STATEMENT OF THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES, AND INVESTMENT

ON THE IMPACT OF THE DOL FIDUCIARY RULE ON THE CAPITAL MARKETS

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Chairman Huizenga, Ranking Member Maloney, and members of the Committee, I am pleased to present this statement expressing the views of the American Council of Life Insurers on the impact of the DOL Fiduciary rule on the capital markets. Thank you for the opportunity to testify before you today.

My name is Mark Halloran and I am the Senior Director, Head of Industry and Regulatory Strategy at Transamerica. Transamerica is one of the nation's leading providers of financial services and insured products, including annuities, to America's families and individuals working to build a solid financial foundation. For the past several years I have worked with the ACLI and many of its member companies on the difficult challenges confronting both retail investors and the financial professionals who serve them under the U.S. Department of Labor's Fiduciary Regulation.

The American Council of Life Insurers is a Washington, D.C.-based trade association with approximately 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 95 percent of industry assets in the United States.

ACLI supports reasonable and appropriately tailored rules that require all sales professionals to act in the best interest of their customers. Prudential regulators such as the

SEC and state insurance regulators, not state courts and the plaintiffs' bar, are best positioned to apply and enforce a best interest standard of care. To meet their financial and retirement security needs, America's savers and retirees deserve rules that ensure continued access to a wide variety of retirement product offerings, retirement savings information and related financial guidance from financial professionals acting in their best interest.

ACLI supports the Discussion Draft being reviewed by the Subcommittee at today's hearing. ACLI thanks Chairman Huizenga, Representative Ann Wagner, and other members of the Committee for their strong leadership on this issue. The Discussion Draft would establish a "best interest" standard of conduct to govern the relationship between broker-dealers and their individual representatives with retail investors.

Perhaps most importantly, the best interest standard of conduct under the Discussion Draft would apply to the totality of the relationship between consumers and financial professionals; not just the one dimension of the relationship that involves ERISA plan or IRA assets. The bill also installs important statutory safeguards to permit transaction-based financial professionals, including broker-dealer registered representatives and insurance agents, to continue to offer products and services to retail investors under traditional compensation models. These safeguards would effectively preserve retail investor access to information, freedom of choice over how to pay for financial advice and a robust, competitive marketplace for insured retirement solutions. The Discussion Draft at long last harmonizes the multi-faceted bodies of law and regulation applicable to the sale of insurance and annuity products at the retail level.

My testimony today focuses on three key areas. First, I will briefly review the clear and present danger that the Department of Labor's Fiduciary Regulation poses to the financial well-being and retirement security of average working Americans. Second, I will address how the Discussion Draft addresses and resolves that threat by preserving retail investor freedoms of access and choice under a coherent "best interest" standard of conduct. Third, I will offer some final thoughts on why we at ACLI believe the Discussion Draft approach brings much needed regulatory harmony, stability, and certainty to the marketplace for retail investment advice.

## The Department of Labor's Fiduciary Regulation Harms Middle Income Savers and Limits Consumer Choices

However well-intentioned it may be, the DOL's Fiduciary Regulation poses a very real threat to the financial well-being and retirement security of working Americans. It is difficult to overstate the magnitude of that threat. The continued availability of what today is taken for granted – a vibrant and competitive marketplace for insured retirement solutions, readily available access to cost effective financial advice and true consumer choice about how to pay for that advice – is seriously jeopardized under the DOL's approach.

The core problem with the DOL Regulation is that it re-characterizes virtually **all** financial services and product sales activity directed to employer-sponsored retirement plans, including participants, or to individual retirement accounts ("IRA's"), as "fiduciary" conduct

within the meaning of ERISA and the Internal Revenue Code. That sweeping approach is enormously problematic for distributors of insurance and annuity products. ERISA's fiduciary standard, which strictly prohibits financial conflicts of interest and the receipt of payments (including sales commissions) from third parties in connection with a recommended transaction, renders the compensation structures that are best tailored for insurance and annuity sales distribution organizations illegal unless and except to the extent that a prohibited transaction exemption is available to cover the transaction.

The Department of Labor has devised a prohibited transaction exemption known as the "Best Interest Contract" or "BIC" Exemption that, in theory, would exempt the receipt of sales commissions and other incentives by fiduciary advisers. As a practical matter it effectively forbids the use of sales commissions as a manner of payment. The conditions of the BIC Exemption are so exceedingly complex and technical as to present serious questions as to whether they can realistically be met. Moreover, the BIC Exemption contains an inherent, deeply-rooted bias that strongly favors the provision of investment advice on a fee for service basis and strongly disfavors the provision of products and services by those who are compensated on a commission, or transaction-based basis. It has retained this bias even though commentators have warned DOL that for all but the wealthiest segment of the retail investor community, fee-based advice is frequently uneconomical and unaffordable.

To make matters worse, the BIC Exemption has been intentionally designed to expose distributors of financial services and products to a significant risk of widespread private plaintiffs' class action claims.

The fee-based advice model that the DOL Regulation favors may meet the needs of active traders and the very wealthy, but not the needs of "buy and hold" investors or purchasers of annuity products, which are designed for long term retirement goals. Fee-based arrangements often carry hefty account minimums (typically between $100,000 and $250,000), and rarely include annuities, as these products do not typically necessitate continual advice and investment management. Retail investors with small or mid-sized accounts need continued access to experienced, knowledgeable transaction-based financial professionals who can inform them about the guaranteed lifetime income features available through annuity products and assist in fitting those products to individual investor needs.

Under the DOL Regulation, an advice gap has developed for small and medium retirement account holders who do not meet higher account minimums for fee-based arrangements. Small and medium retirement account holders are consequently left without any advice. For these savers, the DOL inappropriately relies on computer generated asset allocation platforms, commonly referred to as "Robo-Advisers". Yet, the DOL concedes that these automated asset allocation services likely do *not* offer the same benefits as financial professionals -- 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. The DOL has failed to explain how computer-generated asset allocation platforms, given these crucial limitations, can serve as an adequate substitute for a financial professional.

Less advice from financial professionals can contribute to reduced savings on the part of working Americans and diminished retirement security for retirees in need of guaranteed lifetime income through annuities.

## The Discussion Draft Protects the Interests of Retail Investors

The Discussion Draft takes a common sense approach to addressing and resolving the threats posed by the DOL Regulation and by doing so preserves access to investment advice for average investors and their families. It amends certain provisions of the Securities Exchange Act of 1934 (the "34 Act"), the Dodd Frank Act, ERISA, and the Code to weave together a coordinated and complete "best interest" standard for transaction-based financial professionals that protects all dimensions of the retail investor client relationship, including but not limited to the portion of the relationship that concerns ERISA and IRA assets. By doing so, it renders moot the exceedingly complex, highly technical conditions of the BIC Exemption that today threaten to stifle retail investor freedoms of choice and access.

At the centerpiece of the bill is an amendment to the '34 Act that enshrines a "best interest" standard governing the delivery of investment recommendations by broker-dealers and their individual representatives to retail customers. Best interest recommendations would need to reflect reasonable diligence, care, skill, and prudence in light of the client's investment profile.

The Discussion Draft contains disclosure rules to complement the new standard. At the outset of the customer relationship, broker-dealers would need to clearly and concisely disclose the type and scope of the services to be provided, the standard that may apply to the relationship, the types of compensation that the broker-dealer and its representatives may receive, and any material conflicts of interest. Importantly, the bill safeguards the legal validity of traditional, transaction-based compensation structures by providing that the receipt of sales commissions, recommendations of principal transactions, recommendations of affiliated, unaffiliated or proprietary products or services, or limitations on the range of products and services offered would not, in and of themselves, constitute violations of the '34 Act's best interest standard of care.

Since the Discussion Draft amends the federal securities laws, the new "best interest" standard would govern the totality of a broker-dealer's securities relationship with a retail investor; not just the portion of the relationship that pertains to ERISA plan and IRA recommendations. In regards to ERISA plan and IRA recommendations, the Discussion Draft would stay the hand of DOL by forbidding the promulgation of any regulations defining the circumstances under which a person is deemed to be a "fiduciary" if those regulations would impose any obligations on a broker-dealer or its representatives or on a life insurance company or its agents that is either inconsistent with or in addition to the obligations set forth under the '34 Act. In addition, the ERISA statute and its parallel Internal Revenue Code provisions would be amended to add a new statutory prohibited transaction exemption to cover any recommendations made by a broker-dealer or its registered representatives that are consistent with the '34 Act standard. Similarly, the exemptions would be available to registered investment advisers, banks, and other financial institutions who comply with

standards substantially similar to the ’34 Act standard. This assures a level playing field for all financial professionals and financial institutions.

Life insurance companies and their agents frequently distribute annuity and other insurance products through registered broker-dealer organizations. To that extent, the ERISA protections afforded by the Discussion Draft would be directly available. To cover those instances where annuity and insurance products are distributed other than through a broker-dealer, the same prohibited transaction exemption would be applicable where the manufacturer or distributor of insurance products adopts and implements practices on a nationwide basis that meet or exceed the ’34 Act’s standard and substantially complies with that standard.

The Discussion Draft’s straightforward approach protects the interests of retail investors. Sales recommendations of securities and annuity products will reflect the investors’ best interests, in light of their customer profiles. At the same time, the preservation of transaction-based compensation structures will ensure that consumers have continued access to information and advice and freedom of choice about how to pay for advice.

## The Discussion Draft Facilitates Coordination By Prudential Regulators and Harmonization of the Regulation of Advice to Retail Investors

The regulatory environment governing the delivery of investment advice to retail investors, which has already been de-stabilized by the DOL Regulation, threatens to become even more fractured unless Congress takes action. The bill sensibly places responsibility for issuing regulations in the hands of the primary regulators, the SEC and state insurance regulators. The bill would also place a statutory obligation on the SEC to coordinate and cooperate with state insurance regulators.

## Conclusion

The Discussion Draft’s establishment of a unified standard of care to govern the delivery of financial advice to the retail investor community, its identification of the SEC as the lead regulator for purposes of implementing that standard for securities, and emphasis on coordination and cooperation with state insurance regulators reflects good policy, will stabilize the marketplace for the delivery of retail financial products and services to consumers and will benefit consumer interests by restoring freedom of access and choice.

Thank you for the opportunity to testify today and for your consideration of the views of ACLI.