



**National Association of Insurance and Financial Advisors**

2901 Telestar Court • Falls Church, VA 22042-1205 • (703) 770-8188 • [www.naifa.org](http://www.naifa.org)

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Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attn: Conflict of Interest Rule  
Room N-5655  
U.S. Department of Labor  
200 Constitution Ave., NW  
Washington, DC 20210

Office of Exemption Determinations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Ave., NW  
Suite 400  
Washington, DC 20210

**RE: RIN 1210-AB32 - Proposed Definition of Fiduciary Investment Advice  
RIN 1210-ZA25 - Proposed Prohibited Transaction Exemptions (D-11712, D-11850)**

To Whom It May Concern:

The National Association of Insurance and Financial Advisors (“NAIFA”) appreciates this opportunity to offer supplemental comments on the Department of Labor’s (“Department”) proposed definition of fiduciary “investment advice” (“proposed rule”) and proposed prohibited transaction exemptions (“PTEs”) under the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code of 1986 (“Code”).

Founded in 1890 as The National Association of Life Underwriters (“NALU”), NAIFA is one of the nation’s oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA’s mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

## BACKGROUND & EXECUTIVE SUMMARY

First, NAIFA would like to thank the Department for the opportunity to share our views on the proposed rule and proposed PTEs at the August 11, 2015 public hearing. We very much appreciated Department officials' questions and thoughtful consideration of our testimony and our initial comment letters.<sup>1</sup> This supplemental letter focuses on issues and questions raised during the public hearing, and it is intended to supplement the contents of our earlier letters.

Specifically, NAIFA urges the Department to:

- Expand the proposed rule's education carve-out to be coextensive with the Department's Notice 96-1 or to include all information shared by the advisor prior to execution of a transaction;
- Include a grandfathering provision under the proposed rule for pre-existing clients and accounts;
- Refine the "best interest" standard to clarify that the sale of certain products (e.g., variable annuities and proprietary products) is consistent with all elements of the standard;
- Replace the Best Interest Contract ("BIC") exemption's formal contract requirement with a non-signatory notice requirement;
- Remove any obligation under the BIC exemption for advisors to make warranties about financial institutions' practices and policies;
- Substantially reduce the BIC exemption's conditions and harmonize requirements between the PTEs;
- Cover all annuity products sold to all investors under PTE 84-24. Alternatively, allow all annuity sales for which the advisor receives only insurance-oriented compensation to be transacted under PTE 84-24; and
- Release another proposed rule for public comment prior to finalizing any regulations.

### **I. THE PROPOSAL WILL COST SMALL SAVERS MORE, CREATE AN UNLEVEL PLAYING FIELD BETWEEN ADVISORS AND CONSUMERS, AND LIMIT CONSUMER CHOICE**

Considerable attention was paid at the public hearing to the anticipated consequences of the Department's proposal. NAIFA strongly encourages the Department to reorient its analysis with respect to the proposal's potential costs. While the Department's rule-making agenda has been

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<sup>1</sup> We incorporate by reference our initial comment letters on the proposed rule and the proposed PTEs, which are part of the public record under this rule-making.

driven by the purported cost of “conflicted advice,” there are other notable costs to be considered, namely: the cost of lost advice, the danger of higher costs for small savers, and pass-through costs associated with a much higher cost of doing business under the proposal.

The Department’s proposal effectively leaves advisors with three choices, all of which have significant negative consequences for American consumers:

- (1) do not give investment advice, as defined under the proposed rule, and avoid becoming a fiduciary;
- (2) become a fiduciary and turn all of your compensation arrangements into flat fee-for-service arrangements or wrap accounts (with no third-party compensation); or
- (3) become a fiduciary, retain current compensation arrangements, and comply with a PTE.

***Option 1: Do not Offer Investment Advice***

The first option leaves investors with no meaningful guidance whatsoever because investment “education” is defined so narrowly under the proposed rule (as discussed in more detail below). Taking away professional advice is not a solution to the current retirement savings crisis in this country, and there are substantial costs associated with the loss of advice.

We gave the example during our testimony of an employee with a \$5,000 balance in an employer-provided retirement plan. In NAIFA members’ experience, that individual, without professional advice (particularly from an advisor willing to take on small-account clients) would likely cash out the account when leaving her employment, suffer the resulting tax penalties, and deplete all of her retirement savings—rather than continue to save.<sup>2</sup>

***Option 2: Convert all Accounts to Flat-Fee Arrangements and Avoid PTE Compliance Costs***

Department officials stated at the public hearing (and on multiple other occasions) that the Department does not intend with its proposal to eliminate commission-based or “brokerage” compensation structures. The Department must recognize, however, that the sheer burden and cost of the proposal for commission-based fiduciary investment advisors will cause significant disruptions to traditional business practices—disruptions that will *not* benefit low- or middle-income investors.

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<sup>2</sup> The Department’s own statistics do not contradict our members’ experience. In a recently-released Q&A document, Department officials note that only 10 percent of households in the bottom half of income distribution own any IRA assets, and 25 percent of that group have assets in a job-based plan. Department of Labor Q&A on Small Savers, at 1, *available at* <http://www.dol.gov/ebsa/regs/QA-SmallSavers.pdf> (hereinafter “Department Small Savers Q&As”). While the Department uses these figures to provide a picture of “small savers” in this country, the more important take-away is that lower-income investors need to be encouraged to save more for retirement—regardless of the type of investment vehicle—but certainly when they leave employer-sponsored plans. Less education and lost access to professional advice is not the answer.

Despite the Department’s clear preference for them, fee-based arrangements simply are not better than commission-based models for all consumers. Indeed, fee-based arrangements can harm small savers and ultimately cost them more. The Department claims that “[t]he proposed rule will benefit small savers first and foremost by helping them realize higher investment returns both before and after fees,” reasoning that consumers will be better off because they will not be paying for “conflicted advice” (i.e., advice paid for through commissions, revenue sharing, etc.).<sup>3</sup> Attached hereto as Exhibit 1, however, is a chart demonstrating how a small saver with a monthly retirement plan contribution of \$100 could very well pay significantly more under a fee-based model (i.e., non-conflicted advice) than a commission-based arrangement.

Generally, under a brokerage model, investors pay a one-time commission when an asset is purchased or when “new money” in the account is invested. Under a fee-based model, on the other hand, investors can wind up paying regular (e.g., annual) fees for account “management” services based on the amount of all of the assets under management, not just “new money.” Thus, for some investors, the fee-based arrangement will likely result in unnecessary charges and increased costs—for example, young investors who buy and hold assets for a long period and do not require any real level of “management,” or investors who simply transfer money between investments in the same fund family (a move for which many commission-based advisors receive no compensation). Notably, the Financial Industry Regulatory Authority, Inc. (“FINRA”) identified this same problem in its comment letter to the Department.<sup>4</sup>

Finally, as Department officials noted during the public hearing, the United Kingdom (“UK”) recently launched an investigation into the “advice gap” for small account holders following that country’s 2013 ban on third-party payments and commissions for advisors. While it is true that the UK action is an investigation at this stage, the project was instigated by concerns among UK regulators (and evidence from industry experts) that such a gap does exist.<sup>5</sup> The UK’s experience certainly should give the Department pause about the wisdom and desirability of steering the industry away from commission-based models—a very likely result of the Department’s proposal, given the tremendous burdens, costs, and risks it places on commission-based financial professionals.

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<sup>3</sup> Department Small Savers Q&As, at 3.

<sup>4</sup> See FINRA comment letter, July 17, 2015, *available at* [http://www.finra.org/sites/default/files/FINRACommentLetter\\_DOL\\_07-17-15.pdf](http://www.finra.org/sites/default/files/FINRACommentLetter_DOL_07-17-15.pdf) (hereinafter “FINRA comment letter”), at 5-6 (also noting: “If the Proposal were adopted as is, many broker-dealers will abandon [] small accounts, convert their larger accounts to advisory accounts, and charge them a potentially more lucrative asset-based fee.”).

<sup>5</sup> See, e.g., Wall, Emma, *10 Million Find Advice Too Expensive* (Aug. 28, 2014) (referencing Allianz Global Investors, Deloitte, and Wealth Horizon findings regarding post-reform “advice gap”), *available at* <http://www.morningstar.co.uk/uk/news/128424/PrintArticle.aspx>.

### ***Option 3: Retain a Commission-based Model and Comply with a PTE***

Fee-based advisors are supportive of the Department’s proposal—as consistently reflected in testimony during the public hearing—because they benefit from it.<sup>6</sup> They will not be impacted by the proposal’s onerous PTEs, while their competitors will be, and they will continue serving the same clients under the same business arrangements. Commission-based advisors, on the other hand, will be burdened with a complex new regime (with its attendant costs) and the prospect of losing clients, or at the very least, increasing their clients’ costs.

In effect, the Department’s proposal creates “winners” and “losers” among both advisors and consumers—those who will operate under the status quo and those who will incur substantial new costs, obligations, and risks under a PTE.<sup>7</sup> Then, among advisors and financial institutions who have to comply with a PTE, the playing field will be further divided between those who have to comply with the far more onerous BIC exemption and those who can rely on a less burdensome PTE (e.g., PTE 84-24). This dynamic will result in consumer confusion and less likelihood that annuity products will be recommended at all, which will impact families that need the protection of guaranteed income.<sup>8</sup> Ultimately, the proposal’s skewed structure imposes the Department’s judgment and preferences (i.e., between compensation arrangements and products) on all investors and threatens to harm the very people it is supposedly designed to help.

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<sup>6</sup> For a variety of reasons, high-wealth investors and their advisors will not be negatively impacted by the Department’s proposal like low- and middle-income Americans and their advisors. Many wealthy investors are accustomed to, and are comfortable with, fee-based arrangements. Unlike small savers, they are able to pay substantial up-front fees and they carry high account balances commonly required by fee-based advisors. Further, while the cost of doing business for commission-based advisors will increase substantially (through the cost of implementing new requirements under the proposal, higher errors and omissions insurance premiums, litigation expenses, etc.) and those costs will likely be passed on to consumers with those accounts, fee-based advisors and their clients will not see such cost increases. In other words, wealthy Americans’ investor-advisor relationships, costs, and product choices will largely be untouched, but smaller savers will pay a significant price. See NAIFA’s Comment Letter on the Proposed Rule, Section I.B., pp. 5-7, for a detailed discussion of higher costs for small businesses and small savers.

<sup>7</sup> To be clear, consumers, not just advisors and financial institutions, will pay for the higher cost of doing business under a PTE. Financial institutions will inevitably pass costs on to advisors and, ultimately, to investors.

<sup>8</sup> Under the Department’s proposal, annuity product sales are split between two different PTEs that impose very different requirements. Advisors often discuss various types of annuity products with consumers who are seeking and need a guaranteed income stream for retirement. As soon as an advisor discusses a specific product, under the Department’s proposal, the advisor is no longer providing education, but rather, investment advice. To avoid the potential of triggering *multiple* obligations under two separate PTEs, some advisors will—understandably—avoid conversations about annuity products altogether.

Accordingly, NAIFA encourages the Department to drastically simplify and reduce the hefty burdens associated with the proposed PTEs, particularly the BIC exemption, upon which most NAIFA members will have to rely. Paring back the proposed PTEs' requirements and costs will:

- (1) help ensure that investors can work with the advisor of their choice under compensation arrangements that make sense for them;
- (2) minimize anti-competitive market pressures toward certain business models and products;
- (3) preserve consumer choice between investment products; and
- (4) in general, reduce the likelihood that low- and middle-income investors will suffer adverse consequences under this new regime.

## II. THE PROPOSED RULE

NAIFA's initial letter on the proposed rule contains extensive comments on the Department's proposed definition of fiduciary "investment advice," many of which were echoed by other panelists during the hearing. Specifically, we urge the Department to adopt the following changes to the definition:

- (1) Include an investor reliance requirement;
- (2) Require a mutual understanding between advisor and investor;
- (3) Exclude referrals to other financial professionals from the definition;
- (4) Exclude advice related to distributions without accompanying investment advice (e.g., emergency hardship distributions);
- (5) Exclude welfare plans with no investment component; and
- (6) Exclude marketing activities and preliminary client development conversations.

Also, as discussed in detail below, NAIFA encourages the Department to expand the education carve-out and include a grandfathering provision under the proposed rule for pre-existing clients and accounts.

- A. The Department should expand the education carve-out to be coextensive with Notice 96-1 or, alternatively, to cover all information that does not culminate in a transaction through the advisor.

While the Department's proposed "investment advice" definition did not receive as much attention during the hearing as the proposed BIC exemption, one issue was repeatedly raised by panelists and Department officials: how to distinguish between investment advice and investment education.

NAIFA supports *more* investor education, not less; notably, a position with which no hearing panelists took issue. The Department, on the other hand, questioned during the hearing whether

a broader education carve-out (for which many commenters have advocated) is desirable or necessary. Indeed, in its Small Saver Q&As, the Department states its belief that the proposed rule, even with its circumscribed view of what constitutes education, will somehow “increase the quality of the education provided to savers.”<sup>9</sup> NAIFA strongly disagrees with the Department’s characterization of the proposed rule’s likely impact on investor education. As NAIFA argued in its initial comment letter, a *meaningful* education carve-out is essential for preserving, or better yet, expanding, consumers’ retirement planning and saving—and “education” without any mention of specific products is simply not meaningful.<sup>10</sup>

At the hearing, officials suggested that industry representatives may be reading the proposed education carve-out more narrowly than the Department intended. Specifically, officials stated that the carve-out is designed to allow for “educational” conversations up to the point that a call to action is made (e.g., “You should buy these products.” or “I recommend these products.”). They also stated that the current carve-out allows advisors to discuss specific features (e.g., fees, penalties, etc.) of specific products or product alternatives with prospective clients without giving “investment advice.”

If the Department does intend for advisors to be able to discuss specific product features under “education,” further clarification is needed in the text of the carve-out. For example, questions may arise about how many products an advisor must describe to avoid the appearance of a “recommendation” about specific products (e.g., all of the products offered by the advisor, half of the products she offers, twenty products, etc.). Put another way, does selecting a basket of products to describe entail a recommendation or endorsement on the part of the advisor that would trigger fiduciary obligations?

Educating clients and prospective clients about investment products available to them is vital to the investment process and the investor-advisor relationship, and more generally, to solving the retirement saving crisis in this country. Without very clear lines, however, between fiduciary

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<sup>9</sup> Department Small Savers Q&As, at 2.

<sup>10</sup> Department officials, including Secretary Perez, have repeatedly stated that one of the objectives of this proposal is to encourage investor education. But the proposal actually cuts back on education by limiting advisors who do not wish to trigger fiduciary obligations to generic, very high-level conversations, which will be unhelpful and potentially overwhelming for all investors, but especially unsophisticated or new savers. The Department’s current approach, as reflected in Interpretive Bulletin 96-1, is preferable. Notably, unlike the proposed rule, it allows advisors—under education, not investment advice—to provide asset allocation models that identify specific investment options, so long as they are accompanied by appropriate disclosures about the availability of other similar investments. NAIFA emphasizes that allocation models without any product references, especially for unsophisticated or new savers, are not at all helpful, given the thousands of investment options available today.

NAIFA supports an education model like the one already in place. *See* NAIFA’s Comment Letter on the Proposed Rule, Section II.D., pp. 14-15, for a more detailed discussion of the need for meaningful investment education and suggestions for how to amend the education carve-out.

and non-fiduciary communications (especially given the extent of the proposed PTE requirements) advisors will likely shy away from providing helpful education for fear of taking on unintended obligations and liability.

One potential line between investment education and investment advice is the consummation of a sale or an actual transaction executed through the advisor.<sup>11</sup> Once an investor decides to act upon the education provided,<sup>12</sup> the information becomes investment advice and the attendant requirements are triggered. Such an approach provides clarity and makes logical sense. Without some action or reliance on the investor's part, information delivered by the advisor should be treated as just that—general information—not advice.

From a practical standpoint, the line-drawing exercise between fiduciary investment advice and non-fiduciary communications is significant because of the obligations and liabilities triggered when the fiduciary line is crossed (i.e., changes in compensation structures or compliance with PTE requirements). The line between a recommendation and education or a recommendation and marketing becomes *especially* important when an advisor must rely on the proposed BIC exemption, which, as drafted, requires an executed contract signed by multiple parties *prior to any recommendation* by the advisor.

The imposition of this onerous, formal requirement and the associated liability is highly problematic for advisors, financial institutions, and investors; hence, NAIFA's (and the industry's) insistence that investment advice, as opposed to education or selling, be clearly demarcated through precise definitions and carve-outs. To the extent, then, the Department simplifies and alleviates some of the formal requirements under the BIC exemption and the other proposed PTEs (discussed in further detail below), including modifying the timing of certain requirements, the need for additional definitions or carve-outs under the proposed rule becomes less acute.

B. The Department should include a grandfathering provision under the proposed rule for pre-existing clients.

The proposed definition of fiduciary “investment advice” should apply only to new clients and/or new accounts. Such an approach would minimize the inevitable disruption to existing advisor-investor relationships and compensation arrangements resulting from the Department's proposal, and would help advisors and financial institutions (and their customers) plan for and transition to the new compliance regime. The proposed BIC exemption includes a special exemption for pre-

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<sup>11</sup> This is an alternative approach to the one suggested in NAIFA's first comment letter (i.e., retaining the education model contained in Notice 96-1, as discussed in Section II.D., pp. 14-15).

<sup>12</sup> The element of reliance under the “investment advice” definition was addressed in more detail in our first comment letter. See NAIFA's Comment Letter on the Proposed Rule, Section II.A.1., pp. 8-9. Again, NAIFA encourages the Department to incorporate within its definition a requirement that the investor rely on or take some action based on the information given by the advisor.

existing *transactions* (not clients or accounts).<sup>13</sup> But bifurcation of advisor-client relationships—between old and new compensation arrangements, or between old and new PTE requirements—will only increase consumer confusion, compliance costs, and the likelihood that some consumers will lose access to plans and vital investment advice.

For example, if a NAIFA member currently advises a 401(k) plan and receives commissions and 12b-1 fees for her services, upon the rule’s effective date, the advisor will have to switch the plan to a fee-based arrangement (because the proposed BIC exemption does not offer relief for participant-directed plans, and PTE 84-24’s compensation relief is not broad enough to cover commissions for *agents* of Principal Underwriters). Many employers—particularly small employers—may not be willing or able to switch to a fee-based arrangement. Consequently, rather than manage a 401(k) without professional advice, some employers may cancel their plans. As a result, some employees will take early distributions with the attendant penalties, heightening the potential for cashing out, rather than reinvesting, their retirement savings.

To avoid scenarios like these, the Department should include a broader grandfathering provision under the proposed rule. The provision should make clear that the new definition of fiduciary “investment advice” does not trigger new fiduciary obligations or prohibited transaction rules with respect to pre-existing clients (i.e., clients of the advisor prior to the rule’s applicability date), unless those clients open a new account with the advisor (e.g., rollover a 401(k) account into a new IRA, set up a new SIMPLE IRA account for employees, etc.). In effect, pre-existing client relationships would continue uninterrupted, preserving consumers’ choice in their advisor, their compensation arrangements, and the conditions under which they do business. For new clients and new accounts, however, new PTE requirements would apply.

Alternatively, the Department should include a grandfathering provision for pre-existing advisory relationships with participant-directed plans because without such a provision, under the proposed PTEs, there is great potential (as described above) for detrimental market disruptions. At the very least, the Department should expand the compensation relief under proposed PTE 84-24 to allow registered representatives and agents who advise participant-directed plans (including 401(k)s, SIMPLE IRAs, and SEP IRAs) to continue offering their services under commission-based arrangements.<sup>14</sup>

### **III. PROPOSED BIC EXEMPTION**

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<sup>13</sup> See Proposed BIC Exemption, Section VII. The BIC’s grandfathering provision does not cover current clients who receive investment advice on pre-existing accounts after the rule’s applicability date.

<sup>14</sup> NAIFA argued in its first comment letter that proposed PTE 84-24 should be expanded to: apply to all annuity products sold to all types of investors; cover the purchase by SIMPLE and SEP IRAs of variable annuities and mutual funds; and include compensation relief for registered representatives and agents coextensive with the BIC exemption’s relief. For a full discussion of suggested changes to PTE 84-24, see NAIFA’s Comment Letter on the Proposed PTEs, Section III, pp. 21-24.

The Department has been inundated with stakeholders' concerns about the BIC exemption. NAIFA, in our original comment letter and during the public hearing, pointed to several of our recommended revisions to the BIC exemption:

- (1) Hone the “best interest” standard to clarify that certain products about which there are varying opinions among financial advisors (e.g., variable annuities and proprietary products) are not violative of the standard;
- (2) Expand the scope of the exemption to cover rollovers and distributions (as those activities are covered under the proposed definition of fiduciary “investment advice”);
- (3) Replace the formal contract requirement with a non-signatory binding statement from the advisor that she is bound to act in the client’s best interest, which may be delivered at or before the point of sale;
- (4) Remove advisor warranty obligations with respect to financial institutions’ policies and procedures (over which advisors have no control and about which they have little or no information);
- (5) Clarify that advisors may limit the scope and duration of any fiduciary dealings with a client;
- (6) Remove duplicative disclosure requirements; and
- (7) Clarify that non-securities-licensed advisors can offer, as a general rule, a broad enough array of retirement products to satisfy the best interest standard.

Below, we offer additional suggestions for how to improve the best interest standard and streamline the BIC exemption to make it more workable and in sync with the other PTEs.

- A. The Department should hone the “best interest” standard to take into account varying industry perspectives and opinions on certain investment products and business practices.

While almost all of the panelists at the public hearing, including NAIFA, expressed support for a best interest standard for investment advisors, NAIFA does have two specific concerns about the “best interest” definition.<sup>15</sup> First, given the broad range of opinions among advisors with respect to certain products, we worry that the proposed standard is ripe for litigation. Second, NAIFA

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<sup>15</sup> The proposed “best interest” definition requires advisors to act:

with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the [investor], without regard to the financial or other interests of the [advisor or her affiliates].

has concerns about the “without regard to” clause under the definition, given the business realities for captive advisors.<sup>16</sup>

NAIFA is particularly apprehensive about the sale of variable annuities and propriety products under the proposed best interest standard. Industry professionals’ perspectives and opinions vary widely with respect to these products, which creates distinct problems (i.e., litigation risk) under the “prudent person” portion of the standard. Regardless of advisors’ differing sentiments, however, consumers want to buy—and in fact seek out—variable annuity and proprietary products because they provide unique benefits to investors.

For instance, variable annuities provide guaranteed life income and an opportunity for investors (who may not otherwise have the opportunity) to take advantage of upside in the market. As we noted during our testimony, our members’ clients’ primary concern with respect to retirement planning is out-living their savings. Variable annuities, like other annuity products, provide invaluable protection against longevity risk. Further, consumers who invest in variable annuity products to maximize their retirement security have the opportunity (like wealthier investors who put their savings in other vehicles) to enjoy a greater variety of investment choices and benefit from positive market performance.

Propriety products also benefit consumers. Indeed, some investors choose to work with captive advisors because they *want* the particular proprietary products those advisors offer.<sup>17</sup> Proprietary products from well-known and respected financial institutions provide consumers with peace of mind and high-quality investment options. Additionally, advisors who sell proprietary products are experts regarding those products and can offer consumers extensive information and guidance on their investment options within a fund family. Finally, consumers who work with captive advisors often have a long-standing relationship with the financial institution and the advisor (because, for example, they also have a bank account, home loan, insurance, or other business relationship with the institution), and they feel most comfortable working with a person they know (who also knows them) to protect their retirement savings.

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<sup>16</sup> FINRA—well acquainted with drafting and enforcing a standard of conduct for broker-dealers—agrees with both of NAIFA’s concerns. In its letter to the Department, FINRA noted that “[r]easonable and qualified financial advisers may reach different conclusions about which factors are more significant and which product best meets the criteria that the financial adviser believes are most relevant. . . . A requirement to recommend the ‘best’ product would impose unnecessary and untenable litigation risks on fiduciaries.” FINRA comment letter at 7. Further, FINRA advocates deleting the “without regard to” phrase from the best interest standard. *Id.* at 8.

<sup>17</sup> The Department appears to believe that consumers do not recognize or appreciate when they are working with captive advisors. Given the extensive marketing and name recognition within these propriety product families, however, it is difficult to imagine that consumers are confused about what these advisors are offering. For example, when investors walk into a MassMutual, New York Life, or State Farm office (clearly labeled as such), they recognize that those companies’ products are for sale, just like any other retail setting.

Department officials have indicated that they do not intend for the standard to eliminate the sale of specific products like variable annuities or proprietary products, or to exclude certain advisors from providing investment advice, including non-securities-licensed advisors and advisors who sell only proprietary products. In fact, they raised at the hearing the possibility of including language in the preamble or elsewhere in the final rule clarifying that certain products and classes of advisors can satisfy the standard. The Department's positions on these issues must be made explicit in any final rule to avoid unnecessary (and apparently unintended) litigation. Thus, we reiterate our request that the Department include specific language in any final rule to account for intra-industry differences in opinion and to preserve consumer choice under the "best interest" standard.

In addition to the suggestions offered in our first comment letter,<sup>18</sup> the Department could tie the "prudent person" analysis to standards and safeguards already in existence in the industry. For example, the Department could clarify that products approved by FINRA and the U.S. Securities and Exchange Commission ("SEC") and sold in accordance with FINRA guidance satisfy the "prudent person" standard.<sup>19</sup> Alternatively, or additionally, the Department could state that any transaction executed by an advisor which is evaluated and approved by the advisor's financial institution satisfies the standard.<sup>20</sup> Leveraging these existing tools would strengthen and clarify the "best interest" definition and help avoid needless litigation.

Second, for agents and registered representatives who exclusively sell proprietary products (i.e., captive advisors) the "best interest" standard, as drafted, may present an insurmountable obstacle. For NAIFA members in this situation, the very act of selling a proprietary product

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<sup>18</sup> NAIFA urged the Department to: (1) refine the "prudent person" term by, for example, expanding the clause to reference a "prudent person serving clients with similar retirement needs and offering a similar array of products;" (2) include a clear and explicit statement that offering products on which there are varying opinions within the industry (e.g., variable annuities) does not violate the best interest standard; and (3) include a clear and explicit statement that offering a limited suite of proprietary products does not violate the best interest standard. *See* NAIFA's Comment Letter on the Proposed BIC Exemption and PTE 84-24, Section III.A., pp. 14-15.

<sup>19</sup> *See, e.g.*, FINRA Regulatory Notice 13-45 (Dec. 2013) *available at* <http://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf> (discussing firm responsibilities under suitability standard with respect to IRA rollovers, including supervisory control systems and training of registered representatives); FINRA Regulatory Notice 12-03 (Jan. 2012) *available at* <https://www.finra.org/sites/default/files/NoticeDocument/p125397.pdf> (discussing characteristics of "complex" products and heightened supervisory and compliance procedures for the sale of such products, including reasonable diligence guidelines, post-approval review processes, registered representative training, and factors to consider in discussions with investors).

<sup>20</sup> Broker-dealers already exercise a good deal of oversight over advisors. Advisors' transactions are subject to review by the broker-dealer's compliance personnel, and when the appropriateness of a particular transaction is called into question, the advisor must justify the decision to the broker-dealer's satisfaction or rescind it.

could be construed as being in the financial or other interest of the advisor and/or the financial institution for which the advisor works (e.g., selling the product helps the financial institution, which continues to employ and provide benefits to the advisor), potentially violating the “without regard to” clause under the “best interest” definition.

While NAIFA supports inclusion of Section IV under the BIC exemption, which specifically addresses the sale of proprietary products, the section’s text does not include any specific mention of the “without regard to” clause. Instead, it focuses on offering a broad enough array of products to satisfy an individual investor’s specific needs, which is more aligned with the first half of the best interest standard. The Department should broaden Section IV so that it clearly applies to all parts of the best interest standard.

In sum, NAIFA encourages the Department to make explicit in its final rule that the exclusive sale of proprietary products, the sale of variable annuity products, and advice given by non-securities-licensed advisors are consistent with all elements of the best interest standard.

B. The Department should eliminate several of the BIC requirements and synchronize requirements between PTEs.

The Department clearly is listening to the myriad concerns about the BIC exemption raised by industry representatives and other stakeholders, and apparently recognizes the need to make substantial revisions to its proposal. Throughout the hearing, Department officials solicited panelists’ feedback on a dramatically pared back BIC exemption, ultimately boiled down to:

- (1) an upfront, binding commitment (not necessarily a formal contract) that the advisor will work in the client’s best interest, which could be made at or before the point of sale;
- (2) simplified and streamlined compensation disclosures;
- (3) reasonable overall fees; and
- (4) a warranty or statement that the financial institution does not have policies or procedures in place that work against the client’s best interest.

NAIFA believes the Department’s hypothetical BIC structure is a vast improvement and we appreciate the Department’s willingness to contemplate such changes. We do, however, have a few points of clarification regarding this theoretical structure.

1. *The Department should replace the BIC’s formal contract requirement with a notice requirement.*

Department officials have made clear that any rule-making will include an upfront, binding commitment by advisors to act in their clients’ best interest. NAIFA fully supports the Department’s aim. But we encourage the Department to amend the manner in which the advisor’s commitment is made.

A non-signatory notice delivered at or before the point of sale accomplishes the Department's objective and avoids the complications and burdens attendant with a formal contract requirement.<sup>21</sup> A notice that affirmatively declares an advisor's fiduciary status vis-à-vis the investor would clearly impose upon the advisor a legal obligation to fulfill her fiduciary obligations (or else face various legal claims such as breach of fiduciary duty, promissory estoppel, unfair or deceptive trade practices, etc.). A formal contract executed by the advisor, financial institution and investor is simply not necessary.

A contract is simply "a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty."<sup>22</sup> Contracts need not be formal to be enforceable.<sup>23</sup> A notice can create a binding commitment enforceable under the law. Such a notice need only contain: (1) a promise by the advisor to act in the client's best interest (as defined by the final rule) and (2) a statement that execution of a transaction through the advisor is evidence of the client's reliance on the advisor's promise.<sup>24</sup>

Notably, even a notice requirement goes beyond what is required under PTE 84-24 (and several of the other PTEs that now include a best interest standard). Proposed PTE 84-24 imposes "conditions" that must be satisfied for an advisor or financial institution to take advantage of the exemption; one such condition is acting in the best interest of the client. There is no requirement

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<sup>21</sup> For example, as noted in NAIFA's first comment letter, unsophisticated clients will be wary of signing complicated contracts, especially if asked to sign them *before* any real relationship is formed with the advisor or advisory services are actually rendered. Additionally, for advisors who work with numerous financial institutions and offer a broad range of products, requiring multiple contracts signed by different entities (i.e., all of those whose products are recommended) is unworkable and confusing for investors. See NAIFA's Comment Letter on the Proposed BIC Exemption and PTE 84-24, Section III.C.1., pp. 15-19, for a discussion of the numerous problems with the BIC's contract requirement.

<sup>22</sup> Restatement (Second) of Contracts § 1 (contract defined).

<sup>23</sup> *Id.* cmt. f. (recognizing that there are many types of contracts, including informal and implied contracts).

<sup>24</sup> See *Id.* § 90 ("A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. . . ."); *Id.* cmt. d. ("A promise binding under this section is a contract, and full-scale enforcement by normal remedies is often appropriate. . . ."); see e.g., *Bender v. Design Store Corp.*, 404 A.2d 194, 196-97 (D.C. Cir. 1979) ("[T]o hold a party liable under the doctrine of promissory estoppel there must be a promise which reasonably leads the promisee to rely on it to his detriment, with injustice otherwise not being avoidable. This rule is derived from Restatement of Contracts § 90 (1932). . . . Courts and commentators alike agree that the detrimental reliance factor of promissory estoppel functions to replace one or more of the formal requirements of a contract, usually consideration.") (internal quotations and citations omitted).

under PTE 84-24 to memorialize that obligation; it simply is a duty imposed by the Department. Surely the Department intends for that obligation to be binding and enforceable.

Accordingly, at most, the Department should require advisors operating under the BIC exemption to provide notices to their clients at or before the point of sale stating that the advisor has a legal obligation and promises to act in the client's best interest. The notice could have retroactive effect such that any investment information or education given by the advisor upon which the investor relies (i.e., by proceeding with a transaction) is covered under the best interest obligation. The Department should allow the notice, however, to include reasonable limitations on the duration and scope of the fiduciary relationship between advisor and investor.

2. *Advisors should not and cannot be required to make warranties about financial institutions' policies and practices.*

We reiterate our concern about any warranty requirement imposed on advisors regarding *financial institutions'* compensation and/or incentive policies. Such a warranty is problematic in multiple respects.

First, the warranty is duplicative, given the advisor's binding commitment to act in the client's best interest, as defined in the proposed rule—a commitment that renders a warranty of this nature unnecessary. Second, advisors generally do not have the information necessary to make such a blanket warranty about the practices of a financial institution (or dozens of financial institutions) for which they are an independent agent or a registered representative. Third, perhaps most importantly, advisors cannot make warranties regarding practices and policies over which they have no influence or control. Finally, as discussed in our first comment letter, such a warranty (especially given the Department's examples of acceptable compensation arrangements that would satisfy the warranty) effectively forces financial professionals to not employ traditional compensation arrangements (e.g., 12b-1 fees, revenue sharing, etc.) for which the BIC exemption allegedly provides relief in the first place. In other words, the warranty renders compliance with the exemption superfluous.

3. *The Department should harmonize requirements between the BIC exemption and the other PTEs.*

Absent the warranty piece, the Department's hypothetical BIC exemption essentially mirrors the requirements under proposed PTE 84-24, which makes sense. Proposed PTE 84-24 (addressed in further detail below) contains the key consumer protections the Department seems determined to maintain: a best interest standard, a prohibition on misleading statements, reasonable total compensation for financial professionals, and compensation disclosures.

NAIFA strongly encourages the Department to harmonize requirements between the proposed PTEs, which would create a more level playing field for advisors, products, and investors, and would dramatically reduce compliance difficulties and costs for advisors who deal with diverse products and clients. The features of proposed PTE 84-24 accomplish the Department's objectives, while avoiding the unnecessarily onerous requirements under the proposed BIC.

Accordingly, NAIFA encourages the Department to pursue something close to its hypothetical and adapt the BIC exemption to more closely mirror PTE 84-24.

#### IV. PROPOSED PTE 84-24

- A. To the extent the BIC exemption does not match PTE 84-24, the Department should include all annuity products sold to all types of investors under PTE 84-24.

As explained by multiple panelists during the public hearing, there are multiple reasons to include all annuity products under one PTE. Among those reasons are less consumer confusion and lower compliance burdens and costs for advisors. Additionally, the proposal's current structure may result in fewer guaranteed-income products being sold, without any real conflict-of-interest justification at the advisor level.

1. *Bifurcating annuity products between separate compliance regimes will result in fewer guaranteed-income products being recommended.*

When clients are interested in annuity products, advisors typically educate and advise them on the various product options available. Under the Department's current structure, an advisor who recommends a variable annuity product, and, alternatively, a fixed or indexed annuity product is under two separate compliance regimes with quite different requirements (i.e., would have to execute a contract for one recommendation, but not the other, and provide certain warranties and disclosures for one product, but not the other). This likely will lead to (understandable) consumer confusion and may result in advisors choosing to avoid discussion (i.e., any potential recommendation) of guaranteed-income products altogether.

2. *For many registered representatives, there is no conflict-of-interest rationale for splitting the sale of annuity products between PTEs.*

Unlike upstream financial institutions, NAIFA members (and registered representatives in general) are often compensated in the same manner for sales of fixed and variable annuity products (i.e., they receive an insurance commission for the sale, but do not receive "spin off" compensation from the securities products within variable annuities). As we noted in our first comment letter, in many circumstances (like this one), compensation at the broker-dealer or carrier level has no impact at all on the advice given by the advisor or on the advisor's compensation for that advice. Accordingly, it is important for the Department to keep separate potential conflicts of interest at the financial institution level and at the advisor level.<sup>25</sup>

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<sup>25</sup> As discussed in our first comment letter, this point has broader application than just proposed PTE 84-24. The Department should clearly divorce conflict-of-interest concerns at the advisor level and the upstream financial institution level, and clarify that so long as the advisor's own compensation and practices do not violate prohibited transaction rules, the *advisor* does not need to comply with a PTE. See NAIFA's Comment Letter on the Proposed BIC Exemption and PTE 84-24, Section II.B., p. 12.

At least from some advisors' perspective, there is no conflict-of-interest rationale for bifurcating annuity products into separate PTEs. At a minimum, to the extent advisors are not compensated differently for the sale of different annuity products (i.e., receive only an insurance commission and no compensation for underlying securities), the Department should allow those advisors to rely on PTE 84-24, regardless of the type of annuity sold or to whom the product is sold.

- B. If the Department retains proposed PTE 84-24's current structure, it should at least expand the PTE's scope to include all employer plans and provide adequate compensation relief for registered representatives and agents.

If the Department opts to not put all annuity products sold to all investors under PTE 84-24, the Department should cover under 84-24 the purchase of variable annuities and mutual funds by SIMPLE and SEP IRAs, not just 401(k) plans. There is no logical reason to split these different types of employer plans between PTEs.<sup>26</sup>

Further, the compensation relief under proposed PTE 84-24 should be expanded to be coextensive with the BIC exemption's relief or, at a minimum, it should be expanded to include mutual fund commissions for *agents* of principal underwriters.<sup>27</sup> Without broader compensation relief, registered representatives and agents will be unable to retain commission-based arrangements for participant-directed plans (because the BIC exemption does not apply to those plans at all). As discussed above, some small employers will not be willing or able to convert to—or agree to in the first instance—a fee-based model. Failure to provide adequate PTE relief for advisors to participant-directed plans could result in cancellation of existing employer-sponsored plans and fewer plans being offered in the first place.

## **V. THE DEPARTMENT SHOULD RELEASE A REVISED PROPOSAL BEFORE FINALIZING REGULATIONS AND INCLUDE AN ENFORCEMENT TIMELINE OF AT LEAST THIRTY-SIX MONTHS**

The Department has received thousands of comment letters on its proposal, in addition to four days of substantive testimony, and to its credit seems to be considering substantial changes to the proposed rule and proposed PTEs. The hypothetical BIC exemption mentioned by Department officials during the public hearing is an example of the type of revision (or wholesale reworking) apparently under contemplation by the Department. Given this potential remodeling, the Department should release a revised proposal and accept another round of public comments before issuing final regulations.

The Department's final rule will have a major and lasting impact on an entire industry and millions of consumers. Thus, it is important that any final regulations be fair, workable, and

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<sup>26</sup> For a full discussion regarding coverage of SIMPLE and SEP IRAs under PTE 84-24, see NAIFA's Comment Letter on the Proposed PTEs, Section III.B., pp. 22-23.

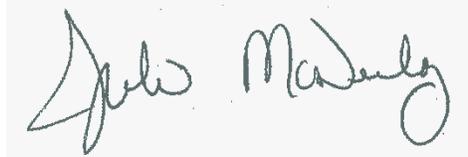
<sup>27</sup> NAIFA's original comment letter included a discussion of the need for broader compensation relief under PTE 84-24 and recommendations on how to expand that relief to allow agents to be compensated for mutual fund sales. See NAIFA's Comment Letter on the Proposed PTEs, Section III.C., pp. 23-24.

*good* for ordinary Americans. In our opinion, the proposal is not there yet, but the Department's suggestions at the hearing indicate that we are likely headed in the right direction. We (and assuredly other stakeholders) would welcome and appreciate the opportunity to comment on a revised proposal.

Regardless of whether the Department releases another proposed rule, the complexity and breadth of the proposal require sufficient time for the industry and consumers to adapt their practices to a brand new regime. Therefore, at the very least, the Department should include an enforcement timeline of at least thirty-six months.

Thank you for your consideration.

Very truly yours,

A handwritten signature in black ink, reading "Juli McNeely", is centered on a light gray rectangular background.

Juli Y. McNeely, LUTCF, CFP, CLU  
NAIFA President 2014-2015

Exhibit:           Chart comparing commission-based and fee-based costs for a small saver

# **Exhibit 1**

Comparison of Commission-Based and Fee-Based Costs for a Small Saver

	New \$ In	COMMISSION - A SHARE Portion of 12b1				FEE BASED EXAMPLES			
		EOY Balance	Upfront 5.75% on New Money*	fee broker receives to service acct .25%	Total broker fees paid each year	EOY Balance	Fee Based Acct 1.5% AUM**	EOY Balance	Fee Based Acct 1.2% AUM**
Year 1	\$ 1,200	\$ 1,215.00	\$ 69.00	\$ 3.04	\$ 72.04	\$ 1,266.00	\$ 18.00	\$ 1,269.60	\$ 14.58
Year 2	\$ 1,200	\$ 2,515.05	\$ 69.00	\$ 6.29	\$ 75.29	\$ 2,535.63	\$ 38.03	\$ 2,543.24	\$ 30.52
Year 3	\$ 1,200	\$ 3,906.10	\$ 69.00	\$ 9.77	\$ 78.77	\$ 3,875.09	\$ 58.13	\$ 3,890.74	\$ 46.69
Year 4	\$ 1,200	\$ 5,394.53	\$ 69.00	\$ 13.49	\$ 82.49	\$ 5,288.22	\$ 79.32	\$ 5,316.41	\$ 63.80
Year 5	\$ 1,200	\$ 6,987.15	\$ 69.00	\$ 17.47	\$ 86.47	\$ 6,779.07	\$ 101.69	\$ 6,824.76	\$ 81.90
Year 6	\$ 1,200	\$ 8,691.25	\$ 69.00	\$ 21.73	\$ 90.73	\$ 8,351.92	\$ 125.28	\$ 8,420.60	\$ 101.05
Year 7	\$ 1,200	\$ 10,514.64	\$ 69.00	\$ 26.29	\$ 95.29	\$ 10,011.28	\$ 150.17	\$ 10,108.99	\$ 121.31
Year 8	\$ 1,200	\$ 12,465.66	\$ 69.00	\$ 31.16	\$ 100.16	\$ 11,761.90	\$ 176.43	\$ 11,895.31	\$ 142.74
Year 9	\$ 1,200	\$ 14,553.26	\$ 69.00	\$ 36.38	\$ 105.38	\$ 13,608.80	\$ 204.13	\$ 13,785.24	\$ 165.42
Year 10	\$ 1,200	\$ 16,786.98	\$ 69.00	\$ 41.97	\$ 110.97	\$ 15,557.28	\$ 233.36	\$ 15,784.78	\$ 189.42
Year 11	\$ 1,200	\$ 19,177.07	\$ 69.00	\$ 47.94	\$ 116.94	\$ 17,612.94	\$ 264.19	\$ 17,900.30	\$ 214.80
Year 12	\$ 1,200	\$ 21,734.47	\$ 69.00	\$ 54.34	\$ 123.34	\$ 19,781.65	\$ 296.72	\$ 20,138.52	\$ 241.66
Year 13	\$ 1,200	\$ 24,479.88	\$ 60.00	\$ 61.20	\$ 121.20	\$ 22,069.64	\$ 331.04	\$ 22,506.55	\$ 270.08
Year 14	\$ 1,200	\$ 27,417.47	\$ 60.00	\$ 68.54	\$ 128.54	\$ 24,483.47	\$ 367.25	\$ 25,011.93	\$ 300.14
Year 15	\$ 1,200	\$ 30,560.70	\$ 60.00	\$ 76.40	\$ 136.40	\$ 27,030.06	\$ 405.45	\$ 27,662.62	\$ 331.95
Year 16	\$ 1,200	\$ 33,923.94	\$ 60.00	\$ 84.81	\$ 144.81	\$ 29,716.71	\$ 445.75	\$ 30,467.06	\$ 365.60
Year 17	\$ 1,200	\$ 37,522.62	\$ 60.00	\$ 93.81	\$ 153.81	\$ 32,551.13	\$ 488.27	\$ 33,434.15	\$ 401.21
Year 18	\$ 1,200	\$ 41,373.20	\$ 60.00	\$ 103.43	\$ 163.43	\$ 35,541.44	\$ 533.12	\$ 36,573.33	\$ 438.88
Year 19	\$ 1,200	\$ 45,493.33	\$ 60.00	\$ 113.73	\$ 173.73	\$ 38,696.22	\$ 580.44	\$ 39,894.58	\$ 478.73
Year 20	\$ 1,200	\$ 49,901.86	\$ 60.00	\$ 124.75	\$ 184.75	\$ 42,024.51	\$ 630.37	\$ 43,408.46	\$ 520.90
<b>TOTAL</b>	\$ 24,000		\$ 1,308.00	\$ 1,036.54	\$ 2,344.54		\$ 5,527.15		\$ 4,521.39

Assumes \$1200 annual deposit earning 7% (net of mutual fund fees).

\*Broker doesn't receive all of this. Some goes to fund family and some to broker dealer. Upfront sales charge is also reduced by breakpoints.

\*\*Most broker dealers have a platform fee of .20%. So the broker receives 1.3% or 1% in these examples.