



**National Association of Insurance and Financial Advisors**

Statement for the United States House of Representatives, Committee on Financial  
Services, Subcommittee on Oversight and Investigations  
and Subcommittee on Capital Markets and Government Sponsored Enterprises

“Preserving Retirement Security and Investment Choices  
for All Americans”

Juli McNeely  
President  
National Association of Insurance and Financial Advisors

September 10, 2015



## National Association of Insurance and Financial Advisors

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

Good morning Chairmen Duffy and Garrett, Ranking Members Green and Maloney, and Members of the Subcommittees. My name is Juli McNeely, and I am testifying today on behalf of the National Association of Insurance and Financial Advisors (“NAIFA”) for whom I currently am serving as President. Thank you for giving us this opportunity to share our perspective on “Preserving Retirement Security and Investment Choices for All Americans.”

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.

I also am a small business owner as I own my own agency – McNeely Financial Services, Inc. based in Spencer, Wisconsin. I am licensed to do both fee and commission-based work but the vast majority of my work is done on a commission basis because that compensation mechanism generally makes the most sense for my clients. I have 52 small-business clients, most of which have fewer than 25 employees, and 484 individual clients who have an average account size of \$70,982. We offer the small business clients group benefit and retirement plan products and advice; we offer individual clients a full range of investment and retirement products and advice, including retirement planning, college funding and investing for other future goals. Many of my clients start out as new savers, and I believe that many of them would not have become savers at all without my assistance and advice.

I intend to focus my testimony today on three core themes:

1. The critical need for main street Americans to access financial advice. We continue to have a savings crisis in this country and impeding the providing of advice will only exacerbate that problem.
2. We are concerned that the Department of Labor “fiduciary duty” proposals – while well-intended – will impose a wide range of new administrative requirements along with a “best interest” standard that invites litigation regarding what satisfies that standard. Through the imposition of these requirements on advisors who are paid on a commission basis, the proposal implicitly favors a fee-for-service model that does not work for most Americans of modest means. The Department has expressed its commitment to revising the proposal to address many of the identified concerns, but they do not appear to intend to issue a re-proposed rule meaning that we will not receive a clean opportunity to fix

issues that inevitably will arise when revisions of this magnitude are made. At a minimum, we hope that the Members of these Subcommittees will encourage the Department to re-propose the rule if it intends to proceed with this rule-making process.

3. If enacted, H.R. 1090, the “Retail Investor Protection Act” (“RIPA”) would stay the Department of Labor fiduciary duty rulemaking process until the Securities and Exchange Commission (“SEC”) has reported to Congress regarding whether the imposition of new duties and obligations is advisable and until the SEC has had the opportunity to issue any such rules if it concludes that it is advisable. Moreover, the one issue the Department of Labor cannot rectify unilaterally is the disharmony that its proposal will create between investments sold through Individual Retirement Accounts and those sold outside of the retirement context; only the SEC can issue rules that would impose a uniform standard in both contexts. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department’s rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes, none of which would advance any legitimate public policy objectives. For these reasons, NAIFA supports RIPA.

After a brief background section on NAIFA, its members and our clients, I discuss these points in more detail below. In addition, we also are submitting copies of the two comment letters we filed with the Department of Labor which outline our specific concerns with individual elements of the Department’s proposals in more detail and which suggest ways in which some of the proposed elements we believe are damaging or burdensome can be ameliorated or corrected.

### **Background**

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors<sup>1</sup> who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial advisor for multiple counties. And often, our members’ relationships with their clients span decades and various phases of clients’ financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client’s needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

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<sup>1</sup> For purposes of this comment letter, the term “advisor” refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

Most of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department’s proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department’s proposed Best Interest Contract (“BIC”) Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of doing business. NAIFA does not oppose a “best interest” fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

Despite Secretary Perez’s statement before Congress on June 17, 2015 that the Department’s proposal makes things “simpler” by imposing a uniform fiduciary standard on investment advisors, the proposal is anything but simple. The proposed DOL rules are complex and contain extensive conditions that will put a tremendous burden on advisors who serve the middle market.

#### **FORESEEABLE CONSEQUENCES OF THE DEPARTMENT’S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS – LESS ACCESS TO MORE EXPENSIVE ADVICE**

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that “we have a retirement crisis” in this country and “we need to save more.”<sup>2</sup> This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved*.<sup>3</sup> As reported by the *Washington Post*, “[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age.”<sup>4</sup> Roughly 45% of people said they plan to

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<sup>2</sup> Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter “June 17 Hearing”), hearing webcast available at <http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027>.

<sup>3</sup> Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It*, *Washington Post*, Aug. 7, 2014.

<sup>4</sup> *Id.*

rely on Social Security to cover expenses during retirement, whether they have personal savings or not.<sup>5</sup>

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department's proposed rule, along with its proposed amendments to existing prohibited transaction exemptions ("PTEs"), threatens to be counterproductive with respect to this country's retirement crisis by making it both more expensive and harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule's restrictive definition of investment "education," advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department's proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal's burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The

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<sup>5</sup> *Id.*

proposal's burden on independent advisors and registered representatives is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and we know is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.<sup>6</sup> And small businesses that work with a financial advisor are 50% more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.<sup>7</sup> Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with \$100,000 or less in annual income, advised individuals have an average of 113% more assets than non-advised investors.<sup>8</sup> The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.<sup>9</sup>

#### B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

- (1) do not give investment advice, as defined under the proposed rule, and avoid becoming a fiduciary;

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<sup>6</sup> Oliver Wyman Study, *The Role of Financial Advisors in the US Retirement Market* (July 10, 2015) (hereinafter "Oliver Wyman Study"), at 5 (citing Oliver Wyman Retail Investor Retirement Survey 2014).

<sup>7</sup> LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3 (a copy of which is attached to the DOL Comment Letters as Exhibit 3).

<sup>8</sup> Oliver Wyman Study, at 6.

<sup>9</sup> LIMRA Survey, at 13.

(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.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment “education” is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members’ Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.<sup>10</sup> The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.<sup>11</sup> Thus, ultimately, fee-based models actually will raise costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

This is in part because fee-based arrangements generally impose fees on all of the assets under management whereas commission arrangements generally only generate compensation for the purchase of new assets. The attached Exhibit 1 shows an illustration of this. In the example, an investor opens a new mutual fund account and deposits \$1,200 annually in the new account for 20 years. The assumed commission load for a managed account – 5.75% – would be paid on new contributions that are made to the account but the only “trailing” compensation that is generated on the overall assets in the account is a standard 0.25% 12b1 fee. Generally, no new contribution commission is paid when an investor moves money between funds in the same fund family and, for that reason, I work closely with my clients to ensure that they keep their investments within a single fund family. Over the 20 year period, the commission model would generate \$2,344.54 for the advisor under this example.

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<sup>10</sup> Oliver Wyman Study, at 6.

<sup>11</sup> *Id.*, at 7.

The exhibit also shows two fee arrangements, both of which are very conservative especially for relatively small asset accounts like these. Using a fee of just 1.2%, the amount of fees generated for the advisor over the same 20 year period – \$4,521.39 – is almost double what the commissioned advisor received.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA’s survey, 87% of advisors anticipate that the Department’s proposal will result in higher errors and omissions (“E&O”) insurance premiums for their practices; and 58% of those said they expect premiums to increase “substantially.” The Department’s proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department’s proposed BIC exemption contract.

Adding to the overall cost of the Department’s proposal is the real threat of conflicting regulatory regimes if and when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department’s rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

All of these costs will have real consequences for consumers. If the Department’s proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below \$178,000. Currently, only 26% of respondents to NAIFA’s survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department’s proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

### C. Fewer Guaranteed-Income Products Will Be Sold

The Department’s proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. This result is also contrary to the Department’s goals, which include encouraging lifetime income payout options like annuities.

We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why the Department has traditionally held a favorable view of most annuity products. Somewhat ironically, however, the Department’s proposal imposes a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal’s structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department’s proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.<sup>12</sup> On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors’ particular needs and retirement savings goals.

#### D. Proposal Must Accommodate Proprietary Products

Another problem posed by the complex best interest contract element of the Department’s proposed rules involves the situation in which the advisor is a registered representative of a broker-dealer that restricts the products that the advisor can sell. This is the proprietary products issue. Because of complex ERISA self-dealing rules, when an advisor can offer only his or her own broker-dealer’s products, it becomes difficult—perhaps impossible—for that advisor to comply with the best interest contract PTE at all. This would foreclose the ability of this kind of advisor to help his or her clients save for retirement at all unless he or she charged the client upfront non-product specific fees for advice. As explained earlier, this is simply not an option for most middle income Americans whose modest means make such a fee-for-advice model unaffordable or unappealing to the retirement saver. The Department’s proposal simply must be modified to accommodate that slice of the market that involves the sale of proprietary products.

#### E. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal’s elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department’s new structure. In the

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<sup>12</sup> The disproportionate burden, discussed in detail above, placed by the Department’s proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department’s proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it purportedly is seeking to protect. A full discussion of NAIFA’s specific issues and concerns with the proposed rules – as well as many suggested potentially corrective measures – is included in the comment letters NAIFA filed with the Department which are attached hereto as noted above.

**NAIFA SUPPORTS H.R. 1090**  
**AS A WAY TO ENSURE SAVERS HAVE ACCESS TO AFFORDABLE RETIREMENT ADVICE**

In response to concerns that investors were confused about what duties were owed to them when advisory services were provided by an “Investment Advisor” as opposed to when the services were provided by a “Broker-Dealer Representative,” Congress directed the SEC in Section 913 of the Dodd-Frank Wall Street Reform Act to harmonize the duties between investment advisors and representatives. This was done in part because of the perceived success of similar reforms in the United Kingdom. Just last month, however, the UK announced that it will conduct a Financial Advice Market Review to examine how financial advice could work better for consumers who are now perceived to be experiencing a shortage of access to investment advice in part because of the burdens imposed by those reforms.

If enacted, H.R. 1090, the “Retail Investor Protection Act” (“RIPA”), would stay the Department of Labor fiduciary duty rulemaking process until the Securities and Exchange Commission (“SEC”) has reported to Congress regarding whether the imposition of new duties and obligations is advisable and until the SEC has had the opportunity to issue any such rules if it concludes that it is advisable.

Moreover, the one issue the Department of Labor cannot rectify unilaterally is the disharmony that its proposal will create between investments sold through Individual Retirement Accounts and those sold outside of the retirement context; only the SEC can issue rules that would impose a uniform standard in both contexts. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department’s rule-making, advisors will be faced with multiple

complex and potentially contradictory compliance regimes, none of which would advance any legitimate public policy objectives. Any SEC rules that are issued necessarily will cover the sale of all securities-based products while the DOL rules jurisdictionally are limited to those sold only through employer retirement plans or Individual Retirement Account vehicles.

We understand that the Department is operating within the jurisdiction of ERISA while the SEC's actions are governed by Dodd-Frank and the Investment Advisors Act. These are different statutes with different goals and parameters. It is, nevertheless, imperative that these differing statutory approaches accommodate each other or retirement savers will pay the price for confusing, potentially contradictory rules. Because the SEC's jurisdiction is broader, especially in the context of IRAs, it makes sense for the SEC to start the process of regulatory modification.

For these reasons, NAIFA supports RIPA.

**IF THE DEPARTMENT PROCEEDS WITH ITS RULEMAKING,  
IT SHOULD RE-PROPOSE THE RULES BEFORE ISSUING FINAL RULES**

By imposing a wide range of new administrative requirements along with a “best interest” standard that invites litigation regarding what satisfies that standard, the proposal implicitly favors a fee-for-service model that does not work for most Americans of modest means. The Department has expressed its commitment to revising the proposal to address many of the identified concerns, but they do not appear to intend to issue a re-proposed rule meaning that we will not receive a clean opportunity to fix issues that inevitably will arise when revisions of this magnitude are made. At a minimum, we hope that the Members of these Subcommittees will encourage the Department to provide interested parties—both within the financial services industry and among the consumers who will be most impacted by the new rules—an opportunity to review the changes the Department says it will make as a result of what it acknowledges has been helpful and important stakeholder input to date. The extent of the changes the Department itself says it will make suggest that a re-proposal (or some other form of pre-finalization review and opportunity for input) will be crucial to the possibility of a workable rule that indeed would serve the best interests of retirement savers.

**CONCLUSION**

The Department of Labor's proposed “fiduciary duty” rules present complex challenges to advisors and their clients. Thank you for giving us the opportunity to outline our views on these important issues and to present our concerns. I welcome the opportunity to address any questions you may have.

# Exhibit 1

Commission-based

versus

Fee-based

Arrangements

	COMMISSION - A SHARE					FEE BASED EXAMPLES			
	New \$ In	Portion of 12b1 fee			Total broker fees paid each year	EOY Balance	Fee Based Acct 1.5% AUM**	EOY Balance	Fee Based Acct 1.2% AUM**
		EOY Balance	Upfront 5.75% on New Money*	broker receives to service acct .25%					
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.



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July 21, 2015

**VIA ELECTRONIC FILING – [www.regulations.gov](http://www.regulations.gov)**

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

**RE: RIN 1210-AB32 - Proposed Definition of Fiduciary Investment Advice**

To Whom It May Concern:

The National Association of Insurance and Financial Advisors (“NAIFA”) appreciates this opportunity to comment on the Department of Labor’s (“Department”) proposed definition of fiduciary “investment advice” under the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code of 1986 (“Code”).<sup>1</sup>

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**

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors<sup>2</sup> who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

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<sup>1</sup> NAIFA has filed a separate comment letter on the Department’s proposed prohibited transaction exemptions, which is attached hereto as Exhibit 1.

<sup>2</sup> For purposes of this comment letter, the term “advisor” refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Many of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of conducting their business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in more detail below, NAIFA has significant concerns about the workability of some portions of the Department's proposed rule, and recommends several adjustments to the proposal. Namely, NAIFA strongly encourages the Department to adopt a final fiduciary investment advice definition that:

- Requires some investor reliance on the investment advice;
- Requires a mutual understanding between the investor and the advisor;
- Excludes referrals to other financial professionals;
- Excludes distribution-related advice that is not investment advice;
- Excludes welfare benefit plans with no investment component;
- Excludes, or includes a carve-out for, marketing and sales activity for all products, services and investors;
- Includes a carve-out for advice relating to employer plan design;
- Allows for meaningful investor education by including a broad education carve-out;

- Allows advisors to place reasonable limitations on the scope and duration of the fiduciary relationship; and
- Includes an enforcement timeline of at least thirty-six months.

In its current form, the proposed rule presents major—and in some cases, insurmountable—obstacles for NAIFA members serving middle-market retail investors (i.e., those who need the most encouragement and assistance when it comes to retirement savings). NAIFA hopes that the objective of the Department’s proposal is not to limit or take away advisory services for Main Street investors, and we greatly appreciate your thoughtful consideration of these comments.

## **I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT’S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS**

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that “we have a retirement crisis” in this country and “we need to save more.”<sup>3</sup> This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved*.<sup>4</sup> As reported by the *Washington Post*, “[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age.”<sup>5</sup> Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.<sup>6</sup>

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department’s proposed

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<sup>3</sup> Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter “June 17 Hearing”), hearing webcast available at <http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027>.

<sup>4</sup> Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It*, *Washington Post*, Aug. 7, 2014.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

rule, along with its proposed amendments to existing prohibited transaction exemptions (“PTEs”), threatens to be counterproductive with respect to this country’s retirement crisis by making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule’s restrictive definition of investment “education,” advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department’s proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal’s burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal’s burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.<sup>7</sup> And small businesses that work with a financial advisor are 50%

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<sup>7</sup> Oliver Wyman Study, *The Role of Financial Advisors in the US Retirement Market* (July 10, 2015) (hereinafter “Oliver Wyman Study”), at 5 (citing Oliver Wyman Retail Investor

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.<sup>8</sup> Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with \$100,000 or less in annual income, advised individuals have an average of 113% more assets than non-advised investors.<sup>9</sup> The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.<sup>10</sup>

#### B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

- (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.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets

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Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

<sup>8</sup> LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 2.

<sup>9</sup> Oliver Wyman Study, at 6.

<sup>10</sup> LIMRA Survey, at 13.

they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.<sup>11</sup> The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.<sup>12</sup> Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA’s survey, 87 % of advisors anticipate that the Department’s proposal will result in higher errors and omissions (“E&O”) insurance premiums for their practices; and 58% of those said they expect premiums to increase “substantially.” The Department’s proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department’s proposed BIC exemption contract.

Adding to the overall cost of the Department’s proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department’s rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and

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<sup>11</sup> Oliver Wyman Study, at 6.

<sup>12</sup> *Id.*, at 7.

dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below \$178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

#### C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.<sup>13</sup> On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

#### D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the

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<sup>13</sup> The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department’s proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

## **II. THE PROPOSED RULE**

Virtually all NAIFA members will be investment advice fiduciaries for purposes of ERISA and the Code under the Department’s proposed rule. The rule, along with the Department’s proposed PTEs, will require major changes in our members’ business practices and client relationships. While NAIFA is not opposed to a “best interest” standard of care for advisors, it is extremely important that such a standard be contained within a feasible operational structure.

As it stands, nearly all of our members who become fiduciaries will have to alter their current compensation arrangements (for at least some clients and some products) or satisfy a PTE. For the reasons discussed above, both options carry significant risk of harm to retail investors. We believe that such risk can be partially mitigated, however, if the Department addresses the specific points of concern discussed below.<sup>14</sup>

### **A. Scope of the Proposed Definition of Fiduciary “Investment Advice”**

1. *The definition of fiduciary investment advice should require some investor reliance on the investment advice.*

The Department’s current five-part test for fiduciary investment advisors includes a requirement that the advice serve as the primary basis for the investment decision(s) ultimately made by the investor.<sup>15</sup> The requirement ensures that clients actually act on the investment advice before a fiduciary relationship arises. NAIFA strongly urges the Department to maintain a similar reliance requirement under its proposed definition of fiduciary investment advice. Otherwise, advisors are forced to take on a fiduciary role, even if their investment advice is completely

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<sup>14</sup> Again, NAIFA has submitted separate detailed comments on suggested adjustments to the Department’s PTE proposals.

<sup>15</sup> See 29 CFR 2510.3-21.

ignored or has no impact whatsoever on the client's investment decisions. Given the substantial cost and burden on fiduciaries under the Department's proposal, fiduciary relationships should at least be limited to situations in which some meaningful advice or service is rendered *and* accepted.

2. *The definition of fiduciary investment advice should require a mutual understanding between investor and advisor.*

Similarly, the Department's current fiduciary investment advice test includes a requirement that the advice be given pursuant to a mutual agreement or understanding between the investor and the advisor.<sup>16</sup> Mutual understanding, like reliance, should be an element of the Department's new definition of fiduciary investment advice. Before a fiduciary relationship exists, both parties should, at a minimum, recognize that the advice is being given and considered for the client's particular investment needs. Without such mutuality, casual or social conversations could be misconstrued as fiduciary communications. Again, considering the burden of the overall fiduciary structure proposed by the Department, some common-sense checks should be in place before fiduciary obligations are imposed on advisors. At the very least, the impacted parties should have an awareness and understanding of what they are undertaking.

3. *Recommendations of other financial professionals should not fall within the definition of fiduciary investment advice.*

As drafted, the Department's proposed definition of fiduciary investment advice covers four general categories of advice:

- (1) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property (including a recommendation to rollover assets or take a distribution);
- (2) A recommendation as to the management of securities or other property (again, including rollover and distribution decisions);
- (3) An appraisal, fairness opinion, or similar statement—verbal or written—concerning the value of securities or other property when provided in connection with a specific transaction; and
- (4) A recommendation of a person who is also going to receive a fee or other compensation for providing the aforementioned types of advice.

The last category—recommendations of other financial professionals—should be excluded from the fiduciary investment advice definition because it is not *investment* advice. In fact, a simple referral is several steps removed from actual investment activity. The Department's definition appears to assume that the recipient of the advice will in fact pursue the recommended professional, that the other professional to whom the prospective client is referred will be in a position (and agree) to work with the client, and that investment advice will actually be given and acted upon.

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<sup>16</sup> *Id.*

Furthermore, inclusion of referrals under the new definition of fiduciary investment advice will effectively eliminate referrals because advisors simply will not be willing to take on fiduciary obligations in situations where the “advice” rendered is to send the investor elsewhere for services. And reducing referrals will harm investors. Professional referrals are a valuable service, particularly to unsophisticated investors or those who are new to retirement planning and saving. A list of names or advertisements in a phone book does not offer any meaningful guidance for investors to narrow down their options or find professional services that are suitable for them. Referrals from individuals in the same business, however, provide investors with some confidence that they will be talking to a reputable advisor who, in at least someone’s estimation, is an appropriate advisor for the investor.

The Department’s proposal to include referrals in the definition of fiduciary investment advice defies logic and will only harm consumers. Accordingly, the Department should remove this category of advice from the proposed definition.

4. *Advice regarding distributions—without accompanying investment advice—should not be included in the definition of fiduciary investment advice.*

As noted above, the Department proposes to include advice regarding distributions under the definition of fiduciary investment advice. This type of advice should be excluded, however, when it is rendered without any accompanying *investment* advice. For example, if an advisor is informed that an investor has suffered an unforeseeable financial loss and needs to take a hardship distribution—and there is no investment recommendation sought or given pertaining to the distributed funds—the advisor’s non-investment advice aimed at facilitating the distribution should not qualify as fiduciary investment advice. Similarly, if an advisor counsels an investor not to take a distribution (i.e., to preserve the status quo with respect to plans and assets), that also should not be considered fiduciary advice.

In these scenarios, the advisor is not delivering advice with respect to particular investments from which the advisor may benefit, but rather is providing generic counseling and assistance for the good of consumers. Thus, the Department should clarify in the final rule that such distribution-related advice is not considered fiduciary investment advice.

5. *Welfare benefit plans with no investment component should be excluded from the rule.*

The Department’s proposed rule defines “plan” as “any employee benefit plan described in section 3(3) of [ERISA] and any plan described in section 4975(e)(1)(A) of the Code.” Section 3(3) of ERISA includes employee pension benefit plans and employee welfare benefit plans, which include health, life, and disability benefits. Department officials indicated at a meeting on May 20, 2015, and during a phone conversation on June 3, 2015, that the Department does not intend the proposed rule to cover welfare plans that do not have an investment component (i.e., plans that are not designed to generate income or increase wealth). NAIFA strongly urges the Department to clarify in its final rule that benefit plans like traditional health, life and disability are not covered under this rule-making.

NAIFA suggests achieving such clarification by adding a definition of “other property.” For example, the definition could read:

“‘*Other property*’ for purposes of this section does not include welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use.”

Alternatively, the term “investment” could be defined as follows:

“‘*Investment*’ for purposes of this section does not include the purchase, sale, holding, or exchanging of welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use.”

In addition to these specific suggestions, there may be other ways for the Department to resolve this issue. NAIFA urges the Department to clarify, in one way or another, that welfare benefit plans with no investment component are not covered under this rule-making.

6. *Marketing of services and preliminary client development conversations should not be considered fiduciary investment advice.*

For the individuals and small businesses served by NAIFA members, effective marketing of our advisors’ services can mean the difference between an employer offering a retirement plan or not, or an individual prematurely cashing out a retirement account or continuing to save. Getting good advice to consumers who need it is a goal we all share. Further, as discussed above with respect to professional referrals, we all agree that consumers should be able to make informed decisions when choosing their advisors.

Department officials said at a technical briefing on May 7, 2015 that they did not intend to capture conversations along the lines of “hire me” or “these are the services I can offer you” under the definition of investment advice. At that same briefing, officials acknowledged that there should be some opportunity for preliminary conversations with prospective clients before fiduciary status and any attendant contract or disclosure requirements are triggered. Secretary Perez echoed those comments while testifying before a congressional committee on June 17, 2015, where he stated that the Department wants consumers to be able to “shop around” and “[the Department’s] goal is to make sure that shopping around can happen.” However, given some elements of the proposed rule, NAIFA believes that these sentiments need to be clarified and memorialized in any final rule.

As drafted, the proposed rule applies to a recommendation:

- (1) of a person who is going to receive compensation for providing investment advice;
- (2) that is individualized or specifically directed to the recipient of the recommendation; and

(3) is provided by someone who may eventually receive compensation as a result of the recommendation.<sup>17</sup>

It appears that this would cover one-on-one sales pitches and targeted advertising by advisors seeking to introduce their services to new clients, which creates an unnecessary barrier to services for individuals and employers who will not sift (or do not feel comfortable sifting) through anonymous advisor listings in the phone book.

The Department could ensure that these initial conversations are not captured by adopting some of the above suggestions (e.g., by requiring some investor reliance and mutual understanding between advisors and investors). Or, as discussed in detail below, the Department could resolve this issue by creating a robust seller's exception. Regardless of the approach taken, NAIFA urges the Department to carve out marketing and preliminary conversations with prospective clients from the investment advice definition.

B. The Department should Adopt a Seller's Exception that Applies Across all Products, Services, and Investors.

The Department's proposed seller's exception (the counterparty carve-out) does not apply to small plans or IRAs at all, and is limited to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract to large plan ("sophisticated") investors.<sup>18</sup> As drafted, the exception also does not appear to cover a discussion about an advisor's services.<sup>19</sup> The Department should replace its proposed counterparty carve-out or create a separate seller's exception that applies to all products, services, and investors.

A robust seller's exception will allow advisors and financial institutions to market their products and services. Marketing, as opposed to true investment advice, poses very little threat of conflicts of interest. Presumably, this is why marketing has not historically been considered fiduciary activity under ERISA or the Code. Indeed, it is unclear whether the Department has statutory authority to capture pure marketing and sales activities under the fiduciary umbrella.

Sales pitches in the financial advisor context are like sales pitches in all other retail contexts; they are take-it-or-leave-it promotions designed to attract consumers in the first instance so that products and services can *then* be delivered. And like other retail contexts, financial advisor marketing should not be limited to certain segments of the population. The Department appears to believe—without apparent justification—that small business owners (i.e., with 99 or fewer employees) are not as sophisticated as large business owners (i.e., with 100 or more employees).

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<sup>17</sup> See proposed § 2510.3-21(a)(1)(iv) (what constitutes investment advice), (a)(2)(ii) (the requirement that said advice be directed to an individual), and (f)(6) (definition of "fee or other compensation, direct or indirect").

<sup>18</sup> See proposed § 2510.3-21(b)(1)(i).

<sup>19</sup> Because the counterparty exception applies only to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract, it is NAIFA's interpretation that it does not cover a discussion of services.

Size of a business is immaterial, however, to the financial knowledge and sophistication of a plan fiduciary. Furthermore, there is no evidence that financial sophistication is needed to understand when someone is making a sales pitch rather than delivering impartial advice. The Department's paternalistic approach is misguided, and will only prevent a large number of consumers from learning about available products and services, which is counterproductive for the retirement crisis in this country.

Any seller's exception could and should include reasonable investor protections, such as clear and explicit disclosures by the advisor that she is not providing impartial or fiduciary investment advice (i.e., the disclosure required under the proposed counterparty exception), but rather is engaged in marketing or sales activity. A full disclosure of this nature supports the Department's objective of improving consumer awareness of advisors' obligations (or lack thereof) in certain circumstances. At the same time, a broad exception allows for effective marketing and client development, which will help advisors reach those populations that are arguably in most need of professional retirement planning assistance.

C. The Final Rule Should Include a Carve-Out for Advice on Plan Design.

An advisor's assistance to employers with menu design for participant-directed plans (including 401(k) plans, SIMPLE IRAs, and SEP IRAs) should be excluded from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products.<sup>20</sup> Thus, the risk of a conflict of interest arising at this stage between the advisor and employee investors is minimal. Furthermore, in the plan design space, the plan administrator—regardless of plan size—is under a separate obligation to make informed and prudent decisions with respect to the plan.<sup>21</sup>

The “plan design exception” should apply when an advisor is providing recommendations to an employer:

- (1) On the types of retirement plans available (e.g., 401(k), SIMPLE IRA, etc.), and associated costs and benefits with respect to plan types;
- (2) On the investment options that will be made available through the plan selected (e.g., mutual fund options, annuity options, etc.), including advice related to the overall allocation of investment options and advice related to narrowing down options within general product categories; and

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<sup>20</sup> NAIFA recognizes that individualized investment advice to plan participants or IRA owners is a different scenario with separate conflict-of-interest concerns.

<sup>21</sup> See 29 U.S.C. § 1002(21)(a)(iii) (under ERISA, a person is a fiduciary with respect to a plan to the extent he has any discretionary authority or discretionary responsibility in the administration of such plan); see also 26 U.S.C. § 4975(e)(3)(C) (corresponding fiduciary definition under the Code).

(3) On plan administration topics, including selection of a managing fiduciary, third-party administrators, and other administrative service providers.<sup>22</sup>

Employers need professional advice in each of these areas to establish and maintain a retirement plan appropriate for their specific needs and employee populations. As explained above, a plan design exception is consistent with the Department's goal of minimizing advisor conflicts of interest, as well as the overarching objective of encouraging individuals to save early for retirement by increasing the availability of employer-sponsored retirement plans.<sup>23</sup>

D. The Final Rule Should Allow for *Meaningful* Investment Education.

During a meeting on May 4, 2015 with NAIFA members, Department officials stated that one of their objectives is to preserve investor education. And Secretary Perez told members of Congress on June 17 that investor education is "exceedingly important." Unfortunately, the narrow scope of the education exception under the proposed rule will not facilitate the goal of preserving or expanding investor education. It will have the opposite result, especially for unsophisticated investors who benefit the most from such education.

Secretary Perez commented on June 17 that, in his view, the "most important part" of an educational discussion between advisor and investor "is the asset allocation conversation." And, he asserted that, under the proposed rule, those conversations do not trigger fiduciary status or obligations. The Secretary's comment is perplexing, to say the least, when one reads the proposal's narrow education exception.

There are approximately 9,000 mutual funds available today, not to mention the host of other types of products available in the retirement space. Telling an inexperienced investor to choose among mutual funds without providing any guidance as to the strength or desirability of any particular funds is not meaningful education; it is simply overwhelming. Meaningful education requires some identification and characterization of specific investment options.

The Department has not historically restricted "education" to generic, high-level conversations. Instead, the Department has allowed for meaningful education to take place, with appropriate disclosures. For instance, under Interpretive Bulletin 96-1,<sup>24</sup> the Department has not included within fiduciary "investment advice" asset allocation models that identify specific investment

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<sup>22</sup> We do not interpret the Department's proposed platform provider carve-out to be broad enough to capture these advisor services. To the extent the Department does intend for the carve-out to cover these activities, NAIFA urges the Department to make that clear in the final rule.

<sup>23</sup> Alternatively, if the Department chooses not to include a plan design exception, NAIFA urges the Department to finalize a more robust PTE 84-24 that would cover plan design services and advice. This alternative approach is described in more detail in NAIFA's comment letter on the Department's proposed PTEs, attached hereto as Exhibit 1.

<sup>24</sup> 29 CFR Part 2509.

alternatives, as long as they are accompanied by a statement indicating that other investment options with similar characteristics may be available. Bulletin 96-1 reasons: “Because the information and materials described above would enable a participant or beneficiary to assess the relevance of an asset allocation model to his or her individual situation, the furnishing of such information would not constitute a “recommendation”. . . and, accordingly, would not constitute [fiduciary investment advice].”<sup>25</sup>

The Department’s rationale in Bulletin 96-1 makes perfect sense and its approach strikes an appropriate balance between ensuring the availability of meaningful investment education and providing investor protection. NAIFA strongly encourages the Department to maintain its current rule on investment education and create an education exception under its proposed rule that encompasses this broader, more helpful approach.

E. Advisors Should be Permitted to Put Reasonable Limitations on the Scope and Duration of the Fiduciary Relationship.

Department officials stated at the May 7, 2015 technical briefing that they do not intend the proposal’s prohibition on exculpatory contractual language<sup>26</sup> to prohibit advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the time period and scope of services the advisor is willing to provide to a given client). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) regarding the expiration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail the provision of ongoing advice (e.g., a one-time sale relationship), the advisor should be able to make clear that the fiduciary relationship concludes with the sale and the advisor does not have perpetual fiduciary obligations to the client.<sup>27</sup> NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a disclosure to the client.

**III. The Department Should Extend the Enforcement Timeline to at least Thirty-Six Months**

The eight-month enforcement timeline for compliance with the new rule proposed by the Department is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department’s proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about

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<sup>25</sup> *Id.*

<sup>26</sup> *See* Proposed BIC Exemption, Section II(f)(1).

<sup>27</sup> A contractual term of this nature would not bar suit by the investor based on breach of fiduciary duty or interfere with any current statutes of limitation with respect to such claims.

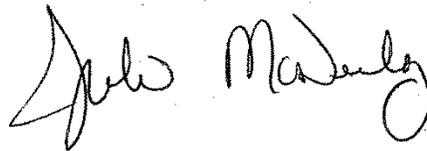
the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

*Each* one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

Very truly yours,

A handwritten signature in black ink, appearing to read "Juli McNeely". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

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

Exhibits:      NAIFA Comment Letter on Proposed Prohibited Transaction Exemptions  
                    LIMRA Secure Retirement Institute 2015 Consumer Survey

# **Exhibit 1**

## **NAIFA Comment Letter on Proposed Prohibited Transaction Exemptions**



**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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July 21, 2015

**VIA ELECTRONIC FILING – [www.regulations.gov](http://www.regulations.gov)**

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-ZA25 - Proposed Prohibited Transaction Exemptions  
D-11712 (Best Interest Contract Exemption) and D-11850 (PTE 84-24)**

To Whom It May Concern:

The National Association of Insurance and Financial Advisors (“NAIFA”) appreciates this opportunity to comment on the Department of Labor’s (“Department” or “DOL”) proposed prohibited transaction exemptions (“PTEs”) under the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code of 1986 (“Code”).<sup>1</sup>

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**

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors<sup>2</sup> who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

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<sup>1</sup> NAIFA has filed a separate comment letter on the Department’s proposed definition of fiduciary “investment advice,” which is attached hereto as Exhibit 1.

<sup>2</sup> For purposes of this comment letter, the term “advisor” refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Most of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of doing business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in further detail below, some of our members' existing compensation arrangements do not violate ERISA or Code prohibited transaction rules, and therefore do not require compliance with a PTE.<sup>3</sup> To the extent NAIFA members must rely on PTEs, however, we have serious concerns about compliance burdens under the Department's proposal, particularly with respect to the Best Interest Contract ("BIC") Exemption and the proposed revisions to PTE 84-24.

Despite Secretary Perez's statement before Congress on June 17, 2015 that the Department's proposal makes things "simpler" by imposing a uniform fiduciary standard on investment advisors, the proposal is anything but simple. The proposed PTEs are complex and contain extensive conditions that will put a tremendous burden on advisors who serve the middle market.

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<sup>3</sup> Diagrams of common compensation arrangements for advising employers on plan design (employer plan model) and for the sale of fixed and variable annuities (annuity models) are attached hereto as Exhibits 2(a) and 2(b), respectively.

Accordingly, NAIFA recommends that the following revisions be made to the proposed BIC exemption and PTE 84-24:

*Best Interest Contract Exemption -*

- Simplify and clarify the exemption’s requirement to the greatest extent possible in order to avoid litigating areas of uncertainty;
- Align the exemption’s conditions as closely as possible with existing SEC requirements to avoid a dual regulatory system for securities products;
- Hone the “best interest” definition to account for varying perspectives and opinions on particular investment products and business practices; specifically:
  - 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;”
  - Provide 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
  - Provide a clear and explicit statement that offering proprietary products (even a limited suite of such products) does not violate the best interest standard;
- Clarify that the exemption covers rollovers and distributions (to the extent those activities are considered fiduciary investment advice);
- Modify the contract conditions, specifically:
  - Eliminate the formal contract requirement and replace it with a non-signatory point-of-sale notice that binds advisors and financial institutions to act in the best interest of their clients;
  - Or, if the Department retains the contract requirement, clarify:
    - that any contract need not be signed prior to the point of sale;
    - that the contract need not be signed by more than one financial institution;
    - that advisors do not have to provide warranties regarding another entity’s (e.g., a financial institution) incentive and compensation arrangements;
    - that the contract may contain language reasonably limiting the scope and duration of the fiduciary relationship;
- Lessen advisors’ disclosure obligations, particularly to the extent they conflict with securities laws or involve information that is not readily accessible to individual advisors;
- Clarify that non-securities licensed advisors can satisfy the best interest standard; and
- Explain and clarify the interplay between the special exemption for insurance and annuity products, the larger BIC exemption, and other available PTE relief.

*Proposed PTE 84-24 –*

- Expand the scope of the PTE to cover all annuity products sold to all types of investors;
- Do not revoke the PTE for SIMPLE and SEP IRA purchases of variable annuities and mutual funds; and

- Expand the PTE’s compensation relief to be coextensive with the BIC exemption, or at the very least, to allow agent commissions for mutual fund sales.<sup>4</sup>

Below is a detailed discussion of the foreseeable impact of the Department’s proposal, as drafted, and the aforementioned recommendations to make the proposal less onerous.

## **I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT’S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS**

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that “we have a retirement crisis” in this country and “we need to save more.”<sup>5</sup> This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved*.<sup>6</sup> As reported by the *Washington Post*, “[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age.”<sup>7</sup> Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.<sup>8</sup>

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department’s proposed rule, along with its proposed amendments to existing prohibited transaction exemptions (“PTEs”), threatens to be counterproductive with respect to this country’s retirement crisis by

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<sup>4</sup> To the extent PTE 84-24’s proposed conditions are the same as those under the BIC exemption, NAIFA’s comments with respect to those conditions apply to both exemptions.

<sup>5</sup> Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter “June 17 Hearing”), hearing webcast available at <http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027>.

<sup>6</sup> Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It*, *Washington Post*, Aug. 7, 2014.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule's restrictive definition of investment "education," advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department's proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal's burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal's burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.<sup>9</sup> And small businesses that work with a financial advisor are 50%

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<sup>9</sup> Oliver Wyman Study, *The Role of Financial Advisors in the US Retirement Market* (July 10, 2015) (hereinafter "Oliver Wyman Study"), at 5 (citing Oliver Wyman Retail Investor Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.<sup>10</sup> Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with \$100,000 or less in annual income, advised individuals have an average of 113% more assets than non-advised investors.<sup>11</sup> The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.<sup>12</sup>

#### B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

- (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.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a

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<sup>10</sup> LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 3.

<sup>11</sup> Oliver Wyman Study, at 6.

<sup>12</sup> LIMRA Survey, at 13.

given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.<sup>13</sup> The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.<sup>14</sup> Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA’s survey, 87 % of advisors anticipate that the Department’s proposal will result in higher errors and omissions (“E&O”) insurance premiums for their practices; and 58% of those said they expect premiums to increase “substantially.” The Department’s proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department’s proposed BIC exemption contract.

Adding to the overall cost of the Department’s proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department’s rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

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<sup>13</sup> Oliver Wyman Study, at 6.

<sup>14</sup> *Id.*, at 7.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below \$178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.<sup>15</sup> On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for

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<sup>15</sup> The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department’s proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

## **II. THE DEPARTMENT SHOULD CLARIFY THAT SOME FEE ARRANGEMENTS DO NOT REQUIRE COMPLIANCE WITH A PROHIBITED TRANSACTION EXEMPTION**

### **A. Non-Variable, Negotiated Fees Paid by the Client should not Trigger PTE Compliance Requirements**

ERISA and Code prohibited transaction rules generally bar fiduciaries from receiving compensation that varies based on the investment advice given or the investment choice made by the investor, as well as compensation from third parties. Flat fee arrangements and other non-variable compensation (e.g., wrap accounts), however, are permitted.<sup>16</sup> Thus, some of our members’ existing compensation models should not violate the prohibited transaction rules or trigger any obligation to comply with a PTE.<sup>17</sup>

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<sup>16</sup> See ERISA §§ 406 and 408b-2(e); DOL Frost Advisory Opinion (97-15A) (May 22, 1997); DOL Field Assistance Bulletin 2007-1 (Feb. 2, 2007).

<sup>17</sup> NAIFA explains in its comment letter on the Department’s proposed rule that advice to employers on plan and menu design (irrespective of plan type) should be excluded entirely from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products. Thus, the risk of a conflict of interest arising at this stage between the advisor and the employee investors is minimal. Second, in the plan design space, the plan administrator—regardless of plan size or type—is under a separate obligation to make informed and prudent decisions with respect to the plan. Therefore, there is already an extra layer of investor protection involved. The arguments in this letter are presented as alternatives, in the event the Department decides not to grant a carve-out for these services from the definition of fiduciary investment advice.

For instance, many NAIFA members advise employers, under a negotiated fee arrangement<sup>18</sup>, on how to set up employee retirement plans. Our members' services include analysis of the employer's specific needs, recommendations related to general plan models (e.g., 401(k), SIMPLE IRA, etc.), and advice about the investment options that are offered through the plan (e.g., particular mutual funds or annuity products). These services generally are provided on a fee basis.

The advisor's fee is negotiated in advance with the client (the employer), and is usually expressed as a percentage of assets held in the plan (i.e., basis points).<sup>19</sup> The fee amount is invoiced through the advisor's broker-dealer (or, in the case of a group annuity product, through the insurance carrier).<sup>20</sup> Once the fee is remitted, the financial institution forwards the advisor's compensation to her. Notably, the advisor's fee amount *does not vary* based on the plan type or investment options selected by the employer. Although the fee is invoiced through the financial institution, the advisor's compensation comes from the employer. The advisor does not receive any other compensation (e.g., trailers, revenue sharing, etc.) from the employer or any third parties for these services.

Some advisors employ this same fee model to advise individual employees on their investment choices within the plan. In such instances, the employer's fee package covers this service for the employees. Again, the advisor's compensation does not vary based on the investment options selected by the employee, and the advisor does not receive any additional compensation from any source for these services.

Similarly, NAIFA members help employers set up SIMPLE and SEP IRAs for their employees. These plans are especially appealing to small employers because they are far less burdensome to administer than traditional 401(k) pension plans. Our advisors provide the same services to employers who choose to offer SIMPLE and SEP IRAs as those described above with respect to setting up a 401(k) plan (i.e., discussing and evaluating plan design options, and narrowing down the options to be offered through the plan). And the same fee structure generally applies, regardless of whether the employer chooses to offer a 401(k) plan or a SIMPLE or SEP IRA (i.e., non-variable fee based on percentage of assets in the plan, negotiated with the employer, invoiced through the financial institution).<sup>21</sup>

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<sup>18</sup> This fee arrangement—the employer plan model—is diagramed in Exhibit 2a.

<sup>19</sup> Notably, our Members are often in a competitive bidding process with other advisors for these employers' business. Thus, our advisors are incentivized to keep costs as low as possible for the employer.

<sup>20</sup> We note that this invoicing step (i.e., billing through a broker-dealer or carrier) creates some confusion in terminology under state law. Some states label any compensation that is billed through a third party a commission, not a fee. However, this pure invoicing function should not create concern for the Department under the ERISA and Code prohibited transaction rules.

<sup>21</sup> SIMPLE and SEP IRAs can differ from plans when it comes to compensation for advising individual employee participants. In some cases, compensation for employee-level advice under a SIMPLE or SEP IRA is done on a commission basis (similar to traditional compensation

Fees paid by employers for plan design services (for all plan types) are negotiated between the advisor and the client and are either a set dollar amount or a percentage of total assets under management. Although the fees are invoiced through a financial institution, they are paid by the client, not a third party. The fees do not vary based on the plan type or investment options selected by the employer. In some cases, the employer’s fee also covers advice to individual employees regarding their investment options under the plan. The Department should clarify that this type of fee arrangement for fiduciary investment advice—whether the advice is given to the employer or the individual employees—is permitted under the current rules and does not require compliance with a PTE.

**B. Upstream Conflicted Compensation should not Trigger PTE Compliance Requirements for Advisors**

In general, NAIFA encourages the Department to divorce conflict-of-interest concerns at the advisor level from those at the broker-dealer or carrier level. Our members often are not aware of the compensation arrangements for carriers and broker-dealers. Furthermore, compensation at the broker-dealer or carrier level, in many circumstances, has no impact at all on an advisor’s investment advice or the advisor’s compensation for that advice.

For example, in the plan design scenario described above, our members receive a flat, negotiated fee for services, and their compensation does not vary based on how the client reacts to the investment advice given. Thus, regardless of upstream compensation arrangements, there is no conflict at the advisor level. The Department should clarify that so long as the advisor’s own compensation does not violate the prohibited transaction rules, the advisor does not need to comply with an exemption.

**III. BEST INTEREST CONTRACT EXEMPTION (“BIC”)**

Secretary Perez and Department officials have stated on several occasions that the objective of the proposed PTEs—particularly the BIC exemption—is to create an enforceable “best interest” fiduciary standard.<sup>22</sup> The Department has professed flexibility, however, regarding how such a standard is operationalized. NAIFA does not oppose the Department’s overall goal; in fact, our members believe that they already satisfy a best interest standard.

NAIFA has significant concerns though about the onerous, costly nature of the proposed BIC exemption (upon which the vast majority of our members will have to rely, due to the clients we serve). Despite the Department’s repeated characterization of the proposed exemption as “principles-based” and flexible, the proposal is in fact highly prescriptive. Its effect, as drafted,

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arrangements for mutual fund sales) and is not directly negotiated with or paid by the employer. We recognize that for advisors to continue to receive this compensation for employee-level advice, they will have to comply with a PTE.

<sup>22</sup> See, e.g., Comments of Secretary Perez, hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter “June 17 Hearing”), hearing webcast available at <http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027>.

will be to drive all advisors and financial institutions to a uniform business model with flat-fee compensation arrangements and unnecessarily formalized and burdensome advisor-client interactions, none of which suits small account holders or unsophisticated investors. For all of the reasons discussed previously in this comment letter, advisory fee-based compensation models are not appropriate or desirable for small account holders, and the dramatic increase in the cost of doing business under the proposed PTEs will substantially increase costs for clients under traditional brokerage-account compensation arrangements.

Furthermore, the BIC exemption's contract requirement portends a substantial increase in litigation and penalty exposure for advisors, especially those advising IRA owners. To the extent *any* of the exemption's requirements are unclear under the final rules, litigation will likely ensue. For instance, the "best interest" standard, as proposed, is open to different interpretations even among industry professionals (discussed more fully below), and is therefore ripe for consumer lawsuits. In addition to the increased threat of litigation, advisors will also face substantial risk of excise tax penalties under the Code as they navigate and implement a brand new compliance regime.<sup>23</sup> A high level of litigation and penalty exposure will increase the cost of doing business for advisors and financial institutions, and in some cases, the amplified risk will cause services to disappear for middle market clients. Thus, NAIFA strongly prefers that the Department finalize a clear, simple BIC exemption, rather than rely on the courts to define the contours of the rule through costly litigation over the span of several years.

Compounding the difficulty with the BIC exemption is the fact that, for securities products, it sets up a dual regulatory regime with the SEC. In every instance where the exemption differs from the SEC's requirements—in the timing and content of disclosures or a brand new contract requirement, for example<sup>24</sup>—advisors and financial institutions will be faced with an extra layer of compliance burden. Therefore, it is important for the Department to finalize the exemption's conditions in such a way that they correspond with or can be incorporated into existing regulatory requirements. Cohesion between regulatory systems will significantly mitigate cost increases and decrease confusion for advisors and consumers.

In general, eliminating or minimizing complexity and uncertainty under the BIC exemption (to the greatest extent possible) will help advisors and investors in the long run by establishing comprehensible obligations and expectations, by limiting litigation risk and expense, and by avoiding excessive regulatory burdens. NAIFA recommends that the Department simplify the BIC exemption's requirements and offers the following specific recommendations for streamlining the proposal.

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<sup>23</sup> The Code currently gives advisors a 14-day correction period in which to correct a transaction that violates certain Code prohibited transaction rules and avoid an excise tax penalty. 26 U.S.C. §§ 4975(d)(23) and (e)(11)(A). Given the complexity of the Department's proposal and the substantial differences between it and the current rules, NAIFA encourages the Department to consider implementing an extended correction period so that advisors have sufficient opportunity to identify and fix any inadvertent errors during this transition period.

<sup>24</sup> *See, e.g.*, SEC disclosure requirements for clients and prospective clients, 17 CFR 275.204-3 (Delivery of Brochures and Brochure Supplements); *see also* Part 2 of Form ADV.

A. The “Best Interest” Standard Should Be Refined to Take into Account Varying Perspectives and Opinions on Investment Products and Business Practices

We all agree that advisors should act in the best interest of their clients. It is important, however, that the concept of “best interest” not be conflated with “best performance.” It is equally important not to confuse “best interest” with “least expensive.”

A Principal Funds chart attached hereto as Exhibit 4 shows the volatility in asset class performance between 1994 and 2013. The best- and worst-performing assets change constantly. Because no one can predict the future, diversification is essential to any investment strategy. Further, not all investment products are created equal—the quality and level of risk of different products can vary dramatically. And of course, clients’ needs differ and fluctuate widely. Thus, in many instances, an appropriately diversified, high-quality, individually-tailored investment portfolio will not include the least costly products; and yet, given the multitude of factors to consider, such a portfolio is in the client’s best interest. To the extent the Department’s best interest standard takes into account individualized needs and considerations, and does not turn on performance or cost, it has NAIFA’s full support.

One element of the Department’s proposed best interest standard does concern us, however. Under the Department’s proposal, advice is in the best interest of the investor when the advisor (and financial institution):

acts 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].<sup>25</sup>

NAIFA encourages the Department to refine the meaning of “prudent person” within this definition.

The retirement planning industry includes diverse advisors who serve diverse clients and deal in a broad array of products. As a result, there always will be disagreement in the industry about the wisdom or desirability of certain approaches or certain products. For example, there is controversy within the industry about the utility and desirability of variable annuity products. There may also be disagreement among industry professionals about captive advisors offering clients a limited suite of proprietary products (i.e., an industry bias toward independent reps over captives).

Despite these differences in opinion, however, these products and approaches are valuable to investors. Indeed, investors *want* them or they would not be offered. Variable annuities, for instance, provide some investors with a much-needed income stream for life, and may be attractive for their upside potential and tax structure, and proprietary products provide consumers with well known, high-quality investment options (often through local Main Street advisors). Ultimately, consumers should be able to choose from a broad range of investment options (and a range of professional advisors) because there is no “one size fits all” in this context.

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<sup>25</sup> Proposed BIC Exemption, Section VIII(d).

NAIFA recommends that the Department take three steps to account for intra-industry differences like these and to preserve consumer choice under the best interest standard:

- (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;” and
- (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.

Without such clarification, these issues will end up being litigated, generating substantial expense and confusion for advisors and investors alike. The likelihood of litigation on these points presents a direct threat to many of our members’ businesses, given the large number of them who deal in annuities and proprietary products. Accordingly, it is vital that the Department hone its best interest standard to ensure it is workable across the industry and not employed to target or undermine specific products or business practices.

B. Scope of the Exemption Should Be Expanded to Cover Rollovers and Distributions

The BIC exemption currently is limited to “services provided in connection with a purchase, sale or holding” of a defined list of assets.<sup>26</sup> NAIFA interprets the current scope of the exemption to exclude advice and services related to rollovers, distributions,<sup>27</sup> and the opening of IRA accounts. Department officials stated at a technical briefing on May 7, 2015 that they do intend to cover rollovers and distributions under the BIC exemption. NAIFA encourages the Department to clarify this point by revising the provision on “covered transactions” under the BIC exemption or by broadening the definition of “asset” for purposes of the exemption.

C. Exemption Conditions

1. *The Department should not require a formal contract, but rather a non-signatory notice.*

The fundamental purpose of the BIC exemption’s contract requirement, according to the Department, is to create a binding obligation—of which consumers are aware—for advisors to act in the best interest of their clients. NAIFA does not take issue with this goal. But NAIFA does encourage the Department to adopt a more tenable approach to achieving its objective.

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<sup>26</sup> Proposed BIC Exemption, Section I(b).

<sup>27</sup> NAIFA argues in its comment letter on the Department’s proposed rule that distributions should not be treated as “investment advice.” This argument is presented in the alternative, in the event the Department does not create such a carve-out.

Requiring a lengthy, complicated contract executed by at least three parties goes beyond what is necessary to create an enforceable obligation. It is our understanding that the Department has proposed such a requirement in order to obtain enforcement authority over IRA advisors who would otherwise only be subject to the Code's fiduciary regime. But it is unclear to us where, under ERISA or the Code, the Department has been granted authority to circumvent the statutory enforcement structure in such a way.

Instead of a formal contract, the Department should require a non-signatory notice at the point of sale, which would bind advisors and financial institutions to act in the best interest of their clients and be actionable if the standard of conduct were not met. A notice-type requirement would entail far fewer implementation challenges than a formal contract, could be effected more quickly, and would provide meaningful disclosure of the conduct standard to customers (without placing on them the burden of executing formal contracts).

To the extent the Department retains a formal contract requirement, however, NAIFA recommends the following changes in order to make any such obligation workable.

- a. Any contract or notice requirement should be triggered at the point of sale and not before.

Secretary Perez and Department officials have said on multiple occasions that they do not intend to require a signed contract before preliminary conversations between an advisor and an investor. The text of the proposed exemption, however, indicates something different; specifically, it requires that a contract be in place *prior to any recommendation* by the advisor that an investor purchase, sell, or hold an asset.<sup>28</sup> In other words, a contract must be in place before an advisor provides a recommendation or an investor decides to rely on that recommendation in any way (or, just as likely, declines to act on it at all).

Any contract or notice requirement should be triggered by an investment *action* taken on the client's behalf (i.e., some affirmative reliance by the investor on the advice). NAIFA encourages the Department to revise its approach such that any contract requirement is tied to an actual transaction (e.g., at the point of sale or as soon as practicable after an executed transaction). A contract requirement at the conversation stage of the investor-client interaction is premature and unnecessary (because there may not even be any action taken in the best interest of the client or not in the best interest of the client), and will only stifle preliminary conversations about investors' options.

Requiring a contract prior to the point of sale presents particular problems for independent advisors selling annuity products (fixed or variable). Some of our advisors sell annuity products from dozens of insurance carriers. If a contract requirement is triggered by a simple recommendation (or, given the Department's restrictive education exception under the definition of "investment advice," any discussion of the relative merits of specific products) with respect to any of these annuity options, we could be dealing with several contracts for a single initial conversation with one client. This scenario, at least with regard to variable annuities, also raises concerns about the required signatories to the contract, which is discussed in the next section.

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<sup>28</sup> Proposed BIC Exemption, Section II(a).

NAIFA urges the Department to also consider that it would take a substantial amount of time and resources for advisors to “paper” their existing clients (sometimes hundreds of clients for a single advisor) with new contracts. NAIFA members estimate that getting new contracts in place will require, for 77% of clients, face-to-face conversations and explanations about the new requirement. In other words, simply mailing out contracts and requesting returned signed copies is not a feasible option for the vast majority of our clients. NAIFA encourages the Department to be mindful of this reality and draft its final rule in such a way that any new contract requirement will not bring on-going services to existing clients to a complete halt while contracts are developed, circulated, explained, and signed.

Finally, the Department should consider an omnibus implementation strategy for existing clients. Specifically, the Department should allow advisors to send notices to their existing clients stating that the advisor has a fiduciary obligation to act in the client’s best interest. As discussed above, such a notice would be binding on the advisor, but would mitigate the burden of obtaining signed contracts with every client. To the extent the Department retains a formal contract requirement, however, a good-faith effort to get executed contracts in place for all existing clients within a reasonable amount of time should satisfy any such requirement.

- b. Only one financial institution signature should be required on any contract.

The proposed BIC exemption requires that the contract be signed by the advisor, the financial institution for which the advisor acts as agent or registered representative, and the investor. NAIFA is concerned that, under the proposed exemption, our members’ contracts may require four signatories.

“Financial institution” is defined under the proposal as the entity (including a registered investment adviser, a bank, an insurance company, or a broker-dealer) that employs the advisor “or otherwise retains such individual as an independent contractor, agent or registered representative.” This structure is especially problematic for variable annuity products, which have both insurance and securities features. When selling these products, our members are appointed by the insurance carrier and are registered representatives of the broker-dealer.<sup>29</sup>

Thus, based on our reading of the proposed BIC exemption, it appears our advisors would need to obtain signatures from both the broker-dealer and the insurance carrier each time they even *recommend* a variable annuity product. And if they recommend multiple variable annuity products, the proposal would require multiple contracts (for the same client and the same discussion), signed by the respective carriers of each recommended product, the advisor, the broker-dealer, and the investor. This simply is not a workable requirement.

Any contract requirement should be satisfied with the signature of the registered representative, her broker-dealer, and the investor, and should not have to include the carrier’s signature. Requiring each carrier’s signature portends an excessively burdensome process. Thus, NAIFA

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<sup>29</sup> On the other hand, fixed annuities are insurance contracts that provide guaranteed lifetime income and do not have a securities component. Thus, when selling fixed annuity products, advisors act as agents for insurance carriers and there are no broker-dealer relationships involved. *See* Annuity Compensation Models, attached hereto as Exhibit 2(b).

asks the Department to clarify in its final rule that any contract need only be signed by the investor, the advisor, and one financial institution (i.e., in the case of securities products, including variable annuities, the advisor's broker-dealer; in the case of fixed annuities, the insurance carrier).

- c. Advisors should not have to provide warranties regarding financial institutions' incentive and compensation arrangements.

The proposed BIC exemption requires advisors to warrant that the financial institution (or any affiliate or related entity) does not use differential compensation or any other actions or incentives that would tend to encourage individual advisors not to act in the best interest of their clients. This warranty effectively undermines any compensation-related benefits an advisor could receive for complying with the BIC exemption. According to the Department, the BIC exemption is designed to allow financial professionals to continue receiving compensation that is ubiquitous in the marketplace (e.g., commissions, 12b-1 fees, revenue sharing, etc.). But this warranty requirement forces those professionals to effectively promise not to employ any of those common compensation arrangements in the first place.<sup>30</sup>

Moreover, this warranty is duplicative. Under the contract requirement, advisors must affirmatively state that they are acting as fiduciaries and in the best interest of the client. The best interest standard is in place to address the very problem presumably targeted by this warranty. Thus, NAIFA urges the Department to remove this warranty requirement from the final rule.

To the extent some version of this warranty remains in the final rule, NAIFA notes that registered representatives generally do not have the information necessary to make such a blanket warranty about the compensation and incentive practices of the financial institution for which they are an independent agent or registered representative. Therefore, NAIFA asks the Department to make clear in its final rule that any such warranty must be made by the financial institution, not the advisor.

- d. Advisors should be permitted to limit the scope and duration of the fiduciary relationship.

BIC exemption contracts may not include "provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms."<sup>31</sup> Department officials stated at the May 7, 2015 technical briefing that they do not intend for this provision to bar advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the scope of services the advisor is willing to provide to a given client or the time period

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<sup>30</sup> The Department's examples in the preamble of acceptable compensation arrangements (i.e., arrangements that would not violate this warranty) indicate that the Department is forcing everyone to flat-fee and wrap account arrangements. For the reasons discussed in the introduction to this comment letter, those arrangements will not benefit NAIFA members' clients.

<sup>31</sup> Proposed BIC Exemption, Section II(f)(1).

during which such services will be provided). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) that limits the duration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail ongoing advice (i.e., a one-time sales relationship), the advisor should be able to make clear that the fiduciary relationship encompasses only the sale, and the advisor does not have perpetual fiduciary obligations to the client. Further, advisors should be able to clarify the scope of (or disclaim) any ongoing monitoring obligations. NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a notice to the client.

## 2. *Advisors' disclosure obligations should be reduced.*

The proposed BIC exemption requires an advisor, prior to the purchase of any asset, to furnish the investor with a chart that provides, for each asset recommended, the “total cost” to the investor of investing in the asset for 1-, 5- and 10-year periods expressed as a dollar amount (using reasonable assumptions about investment performance). “Total cost” includes loads, commissions, opening fees, sub-transfer agent fees, etc. NAIFA interprets this provision to require growth projections for recommended products, which conflicts with current securities regulations.<sup>32</sup> At the May 7, 2015 technical briefing Department officials acknowledged this conflict and represented that they would resolve the issue in the final rule.

Aside from the conflict with securities laws, NAIFA has several general concerns about this type of disclosure requirement (i.e., projecting costs into the future). First, any cost projections—especially when put in a dollar amount—will be inherently unreliable because an advisor simply cannot predict what will happen with the market or with a given asset. Second, advisors’ compensation, which is largely controlled by upstream financial institutions, can change at any given time, especially when compensation is based on an advisor’s total book of business. Thus, any cost disclosure should be expressed in general terms (e.g., gross dealer concessions), not an actual dollar amount, and should not isolate advisor compensation from other entities’ compensation (e.g., break out the broker-dealer and advisor portions of a shared commission). Third, a disclosure requirement of this nature would be very costly and burdensome for small, independent advisors. And fourth, as discussed in greater detail below, investors may not actually benefit from extensive disclosures of this nature.

In addition to the transaction-level total cost disclosure, the proposed BIC exemption includes obligatory annual disclosures, which are to be provided by the advisor or the financial institution for which the advisor is an agent or registered representative. We believe this annual requirement is duplicative and overly burdensome in light of the proposal’s transactional disclosures and should be removed from the final rule. If the requirement is retained, however, NAIFA strongly encourages the Department to clarify that this particular obligation falls on the financial institution, and not the individual advisor. Advisors will not have access to the information subject to this disclosure requirement (e.g., total dollar amount of *all* fees paid by the

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<sup>32</sup> See FINRA Rule 2210(d)(1)(f) (prohibiting performance predictions and projections).

investor, directly or indirectly, and *all* compensation received by the advisor and financial institution, which includes compensation paid to parties upstream from the advisor—fees about which the advisor would not be aware). And again, the burden of the disclosure requirement will be particularly heavy for independent advisors without back office support.

Regardless of which entity ultimately is responsible for making these disclosures, under the Department's proposal, investors will be inundated with complex charts and figures and duplicative information. This could result in heightened consumer confusion and no real consumer benefit. According to a LIMRA Secure Retirement Institute Survey published in May 2015, disclosures do not necessarily help investors grasp how much they are paying in fees or for what they are paying.<sup>33</sup> The survey asked participants in 401(k) plans about their perceptions about fees before and after disclosures were made and concluded that participants' understanding did not improve with disclosure, and half of those surveyed could not say how much they pay in fees following disclosure.<sup>34</sup>

Advisors and financial institutions already make product-specific disclosures to their clients under securities regulations and existing Department regulations like those under section 408b-2 (which, apparently, have limited usefulness). Increasing the cost and burden on advisors by adding unnecessary, confusing disclosures will not help retail investors. Accordingly, NAIFA recommends that the Department significantly narrow the disclosure requirements under the BIC exemption and, to the greatest extent possible, integrate any such requirements with existing client notices and disclosures.

#### D. Limited Product Offerings

NAIFA supports the Department's allowance under the BIC exemption for financial institutions and advisors to offer a limited range of investment options (e.g., proprietary products). The Department should clarify, however, that advisors who are not licensed to deal in securities products can offer, as a general rule, a broad enough variety of products to satisfy the best interest standard (i.e., just through the offering of non-securities insurance and annuity products). Department officials said at a meeting on May 20, 2015 that their intention was not to exclude entire groups of advisors with the best interest standard, and indicated that advisors without securities licenses would be able to satisfy the BIC exemption's requirements.

#### E. Special Exemption for Insurance and Annuity Products

NAIFA also supports the Department's proposed special exemption for insurance and annuity products, which allows advisors to recommend insurance and annuity products from insurance companies that are parties in interest. This special exemption is necessary for NAIFA members who are affiliated with, or captives of, insurance companies. It is NAIFA's understanding that the special exemption's relief is limited to certain party-in-interest (or in the case of IRAs, disqualified person) prohibited transaction rules, and does not extend to prohibited transaction

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<sup>33</sup> LIMRA Survey, at 17.

<sup>34</sup> *Id.*

rules regarding conflicted compensation received by the advisor.<sup>35</sup> Thus, we interpret the proposal to require an advisor who receives compensation prohibited under ERISA or the Code to rely on the larger BIC exemption or PTE 84-24, depending upon the investor and transaction in question, to receive such compensation. NAIFA encourages the Department to elucidate the interaction between the special exemption and the broader PTEs in the final rule.

### **III. PROHIBITED TRANSACTION EXEMPTION 84-24**

#### **A. PTE 84-24 should apply to all annuity products sold to all types of investors.**

The Department's proposed PTE 84-24 creates a convoluted compliance structure under which annuities transaction are divided between securities and non-securities products, and by the type of investor involved in the transaction (i.e., IRAs and plans). Under the proposal, PTE 84-24 will no longer be available for variable annuity or mutual fund sales to IRAs; to sell those products to IRA owners, advisors will have to rely on the more onerous BIC exemption. However, if those same products are sold to plans, PTE 84-24 still applies. For the following reasons, the Department should adopt a more balanced approach and retain 84-24 relief for all insurance and annuity products sold to all types of investors.

First, this structure is unnecessarily complicated and confusing. The proposed PTE 84-24, like the BIC exemption, requires advisors and financial institutions to adhere to impartial conduct standards, including the best interest standard, and to fulfill robust disclosure requirements.<sup>36</sup> It is not clear why the Department feels that some products for some investors should be split off and handled under a separate compliance scheme.

Second, as noted above, NAIFA members are compensated similarly for fixed and variable annuity products (i.e., through an upfront commission). To the extent the Department is concerned about different conflicts of interest arising from different compensation models, that concern is misplaced.

Third, the more complicated the compliance regime, the more costly it will be for advisors, financial institutions, and ultimately, consumers.<sup>37</sup> In this case, the Department's proposed

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<sup>35</sup> The "covered transactions" provision under the special exemption provides relief from specified ERISA § 406(a) rules and from Code § 4975(c)(1)(A) and (D), but does not include 406(b)-type relief.

<sup>36</sup> To the extent 84-24's conditions match the BIC exemption's conditions, NAIFA incorporates the same comments and suggestions made earlier in this comment letter.

<sup>37</sup> It is worth noting that annuity products are already subject to multiple layers of regulation. Because they are insurance products, they are heavily regulated at the state level. States have product content and marketing rules in place, as well as sales practices requirements. Additionally, the NAIC has model regulations (adopted by almost all of the states) on disclosures and suitability in annuity transactions. And of course, at the federal level, the SEC and FINRA regulate the sale of variable annuities. The Department should not add on top of this structure another complex, confusing and costly layer of regulation.

structure places a heavier burden on advisors who serve IRA owners, and particularly, on advisors who sell variable annuity products to those investors. As previously discussed in this letter, annuity products are generally sold to low- and middle-income investors who rely on the income stream from those products, and variable annuities are especially attractive to investors who desire those products' upside potential. Once again, the Department is actually disadvantaging middle market consumers by forcing their advisors to adhere to more onerous and costly requirements under the BIC exemption.

B. PTE 84-24 should cover the purchase by SIMPLE and SEP IRAs of variable annuities and mutual funds.

The Department proposes to revoke PTE 84-24 for the purchase by Individual Retirement Accounts of annuity products that are securities and mutual fund shares. "Individual Retirement Account" is defined broadly to include "individual retirement accounts" and "individual retirement annuities" described in 26 U.S.C. §§ 408(a) and (b), respectively. Subsections 408(k) and (p) then define SEP and SIMPLE IRAs as employer-sponsored "individual retirement accounts" or "individual retirement annuities" (as described in subsections (a) and (b)) with specific participation, contribution and other requirements.<sup>38</sup>

The Department should not revoke PTE 84-24 for SIMPLE and SEP IRA purchases of variable annuities and mutual funds. These employer-sponsored IRAs are akin to traditional pension plans in that they are retirement savings vehicles established for the benefit of individual employees. Because they have fewer reporting requirements and are easier to administer, these types of plans are especially popular with small employers.

As drafted, the Department's proposal unfairly burdens advisors who sell SIMPLE and SEP IRAs to employers (i.e., small employers) instead of traditional 401(k) plans because they are forced to rely on the more onerous BIC exemption in order to place variable annuities and mutual funds in these plans.<sup>39</sup> This discrepancy between requirements for different types of employer-sponsored retirement savings plans is not warranted.

The investment advice services provided to employers who adopt SIMPLE and SEP IRAs are the same as the services provided to employers who adopt 401(k) plans (i.e., evaluation of the employer's particular needs, recommendations about plan types, and recommendations about investment options offered through the plan). To the extent NAIFA members advise employers on plan and menu design and receive some variable or third-party compensation for their services (i.e., do *not* use the common employer fee model described in detail at the beginning of this letter), they should be able to rely on PTE 84-24, regardless of the type of retirement plan in place.

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<sup>38</sup> Section 408(c) provides that "a trust created or organized in the United States by an employer for the exclusive benefit of his employees or their beneficiaries . . . shall be treated as an individual retirement account (described in subsection (a))" if the governing instrument creating the trust meets certain requirements.

<sup>39</sup> As a practical matter, fixed annuities are not sold to employer-sponsored retirement plans of any type.

Like recommendations made to employers with 401(k) plans, investment advice given to employers with SIMPLE and SEP IRAs is a step removed from recommendations pertaining to the employees' ultimate investment decisions. With the help of an advisor, the employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products. Thus, the risk of a conflict of interest arising between the advisor and a plan of any type is minimal. Second, in the plan design space, the plan administrator—regardless of plan size or type—is under a separate obligation to make informed and prudent decisions with respect to the plan. Therefore, there is already an extra layer of investor protection involved.

Accordingly, advice to employers regarding plan and menu design should be covered under PTE 84-24 and not the more onerous BIC exemption, regardless of whether the advisor is selling group annuity or mutual fund products and regardless of whether the employer chooses to offer a traditional 401(k) plan or a SIMPLE or SEP IRA to its employees.

C. PTE 84-24's compensation relief should be expanded.

1. *PTE 84-24's compensation relief should be coextensive with the BIC exemption's relief.*

For transactions that are covered under the proposed 84-24, the Department has limited compensation relief to agents, brokers and principal underwriters to narrowly-defined "Insurance Commissions" and "Mutual Fund Commissions." Unlike current PTE 84-24, the proposal explicitly excludes revenue sharing, administrative fees, marketing payments, and payments from parties other than the insurance company or its affiliates. The Department's justification for such restrictions on compensation relief under 84-24 (and not imposing such restrictions under the BIC exemption) is unclear.

Proposed 84-24 imposes the same "best interest" standard as that under the BIC exemption, as well as other impartial conduct standards and disclosure requirements. The mandate that advisors act in the best interest of their clients should assuage concerns the Department may have about particular compensation arrangements. Thus, the Department should extend 84-24's compensation relief to be coextensive with the BIC exemption's relief.<sup>40</sup>

2. *PTE 84-24's compensation relief should at least be extended to include mutual fund commissions for agents.*

If the Department opts to not extend 84-24's relief to match the BIC exemption's relief, the Department should—at the very least—extend 84-24's coverage to include Mutual Fund Commissions paid to Principal Underwriters *and their agents*. As drafted, the proposed PTE 84-24 allows for payment of insurance commissions to insurance agents and brokers, but does not allow agents or registered reps to receive commissions for mutual fund sales, even though the

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<sup>40</sup> It is our understanding that the special exemption for insurance and annuity products contained under the BIC exemption provides relief from ERISA and Code party in interest/disqualified person rules, whether the transaction falls under the BIC or 84-24 for conflicted compensation relief. Again, we request that the Department clarify this point in its final rule.

same impartial conduct standards and exemption conditions apply equally to the sale of insurance and annuity products, and mutual funds. Without any apparent justification, the Department's proposal allows agents to be paid for one product line, but cuts off their compensation for another.<sup>41</sup> The Department should remedy this discrepancy by allowing agents to be compensated for mutual fund sales.

#### **IV. THE DEPARTMENT SHOULD EXTEND THE ENFORCEMENT TIMELINE TO AT LEAST THIRTY-SIX MONTHS**

The proposed eight-month enforcement timeline for compliance with the new rule is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department's proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

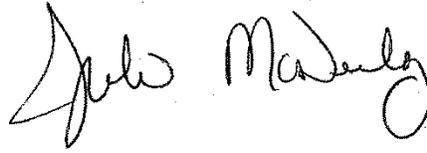
*Each* one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

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<sup>41</sup> Agents and brokers are paid almost exclusively on a commission basis for the sale of mutual fund shares.

Very truly yours,

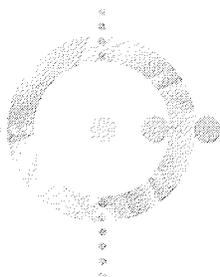
A handwritten signature in black ink, appearing to read "Juli McNeely". The signature is fluid and cursive, with the first name "Juli" written in a larger, more prominent script than the last name "McNeely".

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

Exhibits:      NAIFA Comment Letter on Proposed Rule  
                    Diagrams of Compensation Models  
                    LIMRA Secure Retirement Institute 2015 Consumer Survey  
                    Principal Funds Table on Asset Class Performance from 1994 to 2013

## **Exhibit 2**

LIMRA Secure Retirement Institute 2015  
Consumer Survey

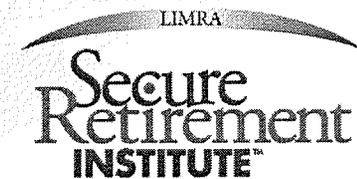


May, 2015

## **Matters of Fact**

### **Consumers, Advisors, and Retirement Decisions (and Results)**

A timely data summary from the LIMRA Secure Retirement Institute to help our members plan, respond, and react... with insights about retirement consumers and their advisor relationships.





## In This Document

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- Advisors Are Linked to Better Results: In-Plan (DC) 4
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- Using a Financial Advisor Strongly Correlates to Diverse Financial and Protection Product “Ownership” 8
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- A Majority of Consumers Do Not Take an Active Role in Managing Their Assets 15
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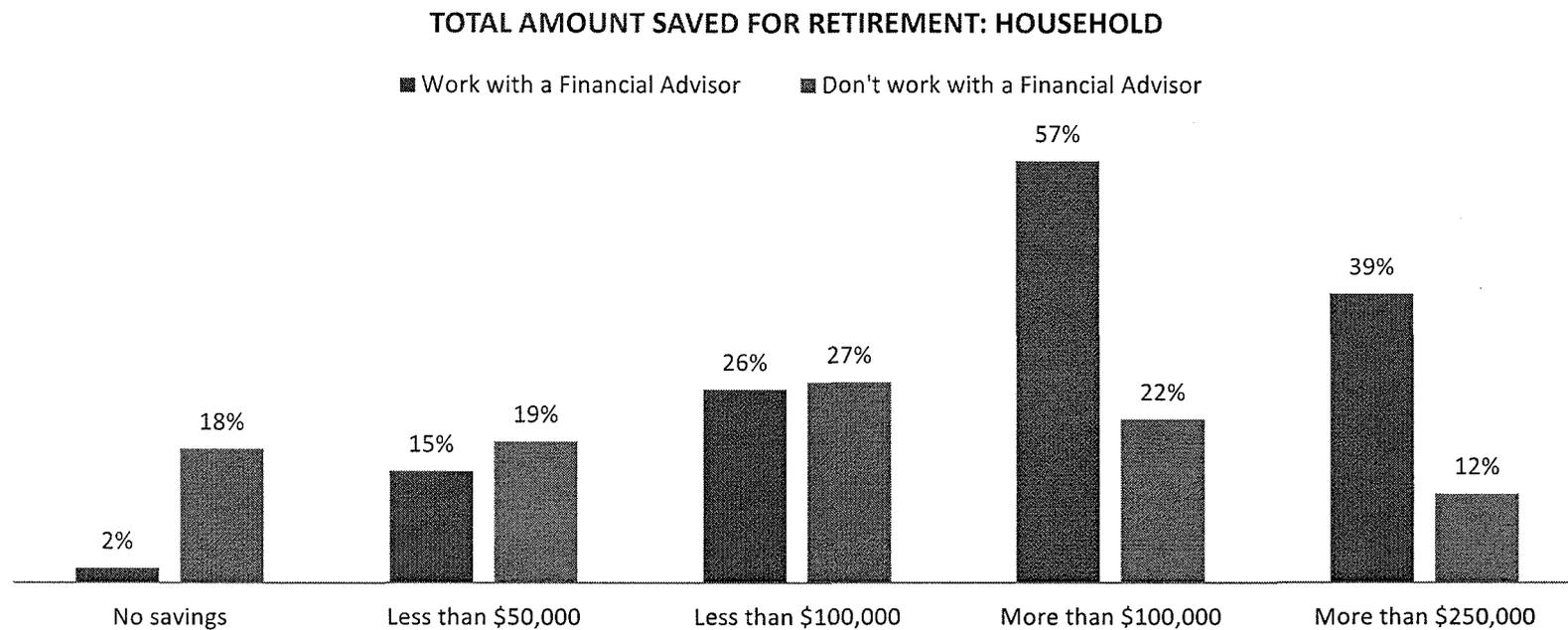
**NOTE:** Throughout this report, the term “Advisor” refers to a paid financial professional (e.g. broker, financial planner or advisor) used to make at least some of household investment decisions.

**Contact:**  
CATHERINE THEROUX  
ASSISTANT VICE PRESIDENT  
PUBLIC & MEDIA RELATIONS

860-285-7787  
CTHEROUX@LIMRA.COM

## Advisors Are Linked to Better Results: Total Retirement Savings

*Households that use financial advisors are three times as likely as non-advised households to have \$250,000 or more in retirement savings ... and are more than twice as likely to have \$100,000 or more.*

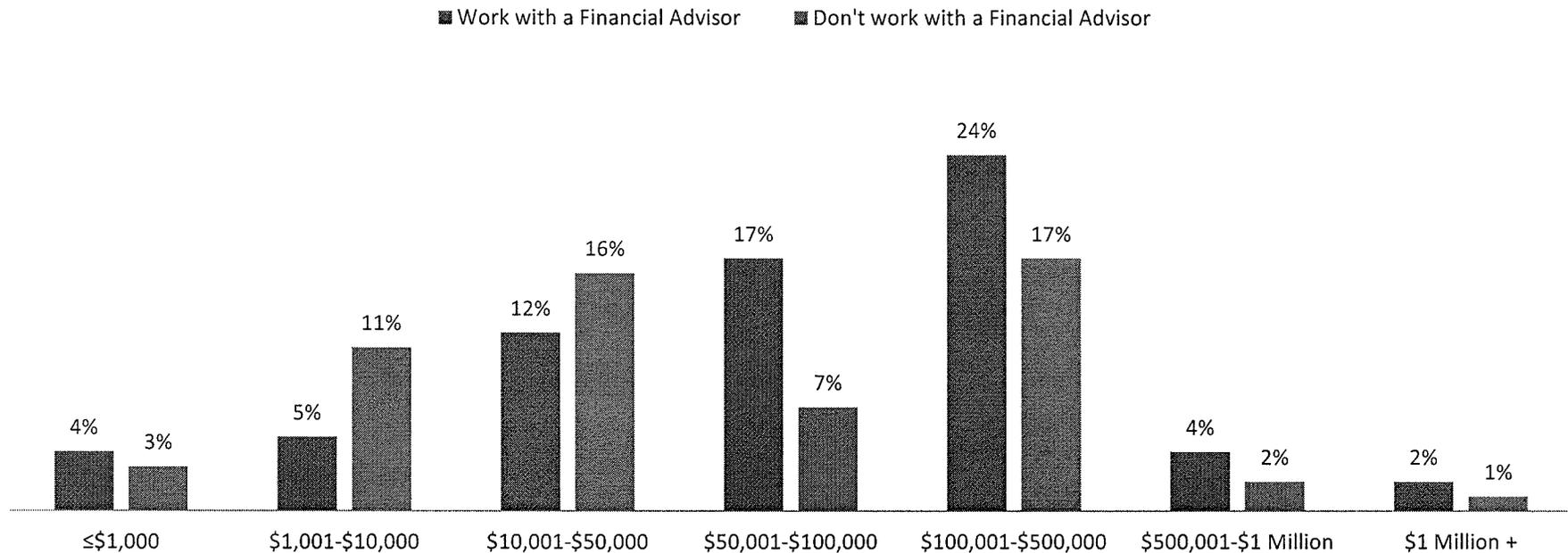


Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

## Advisors Are Linked to Better Results: In-Plan (DC)

*People who engage financial advisors have higher retirement account balances in employer retirement plans.*

### AMOUNT SAVED IN EMPLOYER RETIREMENT PLAN



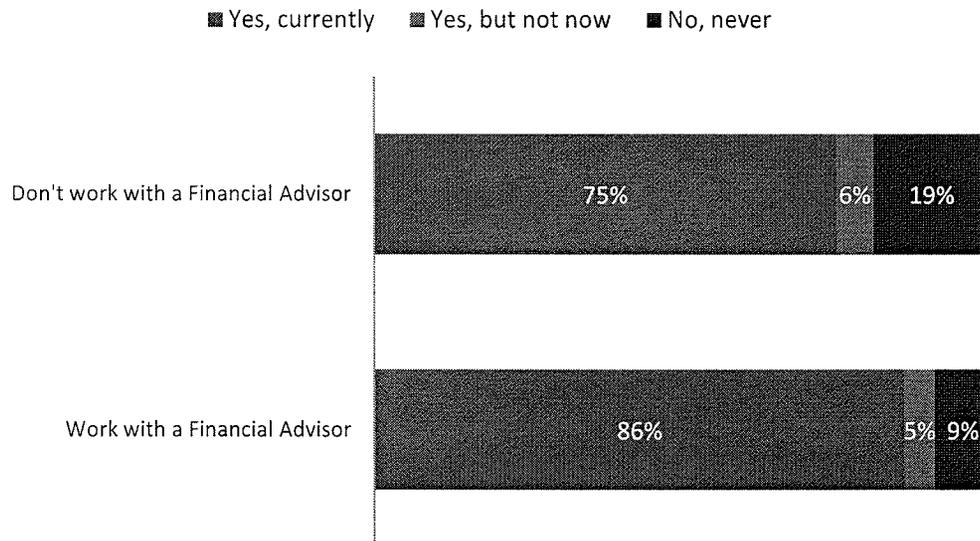
Source: LIMRA Secure Retirement Institute 2014 Consumer Survey



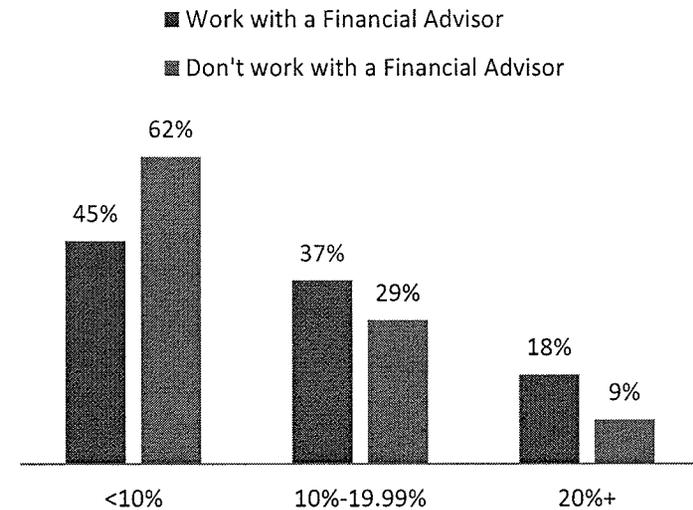
## People With Professionals Are More Engaged in Employer Plans

*People who work with financial advisors are more likely (than those who do not) to participate in their employers' DC plans. More of those with advisors also demonstrate "good" behavior — contribute 10 percent or more to their employers' plans (and are twice as likely to contribute 20 percent or more).*

**CURRENTLY CONTRIBUTING TO AN EMPLOYER'S PLAN**



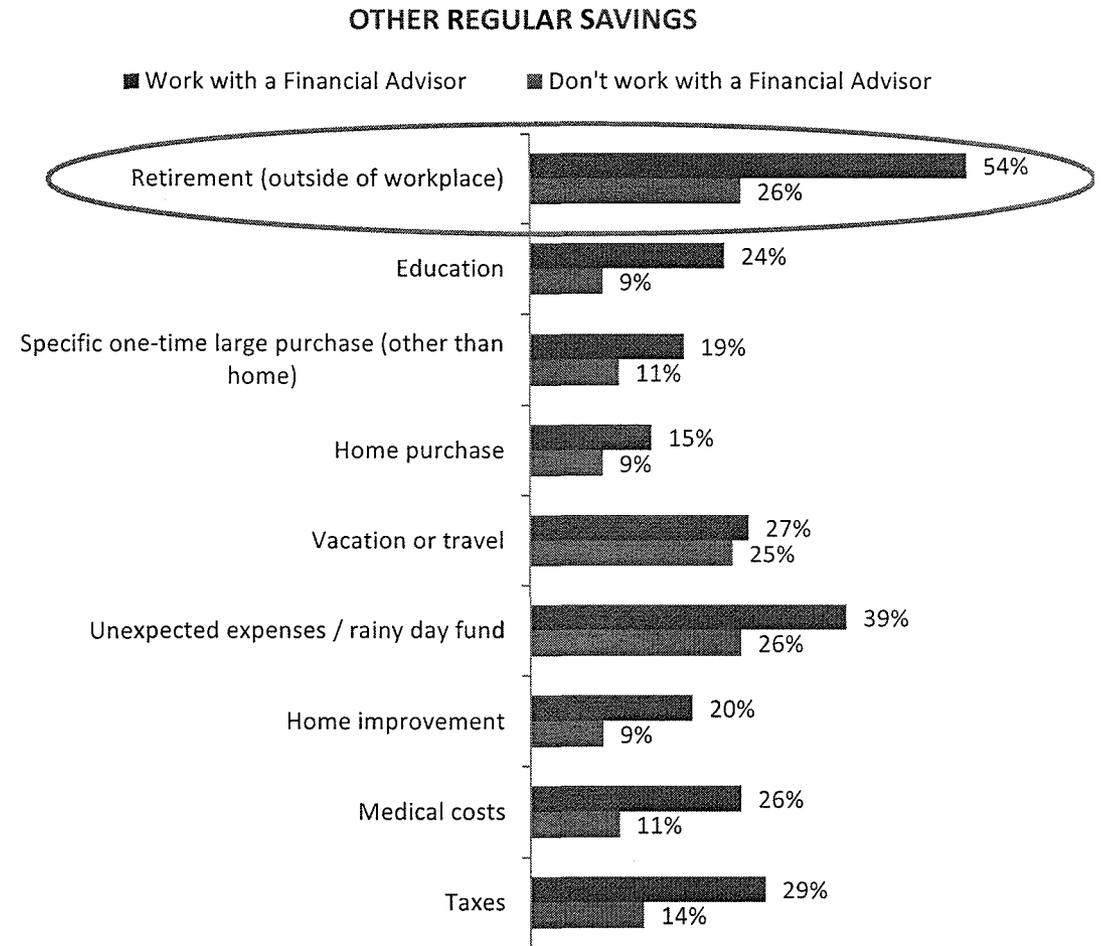
**PERCENT OF SALARY CONTRIBUTED TO EMPLOYER PLAN**



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

## People who Consult Professionals Save Regularly for a Variety of Goals

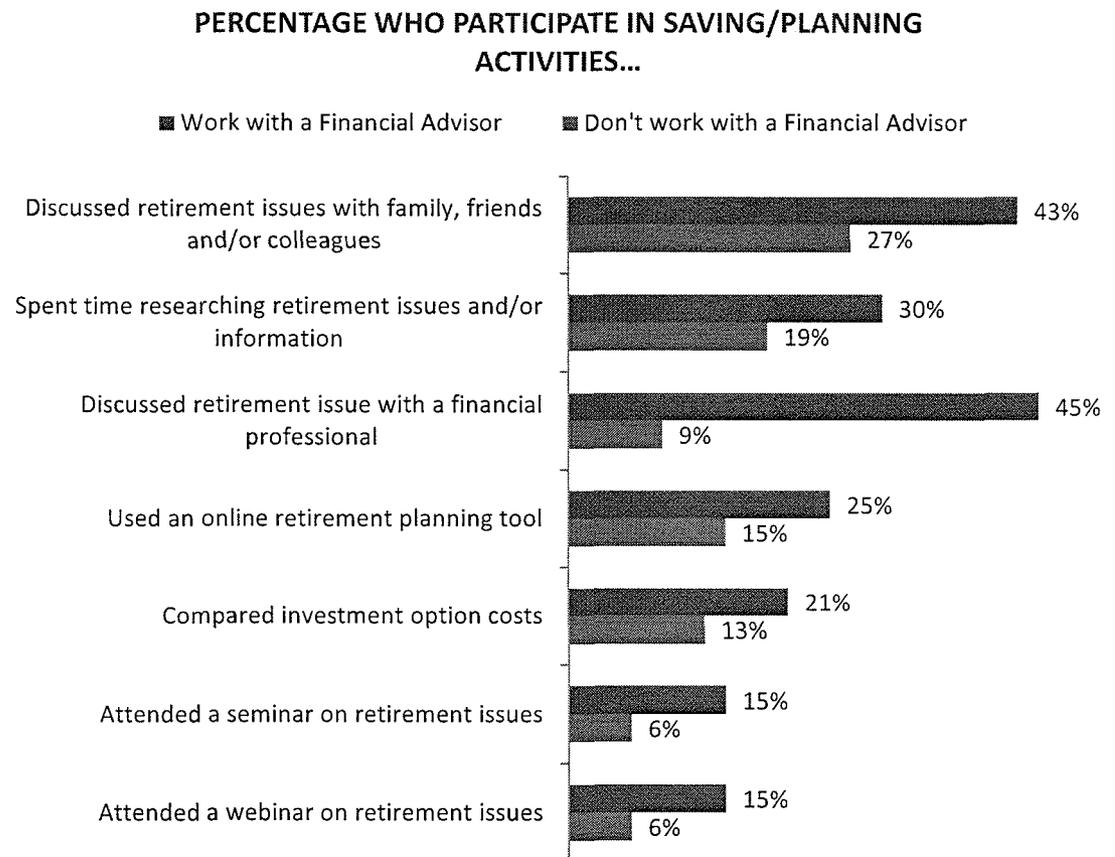
*Advisors can also add value by encouraging clients to save holistically, not just for retirement. For nearly every listed savings goal (except vacation), advisors' clients are significantly more likely to save on a regular basis compared with people who don't consult advisors.*



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

## Advisors are Associated with Engagement and Activity

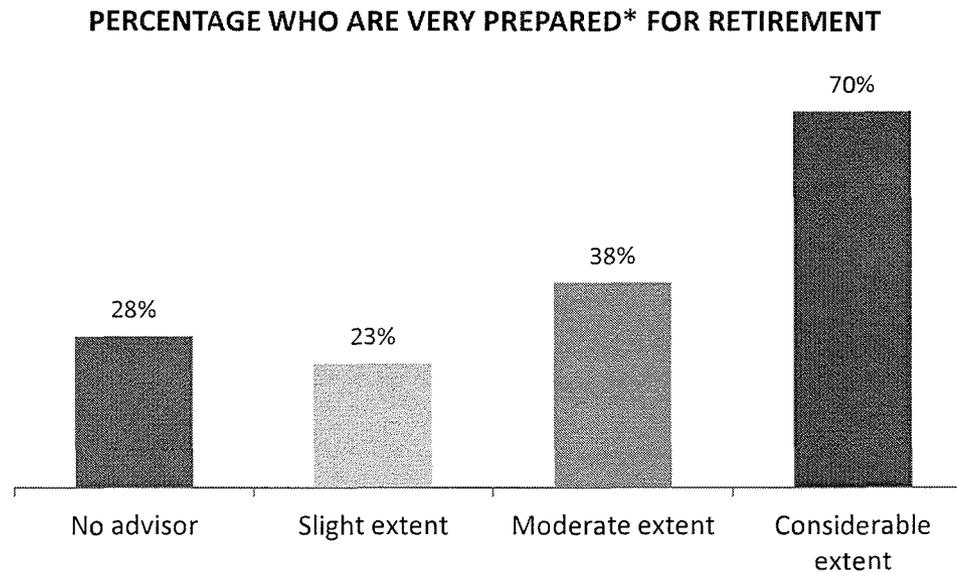
*Advisors can help their clients engage with their own retirement and financial lives. People who use advisors are more likely to discuss their retirements with a range of individuals, from family to financial professionals; and, to conduct basic planning activities such as attending seminars and webinars, and using planning tools.*



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

## Pre-Retirees' Preparedness Linked to Degree of Advisor Reliance

*People who use an advisor – especially to a considerable extent – are significantly better prepared for retirement than those who don't consult an advisor, or who do so only slightly.*



Extent to which advisor was consulted on household's retirement planning needs

\*Answered 10, 9 or 8 on a 10-point scale with 10 = Extremely well prepared and 0 = Not at all prepared

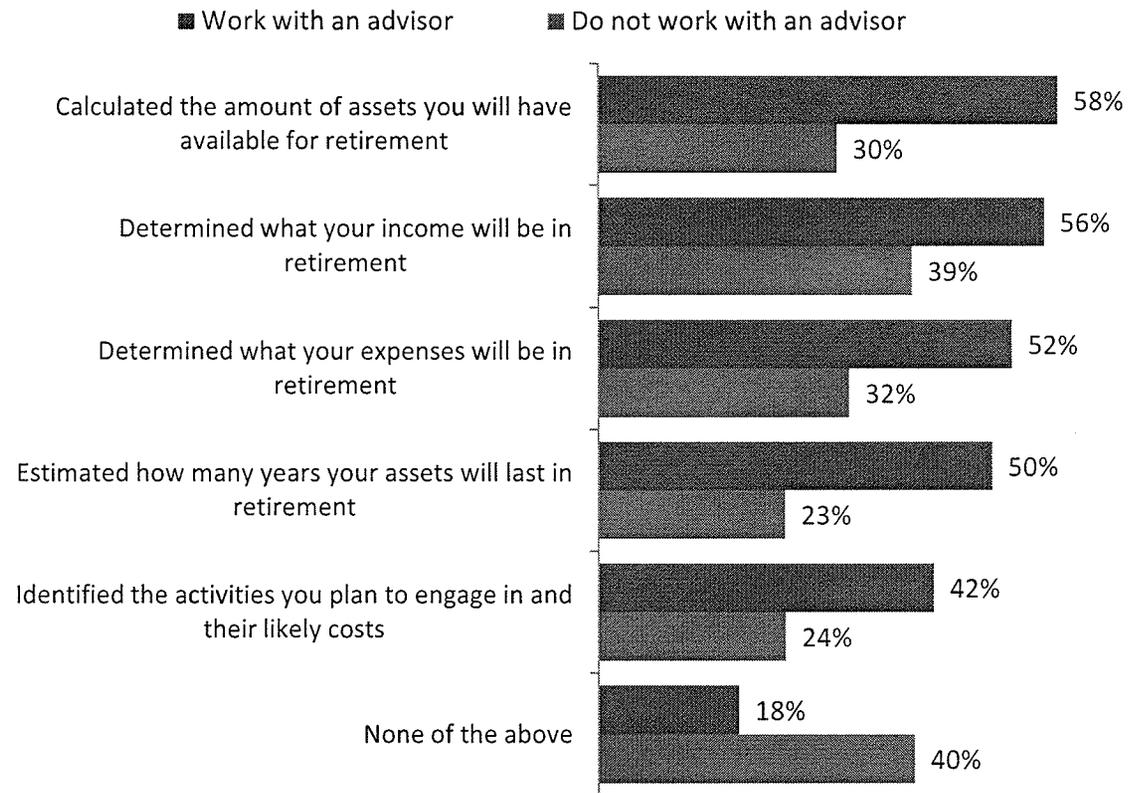
Source: *Advisor Perspectives on Retirement Planning*, LIMRA Secure Retirement Institute, 2012



## Using an Advisor Tracks with Increased Engagement

*Pre-retirees who work with financial professionals are more likely to complete key planning activities.*

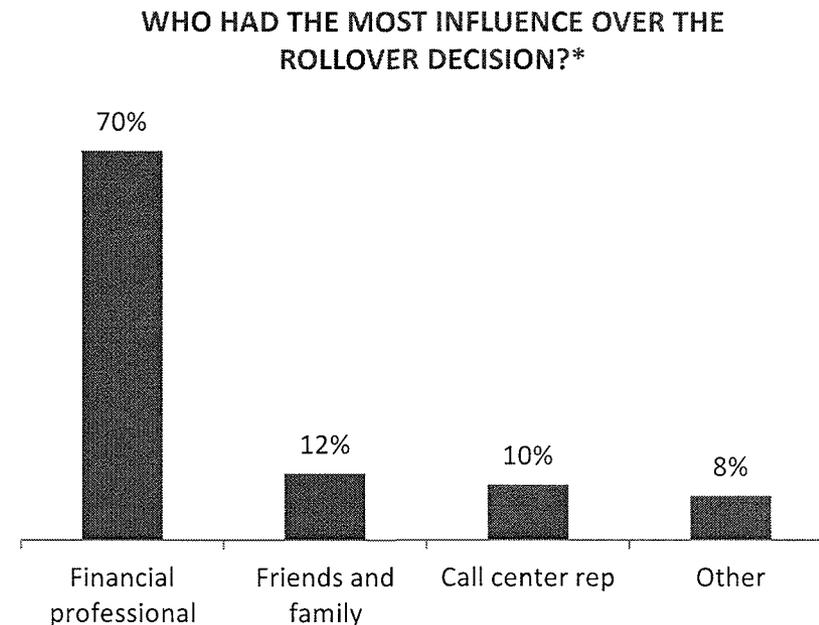
### WHICH RETIREMENT PLANNING ACTIVITIES HAVE YOU COMPLETED?



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

# IRA and Rollover Decisions Are Not Purely a Function of Fees

*Financial professionals/advisors are highly influential in helping individuals to make informed rollover decisions.*



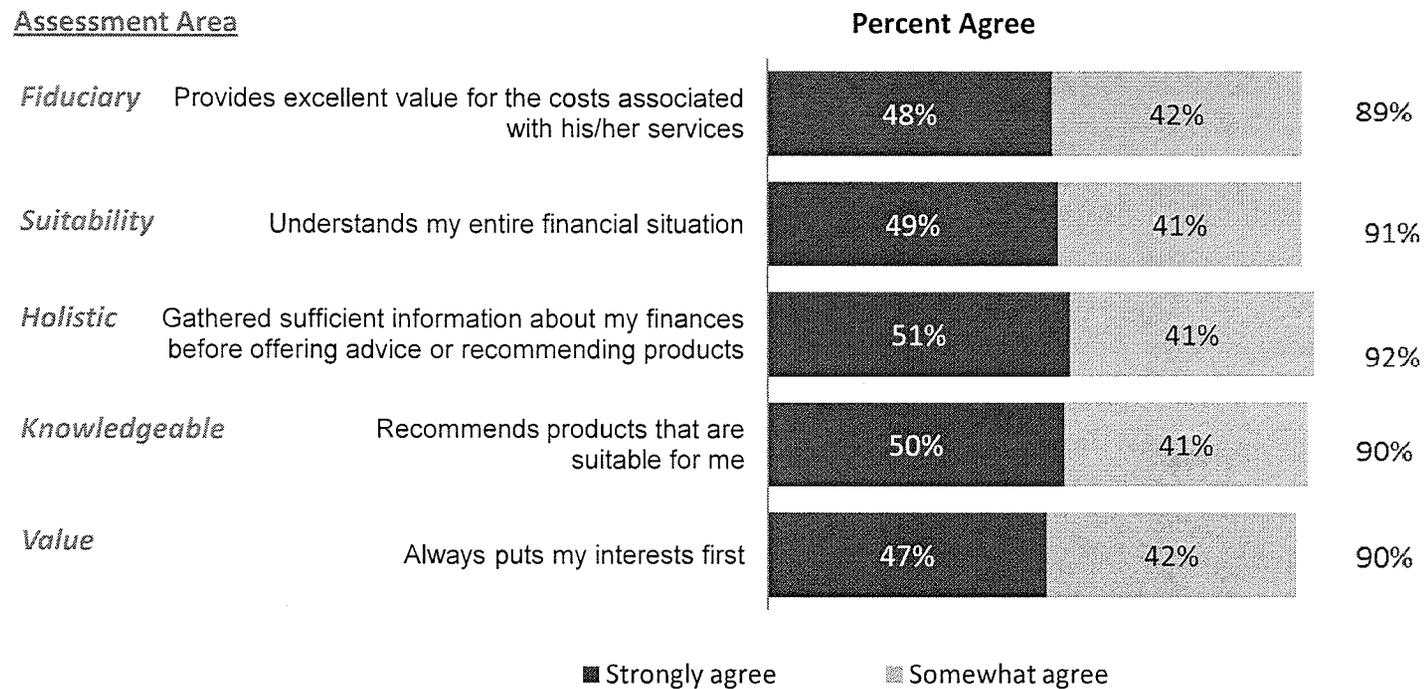
\*When consumers near retirement or recently retired (aged 55 to 70) rolled money from a DC plan into an IRA and spoke with someone about their decision.

Source: LIMRA Secure Retirement Institute 2014 Rollover Consortium

# People Value Their Advisors

*Consumers feel that advisors look out for their best interests, and understand their own needs and goals.*

## CONSUMER ASSESSMENT OF FINANCIAL PROFESSIONALS

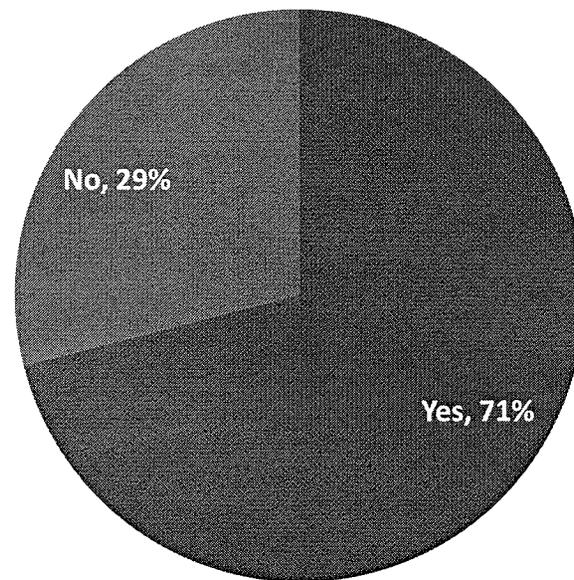


Source: *Quarterly Consumer Sentiment Q2 2015*, LIMRA Secure Retirement Institute.

## Disclosure Does Not Improve Participant Knowledge About Fees

*Even after disclosure, most participants think DC plan fees and expenses are reasonable... but few pay a great deal of attention to disclosure when delivered.*

PERCENT WHO AGREE THAT DC PLAN FEES/EXPENSES ARE REASONABLE

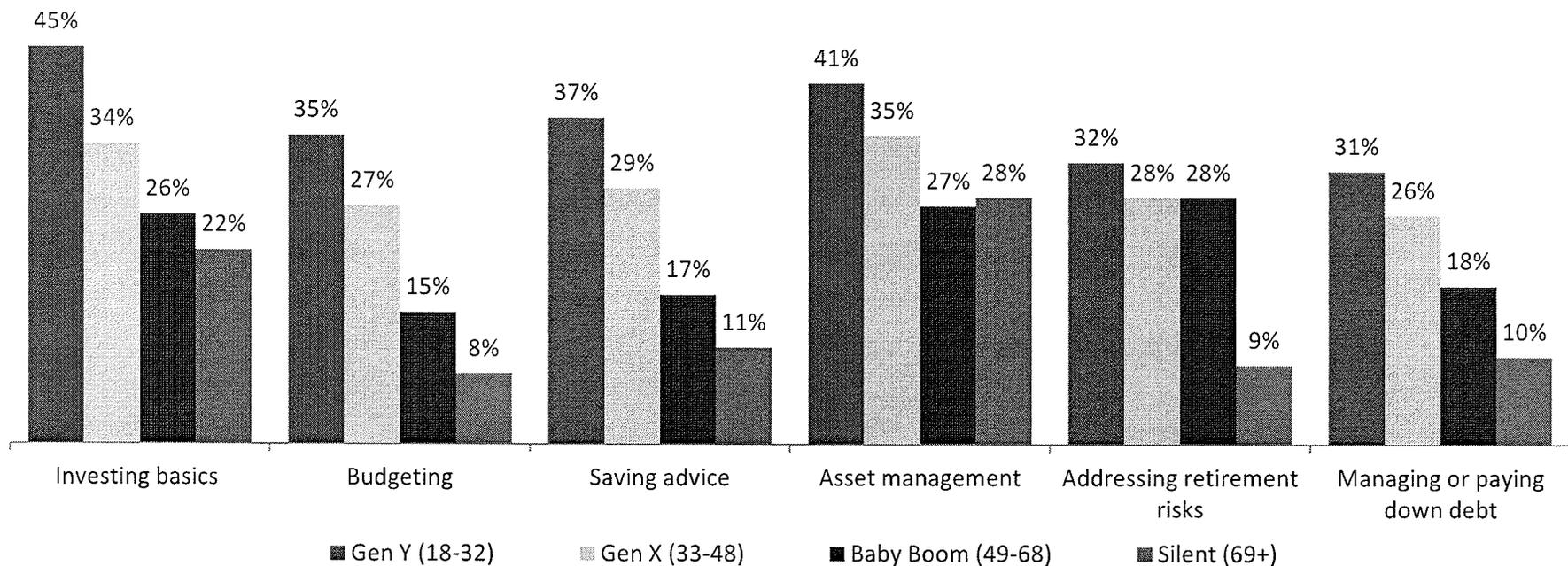


Source: *Deciphering Disclosure*, 2013, LIMRA Secure Retirement Institute

## Consumers Want More Education

*Many consumers, especially younger ones, say that they need additional guidance on matters critical to financial security and retirement planning.*

AREAS WHERE MORE EDUCATION ON FINANCIAL MATTERS IS NEEDED



Source: *Third Quarter 2013 Consumer Perspectives*, LIMRA Secure Retirement Institute.

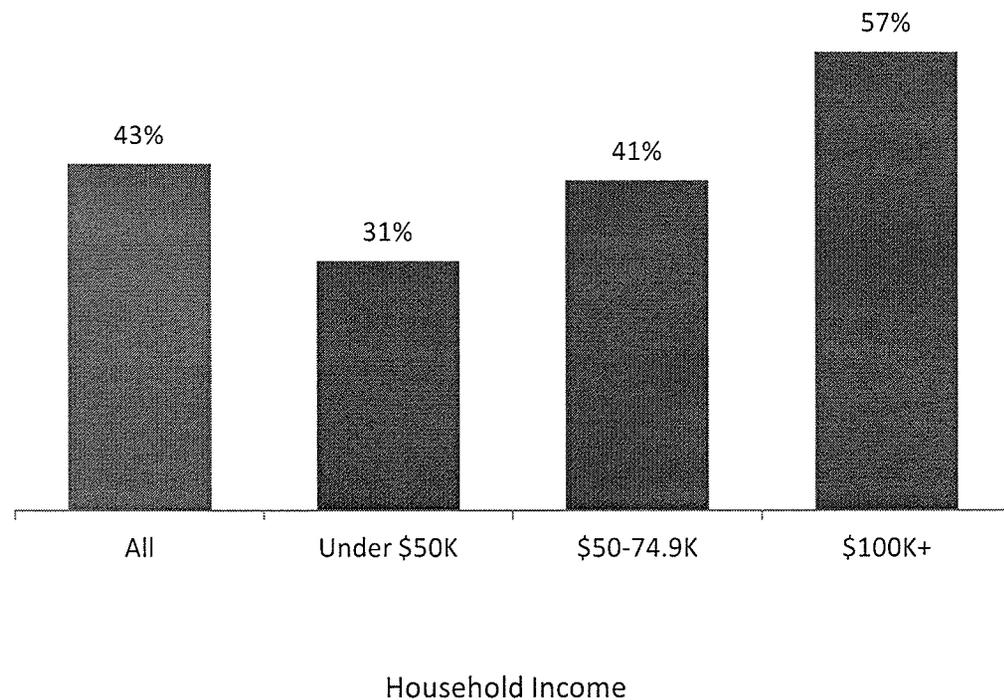
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## A Majority of Consumers Do Not Take an Active Role in Managing Their Assets

*Only 4 in 10 consumers are actively engaged in managing their assets.*

*Even among high-net-worth consumers, only 6 in 10 actively manage their assets.*

PERCENTAGE OF PEOPLE WHO ARE VERY INVOLVED WITH MONITORING AND MANAGING THEIR RETIREMENT SAVINGS.



Sources: *Financial Triage Assessing Consumer Wellness (2015)* and 2014 Consumer Survey, LIMRA Secure Retirement Institute



## “Best Interests” Differ Based on Attitudes and Preferences

*Consumers with similar demographic profiles, wealth levels, and lifestyle ambitions may have very different preferences and financial priorities. Because their attitudes toward money differ, we developed three consumer segments based on the income solutions they prefer.*

### Three money mind-sets:

- **Guarantee Seekers** – Want to know that their income won’t disappear. Have a floor of lifetime guaranteed income and would be interested in converting even more of their savings to a pension-like contractual guarantee. Want to spend money without the day-to-day worry of how long it has to last. Want the peace of mind of a certain outcome.
- **Estate Planners** – Financially savvy. Understand that equity markets generally out-perform risk-free fixed investments. Can withstand a little volatility to maximize the potential of investments. Trust their own investment decisions. Want to maintain personal control over investment decisions and to retain the flexibility to adjust income and spending as needs change over time.
- **Asset Protectors** – Have been saving money for a long time. Do not want to see savings account balance decrease. Will live off the interest and dividends of savings, but are uncomfortable invading principal. Don’t want to be “poorer.”

Source: *A New Perspective on Retirement Income*, 2015, LIMRA Secure Retirement Institute



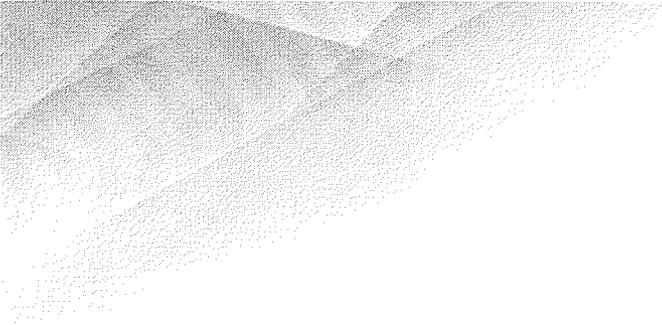
## Additional Facts and Research Data

- Controlling for household wealth, individuals who work with paid financial professionals are more likely to have formal, written retirement plans and to be confident that they are on track with their retirement savings.
- Confidence in being able to live their desired lifestyle in retirement is higher among those working with paid financial professionals, particularly for less-wealthy households.
- Among pre-retiree households with less than \$500,000 in financial assets, there is a significant difference in subjective levels of retirement preparedness between those who work with financial professionals and those who do not work with financial professionals.
- Individuals who work with paid financial professionals are twice as likely as those not working with paid financial professionals to say that they had a discussion reviewing the pros and cons of doing a rollover to an IRA versus leaving the money in the plan.
- For pre-retirees (aged 55 to 70), the most common reasons involve consolidation of assets, gaining greater control over their money, seeking better returns, not wanting to leave their money with their former employer, and access to a greater range of investments.
- Pre-retirees say their desire for consolidation, better returns, and control most influenced their rollover decisions. Fees were not a significant factor.
- Seeking lower fees is not a major motivator, regardless of who had the greatest influence.
- Despite regulatory concern over conflicts of interest, 9 in 10 consumers agree that their financial professional always puts their interests first.
- Nine in ten agree that their financial professionals provide excellent value for the costs associated with their services. This assessment does not vary based on compensation method.
- Half of consumers who work with a financial professional have worked with their advisor for more than five years.
- Two thirds of consumers had a financial professional help with their rollover decision. Seven in ten consumers say the discussion they had with the financial professional about the advantages and disadvantages of the options they could take with their retirement plan assets was helpful.



## Additional Facts and Research Data (Continued)

- DC participants don't spend a lot of time reading their statements. Most people spend less than 10 minutes with their statements.
- The Institute asked participants about their perceptions of 401(k) fees before and after disclosure. People don't have a good grasp of what they were paying, before or after. Despite receiving a fee disclosure notice, half of DC participants can not say how much they pay in fees.
- DC participants are generally satisfied with the value for cost.
- Only one third of consumers have a long-term financial plan. One in three have a monthly household budget.
- Slightly more than half of consumers have neither. Only 19 percent of consumers have both a short-term budget and long-term financial plan.



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**National Association of Insurance and Financial Advisors**

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July 21, 2015

**VIA ELECTRONIC FILING – [www.regulations.gov](http://www.regulations.gov)**

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-ZA25 - Proposed Prohibited Transaction Exemptions  
D-11712 (Best Interest Contract Exemption) and D-11850 (PTE 84-24)**

To Whom It May Concern:

The National Association of Insurance and Financial Advisors (“NAIFA”) appreciates this opportunity to comment on the Department of Labor’s (“Department” or “DOL”) proposed prohibited transaction exemptions (“PTEs”) under the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code of 1986 (“Code”).<sup>1</sup>

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**

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors<sup>2</sup> who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

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<sup>1</sup> NAIFA has filed a separate comment letter on the Department’s proposed definition of fiduciary “investment advice,” which is attached hereto as Exhibit 1.

<sup>2</sup> For purposes of this comment letter, the term “advisor” refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Most of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of doing business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in further detail below, some of our members' existing compensation arrangements do not violate ERISA or Code prohibited transaction rules, and therefore do not require compliance with a PTE.<sup>3</sup> To the extent NAIFA members must rely on PTEs, however, we have serious concerns about compliance burdens under the Department's proposal, particularly with respect to the Best Interest Contract ("BIC") Exemption and the proposed revisions to PTE 84-24.

Despite Secretary Perez's statement before Congress on June 17, 2015 that the Department's proposal makes things "simpler" by imposing a uniform fiduciary standard on investment advisors, the proposal is anything but simple. The proposed PTEs are complex and contain extensive conditions that will put a tremendous burden on advisors who serve the middle market.

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<sup>3</sup> Diagrams of common compensation arrangements for advising employers on plan design (employer plan model) and for the sale of fixed and variable annuities (annuity models) are attached hereto as Exhibits 2(a) and 2(b), respectively.

Accordingly, NAIFA recommends that the following revisions be made to the proposed BIC exemption and PTE 84-24:

*Best Interest Contract Exemption -*

- Simplify and clarify the exemption’s requirement to the greatest extent possible in order to avoid litigating areas of uncertainty;
- Align the exemption’s conditions as closely as possible with existing SEC requirements to avoid a dual regulatory system for securities products;
- Hone the “best interest” definition to account for varying perspectives and opinions on particular investment products and business practices; specifically:
  - 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;”
  - Provide 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
  - Provide a clear and explicit statement that offering proprietary products (even a limited suite of such products) does not violate the best interest standard;
- Clarify that the exemption covers rollovers and distributions (to the extent those activities are considered fiduciary investment advice);
- Modify the contract conditions, specifically:
  - Eliminate the formal contract requirement and replace it with a non-signatory point-of-sale notice that binds advisors and financial institutions to act in the best interest of their clients;
  - Or, if the Department retains the contract requirement, clarify:
    - that any contract need not be signed prior to the point of sale;
    - that the contract need not be signed by more than one financial institution;
    - that advisors do not have to provide warranties regarding another entity’s (e.g., a financial institution) incentive and compensation arrangements;
    - that the contract may contain language reasonably limiting the scope and duration of the fiduciary relationship;
- Lessen advisors’ disclosure obligations, particularly to the extent they conflict with securities laws or involve information that is not readily accessible to individual advisors;
- Clarify that non-securities licensed advisors can satisfy the best interest standard; and
- Explain and clarify the interplay between the special exemption for insurance and annuity products, the larger BIC exemption, and other available PTE relief.

*Proposed PTE 84-24 –*

- Expand the scope of the PTE to cover all annuity products sold to all types of investors;
- Do not revoke the PTE for SIMPLE and SEP IRA purchases of variable annuities and mutual funds; and

- Expand the PTE’s compensation relief to be coextensive with the BIC exemption, or at the very least, to allow agent commissions for mutual fund sales.<sup>4</sup>

Below is a detailed discussion of the foreseeable impact of the Department’s proposal, as drafted, and the aforementioned recommendations to make the proposal less onerous.

## **I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT’S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS**

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that “we have a retirement crisis” in this country and “we need to save more.”<sup>5</sup> This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved*.<sup>6</sup> As reported by the *Washington Post*, “[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age.”<sup>7</sup> Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.<sup>8</sup>

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department’s proposed rule, along with its proposed amendments to existing prohibited transaction exemptions (“PTEs”), threatens to be counterproductive with respect to this country’s retirement crisis by

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<sup>4</sup> To the extent PTE 84-24’s proposed conditions are the same as those under the BIC exemption, NAIFA’s comments with respect to those conditions apply to both exemptions.

<sup>5</sup> Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter “June 17 Hearing”), hearing webcast available at <http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027>.

<sup>6</sup> Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It*, *Washington Post*, Aug. 7, 2014.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule’s restrictive definition of investment “education,” advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department’s proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal’s burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal’s burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.<sup>9</sup> And small businesses that work with a financial advisor are 50%

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<sup>9</sup> Oliver Wyman Study, *The Role of Financial Advisors in the US Retirement Market* (July 10, 2015) (hereinafter “Oliver Wyman Study”), at 5 (citing Oliver Wyman Retail Investor Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.<sup>10</sup> Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with \$100,000 or less in annual income, advised individuals have an average of 113% more assets than non-advised investors.<sup>11</sup> The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.<sup>12</sup>

#### B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

- (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.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a

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<sup>10</sup> LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 3.

<sup>11</sup> Oliver Wyman Study, at 6.

<sup>12</sup> LIMRA Survey, at 13.

given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.<sup>13</sup> The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.<sup>14</sup> Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low- and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA's survey, 87 % of advisors anticipate that the Department's proposal will result in higher errors and omissions ("E&O") insurance premiums for their practices; and 58% of those said they expect premiums to increase "substantially." The Department's proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department's proposed BIC exemption contract.

Adding to the overall cost of the Department's proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

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<sup>13</sup> Oliver Wyman Study, at 6.

<sup>14</sup> *Id.*, at 7.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below \$178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.<sup>15</sup> On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for

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<sup>15</sup> The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department’s proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

## **II. THE DEPARTMENT SHOULD CLARIFY THAT SOME FEE ARRANGEMENTS DO NOT REQUIRE COMPLIANCE WITH A PROHIBITED TRANSACTION EXEMPTION**

### **A. Non-Variable, Negotiated Fees Paid by the Client should not Trigger PTE Compliance Requirements**

ERISA and Code prohibited transaction rules generally bar fiduciaries from receiving compensation that varies based on the investment advice given or the investment choice made by the investor, as well as compensation from third parties. Flat fee arrangements and other non-variable compensation (e.g., wrap accounts), however, are permitted.<sup>16</sup> Thus, some of our members’ existing compensation models should not violate the prohibited transaction rules or trigger any obligation to comply with a PTE.<sup>17</sup>

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<sup>16</sup> See ERISA §§ 406 and 408b-2(e); DOL Frost Advisory Opinion (97-15A) (May 22, 1997); DOL Field Assistance Bulletin 2007-1 (Feb. 2, 2007).

<sup>17</sup> NAIFA explains in its comment letter on the Department’s proposed rule that advice to employers on plan and menu design (irrespective of plan type) should be excluded entirely from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products. Thus, the risk of a conflict of interest arising at this stage between the advisor and the employee investors is minimal. Second, in the plan design space, the plan administrator—regardless of plan size or type—is under a separate obligation to make informed and prudent decisions with respect to the plan. Therefore, there is already an extra layer of investor protection involved. The arguments in this letter are presented as alternatives, in the event the Department decides not to grant a carve-out for these services from the definition of fiduciary investment advice.

For instance, many NAIFA members advise employers, under a negotiated fee arrangement<sup>18</sup>, on how to set up employee retirement plans. Our members' services include analysis of the employer's specific needs, recommendations related to general plan models (e.g., 401(k), SIMPLE IRA, etc.), and advice about the investment options that are offered through the plan (e.g., particular mutual funds or annuity products). These services generally are provided on a fee basis.

The advisor's fee is negotiated in advance with the client (the employer), and is usually expressed as a percentage of assets held in the plan (i.e., basis points).<sup>19</sup> The fee amount is invoiced through the advisor's broker-dealer (or, in the case of a group annuity product, through the insurance carrier).<sup>20</sup> Once the fee is remitted, the financial institution forwards the advisor's compensation to her. Notably, the advisor's fee amount *does not vary* based on the plan type or investment options selected by the employer. Although the fee is invoiced through the financial institution, the advisor's compensation comes from the employer. The advisor does not receive any other compensation (e.g., trailers, revenue sharing, etc.) from the employer or any third parties for these services.

Some advisors employ this same fee model to advise individual employees on their investment choices within the plan. In such instances, the employer's fee package covers this service for the employees. Again, the advisor's compensation does not vary based on the investment options selected by the employee, and the advisor does not receive any additional compensation from any source for these services.

Similarly, NAIFA members help employers set up SIMPLE and SEP IRAs for their employees. These plans are especially appealing to small employers because they are far less burdensome to administer than traditional 401(k) pension plans. Our advisors provide the same services to employers who choose to offer SIMPLE and SEP IRAs as those described above with respect to setting up a 401(k) plan (i.e., discussing and evaluating plan design options, and narrowing down the options to be offered through the plan). And the same fee structure generally applies, regardless of whether the employer chooses to offer a 401(k) plan or a SIMPLE or SEP IRA (i.e., non-variable fee based on percentage of assets in the plan, negotiated with the employer, invoiced through the financial institution).<sup>21</sup>

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<sup>18</sup> This fee arrangement—the employer plan model—is diagramed in Exhibit 2a.

<sup>19</sup> Notably, our Members are often in a competitive bidding process with other advisors for these employers' business. Thus, our advisors are incentivized to keep costs as low as possible for the employer.

<sup>20</sup> We note that this invoicing step (i.e., billing through a broker-dealer or carrier) creates some confusion in terminology under state law. Some states label any compensation that is billed through a third party a commission, not a fee. However, this pure invoicing function should not create concern for the Department under the ERISA and Code prohibited transaction rules.

<sup>21</sup> SIMPLE and SEP IRAs can differ from plans when it comes to compensation for advising individual employee participants. In some cases, compensation for employee-level advice under a SIMPLE or SEP IRA is done on a commission basis (similar to traditional compensation

Fees paid by employers for plan design services (for all plan types) are negotiated between the advisor and the client and are either a set dollar amount or a percentage of total assets under management. Although the fees are invoiced through a financial institution, they are paid by the client, not a third party. The fees do not vary based on the plan type or investment options selected by the employer. In some cases, the employer's fee also covers advice to individual employees regarding their investment options under the plan. The Department should clarify that this type of fee arrangement for fiduciary investment advice—whether the advice is given to the employer or the individual employees—is permitted under the current rules and does not require compliance with a PTE.

**B. Upstream Conflicted Compensation should not Trigger PTE Compliance Requirements for Advisors**

In general, NAIFA encourages the Department to divorce conflict-of-interest concerns at the advisor level from those at the broker-dealer or carrier level. Our members often are not aware of the compensation arrangements for carriers and broker-dealers. Furthermore, compensation at the broker-dealer or carrier level, in many circumstances, has no impact at all on an advisor's investment advice or the advisor's compensation for that advice.

For example, in the plan design scenario described above, our members receive a flat, negotiated fee for services, and their compensation does not vary based on how the client reacts to the investment advice given. Thus, regardless of upstream compensation arrangements, there is no conflict at the advisor level. The Department should clarify that so long as the advisor's own compensation does not violate the prohibited transaction rules, the advisor does not need to comply with an exemption.

**III. BEST INTEREST CONTRACT EXEMPTION (“BIC”)**

Secretary Perez and Department officials have stated on several occasions that the objective of the proposed PTEs—particularly the BIC exemption—is to create an enforceable “best interest” fiduciary standard.<sup>22</sup> The Department has professed flexibility, however, regarding how such a standard is operationalized. NAIFA does not oppose the Department's overall goal; in fact, our members believe that they already satisfy a best interest standard.

NAIFA has significant concerns though about the onerous, costly nature of the proposed BIC exemption (upon which the vast majority of our members will have to rely, due to the clients we serve). Despite the Department's repeated characterization of the proposed exemption as “principles-based” and flexible, the proposal is in fact highly prescriptive. Its effect, as drafted,

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arrangements for mutual fund sales) and is not directly negotiated with or paid by the employer. We recognize that for advisors to continue to receive this compensation for employee-level advice, they will have to comply with a PTE.

<sup>22</sup> See, e.g., Comments of Secretary Perez, hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter “June 17 Hearing”), hearing webcast available at <http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027>.

will be to drive all advisors and financial institutions to a uniform business model with flat-fee compensation arrangements and unnecessarily formalized and burdensome advisor-client interactions, none of which suits small account holders or unsophisticated investors. For all of the reasons discussed previously in this comment letter, advisory fee-based compensation models are not appropriate or desirable for small account holders, and the dramatic increase in the cost of doing business under the proposed PTEs will substantially increase costs for clients under traditional brokerage-account compensation arrangements.

Furthermore, the BIC exemption's contract requirement portends a substantial increase in litigation and penalty exposure for advisors, especially those advising IRA owners. To the extent *any* of the exemption's requirements are unclear under the final rules, litigation will likely ensue. For instance, the "best interest" standard, as proposed, is open to different interpretations even among industry professionals (discussed more fully below), and is therefore ripe for consumer lawsuits. In addition to the increased threat of litigation, advisors will also face substantial risk of excise tax penalties under the Code as they navigate and implement a brand new compliance regime.<sup>23</sup> A high level of litigation and penalty exposure will increase the cost of doing business for advisors and financial institutions, and in some cases, the amplified risk will cause services to disappear for middle market clients. Thus, NAIFA strongly prefers that the Department finalize a clear, simple BIC exemption, rather than rely on the courts to define the contours of the rule through costly litigation over the span of several years.

Compounding the difficulty with the BIC exemption is the fact that, for securities products, it sets up a dual regulatory regime with the SEC. In every instance where the exemption differs from the SEC's requirements—in the timing and content of disclosures or a brand new contract requirement, for example<sup>24</sup>—advisors and financial institutions will be faced with an extra layer of compliance burden. Therefore, it is important for the Department to finalize the exemption's conditions in such a way that they correspond with or can be incorporated into existing regulatory requirements. Cohesion between regulatory systems will significantly mitigate cost increases and decrease confusion for advisors and consumers.

In general, eliminating or minimizing complexity and uncertainty under the BIC exemption (to the greatest extent possible) will help advisors and investors in the long run by establishing comprehensible obligations and expectations, by limiting litigation risk and expense, and by avoiding excessive regulatory burdens. NAIFA recommends that the Department simplify the BIC exemption's requirements and offers the following specific recommendations for streamlining the proposal.

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<sup>23</sup> The Code currently gives advisors a 14-day correction period in which to correct a transaction that violates certain Code prohibited transaction rules and avoid an excise tax penalty. 26 U.S.C. §§ 4975(d)(23) and (e)(11)(A). Given the complexity of the Department's proposal and the substantial differences between it and the current rules, NAIFA encourages the Department to consider implementing an extended correction period so that advisors have sufficient opportunity to identify and fix any inadvertent errors during this transition period.

<sup>24</sup> *See, e.g.*, SEC disclosure requirements for clients and prospective clients, 17 CFR 275.204-3 (Delivery of Brochures and Brochure Supplements); *see also* Part 2 of Form ADV.

A. The “Best Interest” Standard Should Be Refined to Take into Account Varying Perspectives and Opinions on Investment Products and Business Practices

We all agree that advisors should act in the best interest of their clients. It is important, however, that the concept of “best interest” not be conflated with “best performance.” It is equally important not to confuse “best interest” with “least expensive.”

A Principal Funds chart attached hereto as Exhibit 4 shows the volatility in asset class performance between 1994 and 2013. The best- and worst-performing assets change constantly. Because no one can predict the future, diversification is essential to any investment strategy. Further, not all investment products are created equal—the quality and level of risk of different products can vary dramatically. And of course, clients’ needs differ and fluctuate widely. Thus, in many instances, an appropriately diversified, high-quality, individually-tailored investment portfolio will not include the least costly products; and yet, given the multitude of factors to consider, such a portfolio is in the client’s best interest. To the extent the Department’s best interest standard takes into account individualized needs and considerations, and does not turn on performance or cost, it has NAIFA’s full support.

One element of the Department’s proposed best interest standard does concern us, however. Under the Department’s proposal, advice is in the best interest of the investor when the advisor (and financial institution):

acts 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].<sup>25</sup>

NAIFA encourages the Department to refine the meaning of “prudent person” within this definition.

The retirement planning industry includes diverse advisors who serve diverse clients and deal in a broad array of products. As a result, there always will be disagreement in the industry about the wisdom or desirability of certain approaches or certain products. For example, there is controversy within the industry about the utility and desirability of variable annuity products. There may also be disagreement among industry professionals about captive advisors offering clients a limited suite of proprietary products (i.e., an industry bias toward independent reps over captives).

Despite these differences in opinion, however, these products and approaches are valuable to investors. Indeed, investors *want* them or they would not be offered. Variable annuities, for instance, provide some investors with a much-needed income stream for life, and may be attractive for their upside potential and tax structure, and proprietary products provide consumers with well known, high-quality investment options (often through local Main Street advisors). Ultimately, consumers should be able to choose from a broad range of investment options (and a range of professional advisors) because there is no “one size fits all” in this context.

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<sup>25</sup> Proposed BIC Exemption, Section VIII(d).

NAIFA recommends that the Department take three steps to account for intra-industry differences like these and to preserve consumer choice under the best interest standard:

- (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;” and
- (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.

Without such clarification, these issues will end up being litigated, generating substantial expense and confusion for advisors and investors alike. The likelihood of litigation on these points presents a direct threat to many of our members’ businesses, given the large number of them who deal in annuities and proprietary products. Accordingly, it is vital that the Department hone its best interest standard to ensure it is workable across the industry and not employed to target or undermine specific products or business practices.

B. Scope of the Exemption Should Be Expanded to Cover Rollovers and Distributions

The BIC exemption currently is limited to “services provided in connection with a purchase, sale or holding” of a defined list of assets.<sup>26</sup> NAIFA interprets the current scope of the exemption to exclude advice and services related to rollovers, distributions,<sup>27</sup> and the opening of IRA accounts. Department officials stated at a technical briefing on May 7, 2015 that they do intend to cover rollovers and distributions under the BIC exemption. NAIFA encourages the Department to clarify this point by revising the provision on “covered transactions” under the BIC exemption or by broadening the definition of “asset” for purposes of the exemption.

C. Exemption Conditions

1. *The Department should not require a formal contract, but rather a non-signatory notice.*

The fundamental purpose of the BIC exemption’s contract requirement, according to the Department, is to create a binding obligation—of which consumers are aware—for advisors to act in the best interest of their clients. NAIFA does not take issue with this goal. But NAIFA does encourage the Department to adopt a more tenable approach to achieving its objective.

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<sup>26</sup> Proposed BIC Exemption, Section I(b).

<sup>27</sup> NAIFA argues in its comment letter on the Department’s proposed rule that distributions should not be treated as “investment advice.” This argument is presented in the alternative, in the event the Department does not create such a carve-out.

Requiring a lengthy, complicated contract executed by at least three parties goes beyond what is necessary to create an enforceable obligation. It is our understanding that the Department has proposed such a requirement in order to obtain enforcement authority over IRA advisors who would otherwise only be subject to the Code's fiduciary regime. But it is unclear to us where, under ERISA or the Code, the Department has been granted authority to circumvent the statutory enforcement structure in such a way.

Instead of a formal contract, the Department should require a non-signatory notice at the point of sale, which would bind advisors and financial institutions to act in the best interest of their clients and be actionable if the standard of conduct were not met. A notice-type requirement would entail far fewer implementation challenges than a formal contract, could be effected more quickly, and would provide meaningful disclosure of the conduct standard to customers (without placing on them the burden of executing formal contracts).

To the extent the Department retains a formal contract requirement, however, NAIFA recommends the following changes in order to make any such obligation workable.

- a. Any contract or notice requirement should be triggered at the point of sale and not before.

Secretary Perez and Department officials have said on multiple occasions that they do not intend to require a signed contract before preliminary conversations between an advisor and an investor. The text of the proposed exemption, however, indicates something different; specifically, it requires that a contract be in place *prior to any recommendation* by the advisor that an investor purchase, sell, or hold an asset.<sup>28</sup> In other words, a contract must be in place before an advisor provides a recommendation or an investor decides to rely on that recommendation in any way (or, just as likely, declines to act on it at all).

Any contract or notice requirement should be triggered by an investment *action* taken on the client's behalf (i.e., some affirmative reliance by the investor on the advice). NAIFA encourages the Department to revise its approach such that any contract requirement is tied to an actual transaction (e.g., at the point of sale or as soon as practicable after an executed transaction). A contract requirement at the conversation stage of the investor-client interaction is premature and unnecessary (because there may not even be any action taken in the best interest of the client or not in the best interest of the client), and will only stifle preliminary conversations about investors' options.

Requiring a contract prior to the point of sale presents particular problems for independent advisors selling annuity products (fixed or variable). Some of our advisors sell annuity products from dozens of insurance carriers. If a contract requirement is triggered by a simple recommendation (or, given the Department's restrictive education exception under the definition of "investment advice," any discussion of the relative merits of specific products) with respect to any of these annuity options, we could be dealing with several contracts for a single initial conversation with one client. This scenario, at least with regard to variable annuities, also raises concerns about the required signatories to the contract, which is discussed in the next section.

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<sup>28</sup> Proposed BIC Exemption, Section II(a).

NAIFA urges the Department to also consider that it would take a substantial amount of time and resources for advisors to “paper” their existing clients (sometimes hundreds of clients for a single advisor) with new contracts. NAIFA members estimate that getting new contracts in place will require, for 77% of clients, face-to-face conversations and explanations about the new requirement. In other words, simply mailing out contracts and requesting returned signed copies is not a feasible option for the vast majority of our clients. NAIFA encourages the Department to be mindful of this reality and draft its final rule in such a way that any new contract requirement will not bring on-going services to existing clients to a complete halt while contracts are developed, circulated, explained, and signed.

Finally, the Department should consider an omnibus implementation strategy for existing clients. Specifically, the Department should allow advisors to send notices to their existing clients stating that the advisor has a fiduciary obligation to act in the client’s best interest. As discussed above, such a notice would be binding on the advisor, but would mitigate the burden of obtaining signed contracts with every client. To the extent the Department retains a formal contract requirement, however, a good-faith effort to get executed contracts in place for all existing clients within a reasonable amount of time should satisfy any such requirement.

- b. Only one financial institution signature should be required on any contract.

The proposed BIC exemption requires that the contract be signed by the advisor, the financial institution for which the advisor acts as agent or registered representative, and the investor. NAIFA is concerned that, under the proposed exemption, our members’ contracts may require four signatories.

“Financial institution” is defined under the proposal as the entity (including a registered investment adviser, a bank, an insurance company, or a broker-dealer) that employs the advisor “or otherwise retains such individual as an independent contractor, agent or registered representative.” This structure is especially problematic for variable annuity products, which have both insurance and securities features. When selling these products, our members are appointed by the insurance carrier and are registered representatives of the broker-dealer.<sup>29</sup>

Thus, based on our reading of the proposed BIC exemption, it appears our advisors would need to obtain signatures from both the broker-dealer and the insurance carrier each time they even *recommend* a variable annuity product. And if they recommend multiple variable annuity products, the proposal would require multiple contracts (for the same client and the same discussion), signed by the respective carriers of each recommended product, the advisor, the broker-dealer, and the investor. This simply is not a workable requirement.

Any contract requirement should be satisfied with the signature of the registered representative, her broker-dealer, and the investor, and should not have to include the carrier’s signature. Requiring each carrier’s signature portends an excessively burdensome process. Thus, NAIFA

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<sup>29</sup> On the other hand, fixed annuities are insurance contracts that provide guaranteed lifetime income and do not have a securities component. Thus, when selling fixed annuity products, advisors act as agents for insurance carriers and there are no broker-dealer relationships involved. *See* Annuity Compensation Models, attached hereto as Exhibit 2(b).

asks the Department to clarify in its final rule that any contract need only be signed by the investor, the advisor, and one financial institution (i.e., in the case of securities products, including variable annuities, the advisor's broker-dealer; in the case of fixed annuities, the insurance carrier).

- c. Advisors should not have to provide warranties regarding financial institutions' incentive and compensation arrangements.

The proposed BIC exemption requires advisors to warrant that the financial institution (or any affiliate or related entity) does not use differential compensation or any other actions or incentives that would tend to encourage individual advisors not to act in the best interest of their clients. This warranty effectively undermines any compensation-related benefits an advisor could receive for complying with the BIC exemption. According to the Department, the BIC exemption is designed to allow financial professionals to continue receiving compensation that is ubiquitous in the marketplace (e.g., commissions, 12b-1 fees, revenue sharing, etc.). But this warranty requirement forces those professionals to effectively promise not to employ any of those common compensation arrangements in the first place.<sup>30</sup>

Moreover, this warranty is duplicative. Under the contract requirement, advisors must affirmatively state that they are acting as fiduciaries and in the best interest of the client. The best interest standard is in place to address the very problem presumably targeted by this warranty. Thus, NAIFA urges the Department to remove this warranty requirement from the final rule.

To the extent some version of this warranty remains in the final rule, NAIFA notes that registered representatives generally do not have the information necessary to make such a blanket warranty about the compensation and incentive practices of the financial institution for which they are an independent agent or registered representative. Therefore, NAIFA asks the Department to make clear in its final rule that any such warranty must be made by the financial institution, not the advisor.

- d. Advisors should be permitted to limit the scope and duration of the fiduciary relationship.

BIC exemption contracts may not include "provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms."<sup>31</sup> Department officials stated at the May 7, 2015 technical briefing that they do not intend for this provision to bar advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the scope of services the advisor is willing to provide to a given client or the time period

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<sup>30</sup> The Department's examples in the preamble of acceptable compensation arrangements (i.e., arrangements that would not violate this warranty) indicate that the Department is forcing everyone to flat-fee and wrap account arrangements. For the reasons discussed in the introduction to this comment letter, those arrangements will not benefit NAIFA members' clients.

<sup>31</sup> Proposed BIC Exemption, Section II(f)(1).

during which such services will be provided). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) that limits the duration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail ongoing advice (i.e., a one-time sales relationship), the advisor should be able to make clear that the fiduciary relationship encompasses only the sale, and the advisor does not have perpetual fiduciary obligations to the client. Further, advisors should be able to clarify the scope of (or disclaim) any ongoing monitoring obligations. NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a notice to the client.

## 2. *Advisors' disclosure obligations should be reduced.*

The proposed BIC exemption requires an advisor, prior to the purchase of any asset, to furnish the investor with a chart that provides, for each asset recommended, the “total cost” to the investor of investing in the asset for 1-, 5- and 10-year periods expressed as a dollar amount (using reasonable assumptions about investment performance). “Total cost” includes loads, commissions, opening fees, sub-transfer agent fees, etc. NAIFA interprets this provision to require growth projections for recommended products, which conflicts with current securities regulations.<sup>32</sup> At the May 7, 2015 technical briefing Department officials acknowledged this conflict and represented that they would resolve the issue in the final rule.

Aside from the conflict with securities laws, NAIFA has several general concerns about this type of disclosure requirement (i.e., projecting costs into the future). First, any cost projections—especially when put in a dollar amount—will be inherently unreliable because an advisor simply cannot predict what will happen with the market or with a given asset. Second, advisors’ compensation, which is largely controlled by upstream financial institutions, can change at any given time, especially when compensation is based on an advisor’s total book of business. Thus, any cost disclosure should be expressed in general terms (e.g., gross dealer concessions), not an actual dollar amount, and should not isolate advisor compensation from other entities’ compensation (e.g., break out the broker-dealer and advisor portions of a shared commission). Third, a disclosure requirement of this nature would be very costly and burdensome for small, independent advisors. And fourth, as discussed in greater detail below, investors may not actually benefit from extensive disclosures of this nature.

In addition to the transaction-level total cost disclosure, the proposed BIC exemption includes obligatory annual disclosures, which are to be provided by the advisor or the financial institution for which the advisor is an agent or registered representative. We believe this annual requirement is duplicative and overly burdensome in light of the proposal’s transactional disclosures and should be removed from the final rule. If the requirement is retained, however, NAIFA strongly encourages the Department to clarify that this particular obligation falls on the financial institution, and not the individual advisor. Advisors will not have access to the information subject to this disclosure requirement (e.g., total dollar amount of *all* fees paid by the

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<sup>32</sup> See FINRA Rule 2210(d)(1)(f) (prohibiting performance predictions and projections).

investor, directly or indirectly, and *all* compensation received by the advisor and financial institution, which includes compensation paid to parties upstream from the advisor—fees about which the advisor would not be aware). And again, the burden of the disclosure requirement will be particularly heavy for independent advisors without back office support.

Regardless of which entity ultimately is responsible for making these disclosures, under the Department's proposal, investors will be inundated with complex charts and figures and duplicative information. This could result in heightened consumer confusion and no real consumer benefit. According to a LIMRA Secure Retirement Institute Survey published in May 2015, disclosures do not necessarily help investors grasp how much they are paying in fees or for what they are paying.<sup>33</sup> The survey asked participants in 401(k) plans about their perceptions about fees before and after disclosures were made and concluded that participants' understanding did not improve with disclosure, and half of those surveyed could not say how much they pay in fees following disclosure.<sup>34</sup>

Advisors and financial institutions already make product-specific disclosures to their clients under securities regulations and existing Department regulations like those under section 408b-2 (which, apparently, have limited usefulness). Increasing the cost and burden on advisors by adding unnecessary, confusing disclosures will not help retail investors. Accordingly, NAIFA recommends that the Department significantly narrow the disclosure requirements under the BIC exemption and, to the greatest extent possible, integrate any such requirements with existing client notices and disclosures.

#### D. Limited Product Offerings

NAIFA supports the Department's allowance under the BIC exemption for financial institutions and advisors to offer a limited range of investment options (e.g., proprietary products). The Department should clarify, however, that advisors who are not licensed to deal in securities products can offer, as a general rule, a broad enough variety of products to satisfy the best interest standard (i.e., just through the offering of non-securities insurance and annuity products). Department officials said at a meeting on May 20, 2015 that their intention was not to exclude entire groups of advisors with the best interest standard, and indicated that advisors without securities licenses would be able to satisfy the BIC exemption's requirements.

#### E. Special Exemption for Insurance and Annuity Products

NAIFA also supports the Department's proposed special exemption for insurance and annuity products, which allows advisors to recommend insurance and annuity products from insurance companies that are parties in interest. This special exemption is necessary for NAIFA members who are affiliated with, or captives of, insurance companies. It is NAIFA's understanding that the special exemption's relief is limited to certain party-in-interest (or in the case of IRAs, disqualified person) prohibited transaction rules, and does not extend to prohibited transaction

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<sup>33</sup> LIMRA Survey, at 17.

<sup>34</sup> *Id.*

rules regarding conflicted compensation received by the advisor.<sup>35</sup> Thus, we interpret the proposal to require an advisor who receives compensation prohibited under ERISA or the Code to rely on the larger BIC exemption or PTE 84-24, depending upon the investor and transaction in question, to receive such compensation. NAIFA encourages the Department to elucidate the interaction between the special exemption and the broader PTEs in the final rule.

### **III. PROHIBITED TRANSACTION EXEMPTION 84-24**

#### **A. PTE 84-24 should apply to all annuity products sold to all types of investors.**

The Department's proposed PTE 84-24 creates a convoluted compliance structure under which annuities transaction are divided between securities and non-securities products, and by the type of investor involved in the transaction (i.e., IRAs and plans). Under the proposal, PTE 84-24 will no longer be available for variable annuity or mutual fund sales to IRAs; to sell those products to IRA owners, advisors will have to rely on the more onerous BIC exemption. However, if those same products are sold to plans, PTE 84-24 still applies. For the following reasons, the Department should adopt a more balanced approach and retain 84-24 relief for all insurance and annuity products sold to all types of investors.

First, this structure is unnecessarily complicated and confusing. The proposed PTE 84-24, like the BIC exemption, requires advisors and financial institutions to adhere to impartial conduct standards, including the best interest standard, and to fulfill robust disclosure requirements.<sup>36</sup> It is not clear why the Department feels that some products for some investors should be split off and handled under a separate compliance scheme.

Second, as noted above, NAIFA members are compensated similarly for fixed and variable annuity products (i.e., through an upfront commission). To the extent the Department is concerned about different conflicts of interest arising from different compensation models, that concern is misplaced.

Third, the more complicated the compliance regime, the more costly it will be for advisors, financial institutions, and ultimately, consumers.<sup>37</sup> In this case, the Department's proposed

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<sup>35</sup> The "covered transactions" provision under the special exemption provides relief from specified ERISA § 406(a) rules and from Code § 4975(c)(1)(A) and (D), but does not include 406(b)-type relief.

<sup>36</sup> To the extent 84-24's conditions match the BIC exemption's conditions, NAIFA incorporates the same comments and suggestions made earlier in this comment letter.

<sup>37</sup> It is worth noting that annuity products are already subject to multiple layers of regulation. Because they are insurance products, they are heavily regulated at the state level. States have product content and marketing rules in place, as well as sales practices requirements. Additionally, the NAIC has model regulations (adopted by almost all of the states) on disclosures and suitability in annuity transactions. And of course, at the federal level, the SEC and FINRA regulate the sale of variable annuities. The Department should not add on top of this structure another complex, confusing and costly layer of regulation.

structure places a heavier burden on advisors who serve IRA owners, and particularly, on advisors who sell variable annuity products to those investors. As previously discussed in this letter, annuity products are generally sold to low- and middle-income investors who rely on the income stream from those products, and variable annuities are especially attractive to investors who desire those products' upside potential. Once again, the Department is actually disadvantaging middle market consumers by forcing their advisors to adhere to more onerous and costly requirements under the BIC exemption.

B. PTE 84-24 should cover the purchase by SIMPLE and SEP IRAs of variable annuities and mutual funds.

The Department proposes to revoke PTE 84-24 for the purchase by Individual Retirement Accounts of annuity products that are securities and mutual fund shares. "Individual Retirement Account" is defined broadly to include "individual retirement accounts" and "individual retirement annuities" described in 26 U.S.C. §§ 408(a) and (b), respectively. Subsections 408(k) and (p) then define SEP and SIMPLE IRAs as employer-sponsored "individual retirement accounts" or "individual retirement annuities" (as described in subsections (a) and (b)) with specific participation, contribution and other requirements.<sup>38</sup>

The Department should not revoke PTE 84-24 for SIMPLE and SEP IRA purchases of variable annuities and mutual funds. These employer-sponsored IRAs are akin to traditional pension plans in that they are retirement savings vehicles established for the benefit of individual employees. Because they have fewer reporting requirements and are easier to administer, these types of plans are especially popular with small employers.

As drafted, the Department's proposal unfairly burdens advisors who sell SIMPLE and SEP IRAs to employers (i.e., small employers) instead of traditional 401(k) plans because they are forced to rely on the more onerous BIC exemption in order to place variable annuities and mutual funds in these plans.<sup>39</sup> This discrepancy between requirements for different types of employer-sponsored retirement savings plans is not warranted.

The investment advice services provided to employers who adopt SIMPLE and SEP IRAs are the same as the services provided to employers who adopt 401(k) plans (i.e., evaluation of the employer's particular needs, recommendations about plan types, and recommendations about investment options offered through the plan). To the extent NAIFA members advise employers on plan and menu design and receive some variable or third-party compensation for their services (i.e., do *not* use the common employer fee model described in detail at the beginning of this letter), they should be able to rely on PTE 84-24, regardless of the type of retirement plan in place.

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<sup>38</sup> Section 408(c) provides that "a trust created or organized in the United States by an employer for the exclusive benefit of his employees or their beneficiaries . . . shall be treated as an individual retirement account (described in subsection (a))" if the governing instrument creating the trust meets certain requirements.

<sup>39</sup> As a practical matter, fixed annuities are not sold to employer-sponsored retirement plans of any type.

Like recommendations made to employers with 401(k) plans, investment advice given to employers with SIMPLE and SEP IRAs is a step removed from recommendations pertaining to the employees' ultimate investment decisions. With the help of an advisor, the employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products. Thus, the risk of a conflict of interest arising between the advisor and a plan of any type is minimal. Second, in the plan design space, the plan administrator—regardless of plan size or type—is under a separate obligation to make informed and prudent decisions with respect to the plan. Therefore, there is already an extra layer of investor protection involved.

Accordingly, advice to employers regarding plan and menu design should be covered under PTE 84-24 and not the more onerous BIC exemption, regardless of whether the advisor is selling group annuity or mutual fund products and regardless of whether the employer chooses to offer a traditional 401(k) plan or a SIMPLE or SEP IRA to its employees.

C. PTE 84-24's compensation relief should be expanded.

1. *PTE 84-24's compensation relief should be coextensive with the BIC exemption's relief.*

For transactions that are covered under the proposed 84-24, the Department has limited compensation relief to agents, brokers and principal underwriters to narrowly-defined "Insurance Commissions" and "Mutual Fund Commissions." Unlike current PTE 84-24, the proposal explicitly excludes revenue sharing, administrative fees, marketing payments, and payments from parties other than the insurance company or its affiliates. The Department's justification for such restrictions on compensation relief under 84-24 (and not imposing such restrictions under the BIC exemption) is unclear.

Proposed 84-24 imposes the same "best interest" standard as that under the BIC exemption, as well as other impartial conduct standards and disclosure requirements. The mandate that advisors act in the best interest of their clients should assuage concerns the Department may have about particular compensation arrangements. Thus, the Department should extend 84-24's compensation relief to be coextensive with the BIC exemption's relief.<sup>40</sup>

2. *PTE 84-24's compensation relief should at least be extended to include mutual fund commissions for agents.*

If the Department opts to not extend 84-24's relief to match the BIC exemption's relief, the Department should—at the very least—extend 84-24's coverage to include Mutual Fund Commissions paid to Principal Underwriters *and their agents*. As drafted, the proposed PTE 84-24 allows for payment of insurance commissions to insurance agents and brokers, but does not allow agents or registered reps to receive commissions for mutual fund sales, even though the

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<sup>40</sup> It is our understanding that the special exemption for insurance and annuity products contained under the BIC exemption provides relief from ERISA and Code party in interest/disqualified person rules, whether the transaction falls under the BIC or 84-24 for conflicted compensation relief. Again, we request that the Department clarify this point in its final rule.

same impartial conduct standards and exemption conditions apply equally to the sale of insurance and annuity products, and mutual funds. Without any apparent justification, the Department's proposal allows agents to be paid for one product line, but cuts off their compensation for another.<sup>41</sup> The Department should remedy this discrepancy by allowing agents to be compensated for mutual fund sales.

#### **IV. THE DEPARTMENT SHOULD EXTEND THE ENFORCEMENT TIMELINE TO AT LEAST THIRTY-SIX MONTHS**

The proposed eight-month enforcement timeline for compliance with the new rule is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department's proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

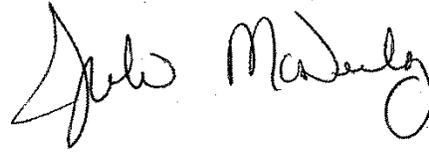
*Each* one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

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<sup>41</sup> Agents and brokers are paid almost exclusively on a commission basis for the sale of mutual fund shares.

Very truly yours,

A handwritten signature in black ink, appearing to read "Juli McNeely". The signature is fluid and cursive, with the first name "Juli" written in a larger, more prominent script than the last name "McNeely".

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

Exhibits:      NAIFA Comment Letter on Proposed Rule  
                    Diagrams of Compensation Models  
                    LIMRA Secure Retirement Institute 2015 Consumer Survey  
                    Principal Funds Table on Asset Class Performance from 1994 to 2013

**Exhibit 1**  
NAIFA Comment Letter on Proposed Rule



**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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July 21, 2015

**VIA ELECTRONIC FILING – [www.regulations.gov](http://www.regulations.gov)**

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

**RE: RIN 1210-AB32 - Proposed Definition of Fiduciary Investment Advice**

To Whom It May Concern:

The National Association of Insurance and Financial Advisors (“NAIFA”) appreciates this opportunity to comment on the Department of Labor’s (“Department”) proposed definition of fiduciary “investment advice” under the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code of 1986 (“Code”).<sup>1</sup>

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**

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors<sup>2</sup> who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

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<sup>1</sup> NAIFA has filed a separate comment letter on the Department’s proposed prohibited transaction exemptions, which is attached hereto as Exhibit 1.

<sup>2</sup> For purposes of this comment letter, the term “advisor” refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Many of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of conducting their business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in more detail below, NAIFA has significant concerns about the workability of some portions of the Department's proposed rule, and recommends several adjustments to the proposal. Namely, NAIFA strongly encourages the Department to adopt a final fiduciary investment advice definition that:

- Requires some investor reliance on the investment advice;
- Requires a mutual understanding between the investor and the advisor;
- Excludes referrals to other financial professionals;
- Excludes distribution-related advice that is not investment advice;
- Excludes welfare benefit plans with no investment component;
- Excludes, or includes a carve-out for, marketing and sales activity for all products, services and investors;
- Includes a carve-out for advice relating to employer plan design;
- Allows for meaningful investor education by including a broad education carve-out;

- Allows advisors to place reasonable limitations on the scope and duration of the fiduciary relationship; and
- Includes an enforcement timeline of at least thirty-six months.

In its current form, the proposed rule presents major—and in some cases, insurmountable—obstacles for NAIFA members serving middle-market retail investors (i.e., those who need the most encouragement and assistance when it comes to retirement savings). NAIFA hopes that the objective of the Department’s proposal is not to limit or take away advisory services for Main Street investors, and we greatly appreciate your thoughtful consideration of these comments.

## **I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT’S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS**

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that “we have a retirement crisis” in this country and “we need to save more.”<sup>3</sup> This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved*.<sup>4</sup> As reported by the *Washington Post*, “[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age.”<sup>5</sup> Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.<sup>6</sup>

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department’s proposed

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<sup>3</sup> Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter “June 17 Hearing”), hearing webcast available at <http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027>.

<sup>4</sup> Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It*, *Washington Post*, Aug. 7, 2014.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

rule, along with its proposed amendments to existing prohibited transaction exemptions (“PTEs”), threatens to be counterproductive with respect to this country’s retirement crisis by making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule’s restrictive definition of investment “education,” advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department’s proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal’s burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal’s burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.<sup>7</sup> And small businesses that work with a financial advisor are 50%

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<sup>7</sup> Oliver Wyman Study, *The Role of Financial Advisors in the US Retirement Market* (July 10, 2015) (hereinafter “Oliver Wyman Study”), at 5 (citing Oliver Wyman Retail Investor

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.<sup>8</sup> Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with \$100,000 or less in annual income, advised individuals have an average of 113% more assets than non-advised investors.<sup>9</sup> The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.<sup>10</sup>

#### B. More Expensive Advice for Small Businesses and Small Account Holders

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

- (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.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets

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Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

<sup>8</sup> LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 2.

<sup>9</sup> Oliver Wyman Study, at 6.

<sup>10</sup> LIMRA Survey, at 13.

they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.<sup>11</sup> The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.<sup>12</sup> Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA’s survey, 87 % of advisors anticipate that the Department’s proposal will result in higher errors and omissions (“E&O”) insurance premiums for their practices; and 58% of those said they expect premiums to increase “substantially.” The Department’s proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department’s proposed BIC exemption contract.

Adding to the overall cost of the Department’s proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department’s rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and

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<sup>11</sup> Oliver Wyman Study, at 6.

<sup>12</sup> *Id.*, at 7.

dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below \$178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

#### C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.<sup>13</sup> On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

#### D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the

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<sup>13</sup> The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department’s proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

## **II. THE PROPOSED RULE**

Virtually all NAIFA members will be investment advice fiduciaries for purposes of ERISA and the Code under the Department’s proposed rule. The rule, along with the Department’s proposed PTEs, will require major changes in our members’ business practices and client relationships. While NAIFA is not opposed to a “best interest” standard of care for advisors, it is extremely important that such a standard be contained within a feasible operational structure.

As it stands, nearly all of our members who become fiduciaries will have to alter their current compensation arrangements (for at least some clients and some products) or satisfy a PTE. For the reasons discussed above, both options carry significant risk of harm to retail investors. We believe that such risk can be partially mitigated, however, if the Department addresses the specific points of concern discussed below.<sup>14</sup>

### **A. Scope of the Proposed Definition of Fiduciary “Investment Advice”**

1. *The definition of fiduciary investment advice should require some investor reliance on the investment advice.*

The Department’s current five-part test for fiduciary investment advisors includes a requirement that the advice serve as the primary basis for the investment decision(s) ultimately made by the investor.<sup>15</sup> The requirement ensures that clients actually act on the investment advice before a fiduciary relationship arises. NAIFA strongly urges the Department to maintain a similar reliance requirement under its proposed definition of fiduciary investment advice. Otherwise, advisors are forced to take on a fiduciary role, even if their investment advice is completely

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<sup>14</sup> Again, NAIFA has submitted separate detailed comments on suggested adjustments to the Department’s PTE proposals.

<sup>15</sup> See 29 CFR 2510.3-21.

ignored or has no impact whatsoever on the client's investment decisions. Given the substantial cost and burden on fiduciaries under the Department's proposal, fiduciary relationships should at least be limited to situations in which some meaningful advice or service is rendered *and* accepted.

2. *The definition of fiduciary investment advice should require a mutual understanding between investor and advisor.*

Similarly, the Department's current fiduciary investment advice test includes a requirement that the advice be given pursuant to a mutual agreement or understanding between the investor and the advisor.<sup>16</sup> Mutual understanding, like reliance, should be an element of the Department's new definition of fiduciary investment advice. Before a fiduciary relationship exists, both parties should, at a minimum, recognize that the advice is being given and considered for the client's particular investment needs. Without such mutuality, casual or social conversations could be misconstrued as fiduciary communications. Again, considering the burden of the overall fiduciary structure proposed by the Department, some common-sense checks should be in place before fiduciary obligations are imposed on advisors. At the very least, the impacted parties should have an awareness and understanding of what they are undertaking.

3. *Recommendations of other financial professionals should not fall within the definition of fiduciary investment advice.*

As drafted, the Department's proposed definition of fiduciary investment advice covers four general categories of advice:

- (1) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property (including a recommendation to rollover assets or take a distribution);
- (2) A recommendation as to the management of securities or other property (again, including rollover and distribution decisions);
- (3) An appraisal, fairness opinion, or similar statement—verbal or written—concerning the value of securities or other property when provided in connection with a specific transaction; and
- (4) A recommendation of a person who is also going to receive a fee or other compensation for providing the aforementioned types of advice.

The last category—recommendations of other financial professionals—should be excluded from the fiduciary investment advice definition because it is not *investment* advice. In fact, a simple referral is several steps removed from actual investment activity. The Department's definition appears to assume that the recipient of the advice will in fact pursue the recommended professional, that the other professional to whom the prospective client is referred will be in a position (and agree) to work with the client, and that investment advice will actually be given and acted upon.

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<sup>16</sup> *Id.*

Furthermore, inclusion of referrals under the new definition of fiduciary investment advice will effectively eliminate referrals because advisors simply will not be willing to take on fiduciary obligations in situations where the “advice” rendered is to send the investor elsewhere for services. And reducing referrals will harm investors. Professional referrals are a valuable service, particularly to unsophisticated investors or those who are new to retirement planning and saving. A list of names or advertisements in a phone book does not offer any meaningful guidance for investors to narrow down their options or find professional services that are suitable for them. Referrals from individuals in the same business, however, provide investors with some confidence that they will be talking to a reputable advisor who, in at least someone’s estimation, is an appropriate advisor for the investor.

The Department’s proposal to include referrals in the definition of fiduciary investment advice defies logic and will only harm consumers. Accordingly, the Department should remove this category of advice from the proposed definition.

4. *Advice regarding distributions—without accompanying investment advice—should not be included in the definition of fiduciary investment advice.*

As noted above, the Department proposes to include advice regarding distributions under the definition of fiduciary investment advice. This type of advice should be excluded, however, when it is rendered without any accompanying *investment* advice. For example, if an advisor is informed that an investor has suffered an unforeseeable financial loss and needs to take a hardship distribution—and there is no investment recommendation sought or given pertaining to the distributed funds—the advisor’s non-investment advice aimed at facilitating the distribution should not qualify as fiduciary investment advice. Similarly, if an advisor counsels an investor not to take a distribution (i.e., to preserve the status quo with respect to plans and assets), that also should not be considered fiduciary advice.

In these scenarios, the advisor is not delivering advice with respect to particular investments from which the advisor may benefit, but rather is providing generic counseling and assistance for the good of consumers. Thus, the Department should clarify in the final rule that such distribution-related advice is not considered fiduciary investment advice.

5. *Welfare benefit plans with no investment component should be excluded from the rule.*

The Department’s proposed rule defines “plan” as “any employee benefit plan described in section 3(3) of [ERISA] and any plan described in section 4975(e)(1)(A) of the Code.” Section 3(3) of ERISA includes employee pension benefit plans and employee welfare benefit plans, which include health, life, and disability benefits. Department officials indicated at a meeting on May 20, 2015, and during a phone conversation on June 3, 2015, that the Department does not intend the proposed rule to cover welfare plans that do not have an investment component (i.e., plans that are not designed to generate income or increase wealth). NAIFA strongly urges the Department to clarify in its final rule that benefit plans like traditional health, life and disability are not covered under this rule-making.

NAIFA suggests achieving such clarification by adding a definition of “other property.” For example, the definition could read:

“‘*Other property*’ for purposes of this section does not include welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use.”

Alternatively, the term “investment” could be defined as follows:

“‘*Investment*’ for purposes of this section does not include the purchase, sale, holding, or exchanging of welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use.”

In addition to these specific suggestions, there may be other ways for the Department to resolve this issue. NAIFA urges the Department to clarify, in one way or another, that welfare benefit plans with no investment component are not covered under this rule-making.

6. *Marketing of services and preliminary client development conversations should not be considered fiduciary investment advice.*

For the individuals and small businesses served by NAIFA members, effective marketing of our advisors’ services can mean the difference between an employer offering a retirement plan or not, or an individual prematurely cashing out a retirement account or continuing to save. Getting good advice to consumers who need it is a goal we all share. Further, as discussed above with respect to professional referrals, we all agree that consumers should be able to make informed decisions when choosing their advisors.

Department officials said at a technical briefing on May 7, 2015 that they did not intend to capture conversations along the lines of “hire me” or “these are the services I can offer you” under the definition of investment advice. At that same briefing, officials acknowledged that there should be some opportunity for preliminary conversations with prospective clients before fiduciary status and any attendant contract or disclosure requirements are triggered. Secretary Perez echoed those comments while testifying before a congressional committee on June 17, 2015, where he stated that the Department wants consumers to be able to “shop around” and “[the Department’s] goal is to make sure that shopping around can happen.” However, given some elements of the proposed rule, NAIFA believes that these sentiments need to be clarified and memorialized in any final rule.

As drafted, the proposed rule applies to a recommendation:

- (1) of a person who is going to receive compensation for providing investment advice;
- (2) that is individualized or specifically directed to the recipient of the recommendation; and

(3) is provided by someone who may eventually receive compensation as a result of the recommendation.<sup>17</sup>

It appears that this would cover one-on-one sales pitches and targeted advertising by advisors seeking to introduce their services to new clients, which creates an unnecessary barrier to services for individuals and employers who will not sift (or do not feel comfortable sifting) through anonymous advisor listings in the phone book.

The Department could ensure that these initial conversations are not captured by adopting some of the above suggestions (e.g., by requiring some investor reliance and mutual understanding between advisors and investors). Or, as discussed in detail below, the Department could resolve this issue by creating a robust seller's exception. Regardless of the approach taken, NAIFA urges the Department to carve out marketing and preliminary conversations with prospective clients from the investment advice definition.

B. The Department should Adopt a Seller's Exception that Applies Across all Products, Services, and Investors.

The Department's proposed seller's exception (the counterparty carve-out) does not apply to small plans or IRAs at all, and is limited to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract to large plan ("sophisticated") investors.<sup>18</sup> As drafted, the exception also does not appear to cover a discussion about an advisor's services.<sup>19</sup> The Department should replace its proposed counterparty carve-out or create a separate seller's exception that applies to all products, services, and investors.

A robust seller's exception will allow advisors and financial institutions to market their products and services. Marketing, as opposed to true investment advice, poses very little threat of conflicts of interest. Presumably, this is why marketing has not historically been considered fiduciary activity under ERISA or the Code. Indeed, it is unclear whether the Department has statutory authority to capture pure marketing and sales activities under the fiduciary umbrella.

Sales pitches in the financial advisor context are like sales pitches in all other retail contexts; they are take-it-or-leave-it promotions designed to attract consumers in the first instance so that products and services can *then* be delivered. And like other retail contexts, financial advisor marketing should not be limited to certain segments of the population. The Department appears to believe—without apparent justification—that small business owners (i.e., with 99 or fewer employees) are not as sophisticated as large business owners (i.e., with 100 or more employees).

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<sup>17</sup> See proposed § 2510.3-21(a)(1)(iv) (what constitutes investment advice), (a)(2)(ii) (the requirement that said advice be directed to an individual), and (f)(6) (definition of "fee or other compensation, direct or indirect").

<sup>18</sup> See proposed § 2510.3-21(b)(1)(i).

<sup>19</sup> Because the counterparty exception applies only to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract, it is NAIFA's interpretation that it does not cover a discussion of services.

Size of a business is immaterial, however, to the financial knowledge and sophistication of a plan fiduciary. Furthermore, there is no evidence that financial sophistication is needed to understand when someone is making a sales pitch rather than delivering impartial advice. The Department's paternalistic approach is misguided, and will only prevent a large number of consumers from learning about available products and services, which is counterproductive for the retirement crisis in this country.

Any seller's exception could and should include reasonable investor protections, such as clear and explicit disclosures by the advisor that she is not providing impartial or fiduciary investment advice (i.e., the disclosure required under the proposed counterparty exception), but rather is engaged in marketing or sales activity. A full disclosure of this nature supports the Department's objective of improving consumer awareness of advisors' obligations (or lack thereof) in certain circumstances. At the same time, a broad exception allows for effective marketing and client development, which will help advisors reach those populations that are arguably in most need of professional retirement planning assistance.

C. The Final Rule Should Include a Carve-Out for Advice on Plan Design.

An advisor's assistance to employers with menu design for participant-directed plans (including 401(k) plans, SIMPLE IRAs, and SEP IRAs) should be excluded from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products.<sup>20</sup> Thus, the risk of a conflict of interest arising at this stage between the advisor and employee investors is minimal. Furthermore, in the plan design space, the plan administrator—regardless of plan size—is under a separate obligation to make informed and prudent decisions with respect to the plan.<sup>21</sup>

The “plan design exception” should apply when an advisor is providing recommendations to an employer:

- (1) On the types of retirement plans available (e.g., 401(k), SIMPLE IRA, etc.), and associated costs and benefits with respect to plan types;
- (2) On the investment options that will be made available through the plan selected (e.g., mutual fund options, annuity options, etc.), including advice related to the overall allocation of investment options and advice related to narrowing down options within general product categories; and

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<sup>20</sup> NAIFA recognizes that individualized investment advice to plan participants or IRA owners is a different scenario with separate conflict-of-interest concerns.

<sup>21</sup> See 29 U.S.C. § 1002(21)(a)(iii) (under ERISA, a person is a fiduciary with respect to a plan to the extent he has any discretionary authority or discretionary responsibility in the administration of such plan); see also 26 U.S.C. § 4975(e)(3)(C) (corresponding fiduciary definition under the Code).

(3) On plan administration topics, including selection of a managing fiduciary, third-party administrators, and other administrative service providers.<sup>22</sup>

Employers need professional advice in each of these areas to establish and maintain a retirement plan appropriate for their specific needs and employee populations. As explained above, a plan design exception is consistent with the Department's goal of minimizing advisor conflicts of interest, as well as the overarching objective of encouraging individuals to save early for retirement by increasing the availability of employer-sponsored retirement plans.<sup>23</sup>

D. The Final Rule Should Allow for *Meaningful* Investment Education.

During a meeting on May 4, 2015 with NAIFA members, Department officials stated that one of their objectives is to preserve investor education. And Secretary Perez told members of Congress on June 17 that investor education is "exceedingly important." Unfortunately, the narrow scope of the education exception under the proposed rule will not facilitate the goal of preserving or expanding investor education. It will have the opposite result, especially for unsophisticated investors who benefit the most from such education.

Secretary Perez commented on June 17 that, in his view, the "most important part" of an educational discussion between advisor and investor "is the asset allocation conversation." And, he asserted that, under the proposed rule, those conversations do not trigger fiduciary status or obligations. The Secretary's comment is perplexing, to say the least, when one reads the proposal's narrow education exception.

There are approximately 9,000 mutual funds available today, not to mention the host of other types of products available in the retirement space. Telling an inexperienced investor to choose among mutual funds without providing any guidance as to the strength or desirability of any particular funds is not meaningful education; it is simply overwhelming. Meaningful education requires some identification and characterization of specific investment options.

The Department has not historically restricted "education" to generic, high-level conversations. Instead, the Department has allowed for meaningful education to take place, with appropriate disclosures. For instance, under Interpretive Bulletin 96-1,<sup>24</sup> the Department has not included within fiduciary "investment advice" asset allocation models that identify specific investment

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<sup>22</sup> We do not interpret the Department's proposed platform provider carve-out to be broad enough to capture these advisor services. To the extent the Department does intend for the carve-out to cover these activities, NAIFA urges the Department to make that clear in the final rule.

<sup>23</sup> Alternatively, if the Department chooses not to include a plan design exception, NAIFA urges the Department to finalize a more robust PTE 84-24 that would cover plan design services and advice. This alternative approach is described in more detail in NAIFA's comment letter on the Department's proposed PTEs, attached hereto as Exhibit 1.

<sup>24</sup> 29 CFR Part 2509.

alternatives, as long as they are accompanied by a statement indicating that other investment options with similar characteristics may be available. Bulletin 96-1 reasons: “Because the information and materials described above would enable a participant or beneficiary to assess the relevance of an asset allocation model to his or her individual situation, the furnishing of such information would not constitute a “recommendation”. . . and, accordingly, would not constitute [fiduciary investment advice].”<sup>25</sup>

The Department’s rationale in Bulletin 96-1 makes perfect sense and its approach strikes an appropriate balance between ensuring the availability of meaningful investment education and providing investor protection. NAIFA strongly encourages the Department to maintain its current rule on investment education and create an education exception under its proposed rule that encompasses this broader, more helpful approach.

E. Advisors Should be Permitted to Put Reasonable Limitations on the Scope and Duration of the Fiduciary Relationship.

Department officials stated at the May 7, 2015 technical briefing that they do not intend the proposal’s prohibition on exculpatory contractual language<sup>26</sup> to prohibit advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the time period and scope of services the advisor is willing to provide to a given client). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) regarding the expiration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail the provision of ongoing advice (e.g., a one-time sale relationship), the advisor should be able to make clear that the fiduciary relationship concludes with the sale and the advisor does not have perpetual fiduciary obligations to the client.<sup>27</sup> NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a disclosure to the client.

**III. The Department Should Extend the Enforcement Timeline to at least Thirty-Six Months**

The eight-month enforcement timeline for compliance with the new rule proposed by the Department is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department’s proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about

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<sup>25</sup> *Id.*

<sup>26</sup> *See* Proposed BIC Exemption, Section II(f)(1).

<sup>27</sup> A contractual term of this nature would not bar suit by the investor based on breach of fiduciary duty or interfere with any current statutes of limitation with respect to such claims.

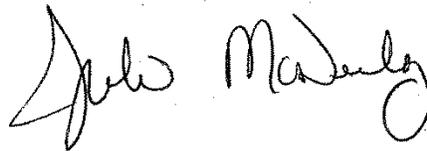
the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

*Each* one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

Very truly yours,

A handwritten signature in black ink, appearing to read "Juli McNeely". The signature is fluid and cursive, with the first name "Juli" written in a larger, more prominent script than the last name "McNeely".

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

Exhibits:      NAIFA Comment Letter on Proposed Prohibited Transaction Exemptions  
                     LIMRA Secure Retirement Institute 2015 Consumer Survey

## **Exhibit 2**

### Diagrams of Compensation Models

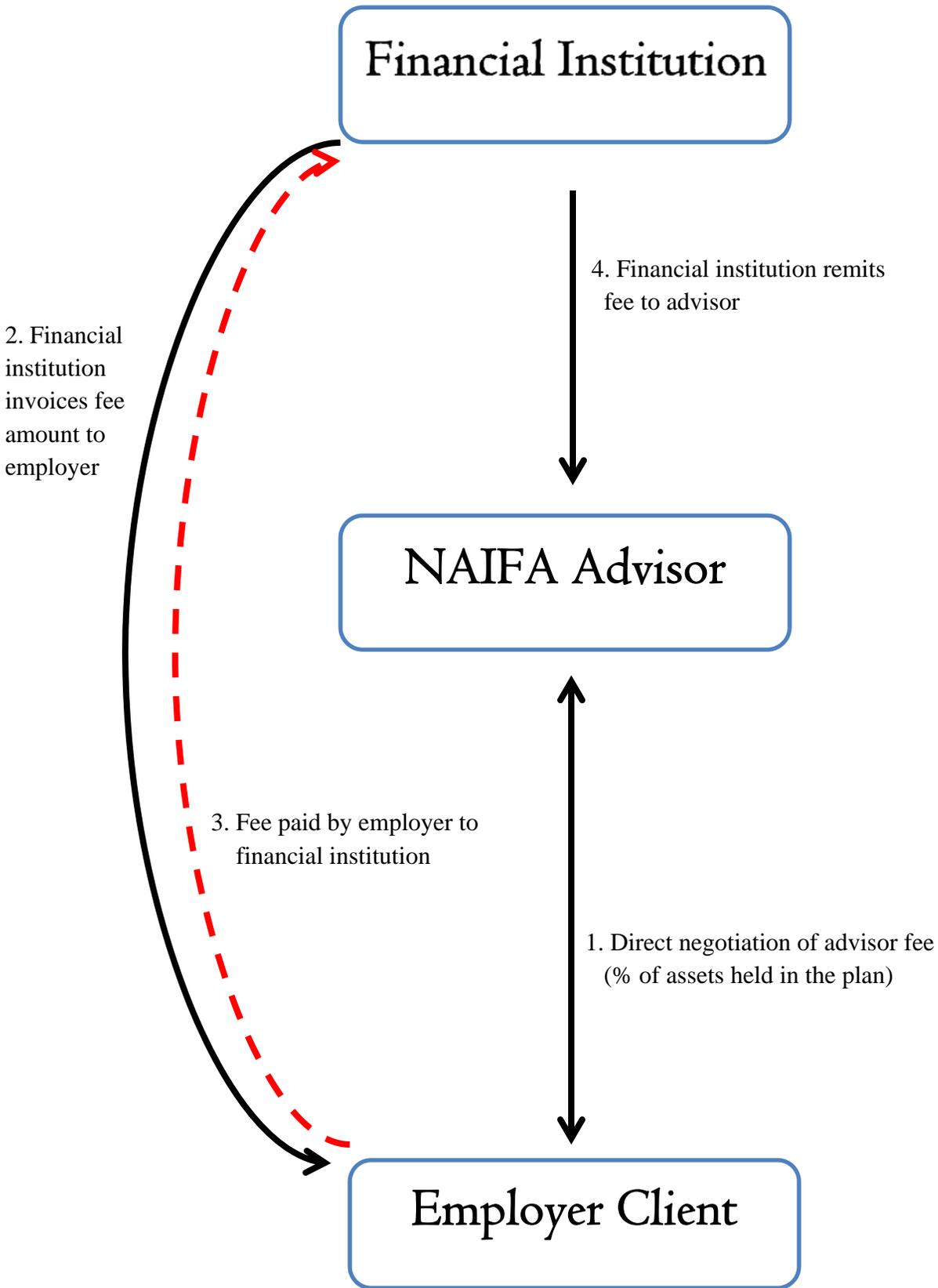
(a) Employer Plan Model

(b) Annuity Models

**EXHIBIT 2(a)**

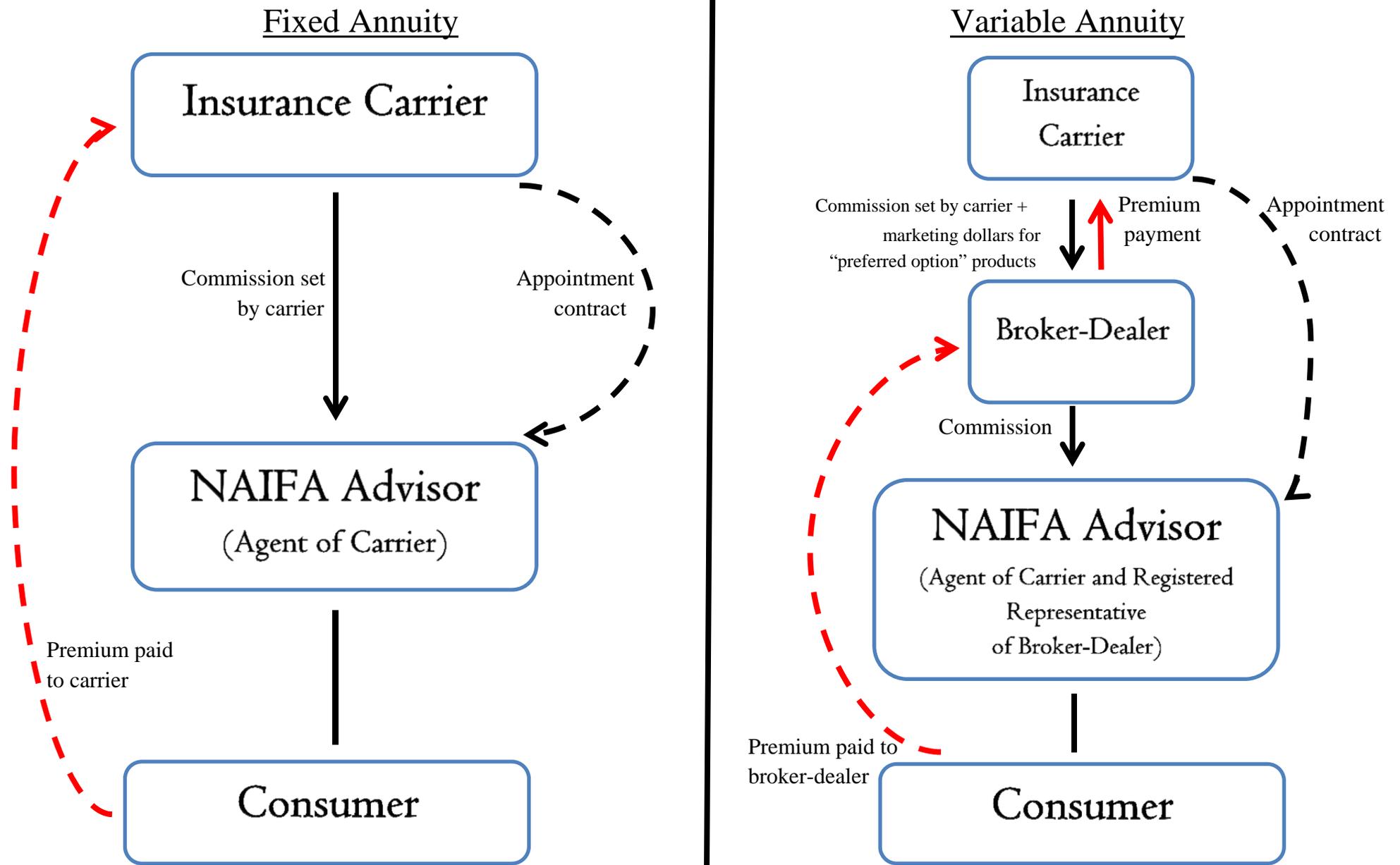
# Employer Plan Compensation Model

(401(k), Simple IRA, etc.)



This diagram represents a common fee arrangement for NAIFA members. It is not meant to depict all compensation scenarios in the employer plan space.

## Annuity Compensation Models



These diagrams represent common fee arrangements for NAIFA members. They are not meant to depict all compensation scenarios in the annuity product space.

## **Exhibit 3**

LIMRA Secure Retirement Institute 2015  
Consumer Survey

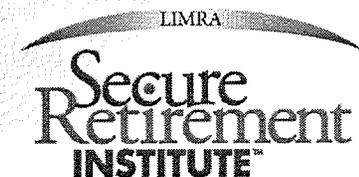


May, 2015

## **Matters of Fact**

### **Consumers, Advisors, and Retirement Decisions (and Results)**

A timely data summary from the LIMRA Secure Retirement Institute to help our members plan, respond, and react... with insights about retirement consumers and their advisor relationships.





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**NOTE:** Throughout this report, the term “Advisor” refers to a paid financial professional (e.g. broker, financial planner or advisor) used to make at least some of household investment decisions.

**Contact:**  
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PUBLIC & MEDIA RELATIONS

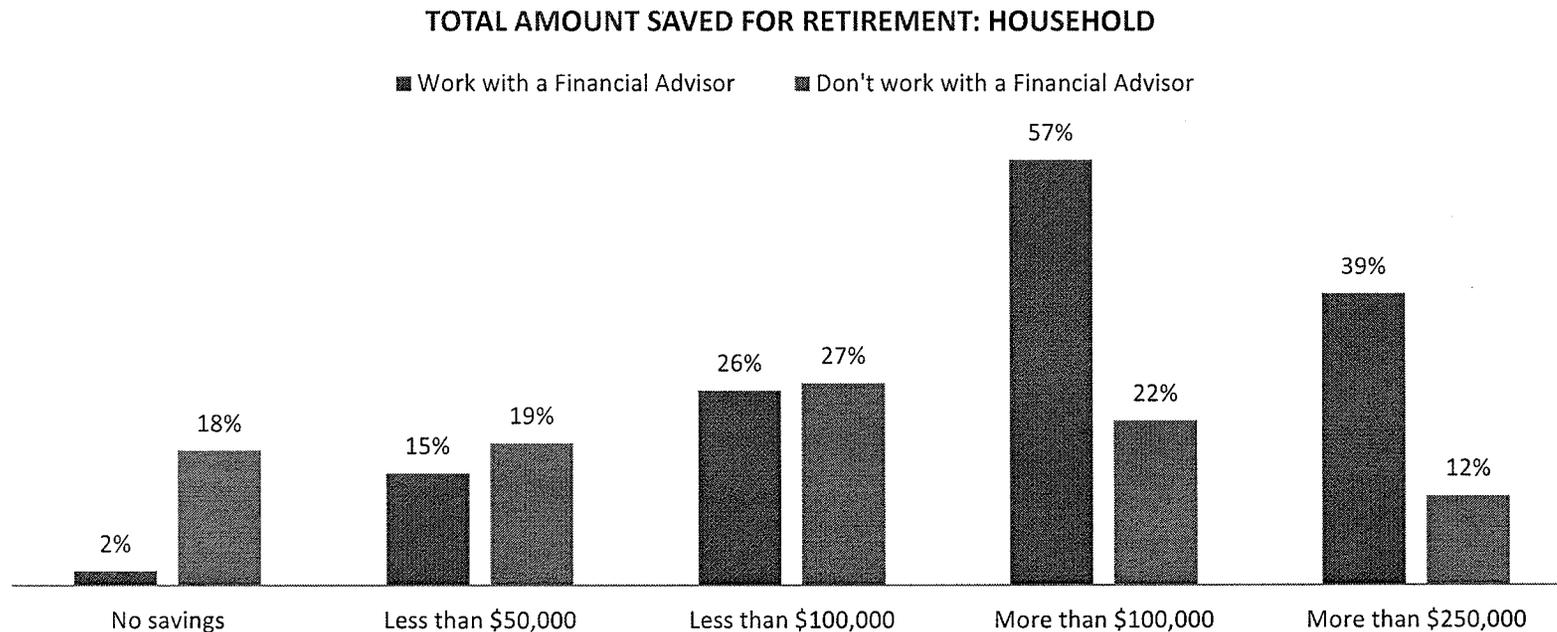
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## Advisors Are Linked to Better Results: Total Retirement Savings

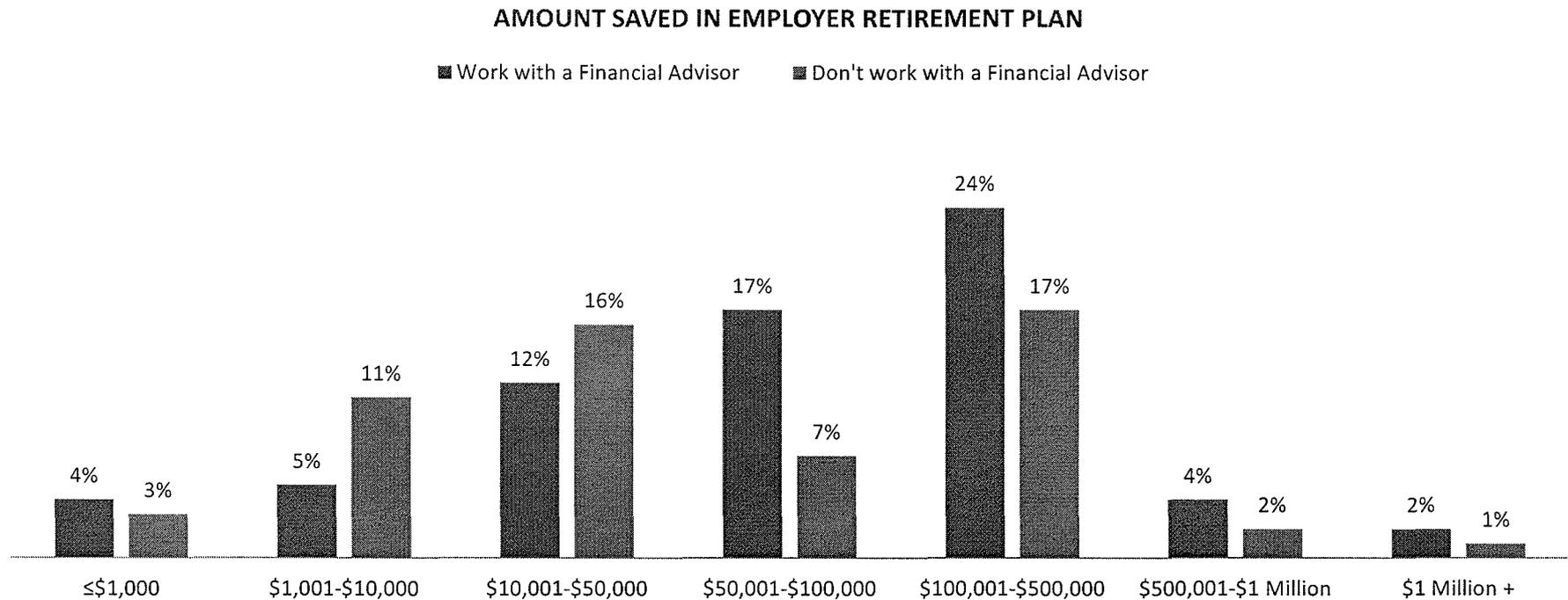
*Households that use financial advisors are three times as likely as non-advised households to have \$250,000 or more in retirement savings ... and are more than twice as likely to have \$100,000 or more.*



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

## Advisors Are Linked to Better Results: In-Plan (DC)

*People who engage financial advisors have higher retirement account balances in employer retirement plans.*

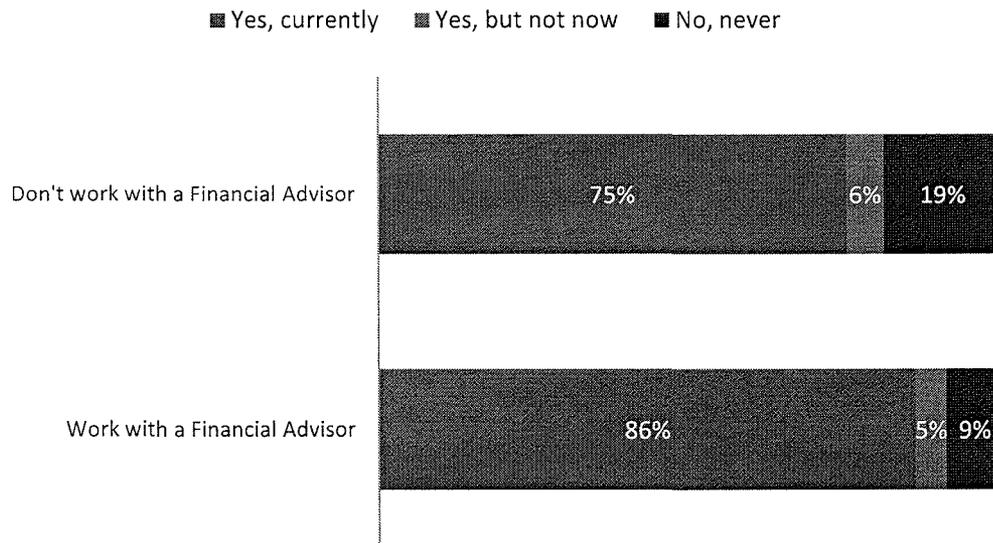


Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

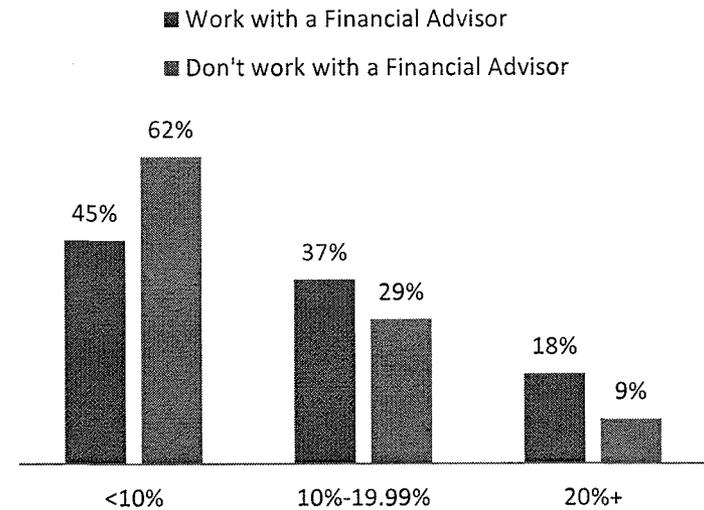
# People With Professionals Are More Engaged in Employer Plans

*People who work with financial advisors are more likely (than those who do not) to participate in their employers' DC plans. More of those with advisors also demonstrate "good" behavior — contribute 10 percent or more to their employers' plans (and are twice as likely to contribute 20 percent or more).*

**CURRENTLY CONTRIBUTING TO AN EMPLOYER'S PLAN**



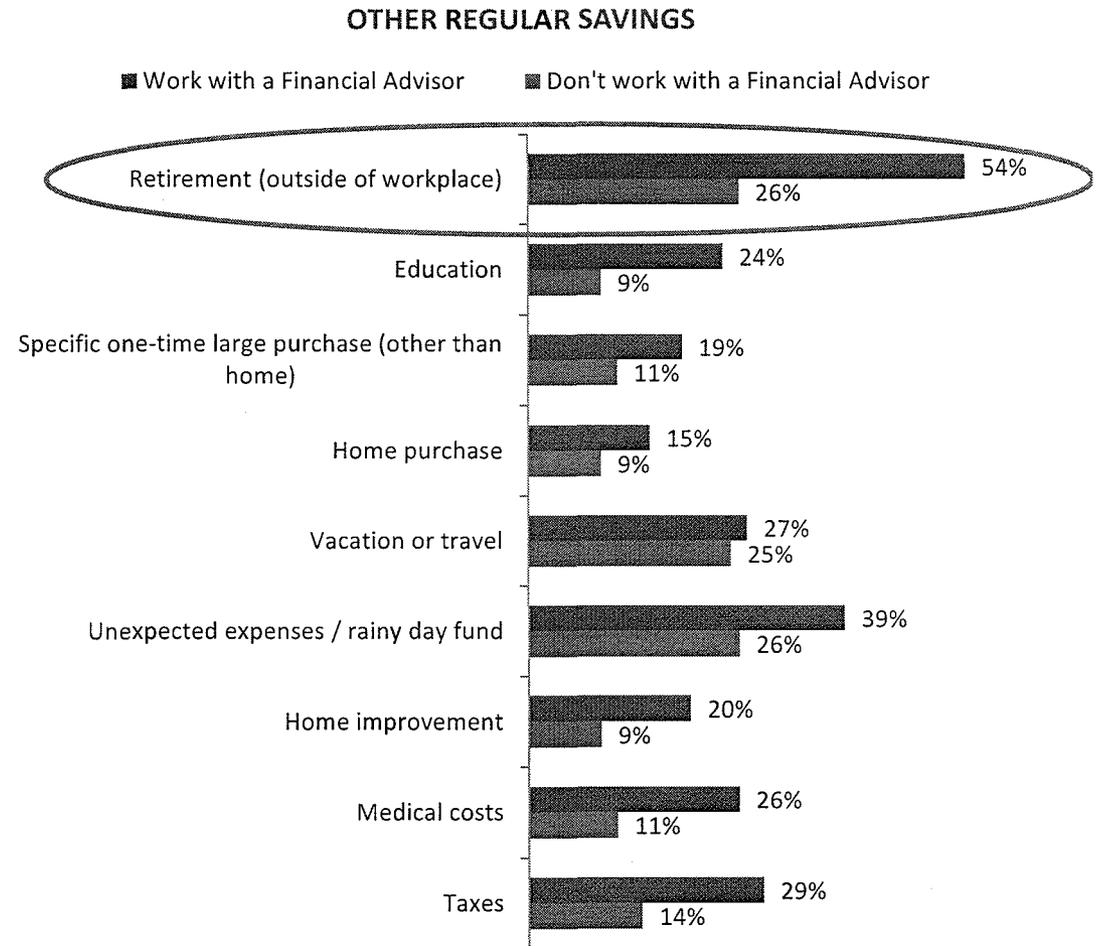
**PERCENT OF SALARY CONTRIBUTED TO EMPLOYER PLAN**



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

## People who Consult Professionals Save Regularly for a Variety of Goals

*Advisors can also add value by encouraging clients to save holistically, not just for retirement. For nearly every listed savings goal (except vacation), advisors' clients are significantly more likely to save on a regular basis compared with people who don't consult advisors.*

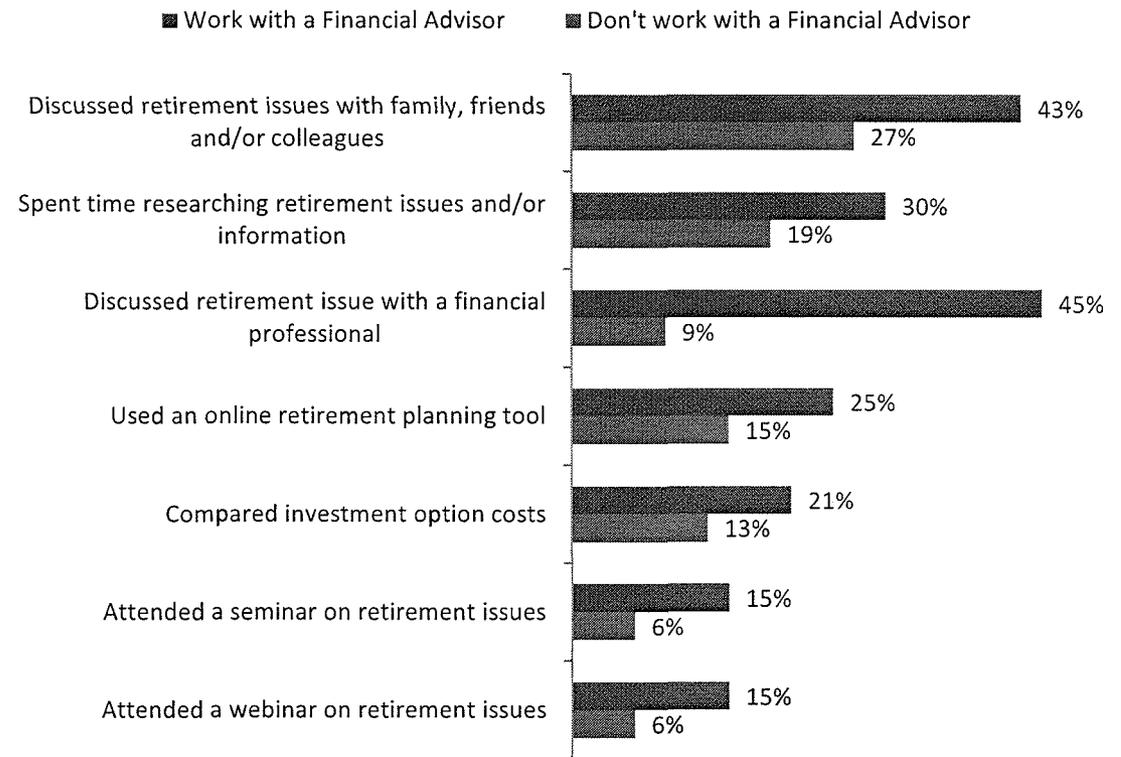


Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

## Advisors are Associated with Engagement and Activity

*Advisors can help their clients engage with their own retirement and financial lives. People who use advisors are more likely to discuss their retirements with a range of individuals, from family to financial professionals; and, to conduct basic planning activities such as attending seminars and webinars, and using planning tools.*

### PERCENTAGE WHO PARTICIPATE IN SAVING/PLANNING ACTIVITIES...

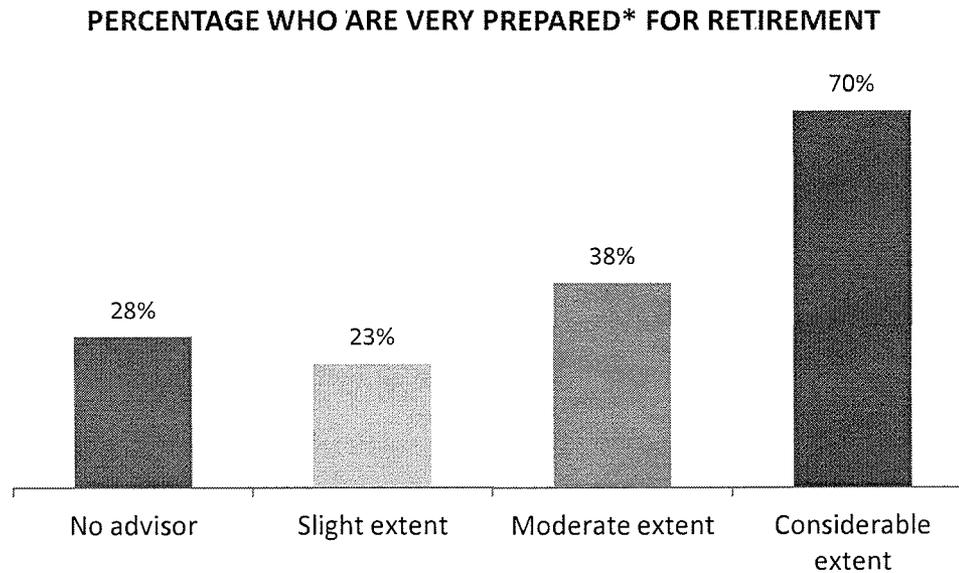


Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

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## Pre-Retirees' Preparedness Linked to Degree of Advisor Reliance

*People who use an advisor – especially to a considerable extent – are significantly better prepared for retirement than those who don't consult an advisor, or who do so only slightly.*



Extent to which advisor was consulted on household's retirement planning needs

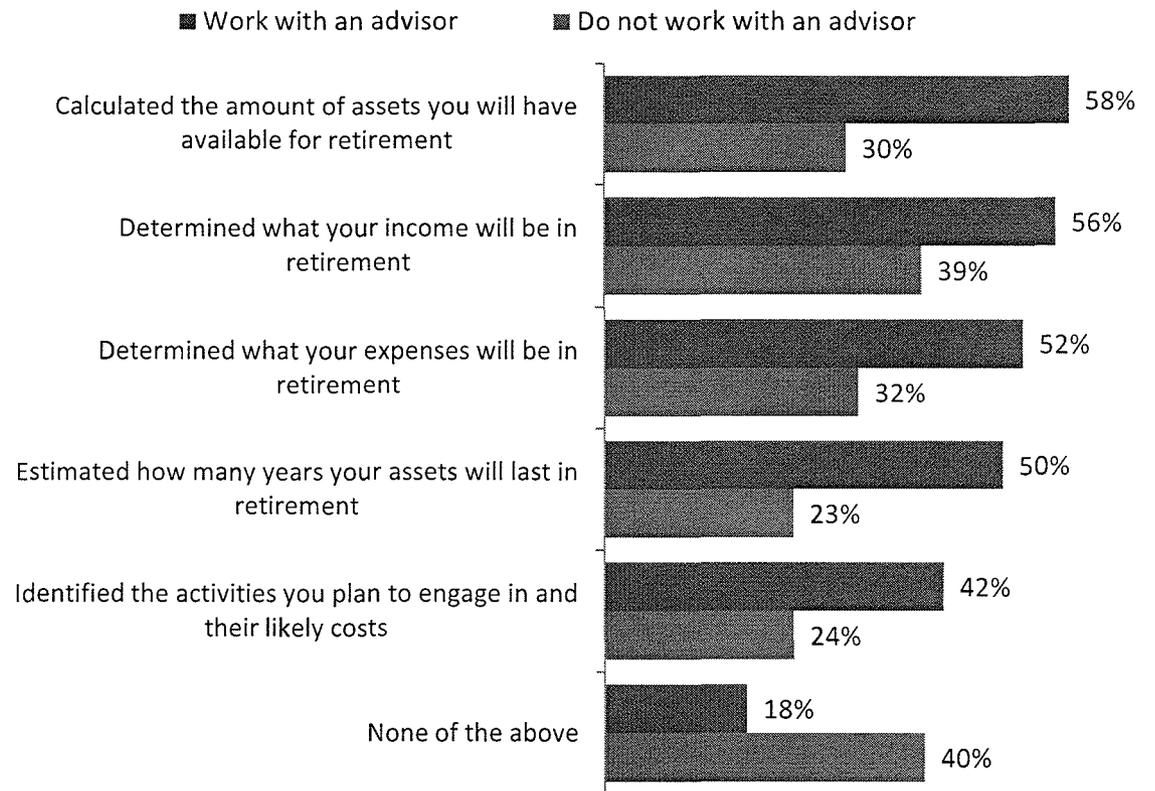
\*Answered 10, 9 or 8 on a 10-point scale with 10 = Extremely well prepared and 0 = Not at all prepared

Source: *Advisor Perspectives on Retirement Planning*, LIMRA Secure Retirement Institute, 2012

# Using an Advisor Tracks with Increased Engagement

*Pre-retirees who work with financial professionals are more likely to complete key planning activities.*

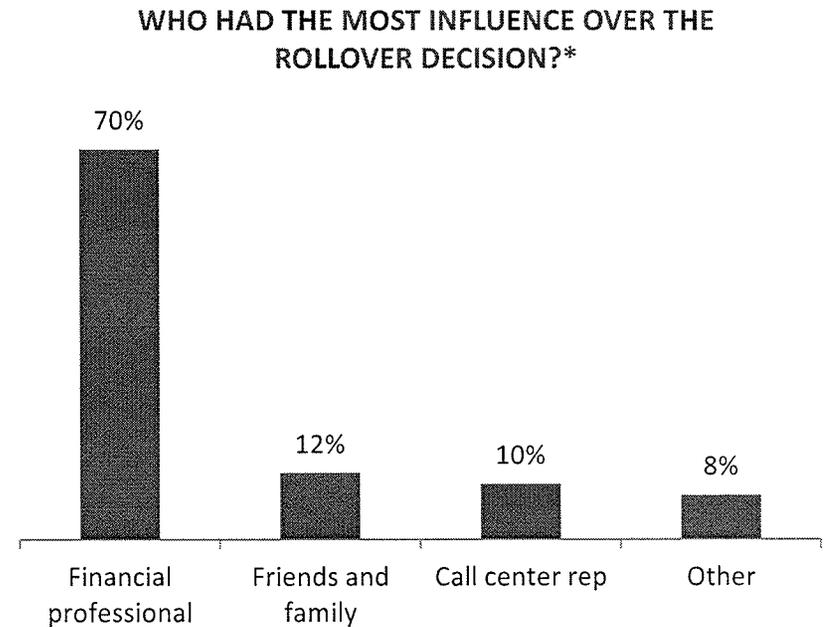
## WHICH RETIREMENT PLANNING ACTIVITIES HAVE YOU COMPLETED?



Source: LIMRA Secure Retirement Institute 2014 Consumer Survey

# IRA and Rollover Decisions Are Not Purely a Function of Fees

*Financial professionals/advisors are highly influential in helping individuals to make informed rollover decisions.*



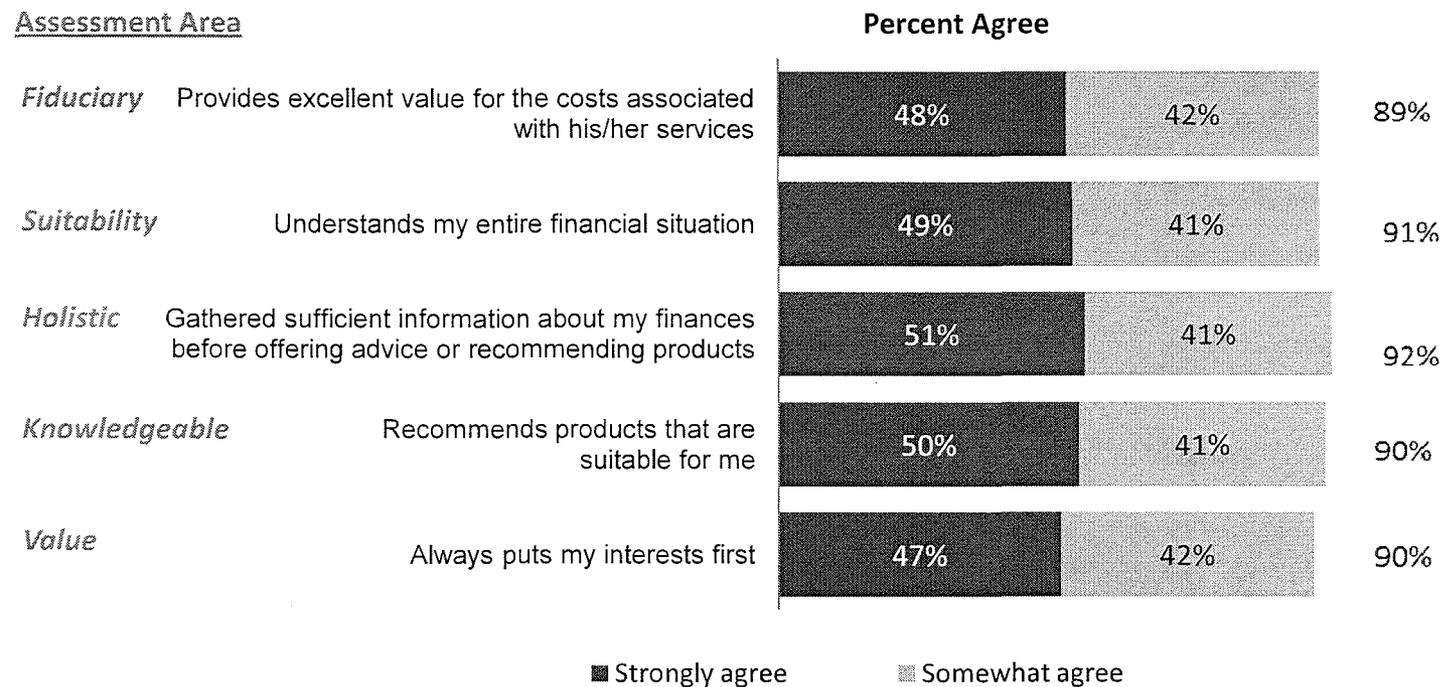
\*When consumers near retirement or recently retired (aged 55 to 70) rolled money from a DC plan into an IRA and spoke with someone about their decision-

Source: LIMRA Secure Retirement Institute 2014 Rollover Consortium

# People Value Their Advisors

*Consumers feel that advisors look out for their best interests, and understand their own needs and goals.*

## CONSUMER ASSESSMENT OF FINANCIAL PROFESSIONALS

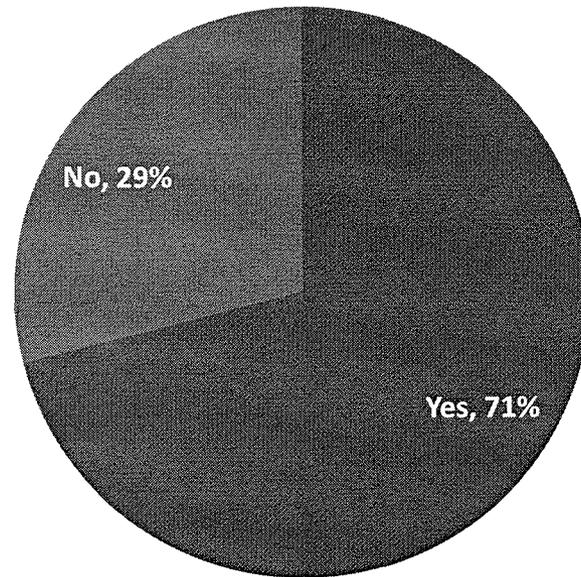


Source: *Quarterly Consumer Sentiment Q2 2015*, LIMRA Secure Retirement Institute.

## Disclosure Does Not Improve Participant Knowledge About Fees

*Even after disclosure, most participants think DC plan fees and expenses are reasonable... but few pay a great deal of attention to disclosure when delivered.*

PERCENT WHO AGREE THAT DC PLAN FEES/EXPENSES ARE REASONABLE

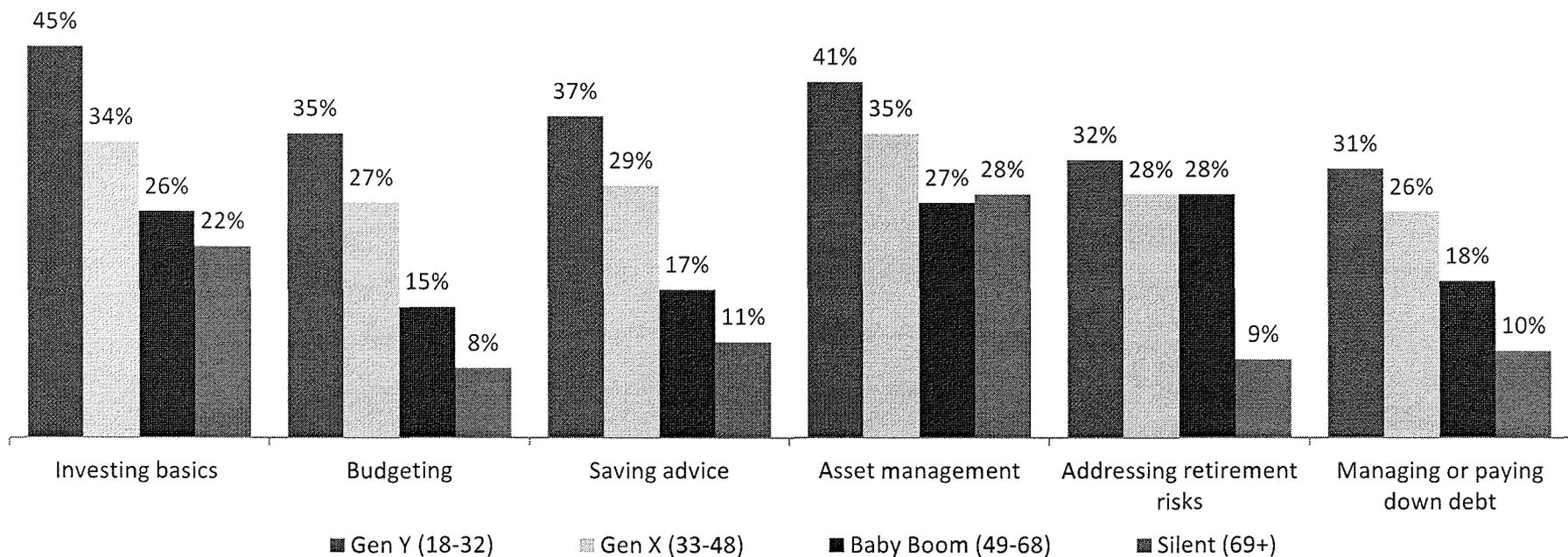


Source: *Deciphering Disclosure*, 2013, LIMRA Secure Retirement Institute

## Consumers Want More Education

*Many consumers, especially younger ones, say that they need additional guidance on matters critical to financial security and retirement planning.*

AREAS WHERE MORE EDUCATION ON FINANCIAL MATTERS IS NEEDED



Source: *Third Quarter 2013 Consumer Perspectives*, LIMRA Secure Retirement Institute.

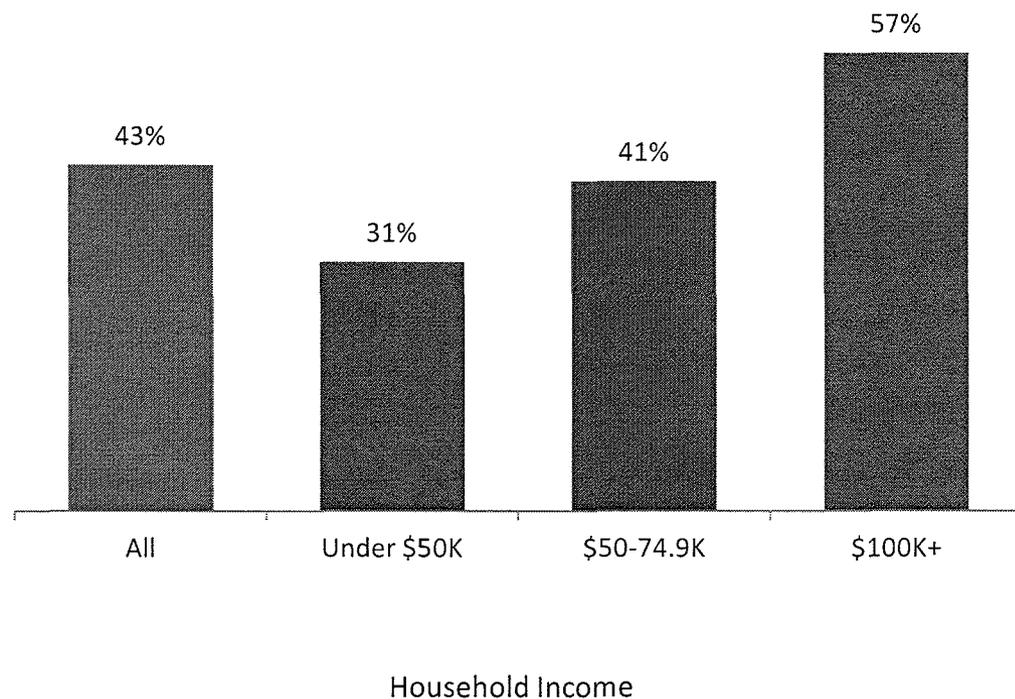


## A Majority of Consumers Do Not Take an Active Role in Managing Their Assets

*Only 4 in 10 consumers are actively engaged in managing their assets.*

*Even among high-net-worth consumers, only 6 in 10 actively manage their assets.*

PERCENTAGE OF PEOPLE WHO ARE VERY INVOLVED WITH MONITORING AND MANAGING THEIR RETIREMENT SAVINGS.



Sources: *Financial Triage Assessing Consumer Wellness (2015)* and 2014 Consumer Survey, LIMRA Secure Retirement Institute





## “Best Interests” Differ Based on Attitudes and Preferences

*Consumers with similar demographic profiles, wealth levels, and lifestyle ambitions may have very different preferences and financial priorities. Because their attitudes toward money differ, we developed three consumer segments based on the income solutions they prefer.*

### Three money mind-sets:

- **Guarantee Seekers** – Want to know that their income won’t disappear. Have a floor of lifetime guaranteed income and would be interested in converting even more of their savings to a pension-like contractual guarantee. Want to spend money without the day-to-day worry of how long it has to last. Want the peace of mind of a certain outcome.
- **Estate Planners** – Financially savvy. Understand that equity markets generally out-perform risk-free fixed investments. Can withstand a little volatility to maximize the potential of investments. Trust their own investment decisions. Want to maintain personal control over investment decisions and to retain the flexibility to adjust income and spending as needs change over time.
- **Asset Protectors** – Have been saving money for a long time. Do not want to see savings account balance decrease. Will live off the interest and dividends of savings, but are uncomfortable invading principal. Don’t want to be “poorer.”

Source: *A New Perspective on Retirement Income*, 2015, LIMRA Secure Retirement Institute



## Additional Facts and Research Data

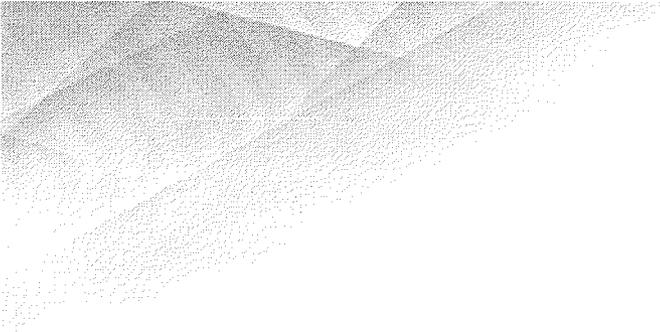
- Controlling for household wealth, individuals who work with paid financial professionals are more likely to have formal, written retirement plans and to be confident that they are on track with their retirement savings.
- Confidence in being able to live their desired lifestyle in retirement is higher among those working with paid financial professionals, particularly for less-wealthy households.
- Among pre-retiree households with less than \$500,000 in financial assets, there is a significant difference in subjective levels of retirement preparedness between those who work with financial professionals and those who do not work with financial professionals.
- Individuals who work with paid financial professionals are twice as likely as those not working with paid financial professionals to say that they had a discussion reviewing the pros and cons of doing a rollover to an IRA versus leaving the money in the plan.
- For pre-retirees (aged 55 to 70), the most common reasons involve consolidation of assets, gaining greater control over their money, seeking better returns, not wanting to leave their money with their former employer, and access to a greater range of investments.
- Pre-retirees say their desire for consolidation, better returns, and control most influenced their rollover decisions. Fees were not a significant factor.
- Seeking lower fees is not a major motivator, regardless of who had the greatest influence.
- Despite regulatory concern over conflicts of interest, 9 in 10 consumers agree that their financial professional always puts their interests first.
- Nine in ten agree that their financial professionals provide excellent value for the costs associated with their services. This assessment does not vary based on compensation method.
- Half of consumers who work with a financial professional have worked with their advisor for more than five years.
- Two thirds of consumers had a financial professional help with their rollover decision. Seven in ten consumers say the discussion they had with the financial professional about the advantages and disadvantages of the options they could take with their retirement plan assets was helpful.





## Additional Facts and Research Data (Continued)

- DC participants don't spend a lot of time reading their statements. Most people spend less than 10 minutes with their statements.
- The Institute asked participants about their perceptions of 401(k) fees before and after disclosure. People don't have a good grasp of what they were paying, before or after. Despite receiving a fee disclosure notice, half of DC participants can not say how much they pay in fees.
- DC participants are generally satisfied with the value for cost.
- Only one third of consumers have a long-term financial plan. One in three have a monthly household budget.
- Slightly more than half of consumers have neither. Only 19 percent of consumers have both a short-term budget and long-term financial plan.



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## **Exhibit 4**

Principal Funds Table on Asset Class  
Performance from 1994 to 2013

# Still trying to time the market? Take a closer look.

This table demonstrates how various asset classes have performed on an annual basis from 1994 through 2013. As you can see, the best performing asset classes change dramatically from year to year. Since no one can predict the future, diversification is critically important to help you reach your investment goals.

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Best ↑	FOREIGN STOCKS 8.06%	LARGE GROWTH STOCKS 38.13%	REITS 35.75%	LARGE GROWTH STOCKS 36.52%	LARGE GROWTH STOCKS 42.16%	SMALL GROWTH STOCKS 41.07%	REITS 25.88%	REITS 15.50%	INV-GRADE BONDS 10.27%	SMALL GROWTH STOCKS 48.51%	REITS 30.41%	FOREIGN STOCKS 14.02%	REITS 34.35%	FOREIGN STOCKS 11.63%	INV-GRADE BONDS 5.24%	HIGH YIELD BONDS 58.21%	SMALL GROWTH STOCKS 28.55%	INV-GRADE BONDS 7.84%	REITS 20.14%	SMALL GROWTH STOCKS 15.20%
	LARGE GROWTH STOCKS 3.13%	LARGE VALUE STOCKS 26.99%	LARGE GROWTH STOCKS 23.96%	MID-CAP STOCKS 32.26%	FOREIGN STOCKS 40.33%	LARGE GROWTH STOCKS 28.25%	SMALL VALUE STOCKS 22.83%	SMALL VALUE STOCKS 14.03%	REITS 5.22%	SMALL VALUE STOCKS 46.03%	SMALL VALUE STOCKS 22.25%	MID-CAP STOCKS 12.55%	FOREIGN STOCKS 26.86%	LARGE GROWTH STOCKS 9.13%	HIGH YIELD BONDS -26.16%	MID-CAP STOCKS 37.58%	REITS 27.58%	REITS 7.28%	SMALL VALUE STOCKS 18.05%	SMALL VALUE STOCKS 34.52%
	REITS 0.81%	SMALL GROWTH STOCKS 31.04%	LARGE VALUE STOCKS 21.99%	SMALL VALUE STOCKS 31.78%	MID-CAP STOCKS 19.12%	FOREIGN STOCKS 27.30%	MID-CAP STOCKS 17.51%	INV-GRADE BONDS 8.42%	HIGH YIELD BONDS -1.37%	FOREIGN STOCKS 39.17%	FOREIGN STOCKS 20.70%	REITS 8.29%	SMALL VALUE STOCKS 23.48%	MID-CAP STOCKS 7.98%	SMALL VALUE STOCKS -28.92%	SMALL GROWTH STOCKS 14.70%	MID-CAP STOCKS 26.64%	HIGH YIELD BONDS 4.98%	FOREIGN STOCKS 17.90%	MID-CAP STOCKS 33.50%
	LARGE VALUE STOCKS 0.64%	MID-CAP STOCKS 30.94%	SMALL VALUE STOCKS 21.37%	LARGE VALUE STOCKS 29.98%	LARGE VALUE STOCKS 14.67%	MID-CAP STOCKS 14.72%	INV-GRADE BONDS 11.63%	HIGH YIELD BONDS 5.28%	SMALL VALUE STOCKS -11.43%	REITS 38.47%	MID-CAP STOCKS 16.48%	LARGE VALUE STOCKS 6.33%	LARGE VALUE STOCKS 20.80%	SMALL GROWTH STOCKS 7.05%	LARGE GROWTH STOCKS -34.92%	FOREIGN STOCKS 32.46%	SMALL VALUE STOCKS 24.50%	LARGE GROWTH STOCKS 4.65%	MID-CAP STOCKS 17.88%	LARGE GROWTH STOCKS 32.75%
	HIGH YIELD BONDS -1.01%	SMALL VALUE STOCKS 25.75%	MID-CAP STOCKS 19.20%	REITS 18.87%	INV-GRADE BONDS 8.67%	LARGE VALUE STOCKS 12.72%	LARGE VALUE STOCKS 6.09%	MID-CAP STOCKS -0.61%	MID-CAP STOCKS -14.51%	MID-CAP STOCKS 35.61%	LARGE VALUE STOCKS 16.71%	SMALL VALUE STOCKS 4.71%	SMALL GROWTH STOCKS 15.45%	INV-GRADE BONDS 6.96%	MID-CAP STOCKS -36.23%	LARGE GROWTH STOCKS 31.57%	HIGH YIELD BONDS 15.12%	LARGE VALUE STOCKS 0.48%	LARGE VALUE STOCKS 17.68%	LARGE VALUE STOCKS 31.99%
	SMALL VALUE STOCKS -1.55%	HIGH YIELD BONDS 19.17%	HIGH YIELD BONDS 11.35%	SMALL GROWTH STOCKS 12.95%	HIGH YIELD BONDS 1.87%	HIGH YIELD BONDS 2.39%	HIGH YIELD BONDS -5.86%	SMALL GROWTH STOCKS 9.23%	FOREIGN STOCKS -15.66%	LARGE VALUE STOCKS 31.79%	SMALL GROWTH STOCKS 14.14%	SMALL GROWTH STOCKS 4.34%	HIGH YIELD BONDS 11.87%	LARGE VALUE STOCKS -1.99%	REITS -37.34%	REITS 27.45%	LARGE VALUE STOCKS 15.10%	MID-CAP STOCKS -1.73%	HIGH YIELD BONDS 15.81%	FOREIGN STOCKS 23.29%
	SMALL GROWTH STOCKS 2.43%	INV-GRADE BONDS 18.48%	SMALL GROWTH STOCKS 11.26%	HIGH YIELD BONDS 12.77%	SMALL GROWTH STOCKS 1.24%	INV-GRADE BONDS -0.83%	FOREIGN STOCKS -13.96%	LARGE VALUE STOCKS -11.71%	LARGE VALUE STOCKS -20.85%	HIGH YIELD BONDS 28.96%	HIGH YIELD BONDS 11.14%	LARGE GROWTH STOCKS 3.46%	LARGE GROWTH STOCKS 11.01%	HIGH YIELD BONDS 1.88%	SMALL GROWTH STOCKS 36.54%	LARGE VALUE STOCKS 21.18%	LARGE GROWTH STOCKS 15.05%	SMALL GROWTH STOCKS 2.51%	LARGE GROWTH STOCKS 14.61%	HIGH YIELD BONDS 7.44%
	INV-GRADE BONDS -2.92%	REITS 18.31%	FOREIGN STOCKS 6.36%	INV-GRADE BONDS 9.68%	SMALL VALUE STOCKS -6.45%	SMALL VALUE STOCKS -1.49%	LARGE GROWTH STOCKS -22.08%	LARGE GROWTH STOCKS -12.73%	LARGE GROWTH STOCKS -23.59%	LARGE GROWTH STOCKS 25.67%	LARGE GROWTH STOCKS 6.13%	HIGH YIELD BONDS 2.74%	MID-CAP STOCKS 10.32%	SMALL VALUE STOCKS -9.78%	LARGE VALUE STOCKS -39.22%	SMALL VALUE STOCKS 20.58%	FOREIGN STOCKS 8.21%	SMALL VALUE STOCKS -5.50%	SMALL GROWTH STOCKS 14.59%	REITS 3.21%
	MID-CAP STOCKS -3.57%	FOREIGN STOCKS 11.65%	INV-GRADE BONDS 3.61%	FOREIGN STOCKS 2.06%	REITS -18.82%	REITS -6.48%	SMALL GROWTH STOCKS -22.43%	FOREIGN STOCKS -21.21%	SMALL GROWTH STOCKS 30.26%	INV-GRADE BONDS 4.11%	INV-GRADE BONDS 4.34%	INV-GRADE BONDS 2.43%	INV-GRADE BONDS 4.33%	REITS -17.83%	FOREIGN STOCKS -43.06%	INV-GRADE BONDS 5.93%	INV-GRADE BONDS 6.54%	FOREIGN STOCKS -11.73%	INV-GRADE BONDS 4.21%	INV-GRADE BONDS -2.02%
	Worst ↓																			

Past performance is not a guarantee of future results.

Source: Zephyr StyleADVISOR. Small value stocks are represented by the Russell 2000® Value Index; small growth stocks are represented by the Russell 2000® Growth Index; large value stocks are represented by the S&P 500/Barra Value Index for 1994–2005 and by the S&P 500/Citigroup Value Index for 2006–2013; large growth stocks are represented by the S&P 500/Barra Growth Index for 1994–2005 and by the S&P 500/Citigroup Growth Index for 2006–2013; mid-cap stocks are represented by the S&P MidCap 400 Index; foreign stocks are represented by the MSCI EAFE Index; REITs are represented by the FTSE NAREIT All REITs Index; high yield bonds are represented by the Barclays Capital U.S. Corporate High-Yield Index; investment-grade bonds are represented by the Barclays Capital U.S. Aggregate Bond Index. This material has been obtained from sources generally considered reliable. No guarantee can be made as to its accuracy. Not intended to represent the performance of any particular investment. Indices are unmanaged and one cannot invest directly in an index.



■ Large Growth Stocks	■ Foreign Stocks
■ Large Value Stocks	■ Investment-Grade Bonds
■ Mid-Cap Stocks	■ High Yield Bonds
■ Small Growth Stocks	■ REITs
■ Small Value Stocks	

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