at 143.
[138] *See* Final RIA at 145.
[139] *See* Final RIA at 145.
[140] *Id.*
[141] *See* Final RIA at 210.

one case and seven in another, noting that "the Department does not have sufficient information to determine whether these firms are representative of the affected industry as a whole."[142] While the Department's candor is commendable, the use of data with known "potential weaknesses" is inexcusable.

x. Explains that the "Department's high, medium, and low estimates of the percentage reduction related to [selected Regulation] changes in implementing the contract requirements are 70 percent, 60 percent, and 50 percent respectively."[143] The Final RIA contains no explanation how the 70, 60 and 50 percent reductions were derived. Likewise, the Final RIA notes that "cost reductions related to changes in the Regulation and exemptions are 20 percent, 10 percent, and 0 percent respectively."[144] Without more, the estimates of cost reductions appear to be the product of alchemy.

xi. Admits that "while the financial products they sell might vary, BDs and insurers should incur costs that are similar to comply with the Regulation and exemptions as they will have to do many of the same things to comply with the Regulation and exemptions.[145]" The Final RIA's conclusion simplistically equates insurer and BD costs without regard to significantly different operational and regulatory structures. This type of assumption is simply conjecture, and fails basic rulemaking standards.

These are only a few of the many defects in the Regulation's statement of costs and benefits. They serve, however, to highlight the absence of statistical rigor and the introduction of cognitive dissonance.

#### 2. The Regulation Harms Small Employers and Moderate Retirement Savers

ACLI noted that the Proposed RIA fully overlooked harm to small businesses and small to moderate balance retirement savers. Our submission noted that the Proposed RIA extolled a parallel 2013 initiative in the UK and cites a significant reduction in commissioned advice. It fails to mention, however, an even greater drop in advice to retirement savers. In 2014, Morningstar UK reported that eleven million investors have fallen through an 'advice gap' following industry regulation. In direct response to this severe problem, the UK launched a comprehensive review of its regulations and its abandoned retirement savers in late 2015. The Final RIA devotes significant space to the UK's program, called the RDR, and attempts to distinguish the UK's concern with a growing advice gap. Inexplicably, the Final RIA uses studies that predate the significant 2015 reservations expressed by UK authorities. The pre-2015 studies have dubious relevance to the unequivocal reconsideration of the RDR and its enlarged advice gap. Effectively, the Final RIA avoids dealing with the startling harm to small and moderate retirement savers.

ACLI's testimony on the proposal emphasized that the U.S. Small Business Administration, the advocate for small businesses, opposed the initiative for overlooking the impact on small

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[142] *See* Final RIA at 219.
[143] *See* Final RIA at 231.
[144] *Id.*
[145] *See* Final RIA at 237.

businesses, and recommended expansion of the seller's exemption as a remedy. The Final RIA makes passing reference to the SBA's concerns, but failed to address the concern about small businesses directly. Nothing in the Final RIA evaluates the damage to small businesses' retirement plans due to advice gaps like those experienced in the UK in this parallel regulatory initiative. That is flatly deficient. Quizzically, the Final RIA sought to simultaneously bootstrap on the RDR's elimination of commissioned advice, but distanced itself from the RDR advice gap with disingenuous distinctions. In effect, the Department wanted the support of the RDR's "good" features without importing its worrisome enlargement of an advice gap.

### 3. Computer Generated Asset Allocation Platforms (a.k.a. "Robo Adviser") are a Poor Substitute for Human Advice

ACLI's comments on the Proposed RIA questioned the assertion that "robo-advisers" will fill any gaps that result from the initiative. Our submission noted that robo-advisers are a new and untested method of providing financial advice and are not necessarily more cost-effective than in-person advice. We observed that there are no rigorous studies that have examined whether a robo-adviser is a good substitute for a human being, especially in troubled markets such as the 2008 market crash. Moreover, ACLI noted that non-commissioned fee-only advice could likely cost more for many retirement savers because of asset management fees that are charged year, after year, after year. In contrast, ACLI noted that commissions occur only once, if at all, which the Final RIA also failed to consider. The Final RIA declined to consider these worthwhile considerations in its calculus of benefits and costs.

Significantly, on February 23, 2017, the SEC issued Investment Management Update No. 2017-02 concerning robo-advisers.[146] The SEC guidance highlights essential substance and disclosure for robo-advisers, including the particular risks inherent in the use of an algorithm to manage client accounts, including that among other things:

- robo-advisers might halt trading or take other temporary defensive measures in stressed market conditions;
- robo advice might rebalance client accounts without regard to market conditions or on a more frequent basis than clients might expect;
- robo-advisers need questionnaires eliciting sufficient information to allow the robo-adviser to conclude that its initial recommendations and ongoing investment advice are suitable and appropriate for that client based on their financial situation and investment objectives; and,
- changes to algorithmic code after inception of the relationship may materially affect customer portfolios.

The SEC's advisory responsibly recognizes that there are many aspects about robo-advisory relationships and mechanics that are complex and need careful disclosure. In ironic contrast, the Final RIA suggests that robo-advisers minimize the need for complex advice.[147] It is challenging to reconcile that the Regulation steers consumers to robo-advice that the SEC believes needs extensive

[146] *See* www.sec.gov/investment/im-guidance-2017-02.pdf .
[147] *See* Final RIA at 181.

disclosure, while the Department concludes that disclosure is inadequate in governing conflicts and that consumers lack the basic financial literacy to comprehend complex transactions.[148]

### 4. Annuities Remain Absent in Final RIA Calculus

ACLI's testimony and comment on the proposed regulation emphasized that although the initiative mentioned annuities a total of 172 times and acknowledged that "31 percent of IRAs include investments in annuities" and that "insurance companies [will] be significantly affected by the proposal," the cost-benefit analysis made no attempt to examine the impact of the proposed rule on annuities, advisers, insurers, or retirement savers using them. The Final RIA also fails to properly address this gaping omission. It is inexplicable that a Regulation designed to greatly affect annuities lacks any relevant analysis about its impact on annuities for retirement savers and advisers.

### 5. The Final RIA Unacceptably Excludes the Protections of Current Regulatory Standards from its Quantification of Need

In its justification, the Proposed RIA asserted that current regulatory protections are inadequate to address its concerns about advice to retirement plan participants. We disagreed with the wholesale disregard of detailed systems of significant protection from the analysis of regulatory need. The Final RIA also demonstrated a near total and unreasonable dismissal of existing and comprehensive regulation under SEC frameworks, FINRA rules, and state insurance laws and regulations.[149]

The Final RIA was dismissive of conflict disclosure, despite Federal regulators' long-standing reliance on this mechanism to fulfill the Investment Adviser Act's standards in support of a fiduciary duty. The Department discounts FINRA rules and state insurance protections as inadequate because suitability is inferior to a fiduciary duty in the Department's eyes, and because a small number of states have not adopted the NAIC Suitability in Annuity Transaction Model Regulation. As the Regulation Final RIA recognizes, Congress dealt with nonuniform adoption of NAIC model regulations when it enacted the Harkin amendment to the Dodd-Frank Act. With a self-executing highest common denominator approach, Congress crafted a workable solution to the small number of states that had not yet implemented the NAIC suitability standards. The Department could easily adopt a parallel and sensible approach without jettisoning the entire network of significant state insurance laws and regulations.

While the Regulation steers advisory relationships toward fee based arrangements, regulators have observed that fee based advice is not always in the best interest of consumers. FINRA has observed that that

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[148] *See* Final RIA at 109, 145, 187.

[149] ACLI's July 21, 2015 submission included a 269 page appendix detailing the comprehensive scope of state and federal regulation of annuities, and 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.

> certain potential problems have been identified through our examination program. For example, it not always clear that customers receive adequate disclosure about the distinctions and features of fee-based versus commission-based accounts, including the differences in fee structures and that fees will probably be higher in a fee-based account if the level of activity is modest. Training and education at some firms are minimal, particularly in giving brokers guidance on how to evaluate whether a fee-based account is appropriate for a customer.[150]

The Final RIA inappropriately and too easily dismisses the comprehensive network of SEC, FINRA and state insurance regulations in its rush to regulatory judgment. The Proposed RIA conveniently overlooked important elements of the regulatory landscape. Annuities were already subject to comprehensive regulation that effectively protects consumers without unreasonably impeding the annuity market. As insurance products, all annuities must satisfy state insurance laws administered by state insurance regulators. In addition, the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA") regulate the sale of variable annuities. This regulatory oversight—strengthened in recent years—ensures that consumers receive truthful, valuable information about investment options and suitable retirement recommendations.

Anyone who sells variable annuities must register as a broker-dealer with FINRA and comply with both general suitability rules governing the sale of all securities (FINRA Rule 2111) and specific, and more stringent, suitability requirements imposed on the sale of variable annuities (FINRA Rule 2330). The Federal securities laws require that variable annuities be registered with the SEC[151], and that customers receive a prospectus filed with the SEC describing the annuity's features[152]. All variable annuity advertising must comply with FINRA Rule 2210-2.

Comprehensive state regulations also govern annuities. The National Association of Insurance Commissioners ("NAIC") Suitability in Annuity Transactions Model Regulation has been adopted in some form by 48 States and the District of Columbia. The NAIC strengthened this regulation in 2010 to prohibit an insurance agent from recommending an annuity until the agent determines that it is suitable for the consumer in light of, among other things, the consumer's age, annual income, financial objectives, liquidity needs, liquid net worth, risk tolerance, and tax status.[153]

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[150] *See Fee-Based Questions and Answers*, www.finra.org/industry/fee-based-account-questions-answers . Elisse B. Walter, who served as acting SEC chair, SEC Commissioner, and FINRA Senior Executive Vice President, 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 would probably be better off with a commission-based program that charges only when trades are made. *See* Elisse Walter, *Current NASD Regulatory Issues on Sales and Marketing* (Sept. 28, 2004) www.finra.org/newsroom/speeches/092804-remarks-27th-annual-sia-sales-and-marketing-conference.

[151] 15 U.S.C. §§ 77f-h.

[152] *Id.* at § 77j.

[153] NAIC Suitability in Annuity Transactions Model Regulation §§ 5(I), 6(A).

The proposed regulation's administrative record established that the buying and selling of annuities is subject to comprehensive, and recently enhanced, state and federal regulations. Those regulations are targeted at the same concerns that underlie the Regulation. Despite that, the Department did not undertake careful analysis of the mandates of existing regulations, explain how or why those regulations left gaps, or attempt to reason how the regulation could fill those gaps. Instead, the Department sought to dismiss the adequacy of existing regulations out of hand. Its rationales for doing so fall flat.

In brushing aside existing regulatory controls, DOL put substantial weight on nine quantitative studies that, in its view, demonstrated that, "notwithstanding existing [regulatory] protections, there is convincing evidence that advice conflicts are inflicting losses on IRA investors." The Department's reliance on those studies was badly misplaced. Significantly, the studies relied on by the Department focused almost exclusively on mutual funds, not insurance products such as variable and fixed indexed annuities. That difference is material given, among other things, that insurance products (unlike mutual funds) are subject to unique state-law suitability standards that protect annuity purchasers.

DOL determined it could extrapolate from mutual-fund studies to "[o]ther types of investments … such as insurance products" because, DOL speculated, those products are also "likely to be subject to underperformance due to conflicts." But DOL offered no reasoned explanation for that claim. Likewise, all of the nine studies relied on data derived from periods well before stricter regulations applicable to annuities went into effect. Seven relied on data from 2005 or earlier; two relied on data ending in 2007 and 2009, respectively. For example, FINRA's general suitability rule, FINRA Rule 2111, took effect in 2012 and significantly strengthened the suitability framework. Since 2012, a broker-dealer must have grounds to believe his or her recommendation is suitable in general and suitable for the particular customer.

Equally important, FINRA Rule 2330 was not fully implemented until 2010. That rule "provide[s] more comprehensive and targeted protection to investors regarding deferred variable annuities."[154] Specifically, annuity sellers must obtain specific customer information, including investment objectives, liquid net worth, financial sophistication, and tax status, before deciding that a customer would benefit from an annuity.

As explained above, the NAIC strengthened its annuity suitability rule in 2010 in a manner parallel to the FINRA suitability rules. The outdated studies relied upon by the Department could not possibly have measured the efficacy of those newly-strengthened regulations. DOL's reliance on stale and irrelevant mutual fund studies to show a regulatory failure predating significant FINRA and NAIC regulatory reforms constitutes unacceptably weak, and disingenuous, rulemaking practice. Without relevant data bearing on the effectiveness of existing annuity regulations, DOL bootstrapped its position with limited, threadbare evidence of harm—from which DOL meretriciously asserted regulatory failures concerning annuities. In the preamble to the rule, the Department cited as evidence of "harm" from variable and fixed indexed annuities a FINRA investor alert and SEC and FINRA staff guidance. But the FINRA alert simply highlights circumstances in which some consumers

[154] FINRA Regulatory Notice 07-53 (2007).

might not want a variable annuity, and it makes clear that "variable annuities can be appropriate as an investment under the right circumstances."[155] If anything, the alert demonstrates that regulators are acutely focused on protecting consumers and continue to monitor the annuity marketplace.

Similarly, the staff guidance cited suggests that fixed indexed annuities may take time for consumers to understand, but that does not suggest widespread harm or the insufficiency of existing regulation. In short, DOL's failure reasonably to analyze the efficiency of the existing regulatory environment negates its judgment that the proposed rule was necessary to protect consumers.

The stale studies DOL cited prove nothing with respect to present-day regulation of annuities because they focused almost exclusively on one type of mutual fund—not annuities—and they relied on data predating significant reforms to the regulatory framework governing retirement products in general and annuities in particular that addressed precisely the concerns DOL sought to remedy through the proposed rule. In a remarkable absence of logic, the Department asserted it was appropriate to extend obsolete mutual-fund studies to the annuity marketplace because "conflicts exist in both the mutual fund and annuity markets."

In the Proposed RIA, DOL failed to acknowledge that annuities are governed by a distinct, customized, and comprehensive regulatory framework that was enhanced in 2010 to account for annuities' unique features. The dated mutual fund studies relied upon by the Department, which focus primarily on investment performance in the historical period 1991 to 2005, do not measure the efficacy of targeted and more rigorous annuity-specific rules. Indeed, these rules already prohibit practices DOL highlighted as justification for the proposal. DOL's qualitative "evidence" of harm to annuity purchasers does not make up for the failure of its quantitative analysis.

#### 6. The Final RIA Fails to Comply with Executive Branch Rulemaking Standards

The Final RIA is underwhelming and inadequate, and it continues to fail to supply any basis for the Regulation the Department promulgated. While it consumed 382 pages and contained many colorful indexes, charts, and graphs, it nevertheless failed the essential standards for Federal agency rulemaking.

A series of operative executive orders govern Executive Branch rulemaking. Executive branch mandates for cost-benefit analysis began in 1981 with Executive Order 12,291 that created a new procedure for the Office of Management and Budget (OMB) to review proposed agency regulations, and ensure the president would have greater control over agencies so as to improve the quality and consistency of agency rulemaking.[156] Cost-benefit analysis formed the core of the review process. The order unambiguously stated that "regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society."[157] Regulatory agencies, therefore, must balance the benefits of proposed rules against their costs.

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[155] FINRA, Variable Annuities: Beyond the Hard Sell (Aug. 31, 2009).
[156] *See* 46 Fed. Reg. 13193, 13193 (Feb. 17, 1981).
[157] *Id.*

Executive Order 12866[158] superseded the 1981 order, but retained cost-benefit analysis as a fundamental requirement in rulemaking. Executive Order 12866 instructs that "in deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating."[159] In a manner parallel to the 1981 order, Executive Order 12866 advises that agencies must perform their analysis and choose the regulatory approach that maximizes net benefits. The 1981 and the 1993 executive orders emphasize different approaches to the same cost –benefit end. The 1981 order required that the benefits "outweigh" the costs, while the 1993 order required only that the benefits "justify" the costs.[160]

Executive Order 13563 reinforced the core principles in Executive Order 12866 by emphasizing that "each agency must . . . propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs."[161] Importantly, five administrations between 1981 and the present day have consistently made cost-benefit analysis a threshold for federal agency rulemaking. The order further notes that "each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible."[162]

OMB guideposts provide federal agencies with extensive guidance to perform cost-benefit analysis in its Circular A-4.21 C, which identifies three fundamental elements to federal agency rulemaking: (i) a statement of the need for the proposed regulation; (ii) discussion of alternative regulatory approaches; and, (iii) an analysis of both qualitative and quantitative costs and benefits of the proposed action and the leading alternatives. The analysis should attempt to express both benefits and costs in a common measure—monetary units—to facilitate the assessment. When benefits or costs cannot be quantified in monetary terms or in some other quantitative measure, the agency should describe them qualitatively.[163] The Final RIA disregarded both judicial precedent[164] for conducting cost-benefit analysis and objective, critical data and analysis with scant explanation.

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[158] 58 Fed. Reg. 51735 (Sep.30, 1993).
[159] *Id.*
[160] *See generally* Peter M. Shane, *Political Accountability in a System of Checks and Balances: The Case of Presidential Review of Rulemaking*, 48 ARK. L. REV. 161, 176-78 (1994) (comparison of 1981 and 1993 executive orders with additional detail and observing that the 1993 "order focuses on a similar mandate, but describes it with greater nuance").
[161] 76 Fed. Reg. 3821 (Jan. 21, 2011).
[162] I*d.* Additional analysis of this order can be found in Helen G. Boutrous, *Regulatory Review in the Obama Administration: Cost-Benefit Analysis for Everyone*, 62 ADMIN. L. REV. 243, 260 (2010).
[163] The. See Office of Mgmt. & Budget, Circular No. A-4, Regulatory Analysis (Sept. 17, 2003), last available at http:// www.whitehouse.gov/OMB/circulars/a004/a-4.pdf. OMB invited full public comment on this 48-page circular in draft form, which contains detailed instructions about conducing cost-benefit analysis, and provides a standard template for running the analysis.
[164] *See Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005), *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010), and *Bus. Roundtable & U.S. Chamber of Commerce v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). In the Business Roundtable and US Chamber of Commerce case, the D.C. Circuit overturned proxy access Rule 14a-11 adopted by the SEC in August 2010. The court determined that the SEC's failure to "apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation" made promulgation of the rule arbitrary and capricious and not in accordance with law. The American Equity case involved the SEC's adoption of Rule 151A under the Securities Act of 1933 which provided guidance as to whether fixed index annuities were entitled to rely on the exclusion provided under Section 3(a)(8) of that act. The court indicated that the SEC did not disclose a reasoned basis for its conclusion that Rule 151A would increase competition and the SEC did not make any finding as to existing level of

In summary, the Final RIA illegitimately connected inapt data and observations to draw unsubstantiated conclusions about commission-based sales and annuities. It breaks down under the overwhelming weight of inadequate data, the Department admissions of dubious extrapolations of information to annuities, and the Department's failure to directly address core comments and testimony by ACLI and others on the Proposed RIA. The Department needs to return to the drawing board and conduct an honest, objectively quantified assessment of the Regulation's benefits and burdens. The Final RIA is deficient because the Regulation is built on two false premises: all commission-based sales are conflicted, and all fee-only advice is always unconflicted and serves retirement savers' best interest. Neither premise is correct, and neither is supported by the Final RIA.

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ACLI supports the application of ERISA's sole interest standard to those engaged as fiduciaries as well as reasonable and appropriately tailored rules that require all sales professionals to act in their customer's best interest regardless of whether they serve as fiduciaries under ERISA. However, based on both the observed and anticipated effects of this Regulation on consumers as described in this letter, the Regulation must be revoked and replaced.

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 its examination and next steps regarding a definition of fiduciary.

Respectfully,

James H. Szostek    Howard M. Bard

competition in the marketplace under state insurance law regimes or the efficiency of existing state insurance law regimes.