DAVIS & HARMAN LLP

ATTORNEYS AT LAW

THE WILLARD
1455 PENNSYLVANIA AVENUE, NW, SUITE 1200
WASHINGTON, DC 20004

TEL 202-347-2230
FAX 202-393-3310 WWW.DAVIS-HARMAN.COM

Jolie H. Matthews
National Association of Insurance Commissioners
444 North Capitol Street, N.W.
Suite 700
Washington, DC 20001

Re: 11/19/18 Draft Amendments to Suitability in Annuity Transactions Model Regulation

Dear Ms. Matthews:

We are writing today on behalf of a group of firm clients, including brokerage firms, mutual funds, insurance companies, asset managers, and banks. We would like to thank you for the opportunity to submit comments regarding the 11/19/18 draft amendments to the Suitability in Annuity Transactions Model Regulation ("Model #275") issued by the National Association of Insurance Commissioners ("NAIC").

We also want to express our deep appreciation for the thoughtful and thorough process undertaken by the NAIC and for its excellent work. We truly believe that this open and inclusive process will lead to a result that best serves and protects consumers.

We have five main points, which are summarized here and discussed in more detail below.

- **<u>We support a national best interest standard, based on rules promulgated by the Securities and Exchange Commission ("SEC") and the model regulation to be issued by the NAIC.</u>**
    - **<u>SEC standard.</u>** We strongly support the application of an SEC-promulgated national best interest standard to investment recommendations provided to retail investors by broker-dealers. As discussed below, the constraints of federal preemption would prevent any state from imposing this standard on all investment professionals in all scenarios dealing with retail investors.
    - **<u>NAIC.</u>** ***We strongly support the SEC and the NAIC working together to apply the same best interest standard***.

- **<u>Consumers and investors are best protected by a national, uniform standard.</u>** A single federal best interest standard for broker-dealers promulgated by the SEC and for annuity transactions pursuant to an NAIC model regulation would protect investors across the country in an efficient and effective manner. A patchwork of inconsistent and/or conflicting state rules would add cost and confusion to what is a national issue. Such cost and confusion would in turn be borne by investors.

- **Critical exceptions need to be retained.** The draft 11/19/18 amendment would completely repeal the exceptions in section 4.B. of Model #275. Currently, under those exceptions, the regulation would generally not apply to transactions involving (1) plans governed by the Employee Retirement Income Security Act of 1974 ("ERISA"), (2) tax-qualified employer-sponsored plans, (3) government and church plans, and (4) employer-sponsored nonqualified plans. For reasons discussed further in the body of this letter, we ask that these exceptions be retained in full.

- **The draft 11/19/18 amendments raise preemption concerns.** If, contrary to our recommendation above, the NAIC rule applies to ERISA plans, the rule will, to that extent, be preempted by ERISA. The disruption and cost associated with rules that are only in place until invalidated in court would be borne by everyone, but mostly by consumers. ***Real-life evidence of this preemption issue is widespread. For example, recent regulations by New York exempt retirement plan generally, including all ERISA plans in recognition of the clear ERISA preemption rules.***

- **Great harm can be done by a standard that attempts to regulate the types of compensation that broker-dealers may receive.** The structure of amounts charged by broker-dealers is based on maximizing the ability of such professionals to serve the broadest array of customers. The now-invalidated fiduciary rule issued by the Department of Labor ("DOL") attempted to modify that structure, strongly favoring fee-based advice over transaction-based compensation such as commissions. Even in the short time that the rule was in effect, this aspect of the DOL rule caused massive harm to low and middle-income individuals, as documented in the Appendices at the end of this letter. We see no evidence that the NAIC is moving in this counterproductive direction, but because of the importance of this issue, we wanted to note it here.

DISCUSSION

1. Support for a national best interest standard promulgated by the SEC.

We strongly support the application of a national SEC-promulgated best interest standard to investment recommendations provided to retail investors by broker-dealers. ***We discuss this here because we believe that it is critical that the SEC and the NAIC work together to apply the same standard .***

Under a national best interest standard, a broker-dealer could be required to satisfy the conditions described below. All of our points below are reflected in either current law, the SEC proposals issued earlier this year, or in our comments on the SEC proposals. Thus, we remain very hopeful for an effective, national best interest standard. In describing these conditions, however, we must note that the constraints of federal preemption would prevent any state from imposing all of these conditions upon all investment professionals in all scenarios dealing with retail investors.

Additionally, a best interest standard should not prohibit financial professionals and investors from agreeing on a dispute resolution system. ***Specifically, financial professionals should not be prevented from contractually agreeing with their clients to settle any disputes through arbitration or through one-on-one litigation.*** This is critical to ensuring that unnecessary litigation costs are not passed on to clients.

- **Duty of loyalty: duty to put the customer's interest above the broker-dealer's interest.** The broker-dealer should be required to put the investor's interest above his or her own interest. Whether this has occurred should not be determined with hindsight, such as being based on whether a recommended investment has performed well. Rather, the determination should be based on the process used by the broker-dealer in arriving at the recommendation. The key question should be whether the process used by the broker-dealer demonstrated a commitment to putting the interest of the investor ahead of the broker-dealer's interest.

- **Duty of care.** A broker-dealer's recommendation should be required to reflect reasonable care, skill, prudence, and diligence, based on the information available about the investor. As with the duty of loyalty, the determination as to whether this requirement has been met should be based on the process the broker-dealer used to make the recommendation, and not on the way that the recommended investment subsequently performed.

    - The scope of this duty should be defined pursuant to the disclosure requirement below. In other words, the broker-dealer should be permitted to define, for example, whether the best interest obligation is ongoing or transactional.

- **Disclosure.** The broker-dealer should be required to disclose:

    - The services that are provided.
    - The best interest duty that is owed to the investor.
    - The scope of that duty, as discussed above. This includes, for example, whether the duty is (1) ongoing and comprehensive, or (2) limited to a particular transaction, period of time, or portion of the investor's portfolio.
    - The types of compensation payable to the broker-dealer firm or any affiliate, including any applicable formula under which the compensation is payable, with respect to a best interest recommendation and related transactions. Because it can be very difficult to translate formulas into dollar amounts, there should be no requirement to disclose any actual dollar amounts that are not charged as dollar amounts.
    - Any material conflicts of interest.

- **Nature of compensation.** There should no restrictions on the type of compensation that a broker-dealer may receive in connection with a recommendation, as long as the compensation is permitted under applicable law and the broker-dealer is required to act in the best interest of clients by satisfying the applicable standards of care.[1] This is an area where DOL's fiduciary rule was seriously flawed. As discussed below, by severely discouraging transaction-based compensation arrangements, the DOL fiduciary rule caused many financial institutions to eliminate or severely limit the use of the brokerage model as a channel for assisting investors. This led in turn to (1) many smaller accounts losing access to any personalized assistance, and (2) many other account owners having to choose between (a) no personalized assistance or (b) more expensive fee-based advisory relationships geared to managed accounts, not individual purchases.

If any new rules are similarly structured to discourage transaction-based pay, or if the rules make it more risky to provide such pay, the same adverse results would certainly follow.

For this purpose, transaction-based pay means any payments based on transactions, including commissions, third-party payments, bonuses, and incentive arrangements.

- **Proprietary products.** Just as there should be no ban on transaction-based pay, there should be no prohibition on providing best interest recommendations with respect to proprietary products. These products would be subject to the same best interest rules, such as disclosure and oversight, as would apply to non-proprietary products. Broker-dealer should be permitted to provide assistance regarding both proprietary and non-proprietary products. It should also be permissible to provide assistance solely or primarily with respect to proprietary.

- **Oversight of assistance provided.** A broker-dealer should be required to maintain policies and procedures that are reasonably designed to achieve compliance with this best interest standard.

- **Reasonable compensation.** It is appropriate to prohibit a broker-dealer from receiving more than reasonable compensation for services rendered. However, as other regulators (including the DOL, with respect to its now vacated best interest rules) have noted, determinations of reasonable compensation are inherently dependent on the marketplace – at what price are market participants willing to offer a product or service? For this purpose, if a broker-dealer routinely receives similar amounts with respect to similarly situated customers, and such compensation is disclosed as required, the compensation should be deemed to be reasonable in the absence of clear evidence to the contrary.

- **Prohibition on misleading statements.** Broker-dealers should be prohibited from making misleading statements.

2. Uniformity.

[1] We recognize that there may be very narrow cases where a form of compensation is inconsistent with acting in the best interest of clients, such as sales contests based on sales of particular high-priced products.

Investors are best served by having one simple, workable set of national rules separately promulgated by the SEC and the NAIC. Inconsistent rules produce a variety of harms:

- **Additional costs that deplete investor savings.** For broker-dealers operating in many or all states, the cost of designing, maintaining, training, and oversight with respect to different rules in different states is very material. And those costs will certainly be passed on to customers. This issue has not received the attention it deserves. There has been enormous scrutiny of fees, and the effect that fees have on savings. Oddly, at the same time, there has been far too little scrutiny of rules that give rise to higher fees. Inconsistent rulemaking is certainly a huge creator of higher fees, as evidenced by the billions of dollars spent nationwide on the now-invalidated DOL rule.
- **Great risk of errors and confusion.** We all know that our world is increasingly mobile. Broker-dealer representatives move between states, as do their customers. With multiple different rules in different jurisdictions, inadvertent errors by broker-dealers will likely increase, causing confusion and possibly undermining investor confidence. And mobile investors receiving different types of advice in different jurisdictions cannot help but be confused.
- **Gaps in advice due to inconsistencies.** If the SEC finalizes its best interest rule, then all firms will develop systems to comply with that rule. What happens if a state then develops different rules that are inconsistent with, and could possibly conflict with, the SEC rule? National firms will have no choice but to delay the provision of assistance in that state until systems are developed to deal with the differences, with the possibility that those differences cannot be dealt with and resolved easily, resulting in longer gaps in advice.

In short, it is very important for there to be as much uniformity as possible in the protection of investors. Accordingly, we support a national standard separately promulgated by the SEC and the NAIC.

3. Section 4.B. of the draft 11/19/18 amendments.

Prior to the draft 1/19/18 amendments, section 4.B. provided that, "[u]nless otherwise specifically included, this regulation shall not apply to transactions involving:"

> B. Contracts used to fund:
>
> > (1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);
> > (2) A plan described by sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer;
> > (3) A government or church plan defined in section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax-exempt organization under section 457 of the IRC;
> > (4) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor[.]

The draft amendment would make section 4.B.'s exemption inapplicable to annuities that are individually solicited. But by reason of the definition of "Annuity" in section 5.A., the entire Model #275 only applies to annuities that are individually solicited. ***As a result, the effect of the draft amendment to section 4.B. is to repeal all of the exceptions listed in 4.B.*** We assume that this was a technical oversight, because if that had been the intent, the draft would simply have eliminated section 4.B.

We would urge you to leave section 4.B. as it has been. Here are the reasons we believe no changes are necessary or advisable:

- **ERISA plans in 4.B.(1).** As discussed in the next section of this letter, states do not have the authority to regulate ERISA plans, and any such regulation would be preempted. Thus, the exception in section 4.B.(1) must be preserved.
- **Tax-qualified employer-sponsored plans in 4.B.(2).** Many of the plans listed in 4.B.(2) are ERISA plans. With respect to the employer-sponsored plans that are not ERISA plans, there is no reason to apply this model regulation. For most employer-sponsored plans, both ERISA and non-ERISA, the plan sponsor must first authorize the offering of the product to participants, as appropriate for the plan, often through a competitive search process that closely evaluates fees and product features. Many of these plan sponsors utilize the services of consultants to complete this search process. A representative assisting participants' plan enrollment and ongoing plan participation, a process which generally includes electing to participate in an investment product, should not be swept into this regulation. In addition, the Internal Revenue Code generally applies strict rules regarding fees and conflicts of interest to non-ERISA plans not covered by the next bullet, making additional regulation unnecessary and overlapping.
- **Government or church plans in 4.B.(3).** Government and church plans have traditionally been exempt from regulatory oversight (e.g., they are exempt from ERISA) because lawmakers believed that these types of employers could be entrusted to act in the best interest of their employees, making the costly burden of regulatory compliance unnecessary.
- **Employer-sponsored nonqualified plans in 4.B.(4).** These annuities are purchased by employers on an institutional basis, and the need for additional regulation is therefore minimal.

4. Preemption issues.

As noted above, the draft 11/19/18 amendments would apply the regulatory requirements of Model #275 to ERISA plans. As stated, such regulation of annuity transactions would be completely preempted with respect to ERISA plans. Accordingly, if the draft amendments are not modified, then any state regulations adopted based on the amended model would be invalidated in court. The result would be enormous cost, disruption, and confusion attributable to rules that would quickly become the subject of lengthy legal challenges and ultimately would be invalidated.

- **<u>ERISA broadly preempts state laws relating to employee benefit plans.</u>** ERISA is a comprehensive federal statute regulating employer-sponsored retirement and welfare benefit plans. When Congress passed ERISA, it included an explicit and far-reaching preemption provision. According to that provision, and except as otherwise provided by law, Title I and Title IV of ERISA "*shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan*" (emphasis added).[2] Importantly for purposes of this discussion, Title I of ERISA establishes a federal standard of care regarding investment advice. Accordingly, ERISA preempts any state law that purports to regulate such advice in the context of an ERISA plan. ***As one court put it, ERISA's preemption provision is "the most sweeping federal preemption statute ever enacted by Congress."***[3]

- **<u>ERISA is the exclusive enforcement mechanism for ERISA plan issues.</u>** When drafting ERISA, Congress was clear that it wanted ERISA's preemption clause to apply broadly. In fact, ERISA's legislative history is full of commentary explaining how the law is intended to be the exclusive authority governing the entire field of employee benefit plans. For example, the text of ERISA itself states that ERISA is intended "to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by . . . providing for appropriate remedies, sanctions, and ready access to the Federal courts."[4] As the Supreme Court has said, "any state-law cause of action that duplicates, supplements, or supplants the ERISA civil enforcement remedy conflicts with the clear congressional intent to make the ERISA remedy exclusive and is therefore pre-empted."[5]

- **<u>Supreme Court: the savings clause does not protect investment advice regulation from preemption.</u>** ERISA's preemption provisions also contain what is known as the "savings clause," which is a carve-out from preemption for state laws regulating *insurance, banking, or securities*. States attempting to develop their own investment advice rules may try to argue that their efforts are not expressly preempted by ERISA because they are regulating "insurance, banking, or securities." This argument, however, is inconsistent with current case law interpreting ERISA's savings clause.

  The case law on ERISA's savings clause interprets it very narrowly. In the case of insurance, the Supreme Court has explained that the savings clause is not applicable unless (1) the state law is "specifically directed towards entities engaged in insurance," and (2) the state law "substantially affect[s] the risk pooling arrangement between the insurer and the insured."[6] Thus, the insurance carve-out from ERISA preemption would not extend to protect state rules seeking to regulate advice regarding insurance products

[2] ERISA § 514.

[3] *California Hospital Association v. Henning*, 569 F. Supp. 1544, 1546 (C.D. Cal.1983).

[4] ERISA § 2(b).

[5] *Aetna Health Inc. v. Davila*, 542 U.S. 200, 209 (2004).

[6] *Kentucky Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329, 334 (2003).

that relate to an ERISA-covered plan because any such regulation would not affect the risk pooling arrangement between the insured and the insurer.

- **Supreme Court: the savings clause is inapplicable to state laws affecting enforcement issues.** Moreover, any state rule is also preempted to the extent that it creates a legal remedy that duplicates, supplements, or supplants ERISA's civil enforcement provisions. Again, by comparison to the reference to the state regulation of insurance under ERISA's savings clause, the Supreme Court has said, "even a state law that can arguably be characterized as 'regulating insurance' will be pre-empted if it provides a separate vehicle to assert a claim for benefits outside of, or in addition to, ERISA's remedial scheme."[7]

In short, ERISA's powerful preemption provision expressly reflects Congress's unambiguous intent for the federal government to regulate all matters relating to employee benefit plans, including the provision of investment advice. States may not add any new or additional requirements to ERISA's comprehensive system with respect to an employee benefit plan.

ERISA preemption is not limited, of course, to investment advice standards. ERISA was designed to establish uniform standards for all matters central to plan administration, including but not limited to, reporting, disclosure, and claims administration.[8] Thus, ERISA's preemption doctrine will present significant challenges to any state investment advice rules to the extent that such standards threaten ERISA's uniform administration of benefits. This could be particularly problematic in the context of any new disclosure or reporting rules that could be imposed on a plan's service providers, which are already subject to detailed disclosure rules under ERISA.[9] Further, a recent Supreme Court decision reaffirmed the breadth of ERISA's preemption doctrine in the context of reporting when it struck down a state reporting requirement imposed on ERISA-covered health plans because the new reporting requirements interfered with a national and uniform system of plan administration.[10]

In sum, there is nothing unclear about the breadth of ERISA's preemption provision or the fact that it would clearly preempt any state investment advice rule that attempts to apply to ERISA plans. For a real-life example of states' recognition of this clear fact, one has to look no further than the New York State Department of Financial Services' First Amendment to 11 NYCRR 224 (addressing "suitability and best interests in life insurance and annuity transactions"), which exempts all ERISA plans from its application. See 11 NYCRR section 224.2(b)(1)).

---

[7] *Davila*, 542 U.S. at 217–18; s*ee also McGuigan v. Reliance Stand. Life Ins. Co.*, 256 F. Supp. 2d 345, 348 (E.D. Pa. 2003); *Hawaii Mgt. All. Ass'n v. Ins. Com'r,* 100 P.3d 952, 965 (Haw. 2004).

[8] *See Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 91 (1983); *Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141, 148 (2001).

[9] *See*, *e.g.*, Labor Reg. § 2550.408b-2.

[10] *Gobeille v. Liberty Mut. Ins. Co.*, 136 S. Ct. 936, 943 (2016).

The type of rule contemplated in the draft 11/19/18 amendments would clearly be preempted with respect to ERISA plans and participants. As a result, the exception in section 4.B.(1) needs to be preserved intact.

5. Documented harm from an incorrectly framed fiduciary standard.

The transaction-based structure of compensation earned by broker-dealers is used to enable broker-dealers to serve the broadest array of customers, including those who do not need year-round assistance and would not want to pay for such assistance when making a single purchase, for example. The now-invalidated fiduciary rule issued by the DOL attempted to modify that structure, severely restricting transaction-based compensation, such as commissions, and strongly favoring fee-based advice over transaction-based compensation. Even in the short time that the rule was in effect, this aspect of the DOL rule caused massive harm to low and middle-income individuals. For many low and middle-income individuals, the DOL rule resulted in a loss of access to personalized investment assistance; for other individuals, the DOL eliminated the brokerage model choice, so that their only means to obtain personalized investment assistance was through a higher-cost advisory arrangement.

We are not suggesting in any way that the NAIC's draft 11/19/18 would raise the same issues as arose under the DOL rule. But due to the importance of this issue, we wanted to note it here.

The Appendices to this letter cite to detailed studies of the harm done by the DOL rule. Appendix A focuses on the harm done to access to investment assistance, while Appendix B highlights the severe harm done to investors' access to guaranteed income for life. Here, we mention a few key examples of the great harm done.

- **10.2 million accounts harmed.** The national accounting firm of Deloitte & Touche studied 21 financial institutions that represent 43% of U.S. financial advisors and 27% of the retirement savings assets in the market. The study found that "[A]s of the [DOL] Rule's first applicability date on June 9th, ***53% of study participants reported limiting or eliminating access to brokerage advice for retirement accounts, which the firms estimate impact 10.2 million accounts and $900 billion AUM."***
- **68% report harm to small accounts.** In a Harper Polling survey of 600 financial professionals, 68% reported that they or their institutions would take on fewer small accounts.
- **75% report taking on fewer small clients.** A NAIFA survey of 1,093 members found that nearly 75% of financial professionals experienced or expected to experience an increase in the minimum account balances for the clients they serve.
- **Decline in availability of annuity products.** The LIMRA Secure Retirement Institute Study estimated that access to guaranteed income products would decline 29% under the DOL fiduciary rule, a projection consistent with subsequent data. This is at a time when policymakers are more concerned than ever about the impending crisis in retirement savings and income for America's aging population.
- **Small employers and small accounts harmed.** A survey of Insured Retirement Institute ("IRI") members found that "more than 60 percent of the distribution firms that participated in the Survey have, are planning to, or are considering exiting or de-

emphasizing target markets such as small IRA holders and small retirement plan sponsors."

- **Devastating effect on small accounts projected.** The consulting firm of A.T. Kearney projected that by 2020, broker-dealer firms will collectively stop serving the majority of the $400 billion currently held in low-balance retirement accounts.

We urge all regulators to avoid the counterproductive approach imposed by the DOL. Instead, any new rules should not penalize the proven transaction-based compensation regime successfully used by broker-dealers to serve small accounts. Conflicts of interest are inherent in such transaction-based compensation, as they are in every commercial transaction in every industry. Such conflicts should be managed and disclosed, not eliminated, in order to preserve access to investment assistance for small accounts.

CONCLUSION

We support a best interest standard structured to help investors and not hurt them, as the DOL rule did. But it is critical for any state organization to consider the federal preemption issues that limit their ability to regulate in this area. Overly broad rules will simply be invalidated, leaving behind great disruption and costs for investors to bear; even narrowly tailored rules will create a patchwork of different rules giving rise to higher costs and confusion. The better approach is for the SEC and the NAIC to work together on a national best interest standard.

Sincerely,

Kent A. Mason

APPENDIX A: GENERAL HARM CREATED BY THE FIDUCIARY RULE

1. **Deloitte & Touche Study (August 9, 2017), as described in SIFMA's August 9, 2017 comment letter (study attached to letter as Appendix I)**
   a. *Description: a study of a cross-section of SIFMA's members, consisting of 21 financial institutions that represent 43% of U.S. financial advisors and 27% of the retirement savings assets in the market.*
   b. "[A]s of the Rule's first applicability date on June 9th, 53% of study participants reported limiting or eliminating access to brokerage advice for retirement accounts, which the firms estimate impact 10.2 million accounts and $900 billion AUM."
   c. "Roughly 95% of study participants indicated that they have reduced access to or choices within the products offered to retirement savers because of efforts to comply with the Rule. Products affected include mutual funds, annuities, structured products, fixed income, private offerings, and more, impacting an estimated 28.1 million accounts. Examples of the reduction in mutual fund availability include: 1) the elimination of no-load funds from brokerage platforms; 2) the elimination of mutual funds held directly at the mutual fund company; 3) reduced product offerings; and 4) elimination of other share classes."
   d. "Across the industry, broker-dealers will have spent more than $4.7 billion in start-up costs relating to the Rule, much of which has already been spent."
   e. "The ongoing costs to comply are estimated at over $700 million annually…."

2. **Harper Polling (July 2017), as described in the Financial Services Roundtable's August 10, 2017 comment letter (report and survey slides attached to letter)**
   a. *Description: a national survey of 600 financial professionals conducted by phone and through online interviews from July 7-12, 2017 (July 17, 2017).*
   b. A majority of respondents reported the Rule is restricting them from serving their clients' best interests.
   c. "Only 12% of respondents report the Rule is helping them to serve their clients best interest and 33% report there has been no impact, yet those respondents still report more complicated paperwork and fewer small accounts." "For those who reported the Rule is helping or has had no impact on their ability to serve their clients best interests, many reported negative changes to client services by (i) servicing fewer small accounts, (ii) offering fewer investment options, (iii) including fewer mutual fund options, and (iv) higher compliance costs, including additional fees for Retirement Investors."
   d. "Only 10% of Certified Financial Planners (CFP) report that the Rule is helping them to serve their clients best interests, and 55% report the Rule is restricting them from serving their clients best interests. This runs counter to the claim by the CFP Board of Standards that the Rule is workable for their members."
   e. 75% of respondents whose "typical clients have starting assets under $25,000 report that they will take on fewer small accounts due to increased compliance costs and legal risks."
   f. 63% reported that "the fiduciary standard will definitely/probably/or has already limited investment options/products they can provide to clients."

g. 56% said "their firms would offer fewer mutual fund products to consumers."
h. "…68% reported that they or their institutions will take on fewer small accounts."

3. American Action Forum (AAF) (March 16, 2017 comment letter)

a. *Description: AAF's comments are based on: (1) an AAF staff survey of the available literature in 2015 on the likely impact of the DOL rule, as discussed in an August 4, 2015 article; (2) a September 17, 2015 AAF article; and (3) AAF research as discussed in a February 22, 2017 article.*
b. Found reported compliance costs of at least $106 million in 2016, representing up-front costs from just four companies.
c. "[A]lmost all retail investors will see their costs increased by 73 to 196 percent due to a mass shift toward fee-based accounts."
d. "[F]irms providing investment advice will see an average of $21.5 million in initial compliance costs and $5.1 million in annual maintenance costs."
e. "[U]p to 7 million Individual Retirement Accounts (IRAs) would fail to qualify for an advisory account due to the balance too low to be sustainable for the advisor. In the shorter term, we found that the fiduciary rule, as written, will result in over $1500 of duplicative fees charged per household retirement account."
f. "…the fiduciary rule would cost $31.5 billion in total costs and $2 billion in annual burdens, making it the most expensive rule of 2016 and the second most expensive non-EPA rule since 2005."

4. Meghan Milloy / American Action Forum (AAF) Research (April 2017), as stated on AAF's website

a. *Description: a research article by Meghan Milloy, Director of Financial Services Policy.*
b. The Rule will result in additional charges to retirement investors of approximately $816 annually per account or over $46 billion in aggregate.
c. "Although the rule has not yet become effective, AAF research has found that three major companies have left part of the brokerage business, and six more are drawing down their business or switching to a fee-based arrangement. From these companies alone, reported compliance costs have already topped $100 million, affecting 92,000 investment advisors, $190 billion in assets, and at least 2.3 million consumers."

5. Chamber of Commerce's Monitoring of Rule's Impact, as described in the Chamber's August 16, 2017 comment letter

a. *Description: outreach conducted by the Chamber to 14 firms that collectively manage $10 trillion in assets.*
b. "[N]early all of the institutions reported excluding some investment products from retirement investors in response to the rule, largely due to concerns about the pending 'level' fee requirements of the 'full' BIC Exemption."
c. "Most of the institutions also reported using the 'grandfathering' provisions included in the final rule, meaning that a substantial number of investors would be prevented from receiving new investment advice going forward, unless they

decide to change the type of account they have (e.g. change from a transaction-based account to a fee-based account)."

6. **NAIFA Survey of 1,093 Members (April 2017)**
   a. Nearly 75% of financial professionals have experienced or expect to experience an increase in the minimum account balances for the clients they serve.
   b. Nearly 90% of advisors believe consumers will need to pay more for their financial advice services.
   c. More than 90% of financial professionals have already experienced or expect to experience restrictions of product offerings to their clients.
   d. 68% of NAIFA's members have been told that they cannot recommend certain mutual fund classes or types to clients, and almost 70% say they cannot recommend certain annuities.

7. **LIMRA Secure Retirement Institute's *Second Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in an August 23, 2017 LIMRA press release**
   a. Total annuity sales for the first half of 2017 decreased 10% over the first half of 2016, the lowest first half sales since 2001.
   b. Q2 2017 is the:
      i. 5th consecutive quarter of decline in overall annuity sales.
      ii. 6th consecutive quarter in which fixed annuity sales have been greater than variable annuity sales, which "hasn't happened in almost 25 years."
   c. "A closer look at what's driving the drop in VA sales reveals qualified VA sales have experienced a more significant decline than non-qualified VAs…. VA qualified sales were down 16 percent in the second quarter, while nonqualified sales were actually up 5 percent. This could be in reaction to the DOL fiduciary rule," according to the director of annuity research.
   d. Variable annuity sales are forecast to drop 10-15% in 2017, returning to levels not seen since 1998.

8. **LIMRA Secure Retirement Institute's *First Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in a May 18, 2017 LIMRA press release**
   a. Indexed annuity sales are forecast to decline 5-10% in 2017 and "another 15-20 percent in 2018 when the BICE goes into effect."

9. **LIMRA Secure Retirement Institute Study (2017), as described in NAIFA's August 4, 2017 comment letter**
   a. "LIMRA estimates that access to guaranteed income products will decline 29% under the Rule/PTEs."

10. **Morningstar Report (2017), as described in the Insured Retirement Institute's April 17, 2017 comment letter**
    a. Variable annuity sales declined nearly 22% from 2015 to 2016 despite a rising stock market.

11. **Survey of Insured Retirement Institute (IRI) Member Firms (July 2017), as described in IRI's August 7, 2017 comment letter**
    a. *Description: IRI surveyed a representative sampling of its insurance company and distributor members from July 18-31, 2017.*
    b. "More than 60 percent of the distribution firms that participated in the Survey have, are planning to, or are considering exiting or de-emphasizing target markets such as small IRA holders and small retirement plan sponsors."
    c. A number of distributors reported that "approximately 155,000 of their clients have already been 'orphaned,' and a number of our insurer members told us that both the adviser and the firm have dissociated from the accounts of hundreds of their annuity contract owners. Far more accounts are expected to be impacted as implementation of the Rule proceeds."

12. **CoreData Report, CoreData Research UK (2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)**
    a. *Description: a non-commissioned report based on an October 2016 survey of 552 U.S. financial advisors.*
    b. 71% of financial professionals will disengage from at least some retirement savers because of the Fiduciary Rule.
    c. 64% of financial professionals think the Fiduciary Rule will have a large negative impact on their mass-market clients (i.e., investors with less than $300,000 in net investable assets).
    d. On average, financial professionals estimate they will no longer work with 25% of their mass-market clients, creating an advice gap for low-balance investors.
    e. 39% of advisors believe the cost of personal financial advice will become too expensive for most investors.
    f. 32% of advisors believe that shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.
    g. 57% of advisors "believe increased paperwork stemming from reporting and disclosure requirements will be one of the top three challenges of the fiduciary rule**.**"
    h. 18% of advisors "believe preparing for potential litigation will be one of the biggest challenges they must overcome."

13. **A.T. Kearney Study (October 2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)**
    a. *Description: a study of the effects of the Fiduciary Rule published in connection with a discussion of how the global management consultant can help financial institutions adjust to the rule.*
    b. Concludes that "[a]s firms move toward fee-based advisory, many low-balance accounts will no longer be served, shifting many assets to formats such as robo-advice and self-directed."
    c. Recommends that broker/dealers should "[a]ccelerate the transition to fee-based services and advisory, and evaluate account thresholds to continue serving (for example, accounts greater than $200,000)."

d. States that "[c]ertain high-cost investment products (such as variable annuities) will be phased out as the business model is no longer viable under the new rule…."
e. By 2020, broker-dealer firms will collectively stop serving the majority of the $400 billion currently held in low-balance retirement accounts.
f. Implementing the DOL's new fiduciary rule for retirement accounts will cost the brokerage industry $11 billion over the next four years.

14. Large Mutual Fund (2017 data), as described in the Chamber of Commerce's April 17, 2017 comment letter

a. *Description: an interview the Chamber conducted with a large mutual fund provider.*
b. One mutual fund's number of orphaned accounts (i.e., accounts without an advisor) nearly doubled in the first three months of 2017, and the average account balance in these orphan accounts is just $21,000. The fund projects that "ultimately 16% of the accounts it services will be orphaned this year because of the Fiduciary Rule." "Extrapolating this prediction suggests that at least 1.6 million small retirement savers have already lost access to investment assistance since January 2017, and an additional 1.6 million are likely to lose access after the Rule becomes applicable."

15. Fidelity Clearing & Custody Solutions Poll (August 2016), as described in September 28, 2016 ThinkAdvisor article

a. *Description: A blind online poll of 459 advisors conducted from August 18-26, 2016. Respondents consisted of 30% independent broker-dealer reps, 21% RIAs, 19% regional BD reps, 15% from wirehouse firms, 11% insurance BD reps, and 3% from banks.*
b. 10% of advisors responding to the survey reported they are planning to leave or retire from the field earlier than expected because of the rule, and another 18% said they are "reconsidering their careers as advisors."

16. 2016 Global Survey of Financial Advisors commissioned by Natixis Global Asset Management, as described on Natixis website and in survey whitepaper

a. *Description: a survey of 2,550 advisors (including 300 in the U.S.) in 15 countries in Asia, Europe, the United Kingdom, and the Americas conducted in July 2016. The online quantitative survey was developed and hosted by CoreData Research.*
b. 38% of respondents said they will likely "disengage with smaller clients" as a result of new regulations.
c. Almost 80% of respondents are "concerned that more stringent regulations could limit access to financial advice for lower balance and mid-tier clients."
d. More than 75% of advisors surveyed "believe increased regulations could even lead to higher costs for clients."

17. The Cerulli Report – U.S. Broker/Dealer Marketplace 2016, as described in Lincoln Financial Group's March 17, 2017 comment letter

a. *Description: an "in-depth analysis of broker/dealers (B/Ds) with financial advisors serving retail investors." Available for purchase.*
b. 66% of advisors believe that small investors will have less access to professional financial advice as a result of the rule.

18. NERA Economic Consulting's comment on the Department of Labor Proposal and Regulatory Impact Analysis (July 17, 2015)

a. *Description: SIFMA retained NERA Economic Consulting to review and comment on the proposed fiduciary rule. To conduct its cost study of the proposal, NERA gathered account-level data from several financial institutions, representing tens of thousands of IRA accounts that were observed from 2012 through Q1 2015.*
b. "Using [a] conservative minimum account balance of $25,000, over 40% of commission-based accounts in our dataset would not be able to open fee-based accounts. Using a $50,000 threshold, over 57% of accounts would not meet minimum balance requirements for a fee-based account. If the effective threshold is $75,000, two-thirds of account holders would be left without any professional investment advice."

19. Chamber of Commerce company interviews, as described in the Chamber's April 17, 2017 comment letter

a. *Description: In-depth, structured interviews of two to five persons with about 10 investment-advisory companies, broker-dealers, insurance companies, and others affected directly or indirectly by the Fiduciary Rule.*
b. Interviewed companies "uniformly report that they have already restricted the choices of investment products available to retirement savers through their fee-based advisory channels, or they intend to do so when the Fiduciary Rule becomes applicable. The majority of companies interviewed have also either already raised the minimum account amounts to qualify for advisory services or have plans to do so upon applicability of the rule. Some firms have raised the minimum for advisory accounts to $100,000 or more, clearly excluding from their services small beginning savers."
c. "[E]ven when the financial institution itself has not increased account minimums, individual brokers may implicitly discourage enrollment of smaller accounts and ration their time to larger accounts to earn better pay and to reduce time spent on compliance associated with smaller, transaction-based accounts."
d. Insurance costs could exceed two to three times the cost estimated by the Department. Some respondents cited numbers as high as $10,000 per professional per year for Errors and Omissions coverage.
e. The Chamber is unaware of any "robo-advisor" that recommends annuity products to generate retirement income, despite the clear need for these products and the Department's reliance on robo-advisors to alleviate the potential loss of access to retirement advice for small savers.

20. **SIFMA survey, as described in document "New Data Shows DOL Fiduciary Rule Harming Small Retirement Savers" (available as attachment to Kent Mason's August 3, 2017 comment letter)**
    a. *Description: a survey of 25 member financial firms impacted by the Fiduciary Rule.*
    b. "More than half the firms are considering moving IRA brokerage clients to call center services only."
    c. "44% of the respondents anticipate that more than half of their clients could see a change in services (e.g., limitation of product choice, shift to fee-based account, or shift to online only, etc.). More than 50% of responding firms anticipate offering only advisory services to a subset of their current IRA brokerage customers."
    d. "… more than 60% of the responding firms stated that they anticipate that some or all of the costs resulting from the potential increase in litigation and liability insurance may be passed on to clients."

21. **Wall Street Journal Reports (February and April 2017), as described in the Financial Services Roundtable's April 17, 2017 comment letter**
    a. Firms have responded to the Rule by taking actions that include: (1) moving clients to fee-based accounts; (2) eliminating commission-based IRAs; (3) raising investment minimums for commission-based IRAs; (4) eliminating variable annuity products; and (5) excluding certain products from commission-based IRAs (e.g., annuities, mutual funds, and exchange-traded funds).

22. **Jonathan Reuter updated analysis, as described in the American Bankers Association's (ABA) March 15, 2017 comment letter**
    a. *Description: ABA recommendations of key developments that an updated DOL analysis of the Fiduciary Rule should account for.*
    b. The author of one of the academic studies cited by the Council of Economic Advisers (CEA), Jonathan Reuter, "issued an updated analysis that looked at more recent mutual fund performance (from 2003 to 2012) and concluded that broker-sold funds underperform no-load funds by an average of 18 basis points, significantly narrower than the 100-basis point difference cited by CEA."

APPENDIX B: HARM TO THE ANNUITY MARKET FROM THE FIDUCIARY RULE

1. **LIMRA Secure Retirement Institute's *Second Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in an August 23, 2017 LIMRA press release**
    a. Total annuity sales for the first half of 2017 decreased 10% over the first half of 2016, *the lowest first half sales since 2001*.
    b. Q2 2017 is the:
        i. 5th consecutive quarter of decline in overall annuity sales.
        ii. 6th consecutive quarter in which fixed annuity sales have been greater than variable annuity sales, which "hasn't happened in almost 25 years."
    c. "A closer look at what's driving the drop in VA sales reveals qualified VA sales have experienced a more significant decline than non-qualified VAs…. *VA qualified sales were down 16 percent in the second quarter, while nonqualified sales were actually up 5 percent. This could be in reaction to the DOL fiduciary rule*," (emphasis added) according to the director of annuity research.
    d. *Variable annuity sales are forecast to drop 10-15% in 2017, returning to levels not seen since 1998.*

2. **LIMRA Secure Retirement Institute's *First Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in May 18, 2017 LIMRA press release**
    a. Indexed annuity sales are forecast to decline 5-10% in 2017 and "another 15-20 percent in 2018 when the BICE goes into effect," referring to the "Best Interest Contract Exemption" under the DOL fiduciary rule.

3. **LIMRA Secure Retirement Institute Study (2017), as described in NAIFA's August 4, 2017 comment letter**
    a. "LIMRA estimates that access to guaranteed income products will decline 29% under the [DOL Fiduciary] Rule/PTEs." (The reference to "PTEs" is to the exemptions from the application of the Fiduciary Rule, which substantially all qualified annuities must use.)

4. **Morningstar Report (2017), as described in the Insured Retirement Institute's April 17, 2017 comment letter**
    a. Variable annuity sales declined nearly 22% from 2015 to 2016 despite a rising stock market, which "has traditionally led to increased sales" of VAs.

5. **Insured Retirement Institute (IRI) member survey (July 2017), as described in IRI's August 7, 2017 comment letter**
    a. "Half of the participating insurance companies reported that some of their distribution partners have already dropped the insurer's products from their shelf as part of their efforts to implement the [Fiduciary] Rule."
    b. "Nearly 60 percent of the participating insurance companies expect that fee-based annuities manufactured in response to the [Fiduciary] Rule will result in higher overall fees to the consumer."
    c. "[A] number of our distributor members reported that approximately 155,000 of their clients have already been 'orphaned,' and a number of our insurer members

told us that both the adviser and the firm have dissociated from the accounts of hundreds of their annuity contract owners. Far more accounts are expected to be impacted as implementation of the Rule proceeds."

6. **Independent Insurance Agents & Brokers of America, Inc. (IIABA) Member Survey (July 2017), as described in IIABA's August 3, 2017 comment letter**
   a. "38%, or 315 respondents, answered that they personally and/or the insurance agency they work for had stopped selling or giving advice related to products impacted by the fiduciary rule, or planned to do so on or before January 1, 2018 when the [fiduciary] rule takes full effect."
   b. "[M]ore than one third of independent insurance agents who responded to the survey will exit the market on or before January 1, 2018; and for those that remain some will offer more limited services to clients."

7. **ACLI (August 7, 2017 comment letter)**
   a. "One ACLI member informed us that it has reduced its proprietary insurance product offerings by 54 percent and its non-proprietary variable annuity offerings available through its broker-dealers by 76 percent."
   b. Consequences of the Fiduciary Rule as reported by ACLI members:
      i. "Some banks are no longer offering access to fixed and indexed annuities, even when they are used outside the context of an employee benefit plan or IRA."
      ii. "Some broker-dealers are no longer offering variable annuities even to savers and retirees with non-qualified assets not subject to the Regulation."
      iii. "Some broker dealers are reducing the number of insurers and annuity products available on their platforms."
      iv. "Some firms are inquiring how quickly they can be removed as the broker dealer of record from existing annuity business."
   c. "[T]he Regulation has already resulted in a dramatic increase of 'orphaned' accounts. Several ACLI member companies have already been notified by distribution partners that they will resign as agent of record to IRA and ERISA plan annuity holders. For example, one ACLI member has informed us that, since the Regulation's June 9, 2017 applicability date, it has received 'disassociation' requests for 84 annuity contracts, and the reason provided for each action was the Regulation. By comparison, this member received only 3 disassociation notices during 2016, none of which included the Regulation as the basis for the disassociation."
   d. One member reported that it has "identified over 250 small retirement plans that have lost access to guidance and advice as a result of the Regulation."

8. **NAIFA Survey of 1,093 Members (April 2017)**
   a. 70% of NAIFA's members say they cannot recommend certain annuities.

9. **CoreData Report, CoreData Research UK (2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)**

a. *Description: a non-commissioned report based on an October 2016 survey of 552 U.S. financial advisors.*
b. 32% of advisors believe that shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.

10. A.T. Kearney Study (October 2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)

a. *Description: a study of the effects of the Fiduciary Rule published in connection with a discussion of how the global management consultant can help financial institutions adjust to the rule.*
b. States that "[c]ertain high-cost investment products (such as variable annuities) will be phased out as the business model is no longer viable under the new rule…."

11. Chamber of Commerce (April 17, 2017 comment letter)

a. The Chamber is unaware of any "robo-advisor" that recommends annuity products to generate retirement income, despite the clear need for these products and the Department's reliance on robo-advisors to alleviate the potential loss of access to retirement advice for small savers.

12. Wall Street Journal Reports (February and April 2017), as described in the Financial Services Roundtable's April 17, 2017 comment letter

a. Firms have responded to the Rule by taking actions that include: (1) moving clients to fee-based accounts; (2) eliminating commission-based IRAs; (3) raising investment minimums for commission-based IRAs; (4) eliminating variable annuity products; and (5) excluding certain products from commission-based IRAs (e.g., annuities, mutual funds, and exchange-traded funds).

13. Cerulli Associates Research, as reported in December 15, 2016 ThinkAdvisor article

a. "U.S. variable annuity and fixed indexed annuity sales are expected to decline by at least 10% through 2018 as the industry struggles to adapt to upcoming regulations put forth by the Department of Labor."
b. Cerulli views insurers' "biggest challenge for the foreseeable future" as being the Fiduciary Rule.

14. Insured Retirement Institute (IRI) First-Quarter 2017 Annuity Sales Report, as described in June 6, 2017 press release

a. *Description: sales results based on data reported by Beacon Research and Morningstar, Inc.*
b. Industry-wide annuity sales declined 18% in the first quarter of 2017 as compared to the first quarter of 2016.
c. Fixed annuity sales during the first quarter of 2017 declined 13.9% as compared to the first quarter of 2016, and variable annuity sales declined 10.2% for the same period.

15. <u>Insured Retirement Institute (IRI)</u>, as reported in December 15, 2016 ThinkAdvisor <u>article</u>

   a. IRI "found that industrywide annuity sales in the third quarter totaled $51.3 billion, an 8.2% drop from sales of $55.9 billion during the second quarter of 2016, and a 12.3% decline from $58.5 billion in the third quarter of 2015."