

# Proposed Best Interest Contract Exemption for Insurance Intermediaries

A Proposed Rule by the [Employee Benefits Security Administration](#) on 01/19/2017

## DOCUMENT DETAILS

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Comments: Written comments and requests for a public hearing on the proposed exemption must be submitted to the Department within 30 days from the date of publication of this Federal Register document. Applicability: The Department proposes to make this exemption available on April 10, 2017. Transition relief is proposed for the period from April 10, 2017, through August 15, 2018; see "Transition Relief," below.

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## DOCUMENT DETAILS

## ENHANCED CONTENT

**Docket Number:**

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**Docket Name:**

Proposed Best Interest Contract Exemption for Insurance Intermediaries

**Docket RIN**

1210-ZA26

**Public Comments:**

33 comments (<https://www.regulations.gov/docketBrowser?rpp=50&so=DESC&sb=postedDate&po=0&dct=PS&D=EBSA-2016-0026>)

## ENHANCED CONTENT

**AGENCY:**

Employee Benefits Security Administration, U.S. Department of Labor.

**ACTION:**

Notification of Proposed Class exemption.

**SUMMARY:**

This document contains a notice of pendency before the Department of Labor of a proposed class exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and the Internal Revenue Code of 1986, as amended (the Code). The provisions at issue generally prohibit fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs) from engaging in self-dealing and receiving compensation from third parties in connection with transactions involving the plans and IRAs. **The exemption proposed in this document, if granted, would allow certain insurance intermediaries, and the insurance agents and insurance companies they contract with, to receive compensation in connection with fixed annuity transactions that may otherwise give rise to prohibited transactions as a result of the provision of investment advice to plan participants and beneficiaries, IRA owners and certain plan fiduciaries (including small plan sponsors).** The proposed exemption includes protective conditions to safeguard the interests of the plans, participants and beneficiaries and IRA owners and is similar to the Department's Best Interest Contract Exemption (PTE 2016-01) granted on April 8, 2016, at 81 FR 21002 (/citation/81-FR-21002), as corrected at 81 FR 44773 (/citation/81-FR-44773) (July 11, 2016).

**DATES:**

*Comments:* Written comments and requests for a public hearing on the proposed exemption must be submitted to the Department within 30 days from the date of publication of this **Federal Register** document. *Applicability:* The Department proposes to make this exemption available on April 10, 2017. Transition relief is proposed for the period from April 10, 2017, through August 15, 2018; see "Transition Relief," below.

**ADDRESSES:**

All written comments and requests for a hearing concerning the proposed class exemption should be sent to the Office of Exemption Determinations by any of the following methods, identified by ZRIN 1210-ZA26:

Federal eRulemaking Portal: <http://www.regulations.gov> (<http://www.regulations.gov>) at Docket ID number: EBSA-2016-0026. Follow the instructions for submitting comments.

*Email to:* [e-OED@dol.gov](mailto:e-OED@dol.gov) (<mailto:e-OED@dol.gov>).

*Fax to:* (202) 693-8474.

*Mail:* Office of Exemption Determinations, Employee Benefits Security Administration, (Attention: D-11926), U.S. Department of Labor, 200 Constitution Avenue NW., Suite 400, Washington, DC 20210.

*Hand Delivery/Courier:* Office of Exemption Determinations, Employee Benefits Security Administration, (Attention: D-11926), U.S. Department of Labor, 122 C St. NW., Suite 400, Washington, DC 20001.

*Instructions:* All comments and requests for a hearing must be received by the end of the comment period. Requests for a hearing must state the issues to be addressed and include a general description of the evidence to be presented at the hearing. The comments and hearing requests will be available for public inspection in the Public Disclosure Room of the Employee Benefits Security Administration, U.S. Department of Labor, Room N-1513, 200 Constitution Avenue NW., Washington, DC 20210. Comments and hearing requests will also be available online at [www.regulations.gov](http://www.regulations.gov) (<http://www.regulations.gov>), at Docket ID number: EBSA-2016-0026 and [www.dol.gov/ebsa](http://www.dol.gov/ebsa) (<http://www.dol.gov/ebsa>), at no charge.

*Warning:* All comments and hearing requests will be made available to the public. Do not include any personally identifiable information (such as Social Security number, name, address, or other contact information) or confidential business information that you do not want publicly disclosed. All comments and hearing requests may be posted on the Internet and can be retrieved by most Internet search engines.

## FOR FURTHER INFORMATION CONTACT:

Brian Shiker or Erin Hesse, telephone (202) 693-8540, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor (this is not a toll-free number).

## SUPPLEMENTARY INFORMATION:

The Department is proposing this class exemption on its own motion pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with procedures set forth in 29 CFR part 2570 (/select-citation/2017/01/19/29-CFR-2570), subpart B (76 FR 66637 (/citation/76-FR-66637), 66644, October 27, 2011). Effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), transferred the authority of the Secretary of the Treasury to issue exemptions of the type proposed by the Secretary of Labor.

## Executive Summary

### Purpose of Regulatory Action

The Department is proposing this exemption in connection with its regulation under ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B) (Regulation), published in the **Federal Register** on April 8, 2016, and effective on April 10, 2017.<sup>[1]</sup> The Regulation defines who is a “fiduciary” of an employee benefit plan under ERISA as a result of giving investment advice to a plan or its participants or beneficiaries. The Regulation also applies to the definition of a “fiduciary” of a plan (including an IRA) under the Code. The Regulation amended a prior regulation, dating to 1975, specifying when a person is a “fiduciary” under ERISA and the Code by reason of the provision of investment advice for a fee or other compensation regarding assets of a plan or IRA. The Regulation takes into account the advent of 401(k) plans and IRAs, the dramatic increase in rollovers, and other developments that have transformed the retirement plan landscape and the associated investment market over the four decades since the 1975 regulation was issued. In light of the extensive changes in retirement investment practices and relationships, the Regulation updates existing rules to distinguish more appropriately between the sorts of advice relationships that should be treated as fiduciary in nature and those that should not.

In conjunction with the Regulation, the Department granted Prohibited Transaction Exemption (PTE) 2016-01 (the Best Interest Contract Exemption), also on April 8, 2016, and corrected on July 11, 2016. The Best Interest Contract Exemption is designed to promote the provision of investment advice that is in the best interest of retail investors such as plan participants and beneficiaries, IRA owners, and certain plan fiduciaries, including small plan sponsors (Retirement Investors). ERISA and the Code generally prohibit fiduciaries from receiving payments from third parties and from acting on conflicts of interest, including using their authority to affect or increase their own compensation, in connection with transactions involving a plan or IRA. Certain types of fees and compensation common in the retail market, such as brokerage or insurance commissions, 12b-1 fees and revenue sharing payments, may fall within these prohibitions when received by fiduciaries as a result of transactions involving advice to the plan, plan participants and beneficiaries, and IRA owners.

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To facilitate continued provision of advice to Retirement Investors under conditions designed to safeguard the interests of these investors, the Best Interest Contract Exemption allows certain investment advice fiduciaries (Financial Institutions and Advisers) to receive various forms of compensation that, in the absence of an exemption, would not be permitted under ERISA and the Code. "Financial Institutions," defined in the exemption to include banks, investment advisers registered under the Investment Advisers Act of 1940 or state law, broker-dealers, and insurance companies, and individual "Advisers" must adhere to basic standards of impartial conduct (Impartial Conduct Standards), namely, giving prudent advice that is in the customer's best interest, avoiding misleading statements, and receiving no more than reasonable compensation. Additionally, Financial Institutions must exercise supervisory authority over Advisers by adopting anti-conflict policies and procedures and insulating the Advisers from incentives to violate the exemption's Impartial Conduct Standards.

The class exemption proposed in this document would provide relief that is similar to the Best Interest Contract Exemption for certain insurance intermediaries that commit to act as Financial Institutions. Insurance intermediaries typically recruit, train and support independent insurance agents and market and distribute insurance products such as traditional fixed rate annuities and fixed indexed annuities. The intermediaries include organizations commonly referred to as independent marketing organizations (IMOs), field marketing organizations (FMOs) and brokerage general agencies (BGAs). The exemption would apply to recommendations of "Fixed Annuity Contracts," which are generally defined as fixed rate annuities and fixed indexed annuities. If the conditions of the exemption are satisfied, insurance intermediaries that satisfy the definition of "Financial Institution," as well as the insurance agents and insurance companies that they contract with, would be permitted to receive compensation and other consideration as a result of the provision of investment advice to Retirement Investors in connection with transactions involving these annuities.

ERISA section 408(a) specifically authorizes the Secretary of Labor to grant administrative exemptions from ERISA's prohibited transaction provisions.<sup>[2]</sup> Regulations at 29 CFR 2570.30 (/select-citation/2017/01/19/29-CFR-2570.30) to 2570.52 describe the procedures for applying for an administrative exemption. Before granting an exemption, the Department must find that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of plans and IRA owners. Interested parties are permitted to submit comments to the Department through February 21, 2017.

## Summary of the Major Provisions

The proposed exemption would be available for insurance intermediaries satisfying the definition of “Financial Institution,” and insurance agents (Advisers) and insurance companies with whom they contract, as well as their affiliates and related entities (as defined in the proposal), when they make investment recommendations regarding Fixed Annuity Contracts to retail “Retirement Investors.” Retirement Investors are plan participants and beneficiaries, IRA<sup>[3]</sup> owners, and non-institutional (or “retail”) fiduciaries. As a condition of receiving compensation that would otherwise be prohibited under ERISA and the Code, the exemption would require the Financial Institutions to acknowledge their fiduciary status and the fiduciary status of the Advisers with whom they contract in writing. The Financial Institution and Advisers would have to adhere to enforceable standards of fiduciary conduct and fair dealing with respect to their advice. In the case of IRAs and non-ERISA plans, the exemption would require that the standards be set forth in an enforceable contract with the Retirement Investor. **Under the exemption's terms, the Financial Institution would not be required to enter into a contract with ERISA plan investors, but it would be obligated to adhere to these same standards of fiduciary conduct, which the investors could effectively enforce pursuant to ERISA section 502(a)(2) and (3).**

The proposed exemption is designed to cover commissions and other forms of compensation received in connection with the recommendation of Fixed Annuity Contracts. Rather than prohibit such compensation structures, the exemption would permit individual Advisers<sup>[4]</sup> and related Financial Institutions to receive commissions and other common forms of compensation, provided that they implement appropriate safeguards against the harmful impact of conflicts of interest on investment advice. The proposed exemption strives to ensure that Advisers' recommendations reflect the best interest of their Retirement Investor customers, rather than the conflicting financial interests of the Advisers and the Financial Institutions with whom they contract. Protected Retirement Investors include plan participants and beneficiaries, IRA owners, and “retail” fiduciaries of plans or IRAs (generally persons who hold or manage less than \$50 million in assets, and are not banks, insurance carriers, registered investment advisers or broker dealers), including small plan sponsors.

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In order to protect the interests of plan participants and beneficiaries, IRA owners, and plan fiduciaries, the exemption would require the Financial Institution to acknowledge fiduciary status for itself and its Advisers. **The Financial Institutions and Advisers would have to adhere to basic standards of impartial conduct. In particular, under the proposal's standards-based approach, the Adviser and Financial Institution must give prudent advice that is in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation.** Additionally, Financial Institutions generally must adopt policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest, and disclose basic information about their conflicts of interest, the recommended Fixed Annuity Contract and the cost of their advice. The exemption is calibrated to align the Adviser's interests with those of the plan or IRA customer, while leaving the Adviser and Financial Institution the flexibility and discretion necessary to determine how best to satisfy the exemption's standards in light of the unique attributes of their business.

## Background

### Regulation Defining a Fiduciary

As explained more fully in the preamble to the Regulation, ERISA is a comprehensive statute designed to protect the interests of plan participants and beneficiaries, the integrity of employee benefit plans, and the security of retirement, health, and other critical benefits. The broad public interest in ERISA-covered plans is reflected in its imposition of fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments. One of the chief ways in which ERISA

protects employee benefit plans is by requiring that plan fiduciaries comply with fundamental obligations rooted in the law of trusts. In particular, plan fiduciaries must manage plan assets prudently and with undivided loyalty to the plans and their participants and beneficiaries.<sup>[5]</sup> In addition, they must refrain from engaging in “prohibited transactions,” which ERISA does not permit because of the dangers posed by the fiduciaries’ conflicts of interest with respect to the transactions.<sup>[6]</sup> When fiduciaries violate ERISA’s fiduciary duties or the prohibited transaction rules, they may be held personally liable for the breach.<sup>[7]</sup> In addition, violations of the prohibited transaction rules are subject to excise taxes under the Code.<sup>[8]</sup>

The Code also has rules regarding fiduciary conduct with respect to tax-favored accounts that are not generally covered by ERISA, such as IRAs. In particular, fiduciaries of these arrangements, including IRAs, are subject to the prohibited transaction rules and, when they violate the rules, to the imposition of an excise tax enforced by the Internal Revenue Service. Unlike participants in plans covered by Title I of ERISA, IRA owners do not have a statutory right to bring suit against fiduciaries for violations of the prohibited transaction rules.

Under this statutory framework, the determination of who is a “fiduciary” is of central importance. Many of ERISA’s and the Code’s protections, duties, and liabilities hinge on fiduciary status. In relevant part, ERISA section 3(21)(A) and Code section 4975(e)(3) provide that a person is a fiduciary with respect to a plan or IRA to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or IRA, or exercises any authority or control with respect to management or disposition of its assets; (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan or IRA, or has any authority or responsibility to do so; or, (iii) has any discretionary authority or discretionary responsibility in the administration of such plan or IRA.

The statutory definition deliberately casts a wide net in assigning fiduciary responsibility with respect to plan and IRA assets. Thus, “any authority or control” over plan or IRA assets is sufficient to confer fiduciary status, and any persons who render “investment advice for a fee or other compensation, direct or indirect” are fiduciaries, regardless of whether they have direct control over the plan’s or IRA’s assets and regardless of their status as an investment adviser or broker under the federal securities laws. The statutory definition and associated responsibilities were enacted to ensure that plans, plan participants and beneficiaries, and IRA owners can depend on persons who provide investment advice for a fee to provide recommendations that are untainted by conflicts of interest. In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA’s fundamental fiduciary standards, nor accountable under ERISA or the Code for imprudent, disloyal, or biased advice.

As amended, the Regulation provides that a person renders investment advice with respect to assets of a plan or IRA if, among other things, the person provides, directly to a plan, a plan fiduciary, plan participant or beneficiary, IRA or IRA owner, the following types of advice, for a fee or other compensation, whether direct or indirect:

(i) A recommendation as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred or distributed from the plan or IRA; and

(ii) A recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services, types of investment account arrangements (brokerage versus advisory), **or recommendations with respect to rollovers, transfers or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer or distribution should be made.**

In addition, in order to be treated as a fiduciary, such person, either directly or indirectly (*e.g.*, through or together with any affiliate), must: Represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described; represent or acknowledge that it is acting as a fiduciary within the meaning of ERISA or the Code; render the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient; or direct the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

The Regulation also provides that as a threshold matter in order to be fiduciary advice, the communication must be a “recommendation,” which is defined as “a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.”<sup>[9]</sup> The Regulation, as a matter of clarification, provides that a variety of other communications do not constitute “recommendations,” including non-fiduciary investment education; general communications; and specified communications by platform providers. These communications which do not rise to the level of “recommendations” under the Regulation are discussed more fully in the preamble to the final Regulation.<sup>[10]</sup>

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The Regulation also specifies certain circumstances where the Department has determined that a person will not be treated as an investment advice fiduciary even though the person's activities technically may satisfy the definition of investment advice. For example, the Regulation contains a provision excluding recommendations to independent fiduciaries with financial expertise that are acting on behalf of plans or IRAs in arm's length transactions, if certain conditions are met. **The independent fiduciary must be a bank, insurance carrier qualified to do business in more than one state, investment adviser registered under the Investment Advisers Act of 1940 or by a state, broker-dealer registered under the Securities Exchange Act of 1934 (Exchange Act), or any other independent fiduciary that holds, or has under management or control, assets of at least \$50 million, and:**

(i) The person making the recommendation must know or reasonably believe that the independent fiduciary of the plan or IRA is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies (the person may rely on written representations from the plan or independent fiduciary to satisfy this condition);

(ii) the person must fairly inform the independent fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and must fairly inform the independent fiduciary of the existence and nature of the person's financial interests in the transaction;

(iii) the person must know or reasonably believe that the independent fiduciary of the plan or IRA is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction (the person may rely on written representations from

the plan or independent fiduciary to satisfy this condition); and

(iv) the person cannot receive a fee or other compensation directly from the plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner for the provision of investment advice (as opposed to other services) in connection with the transaction.

Similarly, the Regulation provides that the provision of any advice to an employee benefit plan (as described in ERISA section 3(3)) by a person who is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, or a swap clearing firm in connection with a swap or security-based swap, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1 (<https://api.fdsys.gov/link?collection=uscode&title=7&year=mostrecent&section=1&type=usc&link-type=html>))a) and section 3(a) of the Exchange Act (15 U.S.C. 78 (<https://api.fdsys.gov/link?collection=uscode&title=15&year=mostrecent&section=78&type=usc&link-type=html>))c(a)) is not investment advice if certain conditions are met. Finally, the Regulation describes certain communications by employees of a plan sponsor, plan, or plan fiduciary that would not cause the employee to be an investment advice fiduciary if certain conditions are met.

## Prohibited Transactions

The Department anticipates that the Regulation will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code. Under the Regulation, these entities will be subject to the prohibited transaction restrictions in ERISA and the Code that apply specifically to fiduciaries. ERISA section 406(b)(1) and Code section 4975(c)(1)(E) prohibit a fiduciary from dealing with the income or assets of a plan or IRA in his own interest or his own account. ERISA section 406(b)(2), which does not apply to IRAs, provides that a fiduciary shall not “in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries.” ERISA section 406(b)(3) and Code section 4975(c)(1)(F) prohibit a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan or IRA in connection with a transaction involving assets of the plan or IRA.

Parallel regulations issued by the Departments of Labor and the Treasury explain that these provisions impose on fiduciaries of plans and IRAs a duty not to act on conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA.<sup>[11]</sup> The prohibitions extend to a fiduciary causing a plan or IRA to pay an additional fee to such fiduciary, or to a person in which such fiduciary has an interest that may affect the exercise of the fiduciary's best judgment as a fiduciary. Likewise, a fiduciary is prohibited from receiving compensation from third parties in connection with a transaction involving the plan or IRA.<sup>[12]</sup>

Investment professionals often receive compensation for services to Retirement Investors in the retail market through a variety of arrangements that violate the prohibited transaction rules applicable to plan fiduciaries. These include commissions paid by the plan, participant or beneficiary, or IRA, or commissions and other payments from third parties that provide investment products. A fiduciary's receipt of such payments would generally violate the prohibited transaction provisions of ERISA section 406(b) and Code section 4975(c)(1)(E) and (F) because the amount of the fiduciary's compensation is affected by the use of its authority in providing investment advice, unless such payments meet the requirements of an exemption.

## Prohibited Transaction Exemptions

As the prohibited transaction provisions demonstrate, ERISA and the Code strongly disfavor conflicts of interest. In appropriate cases, however, the statutes provide exemptions from their broad prohibitions on conflicts of interest. For example, ERISA section 408(b)(14) and Code section 4975(d)(17) specifically exempt transactions involving the provision of fiduciary investment advice to a participant or beneficiary of an individual account plan or IRA owner if the advice, resulting transaction, and the Adviser's fees meet stringent conditions carefully designed to guard against conflicts of interest.

In addition, the Secretary of Labor has discretionary authority to grant administrative exemptions under ERISA and the Code on an individual or class basis, but only if the Secretary first finds that the exemptions are (1)  administratively feasible, (2) in the interests of plans and their participants and beneficiaries and IRA owners, and (3) protective of the rights of the participants and beneficiaries of such plans and IRA owners. Accordingly, fiduciary advisers may always give advice without need of an exemption if they avoid the sorts of conflicts of interest that result in prohibited transactions. However, when they choose to give advice in situations in which they have a conflict of interest, they must rely upon an exemption.

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Pursuant to its exemptive authority, the Department has previously granted several conditional administrative class exemptions that are available to fiduciary advisers in defined circumstances. As a general proposition, these exemptions focused on specific advice arrangements and provided relief for narrow categories of compensation. However, the new Best Interest Contract Exemption (PTE 2016-01) is specifically designed to address the conflicts of interest associated with the wide variety of payments advisers receive in connection with retail transactions involving plans and IRAs. Similarly, the Department has granted a new exemption for principal transactions, Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Principal Transactions Exemption) (PTE 2016-02),<sup>[13]</sup> that permits investment advice fiduciaries to sell or purchase certain debt securities and other investments in principal transactions and riskless principal transactions with plans and IRAs.

At the same time that the Department granted the new exemptions, it also amended existing exemptions to, among other things, ensure uniform application of the Impartial Conduct Standards, which are fundamental obligations of fair dealing and fiduciary conduct, and include obligations to act in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation.<sup>[14]</sup> Taken together, the new exemptions and amendments to existing exemptions ensure that Retirement Investors are consistently protected by Impartial Conduct Standards, regardless of the particular exemption upon which the adviser relies.

The amendments also revoked in whole or in part certain existing exemptions, which provided little or no protections to IRA and non-ERISA plan participants, in favor of a more uniform application of the Best Interest Contract Exemption in the market for retail investments. Most notably for purposes of this proposal, PTE 84-24,<sup>[15]</sup> an exemption previously providing relief for transactions involving all annuity contracts, was amended to apply only to transactions involving "fixed rate annuity contracts," as defined in the exemption.<sup>[16]</sup> **As a result, the exemption no longer provides relief for variable annuities, indexed annuities and any other annuities that do not satisfy the definition of fixed rate annuity contracts.**

With limited exceptions, it is the Department's intent that investment advice fiduciaries in the retail investment market rely on statutory exemptions, the Best Interest Contract Exemption or this proposed exemption, if granted, to the extent that they receive conflicted forms of compensation that would otherwise be prohibited. The new and amended exemptions reflect the Department's view that Retirement Investors should be protected by a more consistent application of fundamental fiduciary standards across a wide range

of investment products and advice relationships, and that retail investors, in particular, should be protected by the stringent protections set forth in the Best Interest Contract Exemption or this proposed exemption, if granted. **When fiduciaries have conflicts of interest, they will uniformly be expected to adhere to fiduciary norms and to make recommendations that are in their customer's best interest.**

## The Best Interest Contract Exemption

In broadest outline, the Best Interest Contract Exemption permits Advisers and the Financial Institutions (as defined in the exemption) that employ or otherwise retain them to receive many common forms of compensation that ERISA and the Code would otherwise prohibit, provided that they give advice that is in their customers' best interest and the Financial Institution implements basic protections against the dangers posed by conflicts of interest. More specifically, under the Best Interest Contract Exemption, **Financial Institutions generally must:**

- Acknowledge fiduciary status with respect to investment advice to the Retirement Investor;
- Adhere to Impartial Conduct Standards requiring them to:
  - Give advice that is in the Retirement Investor's best interest (*i.e.*, prudent advice that is based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to financial or other interests of the Adviser, Financial Institution, or their affiliates, related entities or other parties);
  - Charge no more than reasonable compensation; and
  - Make no misleading statements about investment transactions, compensation, and conflicts of interest; these apply to the F.I., not to the individual advisor
    - **Implement policies and procedures reasonably and prudently designed to prevent violations of the Impartial Conduct Standards;**
    - **Refrain from giving or using incentives for Advisers to act contrary to the customer's best interest; and**
    - **Fairly disclose the fees, compensation, and material conflicts of interest, associated with their recommendations.**

Advisers relying on the exemption must adhere to the Impartial Conduct Standards when making investment recommendations. In order for relief to be available under the exemption, there must be a “Financial Institution” that meets the definition set forth in the exemption and that satisfies the applicable conditions.

Section VIII(e) of the Best Interest Contract Exemption states that a “Financial Institution” can be a registered investment adviser (RIA), a bank or similar financial institution, a broker-dealer or an insurance company. The Department noted in the preamble to the exemption that these entities were identified by Congress as advice providers in the statutory exemption for investment advice under ERISA section 408(g) and Code section 4975(f)(8) and  that they are subject to well-established regulatory conditions and oversight.<sup>[17]</sup> However, in response to requests to broaden the definition to include marketing and distribution intermediaries, the Department added section VIII(e)(5), which states that a Financial Institution also includes “an entity that is described in the definition of Financial Institution in an individual exemption . . . that provides relief for the receipt of compensation in connection with investment advice provided by an investment advice fiduciary, under the same conditions as [the Best Interest Contract Exemption].”<sup>[18]</sup>

Thus, although the definition of Financial Institution in the Best Interest Contract Exemption was limited to certain specified entities, the exemption provided a mechanism under which the definition can be expanded if an individual exemption is granted to another type of entity, under the same conditions. In that event, the individual exemption would provide relief to the applicants identified in the exemption, but the definition of Financial Institution in the Best Interest Contract Exemption would be expanded so that other entities that satisfy the definition in the individual exemption can rely on the Best Interest Contract Exemption. In the preamble to the Best Interest Contract Exemption, the Department stated that “[i]f parties wish to expand the definition of Financial Institution to include marketing intermediaries or other entities, they can submit an application to the Department for an individual exemption, with information regarding their role in the distribution of financial products, the regulatory oversight of such entities, and their ability to effectively supervise individual Advisers' compliance with the terms of this exemption.”<sup>[19]</sup>

Pursuant to section VIII(e)(5) of the Best Interest Contract Exemption, the Department received 22 applications for individual exemptions from insurance intermediaries that contract with independent insurance agents to sell fixed annuities (applicants). The applicants describe themselves as “independent marketing organizations,” “insurance marketing organizations” and “field marketing organizations.”

Collectively, the Department refers to the applicants and similar entities as either “insurance intermediaries” or “IMOs.” The applicants sought individual exemptions under the same conditions as the Best Interest Contract Exemption, but with a new definition of “Financial Institution” incorporating insurance intermediaries.

Because of the large number of applications, the Department determined to propose, on its own motion, a class exemption for such intermediaries based on the facts and representations in the individual applications received by the Department. The applicants employ a wide variety of business models and approaches, however, and the proposal, while designed to provide class relief for insurance intermediaries, may not be available to all the applicants depending on their individual circumstances. As discussed below, there are a variety of compliance options available to the insurance industry under the Best Interest Contract Exemption. This proposed exemption would supplement these options by permitting the IMO or other intermediary to act as a covered “Financial Institution” with supervisory responsibilities under specified conditions, many of which parallel the conditions of the Best Interest Contract Exemption. To the extent insurance intermediaries wish to pursue additional exemptive relief, the Department will consider such additional requests.

Primarily, it is important to note that insurance intermediaries are not required to act as Financial Institutions under this exemption, if granted, in order to participate in the marketplace. They may provide valuable compliance assistance and other services to insurance companies or other insurance intermediaries that act as Financial Institutions under the Best Interest Contract Exemption or this exemption, if granted, and receive compensation for their services. In this regard, both the Best Interest Contract Exemption and this proposal, if granted, would specifically provide relief for compensation paid to “affiliates” and “related entities” of an Adviser and Financial Institution, which would typically include IMOs.<sup>[20]</sup> Therefore, an IMO that does not meet the definition of Financial Institution under this proposal can nevertheless continue to work with an insurance company or other intermediary, and receive compensation, if the insurance agent and the insurance company or other intermediary complies with the conditions applicable to Advisers and Financial Institutions, respectively, in the Best Interest Contract Exemption or this exemption, if granted.<sup>[21]</sup> As the Department noted in recent guidance, even if it decided not to grant this exemption, an insurer could bolster its oversight by contractually requiring an IMO to implement policies and procedures designed to ensure that all of the agents associated with the IMO adhere to the Impartial Conduct Standards. See FAQs

*about Conflict of Interest Rules and Exemptions, Part I, FAQs 22 and 23.* Under this approach, the IMO could eliminate potentially troubling compensation incentives across all the insurance companies that work with the IMO. While the insurance company would remain responsible for compliance with the full Best Interest Contract Exemption, nothing in that exemption would preclude insurers from contracting with other parties, such as IMOs, for compliance work.

Alternatively, even without this new exemption, an insurer could take direct responsibility for supervising agents, regardless of whether it chooses to market its products through a captive sales force, independent agents, or other channels, much as insurers currently have responsibility to oversee the activities of their agents—including independent agents—under state-law suitability rules. As FAQ 22 noted, the insurer's responsibility under the Best Interest Contract Exemption is to oversee the recommendation and sale of its products, not recommendations and transactions involving other insurers. See *FAQs about Conflict of Interest Rules and Exemptions, Part I, FAQ 22.* Under the Best Interest Contract Exemption, the insurer must adopt and implement prudent supervisory and review mechanisms to safeguard the agent's compliance with the Impartial Conduct Standards when recommending the insurer's products; **avoid improper incentives to preferentially push the products, riders, and annuity features that are the most lucrative for the insurer at the customer's expense; ensure that the insurer and agent receive no more than reasonable compensation for their services in connection with the transaction; and adhere to the disclosure and other conditions set forth in its exemption.** Thus, for example, an insurer could adopt policies and procedures that require agents (including independent agents) to engage in a process specified by the insurer for making prudent recommendations; review the agent's final recommendation in light of the customer's investment objectives, risk tolerance, financial circumstances, and needs; ensure that its own compensation practices are in line with industry standards for reasonable compensation for the agent's services; and avoid creating any misaligned incentives that encourage the Adviser to choose between the insurer's various offerings based on the financial interests of the insurer or its affiliates, rather than the customer's interest. If the insurer believes that an independent agent may be improperly motivated by the size of the insurer's commissions as compared to its competitors, it may need to review the agent's recommendations particularly carefully and seek additional assurances from the agent as to the basis of its recommendations. **However, nothing in the Best Interest Contract Exemption requires the insurer to pay precisely the same compensation to its agents as its competitors, as long as the compensation is reasonable in relation to the services rendered, and the insurer carefully oversees the recommendations for compliance with the Impartial Conduct Standards.**<sup>[22]</sup>

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## Applicants for Individual Exemptions

The following entities submitted applications for individual exemptions permitting them to act as Financial Institutions under the Best Interest Contract Exemption: Gradient Insurance Brokerage, Inc., C2P Advisory Group, LLC dba Clarity to Prosperity, Legacy Marketing Group, LLC, InForce Solutions, LLC, Futurity First Insurance Agency, Financial Independence Group, Brokers International Ltd, Insurance Advocates, Advisors Excel, AmeriLife Group, LLC, InsurMark, Annexus, Ideal Producers Group, ECA Marketing, Saybrus Partners, Inc., Alpine Brokerage Services, The Annuity Source, Inc., M&O Financial, Inc., Kestler Financial Group, Inc., First Income Advisors, Crump Life Insurance Services, Inc., and The IMPACT Partnership, LLC. The applicants provided background information on the distribution of fixed annuities, described their business models and discussed their anticipated approaches to compliance with the proposed exemption.

## Distribution of Fixed Annuities

As described by various applicants, fixed annuities—and in particular, fixed indexed annuities—are commonly distributed by independent insurance agents. Independent insurance agents distribute the products of not one insurance company, but rather multiple insurance companies.

Typically, insurance intermediaries recruit, train and support independent insurance agents and market and distribute insurance products. Since the independent agents are not associated with any one particular insurance company, the intermediary steps in to develop sales processes, provide marketing material, and formulate supervisory procedures and methods for the independent agents to use. The insurance companies and the agents have come to rely on these insurance intermediaries to serve a wide variety of functions relating to the distribution of fixed annuities through the independent insurance agent channel. Insurance intermediaries commonly provide services that include: Agent recruitment and screening, licensing and contracting services, creation of product illustrations, case management, IT services, marketing services, new business processing, training and supervising agents and ensuring compliance with existing standards under state insurance law.

Further, insurance intermediaries can serve an important compliance function. Insurance intermediaries may serve to facilitate statutory and regulatory compliance as well as help to resolve compliance issues that may arise between state regulators, the insurance company and an agent. In performing this role, insurance intermediaries can perform compliance reviews, create policies and procedures and vet the practices of agents. Many insurance intermediaries contractually require that an agent comply with specific standards that are set by the insurance intermediary, as well as the federal and state laws and regulations that govern insurance.

Some insurance intermediaries currently work with the insurance companies to ensure that annuities sold by agents are “suitable” for their clients. This suitability standard generally requires agents and insurance companies to review detailed information about the client to determine if the fixed annuity purchase complies with the suitability standards under state insurance law (*see* 2010 NAIC Suitability in Annuity Transactions Model Regulation, which applicants state has been adopted by most state insurance regulators). **In order to assist the insurance company and the agent, the insurance intermediary will ensure that the agent has considered, at a minimum, the client's prospective age, annual income, financial situation and needs (including the source of the funds used to purchase the annuity), financial experience, financial objectives, intended use of the annuity, financial time horizon, existing assets (including investment and life insurance), liquidity needs, liquid net worth, risk tolerance and tax status.**

The distribution services provided by the insurance intermediary generate multiple forms of compensation for the insurance intermediary. Most prominently, the sale of an annuity usually triggers the payment of a commission to the insurance intermediary. The commission can be based on many factors, including, but not limited to, the specific annuity product sold, the state in which it is sold, the premium amount and the age of the annuity owner. An insurance intermediary can also receive compensation for additional services, including, but not limited to, product development, marketing, administrative and compliance services and field support services. The specific compensation terms are generally spelled out in the contracts between the insurance intermediary and the insurance company and the insurance intermediary and the agent.

The compensation payments received by insurance intermediaries may trigger prohibited transaction concerns under both ERISA and the Code. After the applicability date of the Regulation, insurance agents who recommend fixed annuity products will generally be fiduciaries with respect to a Retirement Investor's account. The receipt of a commission or other compensation by a fiduciary, or an entity in which the fiduciary has an interest that would affect its judgment as a fiduciary, as a result of the provision of investment advice is a prohibited transaction for which an exemption is needed.

Under this fixed annuity distribution and compensation model, an insurance company could serve as a “Financial Institution” for purposes of the Best Interest Contract Exemption. However, the applicants express concern that insurance companies may not necessarily agree to satisfy the role of the Financial Institution under the Best Interest Contract Exemption with respect to independent insurance agents, or may prefer to rely upon a captive sales force when relying upon that exemption. Additionally, some of the applicants stated that independent insurance agents do not want to lose the flexibility of their independent status.

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The applicants represent that the independent insurance agent model benefits consumers because independent agents can offer a wider variety of products to satisfy consumers' goals. Thus, the applicants take the position that permitting insurance intermediaries to serve as Financial Institutions will facilitate independent insurance agents' continued sale of fixed annuities in the Retirement Investor marketplace under a single set of policies and procedures. The exemption proposed herein would apply to commissions and other compensation received by an insurance agent, insurance intermediary, insurance companies and any other affiliates and related entities, as a result of a plan's or IRA's purchase of Fixed Annuity Contracts.

### **Business Models**

Many of the applicants stated that they had direct contractual relationships with the majority of the insurance companies for which they distribute fixed annuities. Frequently, these direct contractual relationships with the insurance companies assigned responsibility for the oversight of agents and sub-IMOs to the intermediaries. Some applicants indicated they are at the highest level of an insurance company's distribution hierarchy, or at the “top-tier” or “top-level.”

As top-level IMOs, most applicants represented that they oversee independent, insurance-only agents or sub-IMOs (which in turn oversee independent insurance-only agents), or both. This oversight is accomplished through the top-level IMO's use of its compliance structure and other business and administrative tools. The applicants use their compliance structure to directly oversee agents or to assist sub-IMOs in the distribution of fixed annuities and the oversight of their agents. One applicant, however, stated that it is a sub-IMO. As a sub-IMO, the applicant represents that it has contractual relationships with the insurance companies for which it distributes fixed annuities, but that it also has a contractual relationship with a top-level IMO. The top-level IMO provides the sub-IMO with distribution and other support services. Further, the top-level IMO assists the sub-IMO in accessing a wide variety of insurance products. The sub-IMO represents that contracting with a top-level IMO to provide this access and these services allows it to focus on the training and support of its agents.

Further, other applicants, in addition to describing themselves as top-level IMOs, also represented that they are affiliated with large insurance companies. One of these applicants wholly owns numerous sub-IMOs. Despite the differences in the ownership structure, the applicants represent that they, like the other top-level IMOs, assist in the distribution of fixed annuities, both their affiliates' and those sold by other insurance companies, and provide valuable business and administrative assistance to sub-IMOs and agents.

Finally, some applicants indicated that their services extend to assisting insurance companies in the design of insurance products.

### **Compliance Approach**

The applicants represented to the Department that they have broad experience that will contribute to their ability to satisfy the conditions of the exemption. Some applicants pointed to their experience in providing oversight of independent agents for insurance law compliance. A number of the applicants indicated that they planned to rely on affiliated registered investment advisers and/or broker-dealer entities in developing systems to comply with the exemption.

The applicants generally indicated that they would maintain internal compliance departments and adopt supervisory structures to ensure compliance with the exemption. Several applicants pointed to technology that they would use to ensure compliance. Some applicants indicated that insurance agents would be required to use the intermediary's technology to ensure that clients receive the disclosures and a contract, where required. Agents would also be required to use the intermediary's Web site services and maintain records centrally.

Some of the applicants additionally described how their sales practices would ensure best interest recommendations. A number of the applicants plan to require centralized approval of agent recommendations; in some cases, the recommendations would be reviewed by salaried employees of the intermediary with additional credentials, such as Certified Financial Planners. One applicant indicated that internal review would include a comparison of the proposed product to other similar fixed indexed annuity products available in the marketplace in order to ensure it is appropriate for the purchaser, and that the analysis would include utilizing third party benchmarking services and industry comparisons. Another applicant indicated that it would ensure that an RIA representative would work with insurance-only agents where a recommendation would involve the liquidation of securities, to ensure that both state and federal securities laws are properly followed.

Some applicants additionally stated that their contracts with insurance agents would include certain specific requirements, including: Adherence to the intermediary's policies and procedures with respect to advertising, market conduct and point of sale processes, transparency and documentation; provision of advice in accordance with practices developed by the intermediary; and agreement that the agents will not accept any compensation, direct or indirect, from an insurance company, except as specifically approved by the intermediary. A number of the applicants indicated that they would perform background checks and rigorous selection processes before working with agents and would require ongoing training regarding compliance with the exemption.

A few of the applicants addressed product selection. These applicants indicated that agents making recommendations pursuant to the exemption would be limited to certain products and insurance companies. The applicants indicated there would be ongoing due diligence with respect to insurance companies and product offerings under the exemption.

After consideration of the applicants' representations and the information provided in the applications, the Department has decided to propose a class exemption for insurance intermediaries. The proposal is described below.

## **Description of the Proposed Exemption**

### **General**

Section I of the proposed exemption would provide relief for the receipt of compensation by insurance intermediary Financial Institutions and their "Advisers," "Affiliates," and "Related Entities," as a result of the Adviser's or Financial Institution's provision of investment advice within the meaning of ERISA section 3(21)

(A)(ii) or Code section 4975(e)(3)(B) to a “Retirement Investor” regarding the purchase of a Fixed Annuity Contract. The proposed exemption would broadly provide relief from the restrictions of ERISA section 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(E) and (F).<sup>[23]</sup>

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The definitions and conditions of the proposal vary in certain respects from those in the Best Interest Contract Exemption, as discussed below. **The differences are intended to ensure that transactions involving fixed annuity contracts that are sold by independent insurance agents through insurance intermediaries occur only when they are in the best interest of Retirement Investors.** Fixed indexed annuities, with their blend of limited financial market exposures and minimum guaranteed values, can play an important and beneficial role in retirement preparation, as the Department noted in its Regulatory Impact Analysis for the Regulation.<sup>[24]</sup> **At the same time, however, these annuities, which are anticipated to be the primary type of fixed annuities sold under this exemption, often pose special risks and complexities for investors.**<sup>[25]</sup> Furthermore, when the Department promulgated the Best Interest Contract Exemption, it limited Financial Institution status to entities with well-established regulatory conditions and oversight.<sup>[26]</sup> Insurance intermediaries are not subject to the same regulatory oversight, and often have not played the same supervisory role with respect to advisers, as the Financial Institutions covered by that exemption. As a result of such considerations, this proposal contains a restricted definition of Financial Institution and additional required policies and procedures and disclosures.

These additional protections correspond to concerns, noted previously by the Department and expressed by other regulators, including the Securities and Exchange Commission (SEC) staff, the Financial Industry Regulatory Authority (FINRA), and the North American Securities Administrators Association, regarding fixed indexed annuities and the way they are marketed. **Although indexed annuities are often sold as simple “no risk” products, they are neither simple nor risk free. Without proper care, Retirement Investors can all too easily be misled about the terms, guarantees, and risks associated with these products.**

As FINRA noted in its Investor Alert, “Equity-Indexed Annuities: A Complex Choice”:

Sales of equity-indexed annuities (EIAs) . . . have grown considerably in recent years. Although one insurance company at one time included the word ‘simple’ in the name of its product, EIAs are anything but easy to understand. One of the most confusing features of an EIA is the method used to calculate the gain in the index to which the annuity is linked. To make matters worse, there is not one, but several different indexing methods. Because of the variety and complexity of the methods used to credit interest, investors will find it difficult to compare one EIA to another.<sup>[27]</sup>

**FINRA also explained that equity-indexed annuities “give you more risk (but more potential return) than a fixed annuity but less risk (and less potential return) than a variable annuity.”<sup>[28]</sup>**

Similarly, in its 2011 “Investor Bulletin: Indexed Annuities,” the SEC staff stated: “You can lose money buying an indexed annuity. If you need to cancel your annuity early, you may have to pay a significant surrender charge and tax penalties. A surrender charge may result in a loss of principal, so that an investor may receive less than his original purchase payments. Thus, even with a specified minimum value from the insurance company, it can take several years for an investment in an indexed annuity to ‘break even.’”<sup>[29]</sup> As the SEC staff additionally observed, “[i]t is important to note that indexed annuity contracts commonly allow the insurance company to change the participation rate, cap, and/or margin/spread/asset or administrative fee on a periodic—such as annual—basis. Such changes could adversely affect your return.”<sup>[30]</sup>

The North American Securities Administrators Association, the association of state securities regulators, issued the following statement on equity indexed annuities:

Equity indexed annuities are extremely complex investment products that have often been used as instruments of fraud and abuse. For years, they have taken an especially heavy toll on our nation's most vulnerable investors, our senior citizens for whom they are clearly unsuitable.<sup>[31]</sup>

In the Department's view, the complexity and conflicted payment structures associated with fixed indexed annuities heighten the dangers posed by conflicts of interest when Advisers recommend these products to Retirement Investors. These are complex products requiring careful consideration of their terms and risks. Assessing the prudence of a particular indexed annuity requires an understanding of surrender terms and charges; interest rate caps; the particular market index or indexes to which the annuity is linked; the scope of any downside risk; associated administrative and other charges; the insurer's authority to revise terms and charges over the life of the investment; and the specific methodology used to compute the index-linked interest rate and any optional benefits that may be offered, such as living benefits and death benefits. In operation, the index-linked interest rate can be affected by participation rates; spread, margin or asset fees; interest rate caps; the particular method for determining the change in the relevant index over the annuity's period (annual, high water mark, or point-to-point); and the method for calculating interest earned during the annuity's term (e.g., simple or compounded interest). Investors can all too easily overestimate the value of these contracts, misunderstand the linkage between the contract and index performance, underestimate the costs of the contract, and overestimate the scope of their protection from downside risk (or wrongly believe they have no risk of loss). As a result, Retirement Investors are acutely dependent on sound advice that is untainted by the conflicts of interest posed by Advisers' incentives to secure the annuity purchase, which can be quite substantial.

Accordingly, the Department has taken care to address these concerns, while preserving the beneficial and important role these products can play for retirement investors.<sup>[32]</sup> As noted above, when prudently recommended, fixed indexed annuities can promote investor interests because of their combination of limited financial market exposures and minimum guaranteed values. In addition, the Department seeks additional comments on insurers' ability to change the terms of a fixed indexed annuity contract during the life of the annuity, particularly during the period in which a surrender charge is in effect. To the extent that the insurer can change critical terms, such as the participation rate, indexing method, cap, or relevant fees and charges, it can directly affect its own compensation. And to the extent it can make such changes during the surrender period, it can place the customer in a lose-lose situation: The customer must either accept an unfavorable change to the terms of the annuity or surrender the annuity and incur a charge against the amount of the annuity. The Department asks for comment on these issues and features, with the intent of providing additional guidance on them in the final exemption, if it is granted, or potentially limiting the exemption to annuity contracts that do not permit insurers to change critical terms during periods in which the customer is subject to a surrender charge or penalty. Specifically, the Department asks parties to provide information on how commonly fixed indexed annuity contracts are structured in this manner. In practice, how commonly do insurers make such changes to critical terms during surrender periods? What constraints are imposed on such conduct by state law or otherwise? Similarly, what constraints are placed on the size of surrender charges or the methodology for calculating the charges? How are these rights and practices disclosed to consumers? How commonly do insurers give consumers advance notice of the changes coupled with a right to withdraw assets without penalty before the changes take effect? To what extent can an Adviser prudently recommend a fixed indexed annuity if it is potentially subject to changes in key terms during the

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**surrender period?** To the extent insurers can unilaterally increase their compensation by changing key terms during the surrender period, do they need a separate exemption for the exercise of that authority? Finally, to what extent should the Department be concerned about similar issues with respect to fixed rate annuities?

## Definition of Fixed Annuity Contract

As stated above, the proposed exemption is limited to transactions involving Fixed Annuity Contracts. To ensure that the exemption would not be used more broadly than intended, the proposal includes a definition of Fixed Annuity Contract, which is “an annuity contract that satisfies applicable state standard nonforfeiture laws at the time of issue and the benefits of which do not vary, in whole or in part, on the basis of the investment experience of a separate account or accounts maintained by the insurer. This includes both fixed rate annuity contracts and fixed indexed annuity contracts.” The definition is intended to include fixed immediate annuities but exclude variable annuity contracts, which the Department understands are typically sold through securities distribution channels.

If this proposed exemption is granted, therefore, relief will be available for sales of fixed rate annuities sold by insurance intermediaries and independent insurance agents under several different exemptions. Relief for all annuity sales is available under the Best Interest Contract Exemption if, as discussed above, an insurance company acts as the Financial Institution under the terms of that exemption. Alternatively, relief for fixed rate annuity contracts is available under PTE 84-24. By also proposing relief for such transactions in this exemption, the Department is not indicating that these other exemptions are unavailable. The intent is to provide flexibility to parties depending on their individual circumstances.

The Department requests comment on the proposed definition of Fixed Annuity Contract. Does the definition adequately describe fixed annuities and carve out variable annuities? Are there other attributes of fixed annuity contracts that should be identified in the definition? Finally, should the definition address group annuity contracts, which may not be required to satisfy state nonforfeiture laws? Is relief necessary in this distribution channel for group annuity contracts? If so, should the definition provide that rather than satisfying the state nonforfeiture laws, the group annuity contract must “guarantee return of principal net of reasonable compensation, and provide a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in the state that are applicable to individual annuities”?<sup>[33]</sup>

## Definition of Adviser

The proposed definition of Adviser in Section VIII(a) generally mirrors the definition in the Best Interest Contract Exemption, although a reference to banking law was not included in this proposed definition as the Department did not believe it was relevant. The definition states:

“Adviser” means an individual who:

- (1) Is a fiduciary of the Plan or IRA by reason of the provision of investment advice described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B), or both, and the applicable regulations, with respect to the assets of the Plan or IRA involved in the recommended transaction;
- (2) Is an employee, independent contractor, or agent of a Financial Institution; and
- (3) Satisfies the federal and state regulatory and licensing requirements of insurance laws with respect to the covered transaction, as applicable.

The Department requests comment on whether this definition accurately describes the relationship between independent insurance agents and insurance intermediaries who will serve as Financial Institutions under the exemption, and, if not, how the definition should be revised.

## Definition of Financial Institution

The proposal includes a new definition of Financial Institution that would apply with respect to insurance intermediaries. *See* Section VIII(e). As the Department stated in the preamble to the Best Interest Contract Exemption, the definition of Financial Institution in that exemption included entities identified in the statutory exemption for investment advice under ERISA section 408(g) and Code section 4975(f)(8) and that are subject to well-established regulatory conditions and oversight.<sup>[34]</sup> In addition, in that preamble, the Department requested that intermediaries seeking to serve as Financial Institutions provide information as to their ability to effectively supervise Advisers' compliance with the terms of the exemption.<sup>[35]</sup> The applicants described their ability to oversee Advisers and proposed a variety of safeguards that they believed would be protective of Retirement Investors engaging in these transactions.

The proposed definition of Financial Institution is based on the applicants' representations and suggestions and the Department's additional analysis of how best to safeguard Retirement Investors' interests in this distribution channel. The components of the definition are intended to describe insurance intermediaries that are likely to be able to comply with the exemption and provide meaningful oversight of Advisers working in the fixed annuity marketplace. The proposal seeks to identify insurance intermediaries with the financial stability and operational capacity to implement the anti-conflict policies and procedures required by the exemption. Additionally, insurance intermediaries described in the definition are sufficiently large and established to stand behind their contractual and other commitments to Retirement Investors, and to police conflicts of interest associated with a wide range of insurance products offered by a wide range of insurance companies.

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**As an initial matter, the proposal defines a Financial Institution as an insurance intermediary that has a direct written contract regarding the distribution of Fixed Annuity Contracts with both the insurance company issuing the annuity contract and the Adviser or another intermediary (sub-intermediary) that has a direct written contract with the Adviser.** Additional exemption conditions describe the terms of the required contract, see proposed Section II(d)(6) and (7). By requiring a contractual relationship between the insurance company and the intermediary, the proposal would ensure that the insurance intermediary and the insurance company have a direct relationship that will enable the insurance intermediary to satisfy its obligations under the exemption. By also requiring a contractual relationship between the intermediary and the Adviser or sub-intermediary, the proposal would further ensure that the intermediary will have the right to implement its oversight obligations as a Financial Institution pursuant to the requirements of the exemption, if granted. The Department requests comment on whether this condition should be adjusted to allow for multiple levels of intermediaries.

In addition to the baseline contractual relationship requirement, the proposal sets forth a series of conditions that would apply to the insurance intermediary. Subsection (1) of the proposed definition would require the insurance intermediary to satisfy the applicable licensing requirements of the insurance laws of each state in which it conducts business. Accordingly, the intermediary would be required to operate in accordance with the states' requirements in this respect.

Next, the proposal seeks to confirm that the insurance intermediary has sound business practices that have been reviewed by an independent entity. Subsection (2) of the proposed definition would require that the intermediary have financial statements that are audited annually by an independent certified public accountant. This condition would utilize the definition of Independent in Section VIII(f) of the proposed exemption.<sup>[36]</sup> In addition, under proposed Section III(b)(vii), the audited financial statements must be provided on the Financial Institution's Web site.

This condition was suggested in several individual applications. Some applicants believed that periodic financial audits would provide reasonable assurance of the entity's financial health. The Department agrees. The Department anticipates that requiring an annual audit of the financial statements, coupled with the Financial Institution's web disclosures, will provide an opportunity for the Department and other interested persons to be alerted to any financial weaknesses or other items of concern with respect to the stability or solvency of the Financial Institution, or its ability to stand behind its commitments to Retirement Investors.

As an alternative to an audit of financial statements, one applicant suggested that the audit should relate to the intermediary's internal controls and procedures. The applicant noted that banks and trust companies are currently required to obtain these reports under SSAE 16 (formerly SAS 70), and that the applicant could work with its auditors to prepare a similar report, but suggested that such an approach would require additional transition relief as the accounting industry would have to agree on the appropriate data points for an internal controls audit for an insurance intermediary and the resulting topics of the SSAE 16-like report.

The Department requests comment on the utility of the proposed audited financial statements requirement as a protection of Retirement Investors, and the suggested alternative audit of internal controls and procedures. The Department also requests information on the cost of these alternatives to insurance intermediaries intending to rely on the exemption.

### **Insurance or Assets Set Aside for Potential Liability**

Subsection (3) of the proposed definition would require the Financial Institution to maintain fiduciary liability insurance, or unencumbered cash, bonds, bank certificates of deposit, U.S. Treasury Obligations, or a combination of all of these, available to satisfy potential liability under ERISA or the Code as a result of the firm's failure to meet the terms of this exemption, or any contract entered into pursuant to Section II(a). **The aggregate amount of these items must equal at least 1% of the average annual amount of premium sales of Fixed Annuity Contracts by the Financial Institution to Retirement Investors over the prior three fiscal years of the Financial Institution.** To the extent this condition is satisfied by insurance, the proposal states that the insurance must apply solely to actions brought by the Department of Labor, the Department of Treasury, the Pension Benefit Guaranty Corporation, Retirement Investors or plan fiduciaries (or their representatives) relating to Fixed Annuity Contract transactions, including but not limited to, actions for failure to comply with the exemption or any contract entered into pursuant to Section II(a), and it may not contain an exclusion for Fixed Annuity Contracts sold pursuant to the exemption. Any such insurance also may not have a deductible that exceeds 5% of the policy limits and may not exclude coverage based on a self-insured retention or otherwise specify an amount that the Financial Institution must pay before a claim is covered by the fiduciary liability policy. To the extent this condition is satisfied by retaining assets, the assets must be unencumbered and not subject to security interests or other creditors.

This provision of the proposal seeks to ensure that the Financial Institution can stand behind its commitments to retirement investors and satisfy potential liabilities under the exemption. The Financial Institution's ability to back its commitments ensures that it can be held accountable when it violates its

obligations and, thereby, promotes compliance. A number of the applicants specifically suggested that they would obtain insurance to cover potential liability under the exemption, although the approaches and suggested amounts varied. Additionally, as some applicants indicated uncertainty as to the current availability of insurance for liability under the exemption, the proposal would provide flexibility to the intermediaries to determine whether to acquire insurance or set aside assets to satisfy potential liability.

The Department has concluded that the condition should be included in this proposal based on the suggestion of applicants, as well as its understanding that insurance intermediaries often are not legally required to maintain, and do not maintain, significant amounts of capital. Particularly because these entities do not necessarily have the sort of history of regulatory oversight and supervisory experience that characterize Financial Institutions identified in the  Best Interest Contract Exemption, the Department believes that this additional condition is a necessary enhancement of the protections necessary to ensure that the intermediaries maintain full responsibility for compliance with the proposed exemption's conditions.

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The Department requests comment on the approach taken in proposed subsection (3) of the definition. First, do commenters agree that the exemption should specify that insurance/assets should be based on a percentage of prior sales of Fixed Annuity Contracts? Is a three-year average an appropriate method for determining the amount of premium sales? Should a different and or minimum/maximum amount be specified, or should there be no specific level at all? For example, should the exemption instead require that a "reasonable" amount of insurance be obtained or assets set aside? As an additional protection for Retirement Investors, should individual Advisers be required to carry insurance themselves?

Moreover, should the final exemption retain the proposal's approach of allowing Financial Institutions flexibility to either obtain fiduciary liability insurance or set aside assets to satisfy potential liabilities? If the Department adopts this approach, should it specify how assets should be held (*i.e.*, in an escrow account) in order to ensure they are available in the event there is a judgment against the intermediary? Further, should the condition describe with more specificity which assets are acceptable, how they are to be valued, or how they are to be insulated from the claims of creditors other than Retirement Investors? As an alternative, should the final exemption require both fiduciary liability insurance coverage and a minimum level of assets set aside? If so, how should the requirement for a minimum level of assets be defined?

### **Premium Threshold**

Finally, subsection (4) of the proposed definition would require the insurance intermediary to have had annual Fixed Annuity Contract sales averaging at least \$1.5 billion in premiums over each of the three prior fiscal years to qualify as a Financial Institution. This proposed threshold is intended to identify insurance intermediaries that have the financial stability and operational capacity to implement the anti-conflict policies and procedures required by the exemption. The proposed condition aims to ensure that the insurance intermediary is in a position to meaningfully mitigate compensation conflicts across products and insurers, which is a critical safeguard of the exemption, as proposed. Although this proposed threshold would limit entities that could operate as the supervisory Financial Institution to larger intermediaries, it would not prevent smaller intermediaries from working with larger intermediaries, similarly to how some of them currently operate.

The proposed \$1.5 billion threshold is based on a variety of factors. The intermediaries that approached the Department for individual exemptions and expressed their willingness and ability to function in a supervisory capacity to mitigate conflicts generally indicated sales of this amount or more in their applications, although not all applicants provided this information. Additionally, the Department believes

that the \$1.5 billion dollar threshold will cover those intermediaries that are most likely to make beneficial use of the exemption because economies of scale are likely to yield advantages in efficiently carrying out compliance responsibilities under this proposed exemption, especially if they step into the role that insurance companies would otherwise serve under the Best Interest Contract Exemption. The Department is also concerned that the conditions of the exemption will not serve their purpose in protecting Retirement Investors from conflicts of interest if the insurance intermediary does not have the requisite experience and resources to be able to effectively mitigate the potential adverse impact of these incentives.

To this point, the Department questions whether intermediaries with lower levels of annual sales will be able to effectively mitigate conflicts in an environment that is so heavily dependent on commission compensation, particularly without the history of regulatory oversight and supervisory experience that characterize other Financial Institutions, such as banks, insurance companies, and broker-dealers. One of the chief reasons for extending Financial Institution status to insurance intermediaries is their ability to mitigate the conflicts of interest posed by the variable compensation that independent agents may receive from different insurance companies paying different compensation. Sufficiently large intermediaries that sell many products from a wide variety of insurance companies are in a position to control the compensation that the agent stands to receive from the various insurers and products and, thereby, minimize or eliminate the independent agents' conflicts of interest in choosing between insurance companies and products. In addition, the anti-conflict purpose of the exemption's conditions would not be served with respect to an entity that is so small that the difference between the firm's conflicts and the individual advisers' conflicts is essentially non-existent.

The proposed requirement that the premium threshold be met using the preceding three-year average is intended, again, to identify intermediaries with an established history of significant sales. However, it is not intended as a barrier to new entities becoming Financial Institutions or for smaller intermediaries to operate under this exemption, albeit not as a Financial Institution. The Department notes that while a large intermediary would be responsible for acting as the Financial Institution under the exemption, smaller intermediaries will typically be eligible to obtain prohibited transaction relief under the proposed exemption's provisions that extend to "affiliates" and "related entities." In this regard, the Department understands that the marketplace of intermediaries that distributes fixed annuities is hierarchical. Smaller intermediaries commonly work with larger intermediaries, and receive materials and support from the larger intermediaries in exchange for a fee or a portion of the sales commission. Therefore, smaller intermediaries could obtain relief from ERISA's prohibited transaction rules as long as there is an intermediary in their distribution hierarchy that acts as the Financial Institution and provides the requisite anti-conflict and supervisory role under the exemption, including execution of the best interest contract.<sup>[37]</sup> Accordingly, where several intermediaries (a top-level intermediary and one or more sub-intermediaries) receive commission compensation in connection with an annuity transaction, each intermediary would be eligible for prohibited transaction relief under this proposed exemption, although only one would act as the Financial Institution and need to satisfy the premium threshold.

Importantly, in determining whether an intermediary meets the \$1.5 billion threshold, each intermediary that receives a commission for an annuity transaction could count the total premium amount involved towards the required premium threshold. This will facilitate the ability of smaller intermediaries to satisfy the premium threshold under this exemption, and act as a Financial Institution, if desired. For example, assume an Annuity Adviser contracts with IMO A, which in turn is a part of IMO B's network. IMO B is a Financial Institution under this exemption. If Annuity Adviser sells an annuity to a Retirement Investor for \$100,000, both IMO A and IMO B can count the \$100,000 towards their own \$1.5 billion threshold. If IMO

A eventually reaches the \$1.5 billion threshold (averaged over three years), it could act as a Financial Institution under this exemption, but would not be required to do so, as long as IMO B or another Financial Institution acts in the requisite role.

The Department notes that applicants suggested various other methods of defining which intermediaries should qualify as Financial Institutions. The most prevalent suggestion was to limit the exemption to “top tier” intermediaries with a significant number of direct relationships with insurance carriers. The “top tier” intermediary was generally described as the entity at the top of an insurance carrier's distribution hierarchy. Some applicants stated that the exemption should focus on the “top tier” intermediaries because such entities have a closer tie with the insurance company.

The Department's proposal is not limited to intermediaries with “top tier” status. As an initial matter, the Department understands that many insurance intermediaries have direct contracts with insurance carriers regardless of the intermediary's size and it may not be clear whether a particular contractual relationship is properly characterized as a “top tier” relationship. Additionally, even assuming that “top tier” could be defined objectively, the Department is not certain that status at the top of an insurance company's distribution hierarchy is necessary to indicate that an intermediary is an established entity capable of providing effective oversight of Advisers and mitigating compensation incentives. Accordingly, the Department has tentatively concluded that the premium threshold is a better indicator that an intermediary can serve these functions based on its involvement in a significant amount of sales over its three prior fiscal years.

The Department requests comment on a variety of aspects of the proposed premium threshold condition and possible alternatives. First, the Department seeks comment on alternative approaches to identifying intermediaries that are likely to be able to comply with the exemption and provide meaningful oversight of Advisers working in the fixed annuity marketplace. More specifically, the Department asks whether focusing on premium levels is an effective measure of compliance and conflict mitigation capability. The Department also seeks comment on the requirement that the premium condition be met by averaging premiums over the preceding three fiscal years. In particular, the Department asks the following questions:

- Is the \$1.5 billion threshold likely to identify intermediaries with the history and capability of handling supervisory and regulatory compliance of this nature? If there is a threshold, should it be set at a different level?
- If a premium threshold is adopted, should it be indexed to grow with consumer price inflation or some other reference?
- If a premium threshold is included, is basing it on an average over the prior three years an effective way to account for fluctuations in annual sales to ensure intermediaries have certainty that they will continue to qualify as a Financial Institution? Are there alternative ways to address annual sales fluctuations to provide such certainty?
- In addition to entities that have satisfied the premium threshold, should the Financial Institution definition extend to entities with a “reasonable expectation” of meeting the threshold over the next three years, to ensure that newer or growing entities can more readily become Financial Institutions? Would a subjective threshold of this type provide adequate protections to Retirement Investors? How should the exemption apply to intermediaries that fail to meet the threshold, notwithstanding their previously “reasonable expectation” that they would meet the threshold?

- If the exemption did not include a premium threshold, would smaller intermediaries nevertheless be likely to rely on larger intermediaries for exemption compliance due to cost savings, efficiency, or other reasons?
- Are there a large number of smaller intermediaries selling fixed annuities that do not work with any other intermediaries that could satisfy the \$1.5 billion or similar threshold?
- Should the premium threshold apply specifically to fixed annuity sales, or should it apply more broadly to all sales of insurance and annuity products? If it applies to insurance sales other than fixed annuities, how should premiums for those sales be measured?
- As an alternative or in addition to a premium threshold, should the exemption have a threshold based on the number of annuity contracts sold by the intermediary annually?
- Should a “top tier” requirement replace or be added to a premium threshold requirement? If so, how would the Department define “top tier” status, and should intermediaries be required to have a certain minimum number of contractual relationships with different insurance companies to satisfy such a requirement?
- Alternatively, or in addition to, either a premium threshold or a “top tier” requirement, should the exemption require that the intermediary also have agreements to sell fixed annuities with a specified minimum number of different insurance companies? If so, what would be an appropriate minimum number and why?
- Are there other conditions (*e.g.*, minimum number of employees, annual revenue threshold, capitalization requirement) that would satisfy the Department's intent to ensure the covered Financial Institutions are able and likely to comply with the exemption and engage in meaningful oversight of Advisers working in the fixed annuity marketplace?

## Conditions

Sections II through V of the proposal contain the conditions proposed for relief under the exemption. The conditions are the same as the Best Interest Contract Exemption in many respects, but some of the conditions have been revised, augmented or deleted, as discussed in this section. The Department requests comments on these revisions.

### Sections II(a), (b), (c)

Section II sets forth the requirements that establish the Retirement Investor's enforceable right to adherence to the Impartial Conduct Standards and related conditions. For advice to certain Retirement Investors—specifically, advice regarding IRA investments, and plans that are not covered by Title I of ERISA (non-ERISA plans), such as plans covering only partners or sole proprietors—Section II(a) requires the Financial Institution and Retirement Investor to enter into a written contract that includes the provisions described in Section II(b)-(d) of the exemption and that also does not include any of the ineligible provisions described in Section II(f) of the exemption. Financial Institutions additionally must provide the disclosures set forth in Section II(e).<sup>[38]</sup>

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The contract with Retirement Investors regarding IRAs and non-ERISA plans must include the Financial Institution's acknowledgment of its fiduciary status and that of its Advisers, as required by Section II(b) and the Financial Institution's agreement that it and its Advisers will adhere to the Impartial Conduct Standards

as required by Section II(c). The Impartial Conduct Standards require Advisers and Financial Institutions to provide advice that is in the Retirement Investor's best interest (*i.e.*, prudent advice that is based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to financial or other interests of the Adviser, Financial Institution, or their affiliates, related entities or other parties); charge no more than reasonable compensation; and make no misleading statements about investment transactions, compensation, and conflicts of interest. These provisions are unchanged from the Best Interest Contract Exemption.

In this regard, the Department cautions Financial Institutions and Advisers to avoid inaccurate or misleading statements regarding the risk characteristics of fixed indexed annuity contracts, particularly statements that inaccurately suggest these products have only upside potential and no risk of loss of principal. *See* Equity-Indexed Annuities: Member Responsibilities for Supervising Sales of Unregistered Equity-Indexed Annuities, available at <http://www.finra.org/industry/notices/05-50> (<http://www.finra.org/industry/notices/05-50>). In particular, firms and Advisers violate the Impartial Conduct Standards if they fail to explain any limitations on the upside of the investments (*e.g.*, as imposed by caps, participation rates, and crediting practices), or if they falsely describe fixed indexed annuities as “no risk” products or state that there can be no loss of principal with Fixed Annuity Contracts, without acknowledging the potential impact of surrender charges or other provisions that could, in fact, result in the consumer's receiving less than he or she paid for the contract. As further discussed below, this proposal includes a new proposed Section II(d)(4) that would require that, as part of the policies and procedures requirement, the Financial Institution approve marketing materials used by Advisers, to increase oversight in this area.

### **Section II(d)—Policies and Procedures**

Under Section II(d), the Financial Institution must warrant that it has adopted, and in fact must comply with, anti-conflict policies and procedures reasonably and prudently designed to ensure that Advisers adhere to the Impartial Conduct Standards. The policies and procedures requirements generally include all the elements in the Best Interest Contract Exemption, including the requirement that the Financial Institution designate a person or persons responsible for addressing material conflicts of interest and monitoring Advisers' adherence to the Impartial Conduct Standards. *See* Section II(d)(2).

### **Proposed Section II(d)(3)**

**Proposed Section II(d)(3) specifically addresses incentives to Advisers, and provides that the Financial Institution's policies and procedures must prohibit the use of quotas, appraisals, or performance or personnel actions, bonuses, contests, special awards, differential compensation, or other actions or incentives if they are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the best interest of the Retirement Investor.** The condition applies regardless of the source of the incentive. Independent insurance agents distribute the products of multiple insurance companies and accordingly, may be subject to more than one company's incentives. In some cases, the agents may also work for more than one intermediary. Under the terms of the exemption, however, the intermediary would be expected to ensure that these arrangements did not incentivize the agents to make recommendations that run counter to the best interest standard.

The insurance intermediaries indicated they are well positioned to mitigate the impact of the competing financial incentives offered by multiple insurance companies. Consistent with the intermediaries' representations, one of the key protections of this exemption is the requirement that the insurance intermediary Financial Institution manage the conflicts of interest that independent agents and other

Advisers face in recommending the products of multiple insurance companies. **Proposed Section II(d)(3) would tolerate differential compensation—regardless of source—only to the extent that it is not intended or reasonably expected to cause Advisers to make recommendations that are not in the best interest of the Retirement Investor.** Financial Institutions can allow Advisers to receive differential compensation if it is justified by neutral factors tied to the differences in the services delivered to Retirement Investors. *See* Best Interest Contract Exemption, 81 FR at 21039-40 (preamble discussion of neutral factors analysis); *FAQs about Conflict of Interest Rules and Exemptions, Part I*, FAQ 9 (addressing compensation incentives).<sup>[39]</sup>

The Department views this as a critical safeguard of this proposed exemption. The proposed condition is intended to ensure that an Adviser's relationship with multiple insurance companies and even multiple insurance intermediaries does not generate compensation or incentive structures that undermine the Adviser's provision of advice that is in Retirement Investors' best interest.

Proposed Section II(d)(3) retains the principles based approach of the Best Interest Contract Exemption, and does not purport to detail any single approach for compliance with the condition. A number of applicants indicated that they expect their □ relationships with Advisers to be exclusive with respect to the sale of Fixed Annuity Contracts to Retirement Investors. In that case, the Financial Institution would have a ready means of supervising the insurers and product that the Adviser recommended and controlling associated incentive structures. The proposal does not mandate exclusivity, however; a Financial Institution could alternatively require an Adviser to provide information to the Financial Institution regarding all the compensation and incentives provided by all the other insurance companies and intermediaries through which the Adviser sells Fixed Annuity Contracts. Whatever approach is adopted by a Financial Institution, the Financial Institution will ultimately be responsible for implementing the policies and procedures across all the Advisers' incentive arrangements.

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### **New Proposed Policies and Procedures Requirements**

A new proposed Section II(d)(4) would require Financial Institutions to approve in advance all written marketing materials used by Advisers after determining that such materials provide a balanced description of the risks and features of the annuity contracts to be recommended. The condition ensures that Advisers are not using marketing materials that do not fully and fairly disclose the risks and characteristics of an annuity.

New proposed Section II(d)(5) would impose additional requirements on the person or persons designated as responsible for addressing material conflicts of interest and monitoring Advisers' adherence to the Impartial Conduct Standards. **The new section would require the person to approve, in writing, recommended annuity applications involving Retirement Investors prior to transmitting the applications to the insurance company.** While a specific approval requirement is not in the Best Interest Contract Exemption, a number of applicants suggested they would have internal compliance departments review recommendations prior to the transmittal of an annuity contract to an insurance company. The condition would reinforce the duty of the Financial Institution to monitor and supervise the Advisers operating within the Financial Institution's distribution chain. This may be particularly important when there are sub-intermediaries, who may be more involved in day-to-day activities, between the Adviser and the Financial Institution.

The proposal also would establish certain specific requirements for the relationship between the insurance intermediary and the Adviser. Section II(d)(6) would specify certain aspects of the written contract between the Financial Institution and the Adviser or sub-intermediary. **First, the Financial Institution must require in**

its written contract with the Adviser or sub-intermediary that Advisers may use written marketing materials only if they are approved by the Financial Institution. As discussed above, Section II(d)(4) of this proposal would require Financial Institutions to approve in advance all written marketing materials used by Advisers after determining that such materials provide a balanced description of the risks and features of the annuity contracts to be recommended.

only approved  
marketing materials

**Second, Advisers must be required to provide the transaction disclosure required by Section III(a) of the exemption and orally review the annuity-specific information required in Section III(a)(1) with the Retirement Investor, as discussed below.** These marketing and disclosure conditions address the Department's objective that Advisers and Financial Institutions relying on the exemption should describe recommended annuity contracts fully and fairly, **and that the Retirement Investor must be made aware of aspects of the annuity contract that could impact the amounts ultimately paid to the Retirement Investor.**

THIS COULD BE TRICKY

New proposed Section II(d)(7) sets forth requirements that would govern the compensation of the Adviser and sub-intermediary. The applicants described two broad approaches to paying compensation, and Section II(d)(7) permits both. **Under the first approach, all compensation to be paid to the Adviser or sub-intermediary with respect to the purchase of an annuity contract pursuant to the exemption must be paid to the Adviser or sub-intermediary exclusively by the insurance intermediary. Under this approach, the intermediary would contract with insurance companies to receive the entire commission itself, and then, in turn, would pay an Adviser and/or any sub-intermediary a portion of the commission.**

**Under the second approach, Advisers or sub-intermediaries could receive commissions from insurance companies for the sale of annuities to Retirement Investors provided that the commission structure was approved in advance by the insurance intermediary and all forms of compensation other than commissions, whether cash or non-monetary, are paid to the Adviser or sub-intermediary exclusively by the insurance intermediary. In this approach, insurance companies can continue the practice of paying commissions directly to agents, with an override payment going to the intermediary.**

Under the proposal, the insurance intermediary may elect either compensation approach or some combination of the two. The proposal offers this flexibility because different applicants had different preferences for accomplishing the same general result, that the insurance intermediaries take responsibility for Adviser compensation and other incentives. Some applicants preferred to take in all compensation from insurance companies in order to facilitate compliance with the exemption and avoid the potential for errors. Other applicants preferred the second approach, expressing the view that it would not require the establishment of new internal accounting procedures and the engagement of additional personnel.<sup>[40]</sup>

**A new proposed Section II(d)(8) would also require that Financial Institutions provide, and require Advisers to attend, annual training on compliance with the exemption, conducted by a person who has appropriate technical training and proficiency with ERISA and the Code.** The training must, at a minimum, cover the policies and procedures, the Impartial Conduct Standards, material conflicts of interest, ERISA and Code compliance (including applicable fiduciary duties and the prohibited transaction provisions), ethical conduct, and the consequences for not complying with the conditions of this exemption (including any loss of exemptive relief provided herein). The Department notes that a number of the applicants emphasized the importance of training. The Department agrees and emphasizes that Advisers must be trained on important areas that are key to understanding their duty to Retirement Investors under the exemption and that are not likely covered by state insurance laws.

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## Sections II(e), (f) and (g)

Section II(e) requires the Financial Institution to disclose information about its services and applicable fees and compensation. Section II(e) is generally unchanged from the Best Interest Contract Exemption, although some of the provisions were revised in minor ways to reflect the fact that this proposed exemption is limited to Fixed Annuity Contracts.

Like the Best Interest Contract Exemption, Section II(e)(7) of this proposal would require the Financial Institution to disclose whether or not the Adviser and Financial Institution will monitor the Retirement Investor's annuity contract and alert the Retirement Investor to any recommended change to the contract, and, if monitoring, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted. Financial Institutions and their Advisers should not disclaim responsibility for monitoring if they will receive ongoing compensation justified in whole or in part based on the provision of such monitoring services.

Section II(f) generally provides that the exemption is unavailable if the contract includes exculpatory provisions or provisions waiving the rights and remedies of the plan, IRA or Retirement Investor, including their right to participate in a class action in court. The contract may, however, provide for binding arbitration of individual claims, and may waive contractual rights to punitive damages or rescission to the extent permitted by governing law. Pursuant to Section II(g) of the exemption, advice to Retirement Investors regarding ERISA plans does not have to be subject to a written contract, but Advisers and Financial Institutions must comply with the substantive standards established in Section II(b)-(e) to avoid liability for a non-exempt prohibited transaction. These conditions are unchanged from the Best Interest Contract Exemption.

Section II(h) of the Best Interest Contract Exemption established streamlined conditions for "level fee fiduciaries" defined in section VIII(h) of that exemption. Under that definition, a Financial Institution and Adviser can be level fee fiduciaries if the only fee received by them and their affiliates is a "level fee" that is disclosed in advance to the Retirement Investor. A "level fee" is defined as a fee or compensation that is provided as a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended, rather than a commission or other transaction-based fee.

This proposal, however, does not include provisions for "level fee fiduciaries." Although some of the applicants acknowledged they would level commissions across product categories, the mere leveling of commissions would not cause these Advisers and Financial Institutions to be "level fee fiduciaries" as defined in the Best Interest Contract Exemption because each purchase of a fixed annuity by a Retirement Investor would initiate the payment of a commission based on that particular transaction. The Department seeks comment on this aspect of the proposal. Are there business models in existence for the recommendation and sale of Fixed Annuity Contracts that would satisfy the level fee provisions of the Best Interest Contract Exemption, as described above? <sup>[41]</sup>

### Section III

Section III proposes certain disclosure requirements, in addition to the disclosures in Section II(e) of the exemption. Section III(a)'s provisions on "transaction disclosure" generally require the disclosure of material conflicts of interest and basic information relating to those conflicts and the advisory relationship. In this respect, the proposal mirrors the Best Interest Contract Exemption.

In addition, the transaction disclosure in this proposal has an annuity-specific disclosure requirement that would apply to recommendations of all Fixed Annuity Contracts. A new proposed Section III(a)(1) would require the Financial Institution to provide a transaction disclosure in accordance with the most recent

**Annuity Disclosure Model Regulation published by the National Association of Insurance Commissioners**

**(NAIC) or its successor.**<sup>[42]</sup> Broadly, the 2015 Annuity Disclosure Model Regulation requires the disclosure of information regarding the contract, including, among other items: (i) Value reductions caused by withdrawals or surrenders; (ii) the guaranteed and non-guaranteed elements of the Fixed Annuity Contract and their limitations, including, for fixed indexed annuities, the elements used to determine the index-based interest, such as the participation rates, caps or spreads, and an explanation of how they operate; (iii) an explanation of the initial crediting rate, or for fixed annuities, an explanation of how the index-based interest is determined; (iv) available periodic income options; (v) how values in the annuity contract can be accessed; (vi) the death benefit, if available; (vii) a summary of the federal tax status; (viii) the impact of any riders; and (ix) a list of charges and fees and how they apply.

**Under the proposal, both the Adviser and the Retirement Investor must sign the disclosure after the Adviser orally reviews the information.**

The aim of this disclosure is to ensure that Retirement Investors are informed of the risks and features of annuity products prior to entering into the annuity contract. This disclosure would be required prior to the transmittal of the annuity application to the insurance company and would be required to be made in connection with any recommendations to make additional deposits into the contract. The Department understands that in some cases, insurance companies currently provide an advance disclosure document, commonly referred to as a “statement of understanding.” This condition of the exemption would be satisfied if the required information is provided in a “statement of understanding” in accordance with the applicable time frames specified in the condition. So long as the disclosure is delivered in a document that is distinct from the annuity contract, whether through a “statement of understanding” or otherwise the disclosure will satisfy the condition.

The Department requests comment on the proposed disclosure condition. Does the Annuity Disclosure Model Regulation require the information commenters believe is appropriate and necessary in transactions involving  Fixed Annuity Contracts sold pursuant to the exemption? Should the final exemption require disclosure of any additional information? **In particular, with respect to fixed indexed annuity contracts, should the exemption require an illustration designed to convey the difference between the performance of the applicable index or indices and the amount credited to the customer's annuity, in light of the indexing features such as the participation rate; any spread, margin or asset fees; interest rate caps or floors; and the recognition of dividends. For example, should the exemption require that Financial Institutions provide a chart illustrating prior annual returns of an index for a certain number of years compared to the amounts that would have been credited annually under the terms of the indexed annuity contract?** If commenters believe such a disclosure would be desirable, the Department requests comment on how it should be operationalized.

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Section III(b) requires web-based disclosure that is intended to provide information about the Financial Institutions' arrangements with product manufacturers and other parties for Third Party Payments in connection with specific investments or classes of investments that are recommended to Retirement Investors, a description of the Financial Institution's business model and its compensation and incentive arrangements with Advisers and a copy of the Financial Institution's most recent audited financial statements as required pursuant to Section VIII(d)(2). Other than the disclosure of the audited financial statements, this provision is generally otherwise unchanged from the Best Interest Contract Exemption, except that certain provisions are revised in minor ways to account for the fact that the exemption will provide relief only for Fixed Annuity Contracts.

The Department requests comment on the proposed requirement to maintain a copy of the Financial Institution's most recent audited financial statements on the Web site.

## Section IV

Section IV of the proposal relates to Financial Institutions that limit Advisers' investment recommendations, in whole or in part, based on whether the investments are Proprietary Products (as defined in Section VIII(j)) or to investments that generate Third Party Payments (as defined in Section VIII(n)). For purposes of this proposal, Section IV would apply to all Financial Institutions relying on the exemption because insurance intermediaries sell only investments that generate Third Party Payments (from the insurance company). Among other things, Section IV requires Financial Institutions to document the limitations they place on their Advisers' investment recommendations, the material conflicts of interest associated with proprietary or third party arrangements, and the services that will be provided both to Retirement Investors as well as third parties in exchange for payments. Such Financial Institutions must then reasonably conclude that the limitations will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation, and, after consideration of their policies and procedures, reasonably determine that the limitations and associated conflicts of interest will not cause the Financial Institution or its Advisers to recommend imprudent investments. Financial Institutions must document the bases for their conclusions in these respects and retain the documentation pursuant to the recordkeeping requirements of the exemption, for examination upon request by the Department and other parties set forth in that section.<sup>[43]</sup>

## Sections V, VI and VII

Section V of the proposed exemption would establish record retention and disclosure conditions that a Financial Institution must satisfy for the exemption to be available for compensation received in connection with recommended transactions. This provision is unchanged from the Best Interest Contract Exemption.

Sections VI and VII propose supplemental exemptions. Section VI would apply to certain prohibited transactions commonly associated with annuity purchases but which are not covered by Section I. Section I permits Advisers and Financial Institutions to receive compensation that would otherwise be prohibited by the self-dealing and conflicts of interest provisions of ERISA section 406(a)(1)(D) and 406(b), and Code section 4975(c)(1)(D)-(F). However, Section I does not extend to any other prohibited transaction sections of ERISA and the Code. ERISA section 406(a) and Code section 4975(c)(1)(A)-(D) contain additional prohibitions on certain specific transactions between plans and IRAs and "parties in interest" and "disqualified persons," including service providers. These additional prohibited transactions include: (i) The purchase of a Fixed Annuity Contract by a plan/IRA from a party in interest/disqualified person, and (ii) the transfer of plan/IRA assets to a party in interest/disqualified person. These prohibited transactions are subject to excise tax and personal liability for the fiduciary.

**Section VII proposes an exemption for pre-existing transactions involving Fixed Annuity Contracts.** The exemption permits continued receipt of compensation based on transactions involving Fixed Annuity Contracts that occurred prior to the Applicability Date, as defined in Section VII(a), as well as the receipt of compensation for recommendations to continue to adhere to a systematic purchase program established before the Applicability Date. In this case, the Department anticipates that a systematic purchase program would involve a program in which a Retirement Investor would make regular, pre-scheduled contributions to an annuity contract; however, the Department requests comment on whether such relief is necessary or appropriate. The exemption also explicitly covers compensation received as a result of a recommendation to hold an annuity contract that was purchased prior to the Applicability Date **but would not cover recommendations to exchange an annuity for another annuity.** In addition, a few references to securities that are found in the Best Interest Contract Exemption were deleted from this exemption because it would not provide relief for securities transactions.

This preamble discussion focused on conditions in this proposal that differ from the Best Interest Contract Exemption. The preamble to the Best Interest Contract Exemption includes a lengthy and in-depth discussion of the remaining conditions, which is incorporated into this preamble by reference. Because of the significant length of that discussion, the Department did not repeat it in this document, but rather directs parties to the Best Interest Contract Exemption preamble for a more complete description of the scope, definitional terms, and conditions of the exemption.<sup>[44]</sup>

## Transition Relief

Section IX of the proposal provides for a transition period, from April 10, 2017, to August 15, 2018, under which fewer conditions would apply. During the transition period, the Financial Institution and its Advisers would be required to satisfy the conditions of Section IX(d) of the proposal. Prior to receiving compensation in reliance on the exemption, Financial Institutions would be required under Section IX(d) to notify the Department of their intention to rely on the exemption and make a specific representation to the Department regarding their active engagement in creating systems and safeguards to satisfy the conditions applicable to the relief in Section I, following the transition period. The proposed required representation is: “[Name of Financial Institution] is presently taking steps to put in place the systems necessary to comply with Section I of the Best Interest Contract Exemption for Insurance Intermediaries, and fully intends to comply with all applicable conditions for such relief after the expiration of the transition period.” The Department proposed a transition period to give Financial Institutions under the proposed exemption time to comply with all the exemption's conditions, and the Department anticipates that parties relying on the transition period should be developing an approach to full compliance during the transition period.

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During the transition period, the Adviser and Financial Institution must comply with the Impartial Conduct Standards. Additionally, the Financial Institution would be required to comply with applicable disclosure obligations under state insurance law with respect to the sale of the Fixed Annuity Contract, and certain additional disclosures would be required, including an acknowledgment of the Adviser's and Financial Institution's fiduciary status; a description of their material conflicts of interest; and a disclosure of whether they offer proprietary products or products that generate third party payments and the extent to which they limit investment recommendations on those bases. The Financial Institution would have to approve all written marketing materials used by Advisers, as described in Section II(d)(4). The Financial Institution would have to designate a person responsible for addressing material conflicts of interest and monitoring Advisers' adherence to the Impartial Conduct Standards, and such person would be required to approve, in writing, recommended annuity applications involving Retirement Investors prior to transmitting them to the insurance company. Finally, the Financial Institution would have to comply with the recordkeeping requirements of Section V(b) and (c).

It is proposed that, starting on August 16, 2018, parties intending to rely on the exemption must comply with all of the applicable conditions in Sections II-V.

## No Relief Proposed From ERISA Section 406(a)(1)(C) or Code Section 4975(c)(1)(C) for the Provision of Services

This proposed exemption would not provide relief from a transaction prohibited by ERISA section 406(a)(1)(C), or from the taxes imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(C), regarding the furnishing of goods, services or facilities between a plan and a party in interest. The provision of investment advice to a plan under a contract with a plan fiduciary is a service to the plan and compliance with this exemption will not relieve an Adviser or Financial Institution of the need to comply with ERISA section 408(b)(2), Code section 4975(d)(2), and applicable regulations thereunder.

## Regulatory Impact Analysis

### Executive Order 12866 and 13563 Statement

Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 (/executive-order/13563) emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, "significant" regulatory actions are subject to the requirements of the Executive Order and review by the OMB. Section 3(f) of Executive Order 12866, defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of \$100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant" regulatory actions); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order.

Pursuant to the terms of Executive Order 12866, OMB has tentatively determined that this proposed action is economically significant within the meaning of section 3(f)(1) of the Executive Order. Accordingly, OMB has reviewed the proposed prohibited transaction class exemption and the Department provides the following assessment of its impact.

### Background of Proposed Exemption

As discussed earlier in this preamble, the prohibited transaction rules of ERISA and the Code prohibit employee benefit plan and individual retirement account (IRA) fiduciaries from receiving indirect or variable compensation as a result of their investment advice to the plans and IRAs. **The exemption proposed in this document would allow certain insurance intermediaries, and the insurance agents and insurance companies with whom they contract, to receive compensation in connection with certain fixed annuity transactions that may otherwise give rise to prohibited transactions as a result of the provision of investment advice to plan participants and beneficiaries, IRA owners and certain plan fiduciaries.** The proposed class exemption includes protective conditions, similar to those contained in the Department's Best Interest Contract Exemption (PTE 2016-01) granted on April 8, 2016,<sup>[45]</sup> that are designed to safeguard the interests of plans, participants and beneficiaries, and IRA investors and ensure that they receive investment advice that is in their best interest.

The Best Interest Contract Exemption is available only to certain Financial Institutions that are subject to well-established regulatory conditions and oversight, namely banks, investment advisers registered under the Investment Advisers Act of 1940 or state law, broker-dealers, and insurance companies. However, the exemption provides a mechanism that would make it more broadly available to other entities that are described in the definition of Financial Institution in an individual prohibited transaction exemption

providing relief under the same conditions as in the Best Interest Contract Exemption. Thus, if an individual exemption is granted, other entities that satisfy the applicable conditions could rely on the Best Interest Contract Exemption.<sup>[46]</sup>

In response to this provision, the Department received 22 individual exemption applications from insurance intermediaries that work with independent insurance agents to sell fixed annuity products (“applicants”). The applicants describe themselves as “independent marketing organizations,” “insurance marketing organizations” and “field marketing organizations” among other names. Collectively, the Department refers to the applicants and similar entities as “IMOs” in this analysis. The applicants sought individual exemptions under the same conditions as the Best Interest Contract Exemption, but with a new definition of “Financial Institution” incorporating insurance intermediaries.

Because of the large number and similar characteristics of the applicants, the Department decided that instead of utilizing the individual exemption process described in the Best Interest Contract Exemption, it would propose, on its own motion, a class exemption for IMOs based on the facts and representations provided in the individual exemption applications received by the Department. As discussed more fully below, the Department believes this is the most efficient way to provide relief to IMOs from the prohibited transaction rules of ERISA and the Code so long as they meet the protective conditions of the exemption that would safeguard the interests of affected plans, participants and beneficiaries, and IRA owners. Accordingly, the Department today is proposing a class exemption that would allow IMOs and associated independent insurance agents to continue to recommend fixed annuities in the Retirement Investor marketplace and receive commissions and other variable compensation.

## Background Regarding Fixed-Indexed Annuities and IMOs

### Fixed-Indexed Annuities (FIA) and Their Distribution Channel<sup>47</sup>

As discussed in detail in section 3.2 of the Regulatory Impact Analysis for the Regulation,<sup>[48]</sup> unlike fixed rate annuities where an insurer agrees to credit no less than a specified rate of interest during the time that the account value is growing, fixed-indexed annuities (FIAs) are annuity contracts whose return is based on the performance of a specified market index. Traditionally, common indexes used in FIAs are equity indexes such as the S&P 500 or Dow Jones Industrial Average. Although the S&P 500 is still the most often used index, various alternative indexes—including gold and a hybrid derived from one or more other indexes—have gained market share.<sup>[49]</sup>

Insurers generally guarantee FIA contract holders at least a zero return. However, the actual return on a FIA is not determined until the end of the crediting period and is based on the performance of the index or other external reference.

Similar to variable annuities, the returns of fixed-indexed annuities can vary widely, which results in a risk to investors. Furthermore, insurers generally reserve rights to change participation rates, interest caps, and fees, which can limit the investor's exposure to the upside of the market and effectively transfer investment risks from insurers to investors.

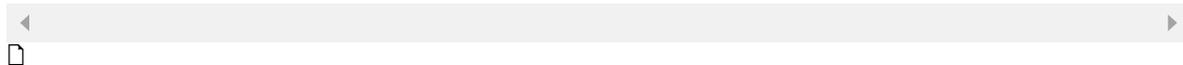
In 2015, FIA sales totaled a record high \$54.5 billion, which represents a 13% increase from sales of \$48.2 billion in 2014.<sup>[50]</sup> This upward trend in FIA sales continued in 2016. In the first-half of 2016, FIA sales increased by 32% to \$31.9 billion compared to the same period in 2015.<sup>[51]</sup> FIA sales are projected to exceed \$64 billion by the end of 2016 according to LIMRA Secure Retirement Institute.<sup>[52]</sup>

Table 1 shows the shares of FIA sales by distribution channel for 2008-2015. In 2015, approximately 63% of FIAs, \$34.1 billion, were sold through the independent agent distribution channel.<sup>[53]</sup> FIA sales through banks and broker-dealers (BDs) have been trending upward over time. In 2008, only 4% of FIAs were sold through banks and 2% were sold through independent BDs. By 2015, FIA sales by banks had steadily grown to 16% and sales by independent BDs had also grown to 12% of total FIA sales. In contrast, the share of FIA sales by independent agents has declined. For example, in 2008, 88% of FIAs were sold by independent agents; however by 2015 their share of FIA sales had decreased to 63%.

Table 1—Share of Fixed Indexed Annuity Sales by Distribution Channel (%) 2008-2015

	2008 (%)	2009 (%)	2010 (%)	2011 (%)	2012 (%)	2013 (%)	2014 (%)	2015 (%)
Independent Agents	88	84	85	86	81	77	66	63
Banks	4	7	7	6	9	13	14	16
Independent BD	2	3	2	2	3	5	13	12
Career Agents	6	6	6	5	6	4	5	6
Full Service National BD	0	0	0	0	1	1	2	3
Total	100	100	100	100	100	100	100	100

Source: LIMRA Individual Annuity Yearbook 2008-2015.



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## Role of IMOs in Distributing Insurance Products and Market Structure

As discussed earlier in this preamble, the main function of IMOs is to market, distribute and wholesale various insurance products.<sup>[54]</sup> This intermediary structure is appealing to both insurance carriers (insurers) and independent insurance producers (insurance agents) because it allows insurers to reduce their overhead costs while facilitating the sale of the products by independent insurance agents, as opposed to their captive insurance agent counterparts.<sup>[55]</sup>

There is no centralized database containing information identifying all existing IMOs in the U.S., because IMOs are licensed as insurance agents or agencies in each state where they operate. Therefore, it is difficult to reliably estimate how many IMOs currently exist in the U.S. Some evidence indicates that the number of IMOs could be in the hundreds,<sup>[56]</sup> or, more specifically, as many as 350.<sup>[57]</sup> Regardless of the total number, one industry observer reported that the top 20 IMOs conduct the lion's share of the business.<sup>[58]</sup> Many large IMOs, such as Annexus, Legacy Marketing Group and Market Synergy Group act as intermediaries between insurers and multiple small IMOs, and therefore, are referred to as Super-IMOs, or IMO aggregators. One media report additionally identifies M&O Marketing, InsurMark and Advisors Excel as other large IMOs.<sup>[59]</sup> In 2015, Annexus alone reported approximately \$4 billion in FIA sales representing approximately 7% of total FIA sales<sup>[60]</sup> and comprising a network of 17 IMOs. Legacy Marketing Group, Inc. contracted with approximately 200 IMOs, and actively conducts business with 50 to 60.<sup>[61]</sup> Market Synergy reported \$15 billion in fixed-indexed sales collectively and consisted of 11 sub-IMOs.<sup>[62]</sup> This information suggests that the IMO market has a complex hierarchical structure.

## Common Characteristics of IMO Individual Exemption Applicants <sup>63</sup>

As discussed earlier in this preamble, the Department has studied the characteristics of IMOs that applied for the individual exemptions. The applications indicate that most IMOs applicants have been in business for 25 to 40 years and operate in all 50 states. For example, one IMO applicant has over 600 offices across 50 states.<sup>[64]</sup> IMO applicants tend to be large: Almost all IMO applicants were identified as Super-IMOs or larger IMOs by industry trade press. Of those applicant IMOs that disclosed their sales information, all indicated sales of more than \$1.5 billion in 2015, and two IMOs reported FIA sales of from \$4-5 billion in 2015.<sup>[65]</sup> Other IMOs reported from \$2-3 billion of annual fixed annuity sales. These data suggest that IMO applicants generate FIA sales equivalent to the FIA sales of some insurance companies. In 2015, FIA sales of the top 10 FIA issuers by sales ranged from \$8.7 billion (Allianz Life of North America) to \$1.8 billion (Security Benefit Life).<sup>[66]</sup>

Most applicant IMOs partner with between 20 and 75 insurers. One IMO indicated that it conducts business with nine out of the top 10 insurers offering FIAs.<sup>[67]</sup> Many of the applicants state that they have direct contractual relationships with the majority of the insurers for whom they distribute fixed annuities. Frequently, these direct contractual relationships include recognition that the applicants are contractually responsible for the oversight of agents and sub-IMOs. This oversight is accomplished through applying the top-level IMO's use of its compliance structure and other business and administrative tools. The applicants use their compliance structure to directly oversee agents or they use those same tools to assist sub-IMOs in the distribution of fixed annuities and the oversight of their agents.

Sub-IMOs have contractual relationships with the insurers for whom they distribute fixed annuities, and they also have contractual relationships with top-level IMOs. Top-level IMOs generally provide their related sub-IMOs with distribution and other support services. Top-level IMOs often assist these sub-IMOs in accessing a wide variety of insurance products. Sub-IMOs contract with top-level IMOs to obtain this access, and these services allow some sub-IMOs to focus on the training and support of their agents.

Some applicants, in addition to describing themselves as top-level IMOs, also represented that they are affiliated with large insurers. One of these applicants, in turn, wholly owns numerous sub-IMOs. Despite the differences in the ownership structure, these applicants represent that they, like the other top-level IMOs, assist in the distribution of fixed annuities, both for their affiliates and for other insurers, and provide valuable business and administrative assistance to sub-IMOs and agents.

The number of smaller IMOs or sub-IMOs that larger IMOs conduct business with varies widely, but most applicant IMOs that disclosed this information in their applications state that they conduct business with between 7 and 35 sub-IMOs. Two IMO applicants indicate that they work with over 100 other IMOs.<sup>[68]</sup> However, not all affiliated sub-IMOs generate sales on a regular basis.<sup>[69]</sup> Several IMO applicants indicate that they work with approximately 2,000 to 4,000 agents and others report that they have approximately 120,000 to 200,000 affiliated agents nationwide. However, according to some IMO applicants, only approximately 20% to 30% of the large number of contracted agents generates sales through them on a regular basis.<sup>[70]</sup> These independent agents can work with multiple IMOs. However, two IMOs indicated that they work with an exclusive group of affiliated agents or employee agents that are selected after undergoing a rigorous screening process.<sup>[71]</sup> The applications indicate that most IMOs currently not maintaining exclusive business relationships with independent agents would require independent agents to exclusively process FIA sales through them if the proposed exemption were granted.

Several IMO applicants are affiliated with BDs and/or registered investment advisers (RIAs). Moreover, some of the IMOs that currently are not affiliated with BDs or RIAs reported that they are developing a BD,<sup>[72]</sup> or have a subsidiary that is in the process of becoming a RIA.<sup>[73]</sup> One IMO stated that it has partnered

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with nearly 20 BDs and provided extensive training and mentoring to registered representatives regarding selling FIAs.<sup>[74]</sup> Two IMOs also stated that they have an affiliated IT firm or proprietary technology platform that will help them comply with the exemption.

The applicants represented to the Department that they have experience in a variety of areas that will contribute to their ability to satisfy the conditions of the Best Interest Contract Exemption. Some applicants pointed to direct experience providing oversight of independent agents for insurance law compliance, while some indicated that they planned to rely on affiliated RIAs and/or BD entities in developing systems to comply with the exemption. The cost of developing a new compliance platform often represents a large share of total compliance costs. Thus, if an IMO does not have to develop a new system, it would save costs significantly for itself and the insurance industry as a whole would save significant costs if other IMOs were similarly positioned. In addition, IMOs with affiliated BDs and/or RIAs can draw from the supervisory experience of BDs and RIAs regarding properly training, monitoring, and not inappropriately incentivizing agents and even share personnel with them. They also can use disclosure forms similar to their affiliated BDs and/or RIAs.

The applicants generally indicated they would maintain internal compliance departments and adopt supervisory structures to ensure compliance with the exemption. Several applicants pointed to technology that would be used in ensuring compliance. Some applicants indicated that insurance agents would be required to use their technology to ensure clients receive disclosures and a contract, where required. Agents would also be required to use the IMO's Web site services and maintain records centrally.

Some applicants additionally described how their sales practices would ensure best interest recommendations. A number of the applicants specifically proposed to require centralized approval of agent recommendations; in some cases, the recommendations would be reviewed by salaried employees of the IMO with additional credentials, such as Certified Financial Planners. One applicant indicated that internal review would include a comparison of the proposed product to other similar fixed indexed annuity products available in the marketplace to ensure it is appropriate for the purchaser, and that the analysis would include utilizing third-party benchmarking services and industry comparisons. Another applicant indicated that it would ensure that a RIA representative would work with insurance-only agents when a recommendation would involve the liquidation of securities to ensure that both state and federal securities laws are properly followed.

Some applicants additionally stated that their contracts with insurance agents would include certain specific requirements, including: Adherence to the IMO's policies and procedures with respect to advertising, market conduct and point of sale processes, transparency and documentation; provision of advice in accordance with practices developed by the IMO; and agreement that the agents will not accept any direct or indirect compensation from an insurance company, except as specifically approved by the IMO. A number of the applicants indicated that they would perform background checks and rigorous selection processes before working with agents and would require agents to receive ongoing training regarding compliance with the exemption.

A few of the applicants addressed product selection. These applicants indicated that agents making recommendations pursuant to the exemption would be limited to certain products and insurance companies. The applicants indicated there would be ongoing due diligence with respect to insurance companies and product offerings under the exemption.

Based on information contained in the submitted applications, some qualified and willing IMOs might be able to perform compliance responsibilities more cost effectively than some insurance companies. Many IMO applicants indicate that they have affiliated BDs or RIAs, and these IMOs have several advantages in managing compliance costs: They can utilize compliance platforms already developed and implemented for BDs and/or RIAs with some necessary adjustments. This would allow large IMOs to save some large start-up fixed costs to develop a new system.

**The applications also indicate that some IMOs already have many of the capacities and much of the infrastructure in place that would be necessary to carry out compliance responsibilities required by the exemption, and thus might incur only relatively small, incremental costs to comply with the exemption conditions.**

The Department cautions that although its careful review of individual exemption applications reveals that many applicant IMOs share the common characteristics discussed above, the Department is uncertain regarding the extent to which these characteristics can be generalized to the overall IMO market. The Department welcomes comments regarding whether these common characteristics can be extrapolated to the broader IMO market  or whether they are distinctive and unique to the IMO applicants.

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## Impact of Proposed Class Exemption

As discussed earlier in this preamble, IMOs are not included within the Financial Institution definition under the Best Interest Contract Exemption. Instead, the exemption provides a mechanism under which the definition can be expanded if an individual exemption is granted to another type of entity. In that event, the individual exemption would provide relief to the applicants identified in the exemption, but the definition of Financial Institution in the Best Interest Contract Exemption would be expanded so that other entities that satisfy the definition in the individual exemption could rely on the Best Interest Contract Exemption. The Department received 22 applications for individual exemptions from IMOs that work with independent insurance agents to sell fixed annuity products. Because of the large number of applications, the Department determined to propose, on its own motion, a class exemption for such intermediaries based on the facts and representations in the individual applications received by the Department.

The following discussion assesses the impact of this class exemption relative to the baseline associated with the aforementioned provision of the Best Interest Contract Exemption. Under this baseline scenario, the Department would have granted individual exemptions to one of more of the applicants. The specific contours of this baseline are necessarily hypothetical, because at this time the Department has neither granted nor proposed any such individual exemptions. For purposes of this assessment, the Department assumes that any such individual exemptions would have included all of the same conditions included in this class exemption, and made available the same exemptive relief to the same market participants. This assumption is reasonable insofar as at this time the Department has not reached a tentative finding with respect to any particular applicant that an exemption with fewer or different conditions would be beneficial to IRA investors and protective of their rights as is required before the Department grants an exemption.

Given this assumption that the scope and conditions of this class exemption are substantively the same as those associated with the appropriate baseline, it follows that the impact of this class exemption relative to the baseline is likely to be limited to the procedural differences between the class and individual exemption procedures. With the exception of these procedural differences, under both the proposed class exemption and the baseline scenario, the same market participants would chiefly pursue the same courses of action and achieve the same results. However, notwithstanding the substantive equivalence of the proposed class

exemption and the baseline, it is possible that some market participants would perceive substantive differences, and make different decisions with different results. The Department invites comments these or any other potential substantive impact of this proposed class exemption relative to the baseline scenario.

This proposed class exemption would extend to IMOs that satisfy its conditions relief that is similar to that for Financial Institutions under the Best Interest Contract Exemption. The Department anticipates that, like the Best Interest Contract Exemption, this proposed exemption will deliver benefits that justify its costs.<sup>[75]</sup>

In issuing the Regulation and Best Interest Contract Exemption, the Department noted that compliance might be more burdensome for some industry segments than for others, that some insurers and some independent insurance agents might be among those needing to make more significant changes, and that this could impose some costs on affected Retirement Investors.

This proposed class exemption offers affected insurers, agents, and IMOs an alternative path to compliance that in some cases is likely to prove more economically efficient than existing paths. The applications that prompted this proposal support the premise that many IMOs have, or can affordably develop, the capacity to perform the functions required of Financial Institutions. In particular, some IMOs' positions as intermediaries between multiple insurers and multiple independent agents may be advantageous for purposes of mitigating agents' conflicts and ensuring that their recommendations are loyal to their customers' interests.

Under the proposed class exemption, market forces will favor migration of these functions to the entities that can perform them most efficiently. To the extent that IMOs take advantage of relief under this proposed exemption to shoulder these responsibilities, insurers may be relieved of what would have been greater costs to perform the same functions. This would improve the efficiency of the market in which insurers, independent agents, and IMOs operate. Meanwhile, the conditions of this exemption aim to ensure that, like Financial Institutions under the Best Interest Contract Exemption, covered IMOs can be relied on to perform their role effectively. If IMOs and related independent agents sell their services and FIAs in efficiently competitive intermediate and consumer markets, then such efficiency would accrue mostly to Retirement Investors.

The Department believes that the proposed class exemption will be more beneficial than would the individual exemption approach that is contemplated under the relevant provision of the Best Interest Contract Exemption. The Department believes that as a practical matter, the same rules could be established via either approach. That is, an individual exemption issued pursuant to the relevant provision of the Best Interest Contract Exemption could be crafted to make the intended relief available to any IMO that satisfied the same conditions as those included in this proposed class exemption. The Department believes, however, that the proposed class exemption offers the less costly route to the desired result. The cost advantage arises not from any difference in ongoing compliance costs, which generally would be the same. Rather the Department anticipates that the availability of the class exemption will obviate the need for some or all current and potential future applicants to pursue to completion an application for an individual exemption,<sup>[76]</sup> and any attendant net procedural cost savings (relative to the baseline) would constitute benefits of this proposed class exemption. The Department invites comments on these potential net cost savings. In addition, although substantively the same as the baseline, by providing a single class exemption this proposal potentially will provide greater simplicity and clearer consistency, and a more clearly even playing field, than multiple individual exemptions might. Finally, relative to one or more individual exemptions, a class exemption may encourage more IMOs to accelerate their efforts to  optimize their competitive market positions.

If the conditions of the exemption are satisfied, IMOs acting as Financial Institutions, and the independent agents and insurers they contract with, would be permitted to receive indirect and variable compensation in connection with recommendations of Fixed Annuity Contracts that would otherwise be prohibited as a result of the Regulation extending fiduciary status to many investment professionals who formerly were not treated as fiduciaries.<sup>[77]</sup> This would provide IMOs with flexibility to maintain their current business model in a cost-effective way, as was contemplated under the relevant provision of the Best Interest Contract Exemption. The applicants represent that the independent insurance agent model benefits consumers, because independent agents are able to offer a wider variety of products to satisfy consumers' goals. The class exemption would allow IMOs to serve as Financial Institutions, which will allow independent insurance agents to continue to recommend fixed annuities in the Retirement Investor marketplace under a single set of policies and procedures.

The Department expects that IMOs will determine whether to seek relief under this exemption's conditions based on their long-term strategic goals and will do so only if it makes economic sense. IMOs that choose not to use the exemption, or that are unable to satisfy the conditions, may still play a role in the fixed annuity distribution channel by providing valuable compliance assistance and other services to insurance companies or other insurance intermediaries who act as Financial Institutions under the Best Interest Contract Exemption, or this exemption if granted, and receive compensation for their services.

The proposed class exemption would require IMOs to structure compensation received for transactions involving Fixed Annuity Contracts in a way that mitigates conflicts of interests and does not improperly incentivize independent agents to sell one product over another.<sup>[78]</sup> Furthermore, it requires IMOs to satisfy some additional conditions that do not apply to Financial Institutions using the Best Interest Contract Exemption such as (i) conducting annual audits of financial statements, (ii) providing an annuity-specific disclosure to Retirement Investors, and (iii) obtaining fiduciary liability insurance coverage or setting aside sufficient reserves to cover potential liability exposure.<sup>[79]</sup>

The Department considered the alternative of issuing the proposed class exemption without imposing additional conditions to those contained in the Best Interest Contract Exemption, but chose to propose these additional conditions to ensure that transactions involving recommendations for Retirement Investors to purchase FIAs that are sold by independent agents through IMOs occur only when they are in their clients' best interest. These protections respond to the Department's concern that IMOs are not subject to well-established regulatory conditions and oversight like those that apply to Financial Institutions eligible to act as Financial Institutions under the Best Interest Contract Exemption and concerns expressed by the SEC, FINRA, and North American Securities Administrators Administration regarding how FIAs have been designed and marketed. The conditions would provide additional protection to consumers to ensure that Retirement Investors are adequately protected from the deleterious effects of conflicts of interest. However, these additional conditions will impose some compliance burden on IMOs relying on the exemption. Due to data limitations, the Department only was able to quantify the incremental costs associated with additional annuity disclosure. The Department discusses the impact of these additional conditions below.

*Obtain Fiduciary Liability Insurance or Set Aside Reserves:* One of the additional conditions requires IMOs to maintain fiduciary liability insurance, or cash, bonds, bank certificates of deposit, U.S. Treasury Obligations, or a combination of all of these, available to satisfy potential liability under ERISA or the Code as a result of this exemption. The aggregate amount of these items must equal at least 1% of the average annual amount of premium sales of Fixed Annuity Contract sales by the Financial Institution to Retirement Investors over the prior three fiscal years of the Financial Institution. For example, an IMO with average sales of \$2 billion could satisfy this condition by setting aside \$20 million. If valued at 7 percent (3 percent)

net, the attendant opportunity cost for such an IMO would amount to \$1.4 million (\$600,000) in the first year. The aggregate opportunity cost would be proportional to the total sales of all IMOs pursuing this course, assuming a uniform valuation rate.

To the extent this condition is satisfied by insurance, the proposal states that the insurance must apply solely to actions brought by the Department of Labor, the Department of Treasury, the Pension Benefit Guaranty Corporation, Retirement Investors or plan fiduciaries (or their representatives) relating to Fixed Annuity Contract transactions, including but not limited to actions for failure to comply with the exemption or any contract entered into pursuant to the exemption, and it may not contain an exclusion for Fixed Annuity Contracts sold pursuant to the exemption. Any such insurance also may not have a deductible that exceeds 5% of the policy limits nor exclude coverage based on a self-insured retention or otherwise specify an amount that the Financial Institution must pay before a claim is covered by the fiduciary liability policy. To the extent this condition is satisfied by retaining assets, the assets must be unencumbered and not subject to security interests or other creditors.

This condition provides IMOs with the flexibility to either obtain fiduciary liability insurance or set aside sufficient assets to satisfy potential liabilities. The Department expects that IMOs will choose the option that makes the best sense for them economically. If insurance markets are efficient and loss ratios are not very high, it is likely that insurance will be more attractive, unless an IMO faces particularly high fiduciary risks. In addition, an IMO with a more profitable best use for cash is more likely to find insurance more attractive than a cash set-aside. A number of the applicants specifically suggested that they would obtain insurance to cover □ potential liability under the exemption, although the approaches and suggested amounts varied. However, some applicants indicated uncertainty as to the current availability of insurance for liability under the exemption.

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An upper bound on the costs of this provision an estimate is obtained by looking at the costs of using the set-aside reserve option. As discussed above, in 2015, approximately \$34.1 billion in total sales FIAs were sold through the independent agent distribution channel. If all sales in the independent agent distribution channel were through an IMO utilizing the exemption then one percent, or \$341 million, would have to be set aside as a reserve. The opportunity costs of this reserve using a return of 7 percent (3 percent) would be \$23.9 million (\$10.2 million) for one year. There are at least three reasons why this estimate is too high: not all sales through the independent agent channel would be made using this exemption, the estimate of the total sales includes not just FIAs sold to IRAs, but all FIA sales, and to the extent the insurance option is cheaper IMOs will use that less expensive option and costs will be lower.<sup>[80]</sup> The Department invites comments on these cost estimates.

This condition requiring IMOs to set aside cash or maintain insurance is likely to yield benefits for consumers. Set asides or insurance premiums that are paid out to compensate consumers for losses arising from fiduciary breaches will represent one, direct such benefit. In addition, the condition may deter fiduciary breaches. Some applicants indicated that they may pass on expenses attributable to this condition to advisers, particularly to advisers whose records or observed conduct indicate high fiduciary risk, or may step up efforts to screen advisers and end relationships with those deemed most risky. These steps by IMOs in turn could reinforce advisers' motivation to maintain high fiduciary standards.

The Department considered an alternative of requiring a fixed minimum amount of fiduciary liability insurance to be purchased and requiring individual Advisers to carry the insurance themselves. The Department, however, chose the alternative of basing the insurance coverage or reserve requirement on

premiums, because it views this method as the most efficient way to ensure that Financial Institutions have sufficient financial resources to satisfy any potential liabilities. The Department solicited comments on this approach and potential alternatives to the Department's chosen alternative earlier in this preamble.

*Audited Financial Statements:* In order to confirm that the IMO has sound business practices, the Department chose the alternative of requiring IMOs to have financial statements that are audited annually by an independent certified public accountant. In addition, the audited financial statements must be available on the IMO's Web site. The cost of such audits will depend on the degree to which IMOs currently maintain detailed, audit-ready records, and the extent and complexity of IMOs operations and records. The Department invites comments on these costs.

The Department understands that insurance companies submit their financial statements on a quarterly basis to the NAIC, which collects these data on behalf of state insurance commissioners.<sup>[81]</sup> Unlike insurance companies; however, IMOs are generally not required to submit their financial statements to any regulatory authority. The Department does not believe IMOs will incur prohibitive costs to comply with the provision, because the condition was suggested by several applicants seeking individual exemptions. Some applicants indicated that periodic financial audits would provide reasonable assurance of the entity's financial health. The Department expects that requiring IMOs to conduct an annual audit of their financial statements, coupled with its disclosure on the Web site, will provide an opportunity for the Department and other interested persons to be alerted to any financial weaknesses or other items of concern with respect to the stability or solvency of the Financial Institution, or its ability to stand behind its commitments to Retirement Investors.

As an alternative to an audit of financial statements, one applicant suggested that the audit should relate to the intermediary's internal controls and procedures. The applicant noted that banks and trust companies are currently required to obtain these reports under SSAE 16 (formerly SAS 70), and that the applicant could work with its auditors to prepare a similar report, but suggested that such an approach would require additional transition relief as the accounting industry would have to agree on the appropriate data points for an internal controls audit for an insurance intermediary and the resulting topics of the SSAE 16-like report. The Department did not propose this alternative, because there are no clear standards for such a compliance-based audit, and the Department believes it is most critical for financial statements to be audited to ensure that the financial viability of the IMO and its ability to meet its commitment to Retirement Investors can be determined and assessed.

*Mitigate Adverse Incentives:* Proposed Section II(d)(3) specifically addresses incentives to Advisers, and provides that the Financial Institution's policies and procedures would be required to prohibit the use of quotas, appraisals, or performance or personnel actions, bonuses, contests, special awards, differential compensation, or other actions or incentives if they are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the best interest of the Retirement Investor. The condition applies regardless of the source of the incentive. Moreover, the Department understands that some independent agents work with more than one intermediary. As noted above, the IMO applicants indicated that they have the capability to mitigate the incentives with respect to multiple insurance companies. The Department views this as a critical safeguard of this proposed exemption. The proposed condition is intended to ensure that an Adviser's relationship with multiple insurance companies (or multiple insurance intermediaries) does not generate compensation or incentive structures that undermine the Adviser's provision of advice that is in Retirement Investors' best interest.

Proposed Section II(d)(3) does not specify the precise manner by which a Financial Institution must comply with the condition. The Department considered the alternative of requiring Financial Institutions to make their relationships with their Advisers exclusive with respect to the sale of Fixed Annuity Contracts to Retirement Investors. However, in order to provide maximum flexibility the Department chose not to require exclusivity in the proposal. Accordingly, a Financial Institution may take the alternative approach of contractually requiring an Adviser to provide information to the Financial Institution regarding all of the compensation and incentives provided by all of the other insurance companies and intermediaries through which the Adviser sells Fixed Annuity Contracts in which case the Financial Institution ultimately would be responsible for implementing the policies and procedures to mitigate adverse incentives across all of the Advisers' incentive arrangements.

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*Annuity Specific Disclosure:* Section III(a) of the proposed class exemption requires an annuity-specific disclosure in connection with recommendations of all Fixed Annuity Contracts. As stated, the disclosure applies to all Fixed Annuity Contracts; however, the elements of the disclosure are required to be made only to the extent applicable.

The objective of this disclosure is to ensure that Retirement Investors are informed of the risks and features of annuity products prior to entering into the annuity contract. While the information required to be disclosed could be available in the annuity contract or other document, the Department chose this alternative because it believes that the consumer will be better able to make an informed choice regarding whether to invest in the product if the features of the annuity contract are specifically highlighted in advance of the purchase in a separate, stand-alone written document. This disclosure would be required prior to the transmittal of the annuity application to the insurance company and would have to be made in connection with any recommendations to make additional deposits into the contract. The Department understands that in some cases, insurance companies currently provide an advance disclosure document, often referred to as a "statement of understanding." This condition of the exemption would be satisfied if the required information is provided in a statement of understanding or similar document in accordance with the applicable time frames specified in the condition. The Department provides an estimate regarding the costs associated with the annuity-specific disclosure in the "Paperwork Reduction Act" section below.

*Premium Threshold:* Finally, the proposed exemption would require IMOs to have transacted annual fixed annuity sales averaging at least \$1.5 billion in premiums over each of the three prior fiscal years. As discussed above, this threshold equates approximately to the sales of the top 20 insurance companies. Relative to the top insurers, in 2014, an IMO with \$1.5 billion sales in fixed annuities would have been 18th in sales, whereas in 2015, it would have been slightly below the top 20 in fixed annuity sales.

The Department chose the alternative of imposing this condition, to ensure that IMOs using the exemption are well-established entities possessing the financial stability and operational capacity to implement the anti-conflict policies and procedures required by the exemption. This proposed condition aims to ensure that the IMO is in the position to mitigate compensation incentives across products, which is a critical safeguard of the proposed exemption.

The proposed \$1.5 billion threshold was based on the representations in the applications. Not all applicants provided this information, but the applicants that did generally indicated sales of this amount or more. In addition, almost all IMOs that applied for individual exemptions are identified in media reports as large IMOs or super-IMOs. Some IMO applicants reported \$4 billion to \$5 billion in FIA sales alone in 2015.<sup>[82]</sup> Putting this into context, these sales are higher than FIA sales of all but 2 insurance companies.<sup>[83]</sup> In 2015, the insurance company that ranked 2nd in FIA sales reported \$6.8 billion, while the insurance company

ranked 3rd reported \$3.7 billion in FIA sales.<sup>[84]</sup> Other IMO applicants reported more than \$2 billion in FIA sales in 2015.<sup>[85]</sup> This suggests that four IMOs seeking exemptions generated approximately 42% of FIA sales through the independent agent channel in 2015.<sup>[86]</sup>

The Department believes that this dollar threshold covers IMOs most likely to make beneficial use of the exemption, because economies of scale are likely to yield advantages in efficiently carrying out compliance responsibilities. The largest share of compliance costs often is up-front fixed costs incurred to construct a compliance infrastructure. As the IMO gets larger, the burden of fixed costs can be spread out more widely.

Because the sales threshold is based on a three-year average, some year-to-year volatility in sales would not cause IMOs to lose their eligibility for the exemption. Smoothing sales over three years provides IMOs with the degree of certainty and continuity that are necessary for IMOs to justify up-front expenditures to update compliance systems. However, if an exempted IMO falls slightly below this threshold, it may look for a way to boost sales volume, such as by acquiring another IMO or recruiting highly productive independent agents. Thus, in certain situations, this condition may accelerate mergers and acquisitions among IMOs. One applicant has reported that it already acquired three IMOs.<sup>[87]</sup> All of these additional conditions are designed to protect the interest of consumers who purchase annuity products through the IMO distribution channel.

These additional conditions could impose additional burdens on IMOs seeking exemptive relief that are not incurred by Financial Institutions seeking relief under the Best Interest Contract Exemption. However, with the exception of the annuity-specific disclosure, the Department does not have sufficient data to quantify the incremental costs associated with these conditions. Instead, the Department solicits public comments regarding costs related to the additional conditions set forth in the proposed class exemption.

## Uncertainty

While the Department received 22 individual exemption applications from IMOs, it is uncertain regarding how many applicants and/or other IMOs would use the proposed class exemption, if it is granted. The Department also is uncertain about the extent to which covered IMOs' compliance burdens, including burdens attributable to the additional conditions not required of Financial Institutions under the Best Interest Contract Exemption, would be less than the reduction in burden that otherwise would be shouldered by insurers acting as Financial Institutions. The Department invites comments regarding the uncertainties discussed above.

## Paperwork Reduction Act

As part of its continuing effort to reduce paperwork and respondent burden, the Department conducts a preclearance consultation program to provide the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506 ([\(https://api.fdsys.gov/link?collection=uscode&title=44&year=mostrecent&section=3506&type=usc&link-type=html\)](https://api.fdsys.gov/link?collection=uscode&title=44&year=mostrecent&section=3506&type=usc&link-type=html))(c)(2)(A)). This helps to ensure that the public understands the Department's collection instructions, respondents can provide the requested data in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the Department can properly assess the impact of collection requirements on respondents.

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Currently, the Department is soliciting comments concerning the proposed information collection request (ICR) included in the Proposed Best Interest Contract Exemption for Insurance Intermediaries (PTE). A copy of the ICR may be obtained by contacting the PRA addressee shown below or at

<http://www.RegInfo.gov> (<http://www.RegInfo.gov>).

The Department has submitted a copy of the proposed PTE to the Office of Management and Budget (OMB) in accordance with 44 U.S.C. 3507 (<https://api.fdsys.gov/link?collection=uscode&title=44&year=mostrecent&section=3507&type=usc&link-type=html>)(d) for review of its information collections. The Department and OMB are particularly interested in comments that:

- Evaluate whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency's estimate of the burden of the collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, *e.g.*, permitting electronic submission of responses.

Comments should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503; Attention: Desk Officer for the Employee Benefits Security Administration. OMB requests that comments be received within 30 days of publication of the proposed PTE to ensure their consideration.

*PRA Addressee:* Address requests for copies of the ICR to G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW., Room N-5718, Washington, DC 20210. Telephone (202) 693-8410; Fax: (202) 219-5333. These are not toll-free numbers. ICRs submitted to OMB also are available at <http://www.RegInfo.gov> (<http://www.RegInfo.gov>).

As discussed in detail below, the proposed class exemption will require Financial Institutions to enter into a contractual arrangement with Retirement Investors regarding investments in IRAs and plans not subject to Title I of ERISA (non-ERISA plans), adopt written policies and procedures and make disclosures to Retirement Investors (including with respect to ERISA plans), the Department, and on a publicly accessible Web site, in order to receive relief from ERISA's and the Code's prohibited transaction rules for the receipt of compensation as a result of a Financial Institution's and its Adviser's advice (*i.e.*, prohibited compensation). Financial Institutions will have to prepare a written documentation regarding the limitations that they place on recommendations. Financial Institutions will be required to have all transactions reviewed internally by a senior compliance official and maintain records necessary to prove that the conditions of the exemption have been met. In addition, the exemption provides a transition period from the Applicability Date to August 15, 2018. As a condition of relief during the transition period, Financial Institutions must make a disclosure (transition disclosure) to all Retirement Investors (in ERISA plans, IRAs, and non-ERISA plans) prior to or at the same time as the execution of recommended transactions. These requirements are ICRs subject to the Paperwork Reduction Act.

The Department has made the following assumptions in order to establish a reasonable estimate of the paperwork burden associated with these ICRs:

- 51.8 percent of disclosures to ERISA plans and plan participants<sup>[88]</sup> and 44.1 percent of contracts with and disclosures to IRAs and non-ERISA plans<sup>[89]</sup> will be distributed electronically via means already used by respondents in the normal course of business and the costs arising from electronic distribution will be negligible, while the remaining contracts and disclosures will be distributed on paper and mailed at a cost of \$0.05 per page for materials and \$0.47 for first class postage;

- Financial Institutions will use existing in-house resources to distribute required disclosures.
- Tasks associated with the ICRs performed by in-house personnel will be performed by clerical personnel at an hourly wage rate of \$54.74 and financial managers at an hourly wage rate of \$167.39.<sup>[90]</sup>
- Financial Institutions will hire outside service providers to assist with nearly all other compliance costs;
- Outsourced legal assistance will be billed at an hourly rate of \$335.00.<sup>[91]</sup>
- Approximately 19 large insurance intermediary Financial Institutions will use this exemption.<sup>[92]</sup> These Financial

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Institutions will use this exemption in conjunction with any transactions involving recommendations regarding the purchase or sale of fixed annuity contracts in the retirement market.

### **Compliance Costs Substantially Similar to Those in PTE 2016-01**

The Department believes that nearly all Financial Institutions will contract with outside service providers to implement the various compliance requirements of this exemption. As discussed previously, the conditions in this proposed PTE are similar to the conditions in the Department's Best Interest Contract Exemption (PTE 2016-01) but with some additional requirements. The Department believes it accurately estimated the aggregate burden imposed on the insurance industry in the Best Interest Contract Exemption, and it acknowledges that most of the entity-level burden attributed to insurance companies in the Best Interest Contract Exemption will instead be incurred by IMOs covered by this proposed PTE. For the conditions that are substantially similar between this PTE and PTE 2016-01, the Department estimates that IMOs will incur compliance costs identical to similarly sized insurance companies. Accordingly, for the conditions in this PTE that are substantially similar to those in PTE 2016-01, the per-firm costs are as follows:

- *Start-Up Costs for Large Insurance Intermediaries:* \$6.6 million
- *Ongoing Costs for Large Insurance Intermediaries:* \$1.7 million

In order to receive compensation covered under this exemption, Section II requires Financial Institutions to acknowledge, in writing, their fiduciary status and adopt written policies and procedures designed to ensure compliance with the Impartial Conduct Standards. Financial Institutions and Advisers must make certain disclosures to Retirement Investors. Financial Institutions must generally enter into a written contract with Retirement Investors with respect to investments in IRAs and non-ERISA plans with certain required provisions, including affirmative agreement to adhere to the Impartial Conduct Standards.

Sections III and V require Financial Institutions and Advisers to make certain disclosures. These disclosures include: (1) A pre-transaction disclosure, stating the best interest standard of care, describing any Material Conflicts of Interest with respect to the transaction, disclosing the recommendation of proprietary products and products that generate third party payments (where applicable), and informing the Retirement Investor of disclosures available on the Financial Institution's Web site and informing the Retirement Investor that the investor may receive specific disclosure of the costs, fees, and other compensation associated with the transaction; (2) a disclosure, on request, describing in detail the costs, fees, and other compensation associated with the transaction; (3) a web-based disclosure; and (4) a one-time disclosure to the Department.

Under Section IV, Financial Institutions will have to prepare a written documentation regarding the limitations they place on recommendations.

Section IX requires Financial Institutions to make a transition disclosure, acknowledging their fiduciary status and that of their Advisers with respect to the advice, stating the Best Interest standard of care, and describing the Financial Institution's Material Conflicts of Interest and any limitations on product offerings, prior to or at the same time as the execution of any transactions during the transition period from the Applicability Date to August 15, 2018. The transition disclosure can cover multiple transactions, or all transactions occurring in the transition period.

Financial Institutions will also be required to maintain records necessary to prove that the conditions of the exemption have been met.

The Department is able to disaggregate an estimate of many of the legal costs from the costs above; however, it is unable to disaggregate any of the other costs.

In response to a recommendation made during the Department's August 2015 public hearing on the proposed Regulation, and in an attempt to create estimates with a clearer empirical evidentiary basis, the Department itself drafted examples of certain portions of the required disclosures, including a sample contract, the one-time disclosure to the Department, and the transition disclosure. The Department believes that the time spent updating existing contracts and disclosures in future years would be no longer than the time necessary to create the original disclosure. The Department did not attempt to draft the complete set of required disclosures because it expects that the amount of time necessary to draft such disclosures will vary greatly among firms. For example the Department did not attempt to draft sample policies and procedures, disclosures describing in detail the costs, fees, and other compensation associated with the transaction, documentation of the limitations regarding proprietary products or investments that generate third party payments, or a sample web disclosure. The Department expects the amount of time necessary to complete these disclosures will vary significantly based on a variety of factors including the nature of a firm's compensation structure, and the extent to which a firm's policies and procedures require review and signatures by different individuals.

Considered in conjunction with the estimates provided in the proposal for PTE 2016-01, the Department estimates that outsourced legal assistance to draft standard contracts, contract disclosures, pre-transaction disclosures, the one-time disclosure to the Department, and the transition disclosures will cost an average of \$3,857 per firm for a total of \$73,000 during the first year. In subsequent years, it will cost an average of \$3,076 per firm for a total of \$58,000 annually to update the contracts, contract disclosures, and pre-transaction disclosures.

The legal costs of these disclosures were disaggregated from the total compliance costs because these disclosures are expected to be relatively uniform. Although the tested disclosures generally took less time than many of the commenters on the proposal for PTE 2016-01 said they would, the Department acknowledges that the disclosures that were not tested are those that are expected to be the most time consuming. Importantly, as explained in greater detail in section 5.3 of the regulatory impact analysis for the Regulation, the Department is primarily relying on cost data provided by the Securities Industry and Financial Markets Association (SIFMA) and the Financial Services Institute (FSI) to calculate the total cost of the legal disclosures, rather than its own internal drafting of disclosures. Accordingly, in the event that any of the Department's estimates understate the time necessary to create and update the disclosures, it does not impact the total burden estimates. The total burden estimates were derived from SIFMA and FSI's all-inclusive costs. Therefore, in the event that legal costs are understated, other  cost estimates in this analysis would be overstated in an equal manner.

In addition to legal costs for creating the contracts and disclosures, the start-up cost estimates include the costs of implementing and updating the IT infrastructure, creating the Web disclosures, gathering and maintaining the records necessary to produce the various disclosures and to prove that the conditions of the exemption have been met, developing policies and procedures, documenting limitations regarding proprietary products or investments that generate third party payments, addressing material conflicts of interest, monitoring Advisers' adherence to the Impartial Conduct Standards, and any other steps necessary to ensure compliance with the conditions of the exemption not described elsewhere. In addition to legal costs for updating the contracts and disclosures, the ongoing cost estimates include the costs of updating the IT infrastructure, updating the Web disclosures, reviewing processes for gathering and maintaining the records necessary to produce the various disclosures and to prove that the conditions of the exemption have been met, reviewing the policies and procedures, producing the detailed transaction disclosures on request, documenting limitations regarding proprietary products or investments that generate third party payments, monitoring investments as agreed upon with the Retirement Investor, addressing material conflicts of interest, monitoring Advisers' adherence to the Impartial Conduct Standards, and any other steps necessary to ensure compliance with the conditions of the exemption not described elsewhere. These costs total \$126.1 million during the first year and \$31.4 million in subsequent years. These costs do not include the costs of distributing disclosures and contracts, nor do they include the costs of the additional requirements imposed on insurance intermediary Financial Institutions in this proposed PTE, all of which are discussed below.

### **Distribution of Disclosures and Contracts**

The Department estimates that 15,000 Retirement Investors through ERISA plans and 212,000 Retirement Investors through IRAs and non-ERISA plans will receive a three-page transition disclosure during the first year.<sup>[93]</sup>

**Additionally, 15,000 Retirement Investors with respect to ERISA plans will receive a fifteen-page contract disclosure, and 212,000 Retirement Investors with respect to IRAs and non-ERISA plans will receive a fifteen-page contract during the first year.** In subsequent years, 4,300 Retirement Investors with respect to ERISA plans<sup>[94]</sup> will receive a fifteen-page contract disclosure and 42,000 Retirement Investors with respect to IRAs and non-ERISA plans<sup>[95]</sup> will receive a fifteen-page contract.

The transition disclosure will be distributed electronically to 51.8 percent of ERISA plan investors and 44.1 percent of IRAs and non-ERISA plan investors during the first year. Paper disclosures will be mailed to the remaining 48.2 percent of ERISA plan investors and 55.9 percent of IRAs and non-ERISA plan investors. The contract disclosure will be distributed electronically to 51.8 percent of ERISA plan investors during the first year or during any subsequent year in which the plan begins a new advisory relationship. Paper contract disclosures will be mailed to the remaining 48.2 percent of ERISA plan investors. The contract will be distributed electronically to 44.1 percent of IRAs and non-ERISA plan investors during the first year or during any subsequent year in which the investor enters into a new advisory relationship. Paper contracts will be mailed to the remaining 55.9 percent of IRAs and non-ERISA plan investors. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately \$232,000 during the first year and \$31,000 during subsequent years. Paper distribution will also require two minutes of clerical time to print and mail the disclosure or contract, resulting in 8,400 hours at an equivalent cost of \$459,000 during the first year and 900 hours at an equivalent cost of \$47,000 during subsequent years.

The Department assumes that Retirement Investors interested in engaging in the purchase or sale of fixed indexed annuities will engage in one transaction per year that requires a pre-transaction disclosure. Therefore, the Department estimates that plans and IRAs will receive 227,000 three-page pre-transaction disclosures during the second year and all subsequent years. The pre-transaction disclosures will be distributed electronically for 51.8 percent of the ERISA plan investors and 44.1 percent of the IRA holders and non-ERISA plan participants. The remaining 126,000 disclosures will be mailed. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately \$78,000. Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 4,200 hours at an equivalent cost of \$230,000 annually.

The Department estimates that Financial Institutions will receive ten requests per year for more detailed information on the fees, costs, and compensation associated with the transaction during the second year and all subsequent years. The Department solicits comments on the number of requests for more detailed information that Financial Institutions can expect to receive. The detailed disclosures will be distributed electronically for 51.8 percent of the ERISA plan investors and 44.1 percent of the IRA holders and non-ERISA plan participants. The Department believes that requests for additional information will be proportionally likely with each Retirement Investor type. Therefore, approximately 105 detailed disclosures will be distributed on paper. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately \$76. Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 4 hours at an equivalent cost of \$192 annually.

Finally, the Department estimates that all 19 Financial Institutions will submit the required one-page disclosure to the Department electronically at de minimis cost during the first year.

### **Costs for Provisions Not Included in PTE 2016-01**

In order to receive compensation covered under this proposed exemption, Section II(d)(5) requires a person designated pursuant to Section II(d)(2) as responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to Impartial Conduct Standards to approve, in writing, recommended annuity applications involving Retirement Investors prior to transmitting the applications to the insurance company. Section III(a) requires the Financial Institution to furnish the Retirement Investor with a pre-transaction disclosure in accordance with the most recent Annuity Disclosure Model Regulation published by the NAIC or its successor. Section VIII(e)(2) requires a Financial Institution to have financial statements that are audited annually by an Independent certified public accountant.

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As discussed previously in this analysis, the Department estimates that Advisers working on behalf of Financial Institutions will make 227,000 recommendations to Retirement Investors annually. The Department estimates that, on average, it will take a financial manager fifteen minutes to review and approve recommendations. This results in 57,000 hours annually at an equivalent cost of \$9.5 million.

The Department assumes that each of the 19 Financial Institutions will hire outside service providers to create a template for the pre-transaction annuity disclosure. The Department estimates that it will take legal service providers 1.5 hours to create the template during the first year and 1.5 hours to update the template during subsequent years. Once the template has been created, the disclosure itself will be populated by the IT systems (the costs of IT updates were discussed previously). The total cost burden for the outsourced legal assistance to create and update the template for the pre-transaction annuity disclosure is estimated to be \$10,000 annually.

The Department estimates that plans and IRAs will receive 227,000 one page pre-transaction annuity disclosures annually. The pre-transaction disclosures will be distributed electronically for 51.8 percent of the ERISA plan investors and 44.1 percent of the IRA holders and non-ERISA plan participants. The remaining 126,000 disclosures will be mailed. The Department estimates that electronic distribution will result in de minimis cost, while paper distribution will cost approximately \$65,000. Paper distribution will also require two minutes of clerical time to print and mail the statement, resulting in 4,200 hours at an equivalent cost of \$230,000 annually.

The Department assumes that maintaining financial statements that are audited annually by an Independent certified public accountant is a best practice for businesses in this industry and that Financial Institutions generally engage in this practice. Therefore, no additional burden is assessed for this requirement. The Department solicits comment on how widespread the practice of obtaining annual audits is. In the event that it is not a usual and customary business practice, the Department solicits comments regarding the costs associated with this requirement.

### **Overall Summary**

Overall, the Department estimates that in order to meet the conditions of this class exemption, Financial Institutions and Advisers will distribute approximately 681,000 disclosures and contracts during the first year and 501,000 disclosures and contracts annually during subsequent years. Distributing these disclosures and contracts, reviewing recommendations, and maintaining records that the conditions of the exemption have been fulfilled will result in a total of 69,000 hours of burden during the first year and 66,000 hours of burden annually during subsequent years. The equivalent cost of this burden is \$10.2 million during the first year and \$10.0 million annually in subsequent years. This exemption will result in an outsourced labor, materials, and postage cost burden of \$126.4 million during the first year and \$31.6 million annually during subsequent years.

These paperwork burden estimates are summarized as follows:

*Type of Review:* New collection.

*Agency:* Employee Benefits Security Administration, Department of Labor.

*Title:* Proposed Best Interest Contract Exemption for Insurance Intermediaries.

*OMB Control Number:* 1210-NEW.

*Affected Public:* Businesses or other for-profits; not for profit institutions.

*Estimated Number of Respondents:* 19.

*Estimated Number of Annual Responses:* 681,449 during the first year and 501,199 annually during subsequent years.

*Frequency of Response:* When engaging in exempted transaction.

*Estimated Total Annual Burden Hours:* 69,369 during the first year and 66,037 annually in subsequent years; includes 8,389 during the first year and 5,057 annually in subsequent years of duplicative burden that will be transferred over from OMB Control Number 1210-0156 upon approval of this information collection

request.

*Estimated Total Annual Burden Cost:* \$126,369,454 during the first year and \$31,617,550 annually during subsequent years; includes \$126,294,476 during the first year and \$31,542,571 annually in subsequent years of duplicative burden that will be transferred over from OMB Control Number 1210-0156 upon approval of this information collection request.

## Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 (<https://api.fdsys.gov/link?collection=uscode&title=5&year=mostrecent&section=601&type=usc&link-type=html>) *et seq.*) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 (<https://api.fdsys.gov/link?collection=uscode&title=5&year=mostrecent&section=551&type=usc&link-type=html>) *et seq.*) and which are likely to have a significant economic impact on a substantial number of small entities. Unless an agency certifies that a rule will not have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires the agency to present an initial regulatory flexibility analysis at the time of the publication of the notice of proposed rulemaking describing the impact of the rule on small entities. Small entities include small businesses, organizations and governmental jurisdictions.

As discussed above, only IMOs that have transacted sales averaging at least \$1.5 billion in premiums per fiscal year over its prior three fiscal years are eligible to use the proposed exemption. The Small Business Administration (SBA) defines a small business in the Financial Investments and Related Activities Sector as a business with up to \$38.5 million in annual receipts. Although the Department believes that revenues of IMOs are closely related to sales volume, the Department is uncertain regarding the exact relationship between sales and revenue for these entities.

Based on the limited information disclosed by the individual exemptions applicants, the Department believes that receipts of IMOs that are eligible to use proposed class exemption are likely to exceed the SBA revenue threshold and, therefore, such entities are unlikely to be considered small entities for purposes of the RFA. <sup>[96]</sup> Small IMOs not meeting the sales threshold would not incur any compliance costs, because they are not eligible to use the exemption. These IMOs could partner with larger IMOs using the proposed exemption insurers using the Best Interest Contract Exemption in order to conduct commission-based sales.

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Accordingly, based on the foregoing, pursuant to section 605(b) of the RFA, the Assistant Secretary of the Employee Benefits Security Administration hereby proposes to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities.

## Congressional Review Act

The proposed exemption is subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 (<https://api.fdsys.gov/link?collection=uscode&title=5&year=mostrecent&section=801&type=usc&link-type=html>) *et seq.*) and, if finalized, will be transmitted to Congress and the Comptroller General for review. The proposed exemption is a “major rule” as that term is defined in 5 U.S.C. 804 (<https://api.fdsys.gov/link?collection=uscode&title=5&year=mostrecent&section=804&type=usc&link-type=html>), because it is likely to result in (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers, individual industries, or Federal, State, or local government agencies, or geographic

regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets.

## **Federalism Statement**

Executive Order 13132 (/executive-order/13132) outlines fundamental principles of federalism. It also requires adherence to specific criteria by federal agencies in formulating and implementing policies that have “substantial direct effects” on the states, the relationship between the national government and states, or on the distribution of power and responsibilities among the various levels of government. Federal agencies promulgating regulations that have these federalism implications must consult with state and local officials, and describe the extent of their consultation and the nature of the concerns of state and local officials in the preamble to the final regulation. The Department does not believe this proposed class exemption has federalism implications because it has no substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.

## **General Information**

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under ERISA section 408(a) and Code section 4975(c)(2) does not relieve a fiduciary, or other party in interest or disqualified person with respect to a plan, from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of ERISA section 404 which require, among other things, that a fiduciary act prudently and discharge his or her duties respecting the plan solely in the interests of the participants and beneficiaries of the plan. Additionally, the fact that a transaction is the subject of an exemption does not affect the requirement of Code section 401(a) that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) Before the exemption may be granted under ERISA section 408(a) and Code section 4975(c)(2), the Department must find that the exemption is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of the plan and IRA owners;

(3) If granted, the proposed exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the exemption; and

(4) The proposed exemption, if granted, is supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

## **Proposed Exemption**

### **Section I—Best Interest Contract Exemption for Insurance Intermediaries**

(a) In general, ERISA and the Internal Revenue Code prohibit fiduciary advisers to employee benefit plans (Plans) and individual retirement accounts (IRAs) from receiving compensation that varies based on their investment advice. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. This exemption permits certain persons who provide investment advice to Retirement Investors, and associated Financial Institutions, Affiliates and other Related Entities, to receive such otherwise prohibited compensation as described below.

**(b) Covered transactions. This exemption permits Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive compensation as a result of their provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) to a Retirement Investor regarding the purchase of a Fixed Annuity Contract, as defined in Section VIII(d).**

As defined in Section VIII(m) of the exemption, a Retirement Investor is: (1) A participant or beneficiary of a Plan with authority to direct the investment of assets in his or her Plan account or to take a distribution; (2) the beneficial owner of an IRA acting on behalf of the IRA; or (3) a Retail Fiduciary with respect to a Plan or IRA.

**As detailed below, Financial Institutions and Advisers seeking to rely on the exemption must adhere to Impartial Conduct Standards in rendering advice regarding Fixed Annuity Contracts. In addition, Financial Institutions must adopt policies and procedures designed to ensure that their individual Advisers adhere to the Impartial Conduct Standards; disclose important information relating to fees, compensation, and Material Conflicts of Interest; and retain records demonstrating compliance with the exemption.** The exemption provides relief from the restrictions of ERISA section 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(D), (E) and (F). The Adviser and Financial Institution must comply with the applicable conditions of Sections II-V to rely on this exemption. This document also contains separate exemptions in Section VI (Exemption for Purchases of Fixed Annuity Contracts) and Section VII (Exemption for Pre-Existing Transactions).

(c) Exclusions. This exemption does not apply if:

(1) The Plan is covered by Title I of ERISA, and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser or Financial Institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the Plan, or an affiliate thereof, that was selected to provide advice to the Plan by a fiduciary who is not Independent;

(2) The compensation is received as a result of investment advice to a Retirement Investor generated solely by an interactive Web site in which computer software-based models or applications provide investment advice based on personal information each investor supplies through the Web site without any personal interaction or advice from an individual Adviser (*i.e.*, “robo-advice”); or

**(3) The Adviser has or exercises any discretionary authority or discretionary control with respect to the recommended transaction.**

## Section II—Contract, Impartial Conduct, and Other Requirements

The conditions set forth in this section include certain Impartial Conduct Standards, such as a Best Interest Standard, that Advisers and Financial Institutions must satisfy to rely on the exemption. **In addition, Section II(d) and (e) require Financial Institutions to adopt anti-conflict policies and procedures that are reasonably designed to ensure that Advisers adhere to the Impartial Conduct Standards, and requires disclosure of**

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important information about the Financial Institutions' services, applicable fees and compensation. With respect to IRAs and Plans not covered by Title I of ERISA, the Financial Institutions must agree that they and their Advisers will adhere to the exemption's standards in a written contract that is enforceable by the Retirement Investors. To minimize compliance burdens, the exemption provides that the contract terms may be incorporated into annuity contracts or applications, and permits reliance on a negative consent process with respect to existing contract holders. Advisers and Financial Institutions need not execute the contract before they make a recommendation to the Retirement Investor. However, the contract must cover any advice given prior to the contract date in order for the exemption to apply to such advice. There is no contract requirement for recommendations to Retirement Investors about investments in Plans covered by Title I of ERISA, but the Impartial Conduct Standards and other requirements of Section II(b)-(e), including a written acknowledgment of fiduciary status, must be satisfied in order for relief to be available under the exemption, as set forth in Section II(g). Section II imposes the following conditions on Financial Institutions and Advisers:

(a) Contracts with Respect to Investments in IRAs and Other Plans Not Covered by Title I of ERISA. If the investment advice concerns an IRA or a Plan that is not covered by Title I of ERISA, the advice is subject to an enforceable written contract on the part of the Financial Institution, which may be a master contract covering multiple recommendations, that is entered into in accordance with this Section II(a) and incorporates the terms set forth in Section II(b)-(d). The Financial Institution additionally must provide the disclosures required by Section II(e). The contract must cover advice rendered prior to the execution of the contract in order for the exemption to apply to such advice and related compensation.

(1) Contract Execution and Assent.

(i) New Contracts. Prior to or at the same time as the execution of the recommended transaction, the Financial Institution enters into a written contract with the Retirement Investor acting on behalf of the Plan, participant or beneficiary account, or IRA, incorporating the terms required by Section II(b)-(d). The terms of the contract may appear in a standalone document or they may be incorporated into an annuity contract or application, or similar document, or amendment thereto. The contract must be enforceable against the Financial Institution. The Retirement Investor's assent to the contract may be evidenced by handwritten or electronic signatures.

(ii) Amendment of Existing Contracts by Negative Consent. As an alternative to executing a contract in the manner set forth in the preceding paragraph, the Financial Institution may amend Existing Contracts to include the terms required in Section II(b)-(d) by delivering the proposed amendment and the disclosure required by Section II(e) to the Retirement Investor prior to August 15, 2018, and considering the failure to terminate the amended contract within 30 days as assent. If the Retirement Investor does terminate the contract within that 30-day period, this exemption will provide relief for 14 days after the date on which the termination is received by the Financial Institution. An Existing Contract is an annuity contract that was executed before August 15, 2018, and remains in effect. If the Financial Institution elects to use the negative consent procedure, it may deliver the proposed amendment by mail or electronically, but it may not impose any new contractual obligations, restrictions, or liabilities on the Retirement Investor by negative consent.

(2) Notice. The Financial Institution maintains an electronic copy of the Retirement Investor's contract on its Web site that is accessible by the Retirement Investor.

(b) Fiduciary. The Financial Institution affirmatively states in writing that it and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to any investment advice provided by the Financial Institution or the Adviser subject to the contract or, in the case of an ERISA plan, with respect to any investment recommendations regarding the Plan or participant or beneficiary account.

(c) Impartial Conduct Standards. The Financial Institution affirmatively states that it and its Advisers will adhere to the following standards and, they in fact, comply with the standards:

(1) When providing investment advice to the Retirement Investor, the Financial Institution and the Adviser(s) provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VIII(c), such advice reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party;

(2) The recommended transaction will not cause the Financial Institution, Adviser or their Affiliates or Related Entities to receive, directly or indirectly, compensation for their services that is in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(3) Statements by the Financial Institution and its Advisers to the Retirement Investor about the recommended transaction, fees and compensation, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's investment decisions, will not be materially misleading at the time they are made.

(d) Warranties. The Financial Institution affirmatively warrants, and in fact complies with, the following:

(1) The Financial Institution has adopted and will comply with written policies and procedures reasonably and prudently designed to ensure that its Advisers adhere to the Impartial  Conduct Standards set forth in Section II(c);

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(2) In formulating its policies and procedures, the Financial Institution has specifically identified and documented its Material Conflicts of Interest; adopted measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and designated a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring their Advisers' adherence to the Impartial Conduct Standards;

(3) The Financial Institution's policies and procedures prohibit the use of quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Notwithstanding the foregoing, this Section II(d)(3) does not prevent the provision of differential compensation (whether in type or amount, and including, but not limited to, commissions) based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the Financial Institution's policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries (such compensation

practices can include differential compensation based on neutral factors tied to the differences in the services delivered to the Retirement Investor with respect to the different types of investments, as opposed to the differences in the amounts of Third Party Payments the Financial Institution receives in connection with particular investment recommendations);

(4) The Financial Institution has approved in advance all written marketing materials used by Advisers after determining that such materials provide a balanced description of the risks and features of the Fixed Annuity Contracts to be recommended;

(5) A person designated pursuant to Section II(d)(2) as responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards approves, in writing, recommended annuity applications involving Retirement Investors prior to transmitting the applications to the insurance company;

(6) The Financial Institution requires in its written contract with Advisers or sub-intermediaries that Advisers must (i) use written marketing materials only if they are approved in advance by the Financial Institution as described in Section II(d)(4), and (ii) provide the disclosure required by Section III(a) and orally review the information in Section III(a)(1) with the Retirement Investor;

(7) The Financial Institution either: (i) Requires in its written contract with the insurance company and each Adviser or sub-intermediary that all compensation to be paid to the Adviser or sub-intermediary with respect to the purchase of a Fixed Annuity Contract by a Retirement Investor pursuant to this exemption must be paid to the Adviser or sub-intermediary exclusively by the Financial Institution; or (ii) requires in its written contract with the insurance company and each Adviser or sub-intermediary that with respect to the purchase of a Fixed Annuity Contract by a Retirement Investor pursuant to this exemption, (A) the Adviser or sub-intermediary may only sell annuities to Retirement Investors for which the commission structure has been approved in advance by the IMO and (B) all other forms of compensation, whether cash or non-monetary, must be paid to the Adviser or sub-intermediary exclusively by the Financial Institution; and

(8) The Financial Institution will provide, and require its Advisers to attend, annual training on compliance with the exemption that is conducted by a person who has appropriate technical training and proficiency with ERISA and the Code. The training must, at a minimum, cover the policies and procedures, the Impartial Conduct Standards, Material Conflicts of Interest, ERISA and Code compliance (including applicable fiduciary duties and the prohibited transaction provisions), ethical conduct, and the consequences of failure to comply with the conditions of this exemption (including any loss of exemptive relief provided herein).

(e) Disclosures. In the Best Interest Contract or in a separate single written disclosure provided to the Retirement Investor with the contract, or, with respect to ERISA plans, in another single written disclosure provided to the Plan prior to or at the same time as the execution of the recommended transaction, the Financial Institution clearly and prominently:

(1) States the Best Interest standard of care owed by the Adviser and Financial Institution to the Retirement Investor; informs the Retirement Investor of the services provided by the Financial Institution and the Adviser; and describes how the Retirement Investor will pay for services, directly or through Third Party Payments. If, for example, the Retirement Investor will pay through commissions or other forms of transaction-based payments, the contract or writing must clearly disclose that fact;

(2) Describes Material Conflicts of Interest; discloses any fees or charges the Financial Institution, its Affiliates, or the Adviser imposes upon the Retirement Investor or the Retirement Investor's annuity; and states the types of compensation that the Financial Institution, its Affiliates, and the Adviser expect to receive from third parties in connection with Fixed Annuity Contracts recommended to Retirement Investors;

(3) Informs the Retirement Investor that the Retirement Investor has the right to obtain copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), as well as the specific disclosure of costs, fees, and compensation, including Third Party Payments, regarding recommended transactions, as set forth in Section III(a), below, described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature in sufficient detail to permit the Retirement Investor to make an informed judgment about the costs of the transaction and about the significance and severity of the Material Conflicts of Interest, and describes how the Retirement Investor can get the information, free of charge; provided that if the Retirement Investor's request is made prior to the transaction, the information must be provided prior to the transaction, and if the request is made after the transaction, the information must be provided within 30 business days after the request;

(4) Includes a link to the Financial Institution's Web site as required by Section III(b), and informs the Retirement Investor that: (i) Model contract disclosures updated as necessary on a quarterly basis are maintained on the Web site, and (ii) the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d) are available free of charge on the Web site;

(5) Discloses to the Retirement Investor whether the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to any recommended Fixed  Annuity Contracts; and to the extent the Financial Institution or Adviser limits investment recommendations, in whole or part, to Proprietary Products or annuities that generate Third Party Payments, notifies the Retirement Investor of the limitations placed on the universe of investments that the Adviser may offer for purchase, sale, exchange, or holding by the Retirement Investor. The notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the annuities are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis;

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(6) Provides contact information (telephone and email) for a representative of the Financial Institution that the Retirement Investor can use to contact the Financial Institution with any concerns about the advice or service they have received; and

(7) Describes whether or not the Adviser and Financial Institution will monitor the Retirement Investor's annuity contract and alert the Retirement Investor to any recommended change to the annuity contract, and, if so monitoring, the frequency with which the monitoring will occur and the reasons for which the Retirement Investor will be alerted.

(8) The Financial Institution will not fail to satisfy this Section II(e), or violate a contractual provision based thereon, solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this Section II(e) requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the

materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(f) Ineligible Contractual Provisions. Relief is not available under the exemption if a Financial Institution's contract contains the following:

(1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms;

(2) Except as provided in paragraph (f)(4) of this Section, a provision under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or in an individual or class claim agrees to an amount representing liquidated damages for breach of the contract; provided that, the parties may knowingly agree to waive the Retirement Investor's right to obtain punitive damages or rescission of recommended transactions to the extent such a waiver is permissible under applicable state or federal law; or

(3) Agreements to arbitrate or mediate individual claims in venues that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption.

(4) In the event that the provision on pre-dispute arbitration agreements for class or representative claims in paragraph (f)(2) of this Section is ruled invalid by a court of competent jurisdiction, this provision shall not be a condition of this exemption with respect to contracts subject to the court's jurisdiction unless and until the court's decision is reversed, but all other terms of the exemption shall remain in effect.

(g) ERISA plans. Section II(a) does not apply to recommendations to Retirement Investors regarding investments in Plans that are covered by Title I of ERISA. For such investment advice, relief under the exemption is conditioned upon the Adviser and Financial Institution complying with certain provisions of Section II, as follows:

(1) Prior to or at the same time as the execution of the recommended transaction, the Financial Institution provides the Retirement Investor with a written statement of the Financial Institution's and its Advisers' fiduciary status, in accordance with Section II(b).

(2) The Financial Institution and the Adviser comply with the Impartial Conduct Standards of Section II(c).

(3) The Financial Institution adopts policies and procedures incorporating the requirements and prohibitions set forth in Section II(d), and the Financial Institution and Adviser comply with those requirements and prohibitions.

(4) The Financial Institution provides the disclosures required by Section II(e).

(5) The Financial Institution and Adviser do not in any contract, instrument, or communication: Purport to disclaim any responsibility or liability for any responsibility, obligation, or duty under Title I of ERISA to the extent the disclaimer would be prohibited by ERISA section 410; purport to waive or qualify the right of the Retirement Investor to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, or require arbitration or mediation of individual claims in locations that are distant or that otherwise unreasonably limit the ability of the Retirement Investors to assert the claims safeguarded by this exemption.

### **Section III—Web and Transaction-Based Disclosures**

The Financial Institution must satisfy the following conditions with respect to an investment recommendation, to be covered by this exemption:

(a) Transaction Disclosure. The Financial Institution provides the Retirement Investor, prior to the transmittal of a recommended application for a Fixed Annuity Contract to the insurance company, the following disclosure, clearly and prominently, in a single written document, that:

(1) Provides a disclosure regarding the Fixed Annuity Contract that is in accordance with the most recent Annuity Disclosure Model Regulation published by the National Association of Insurance Commissioners, or its successor, as of the time of the transaction;

(2) States the Best Interest standard of care owed by the Adviser and Financial Institution to the Retirement Investor; and describes any Material Conflicts of Interest;

(3) Informs the Retirement Investor that the Retirement Investor has the right to obtain copies of the Financial Institution's written description of its policies and procedures adopted in accordance with Section II(d), **as well as specific disclosure of costs, fees and other compensation including Third Party Payments regarding recommended transactions.** The costs, fees, and other compensation may be described in dollar amounts, percentages, formulas, or other means reasonably designed to present materially accurate disclosure of their scope, magnitude, and nature in  sufficient detail to permit the Retirement Investor to make an informed judgment about the costs of the transaction and about the significance and severity of the Material Conflicts of Interest. **The information required under this Section must be provided to the Retirement Investor prior to the transaction, if requested prior to the transaction,** and, if the request is made after the transaction, the information must be provided within 30 business days after the request; and

(4) Includes a link to the Financial Institution's Web site as required by Section III(b) and informs the Retirement Investor that: (i) Model contract disclosures or other model notices, updated as necessary on a quarterly basis, are maintained on the Web site, and (ii) the Financial Institution's written description of its policies and procedures as required under Section III(b)(1)(iv) are available free of charge on the Web site.

**(5) Following disclosure of the information in Section III(a)(1), the Adviser must orally review the information with the Retirement Investor, and both the Adviser and Retirement Investor must sign the transaction disclosure and indicate that the oral review has occurred.**

(6) The disclosures in subsections (2)-(4) do not have to be repeated for subsequent recommendations by the Adviser and Financial Institution to invest in the same Fixed Annuity Contract within one year of the provision of the contract disclosure in Section II(e) or a previous disclosure pursuant to this Section III(a), unless there are material changes in the subject of the disclosure.

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**(b) Web Disclosure. For relief to be available under the exemption for any investment recommendation, the conditions of Section III(b) must be satisfied.**

(1) The Financial Institution maintains a Web site, freely accessible to the public and updated no less than quarterly, which contains:

(i) A discussion of the Financial Institution's business model and the Material Conflicts of Interest associated with that business model;

(ii) A schedule of typical contract fees and service charges, if applicable;

(iii) A model contract or other model notice of the contractual terms (if applicable) and required disclosures described in Section II(b)-(e), which are reviewed for accuracy no less frequently than quarterly and updated within 30 days if necessary;

(iv) A written description of the Financial Institution's policies and procedures that accurately describes or summarizes key components of the policies and procedures relating to conflict-mitigation and incentive practices in a manner that permits Retirement Investors to make an informed judgment about the stringency of the Financial Institution's protections against conflicts of interest;

(v) To the extent applicable, a list of all product manufacturers and other parties with whom the Financial Institution maintains arrangements that provide Third Party Payments to either the Adviser or the Financial Institution with respect to Fixed Annuity Contracts recommended to Retirement Investors; a description of the arrangements, including a statement on whether and how these arrangements impact Adviser compensation, and a statement on any benefits the Financial Institution provides to the product manufacturers or other parties in exchange for the Third Party Payments;

(vi) Disclosure of the Financial Institution's compensation and incentive arrangements with Advisers including, if applicable, any incentives (including both cash and non-monetary compensation or awards) to Advisers for recommending particular product manufacturers or Fixed Annuity Contracts to Retirement Investors, or for Advisers to move to the Financial Institution from another firm or to stay at the Financial Institution, and a full and fair description of any payout or compensation grids, but not including information that is specific to any individual Adviser's compensation or compensation arrangement; and

(vii) A copy of the Financial Institution's most recent audited financial statements required in accordance with Section VIII(e)(2).

(viii) The Web site may describe the above arrangements with product manufacturers, Advisers, and others by reference to dollar amounts, percentages, formulas, or other means reasonably calculated to present a materially accurate description of the arrangements. Similarly, the Web site may group disclosures based on reasonably-defined categories of Fixed Annuity Contracts, product manufacturers, Advisers, and arrangements, and it may disclose reasonable ranges of values, rather than specific values, as appropriate. But, however constructed, the Web site must fairly disclose the scope, magnitude, and nature of the compensation arrangements and Material Conflicts of Interest in sufficient detail to permit visitors to the Web site to make an informed judgment about the significance of the compensation practices and Material Conflicts of Interest with respect to transactions recommended by the Financial Institution and its Advisers.

(2) To the extent the information required by this Section is provided in other disclosures which are made public, the Financial Institution may satisfy this Section III(b) by posting such disclosures to its Web site with an explanation that the information can be found in the disclosures and a link to where it can be found.

(3) The Financial Institution is not required to disclose information pursuant to this Section III(b) if such disclosure is otherwise prohibited by law.

(4) In addition to providing the written description of the Financial Institution's policies and procedures on its Web site, as required under Section III(b)(1)(iv), Financial Institutions must provide their complete policies and procedures adopted pursuant to Section II(d) to the Department upon request.

(5) In the event that a Financial Institution determines to group disclosures as described in subsection (1)(vii), it must retain the data and documentation supporting the group disclosure during the time that it is applicable to the disclosure on the Web site, and for six years after that, and make the data and documentation available to the Department within 90 days of the Department's request.

(c)(1) The Financial Institution will not fail to satisfy the conditions in this Section III solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, or if the Web site is temporarily inaccessible, provided that, (i) in the case of an error or omission on the Web site, the Financial Institution discloses the correct information as soon as practicable, but not later than seven (7) days after the date on which it discovers or reasonably should have discovered the error or omission, and (ii) in the case of an error or omission with respect to the transaction disclosure, the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission.

(2) To the extent compliance with the Section III disclosures requires Advisers and Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (i) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (ii) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(3) The good faith provisions of this Section apply to the requirement that the Financial Institution retain the data and documentation supporting the group disclosure during the time that it is applicable to the disclosure on the Web site and provide it to the Department upon request, as set forth in subsection (b)(1)(vii) and (b)(5) above. In addition, if such records are lost or destroyed, due to circumstances beyond the control of the Financial Institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and no party, other than the Financial Institution responsible for complying with subsection (b)(1)(vii) and (b)(5) will be subject to the civil penalty that may be assessed under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b), if applicable, if the records are not maintained or provided to the Department within the required timeframes.

#### **Section IV—Proprietary Products and Third Party Payments**

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(a) General. A Financial Institution that at the time of the transaction restricts Advisers' investment recommendations, in whole or part, to Proprietary Products or to Fixed Annuity Contracts that generate Third Party Payments, may rely on this exemption provided all the applicable conditions of the exemption are satisfied.

(b) Satisfaction of the Best Interest standard. The Financial Institution satisfies the Best Interest standard of Section VIII(c) as follows:

(1) Prior to or at the same time as the execution of the recommended transaction, the Retirement Investor is clearly and prominently informed in writing that the Financial Institution offers Proprietary Products or receives Third Party Payments with respect to the purchase, sale, exchange, or holding of Fixed Annuity Contracts; and the Retirement Investor is informed in writing of the limitations placed on the universe of Fixed Annuity Contracts that the Adviser may recommend to the Retirement Investor. The notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the annuities are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis;

(2) Prior to or at the same time as the execution of the recommended transaction, the Retirement Investor is fully and fairly informed in writing of any Material Conflicts of Interest that the Financial Institution or Adviser have with respect to the recommended transaction, and the Adviser and Financial Institution comply with the disclosure requirements set forth in Section III above (providing for web and transaction-based disclosure of costs, fees, compensation, and Material Conflicts of Interest);

(3) The Financial Institution documents in writing its limitations on the universe of recommended Fixed Annuity Contracts; documents in writing the Material Conflicts of Interest associated with any contract, agreement, or arrangement providing for its receipt of Third Party Payments or associated with the sale or promotion of Proprietary Products; documents in writing any services it will provide to Retirement Investors in exchange for Third Party Payments, as well as any services or consideration it will furnish to any other party, including the payor, in exchange for the Third Party Payments; reasonably concludes that the limitations on the universe of recommended Fixed Annuity Contracts and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation for Retirement Investors as set forth in Section II(c)(2); reasonably determines, after consideration of the policies and procedures established pursuant to Section II(d), that these limitations and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to make imprudent investment recommendations; and documents in writing the bases for its conclusions;

(4) The Financial Institution adopts, monitors, implements, and adheres to policies and procedures and incentive practices that meet the terms of Section II(d); and, in accordance with Section II(d)(3), neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity uses or relies upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause the Adviser to make imprudent investment recommendations, to subordinate the interests of the Retirement Investor to the Adviser's own interests, or to make recommendations based on the Adviser's considerations of factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor;

(5) At the time of the recommendation, the amount of compensation and other consideration reasonably anticipated to be paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities for their services in connection with the recommended transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and

(6) The Adviser's recommendation reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor; and the Adviser's recommendation is not based on the financial or other interests of the Adviser or on the Adviser's consideration of any factors or interests other than the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor.

### **Section V—Disclosure to the Department and Recordkeeping**

This Section establishes record retention and disclosure conditions that a Financial Institution must satisfy for the exemption to be available for compensation received in connection with recommended transactions.

(a) EBSA Disclosure. Before receiving compensation in reliance on the exemption in Section I, the Financial Institution notifies the Department of its intention to rely on this exemption. The notice will remain in effect until revoked in writing by the Financial Institution. The notice need not identify any Plan or IRA. The notice must be provided by email to *e-BICE@dol.gov* (*mailto:e-BICE@dol.gov*).

(b) Recordkeeping. The Financial Institution maintains for a period of six (6) years, in a manner that is reasonably accessible for examination, the records necessary to enable the persons described in paragraph (c) of this Section to determine whether the conditions of this exemption have been  met with respect to a transaction, except that:

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(1) If such records are lost or destroyed, due to circumstances beyond the control of the Financial Institution, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and

(2) No party, other than the Financial Institution responsible for complying with this paragraph (c), will be subject to the civil penalty that may be assessed under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b), if applicable, if the records are not maintained or are not available for examination as required by paragraph (c), below.

(c)(1) Except as provided in paragraph (c)(2) of this Section or precluded by 12 U.S.C. 484 (<https://api.fdsys.gov/link?collection=uscode&title=12&year=mostrecent&section=484&type=usc&link-type=html>), and notwithstanding any provisions of ERISA section 504(a)(2) and (b), the records referred to in paragraph (b) of this Section are reasonably available at their customary location for examination during normal business hours by:

(i) Any authorized employee or representative of the Department or the Internal Revenue Service;

(ii) Any fiduciary of a Plan that engaged in an investment transaction pursuant to this exemption, or any authorized employee or representative of such fiduciary;

(iii) Any contributing employer and any employee organization whose members are covered by a Plan described in paragraph (c)(1)(ii), or any authorized employee or representative of these entities; or

(iv) Any participant or beneficiary of a Plan described in paragraph (c)(1)(ii), IRA owner, or the authorized representative of such participant, beneficiary or owner; and

(2) None of the persons described in paragraph (c)(1)(ii)-(iv) of this Section are authorized to examine records regarding a recommended transaction involving another Retirement Investor, privileged trade secrets or privileged commercial or financial information of the Financial Institution, or information identifying other individuals.

(3) Should the Financial Institution refuse to disclose information on the basis that the information is exempt from disclosure, the Financial Institution must, by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the transaction or transactions for which records are missing or have not been maintained. It does not affect the relief for other transactions.

#### **Section VI—Exemption for Purchases of Fixed Annuity Contracts**

(a) In general. In addition to prohibiting fiduciaries from receiving compensation from third parties and compensation that varies based on their investment advice, ERISA and the Internal Revenue Code prohibit the purchase by a Plan, participant or beneficiary account, or IRA of a Fixed Annuity Contract from an insurance company that is a service provider to the Plan or IRA. This exemption permits a Plan, participant or beneficiary account, or IRA to engage in a purchase with a Financial Institution that is a service provider or other party in interest or disqualified person to the Plan or IRA. This exemption is provided because Fixed Annuity Contract transactions often involve prohibited purchases involving entities that have a pre-existing party in interest relationship to the Plan or IRA.

(b) Covered transactions. The restrictions of ERISA section 406(a)(1)(A) and (D), and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A) and (D), shall not apply to the purchase of a Fixed Annuity Contract by a Plan, participant or beneficiary account, or IRA, from a Financial Institution that is a party in interest or disqualified person.

(c) The following conditions are applicable to this exemption:

(1) The transaction is effected by the Financial Institution in the ordinary course of its business;

(2) The compensation, direct or indirect, for any services rendered by the Financial Institution and its Affiliates and Related Entities is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and

(3) The terms of the transaction are at least as favorable to the Plan, participant or beneficiary account, or IRA as the terms generally available in an arm's length transaction with an unrelated party.

(d) *Exclusions:* The exemption in this Section VI does not apply if:

(1) The Plan is covered by Title I of ERISA and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser and Financial Institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the Plan, or an affiliate thereof, that was selected to provide advice to the plan by a fiduciary who is not Independent.

(2) The compensation is received as a result of investment advice to a Retirement Investor generated solely by an interactive Web site in which computer software-based models or applications provide investment advice based on personal information each investor supplies through the Web site without any personal interaction or advice from an individual Adviser (*i.e.*, “robo-advice”); or

(3) The Adviser has or exercises any discretionary authority or discretionary control with respect to the recommended transaction.

## Section VII—Exemption for Pre-Existing Transactions

(a) In general. ERISA and the Internal Revenue Code prohibit Advisers, Financial Institutions and their Affiliates and Related Entities from receiving compensation that varies based on their investment advice. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. Some Advisers and Financial Institutions did not consider themselves fiduciaries within the meaning of 29 CFR 2510 (/select-citation/2017/01/19/29-CFR-2510)-3.21 before the applicability date of the amendment to 29 CFR 2510 (/select-citation/2017/01/19/29-CFR-2510)-3.21 (the Applicability Date). Other Advisers and Financial Institutions entered into transactions involving Plans, participant or beneficiary accounts, or IRAs before the Applicability Date, in accordance with the terms of a prohibited transaction exemption that has since been amended. This exemption permits Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive compensation in connection with a Plan's, participant or beneficiary account's or IRA's purchase, exchange, or holding of a Fixed Annuity Contract that was acquired prior to the Applicability Date, as described and limited below.

(b) Covered transaction. Subject to the applicable conditions described below, the restrictions of ERISA section 406(a)(1)(A), 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (D), (E) and (F), shall not apply to the receipt of compensation by an Adviser, Financial Institution, and any Affiliate and Related Entity, as a result of investment advice (including advice to hold) provided to a Plan, participant or beneficiary or IRA owner in connection □ with the purchase, or holding of a fixed annuity (i) that was acquired before the Applicability Date, or (ii) that was acquired pursuant to a recommendation to continue to adhere to a systematic purchase program established before the Applicability Date. This Exemption for Pre-Existing Transactions is conditioned on the following:

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(1) The compensation is received pursuant to an agreement, arrangement or understanding that was entered into prior to the Applicability Date and that has not expired or come up for renewal post-Applicability Date;

(2) The purchase, exchange, holding or sale of the investment property was not otherwise a non-exempt prohibited transaction pursuant to ERISA section 406 and Code section 4975 on the date it occurred;

(3) The compensation is not received in connection with the Plan's, participant or beneficiary account's or IRA's investment of additional amounts in the previously acquired investment vehicle;

(4) The amount of the compensation paid, directly or indirectly, to the Adviser, Financial Institution, or their Affiliates or Related Entities in connection with the transaction is not in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2); and

(5) Any investment recommendations made after the Applicability Date by the Financial Institution or Adviser with respect to the investment property reflect the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, and are made without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

## Section VIII—Definitions

For purposes of this exemption:

(a) “Adviser” means an individual who:

(1) Is a fiduciary of the Plan or IRA by reason of the provision of investment advice described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B), or both, and the applicable regulations, with respect to the assets of the Plan or IRA involved in the recommended transaction;

(2) Is an employee, independent contractor, or agent of a Financial Institution; and

(3) Satisfies the federal and state regulatory and licensing requirements of insurance laws with respect to the covered transaction, as applicable

(b) “Affiliate” of an Adviser or Financial Institution means—

(1) Any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, “control” means the power to exercise a controlling influence over the management or policies of a person other than an individual;

(2) Any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)), of the Adviser or Financial Institution; and

(3) Any corporation or partnership of which the Adviser or Financial Institution is an officer, director, or partner.

(c) Investment advice is in the “Best Interest” of the Retirement Investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

**(d) “Fixed Annuity Contract” means an annuity contract that satisfies applicable state standard nonforfeiture laws at the time of issue and the benefits of which do not vary, in whole or in part, on the basis of the investment experience of a separate account or accounts maintained by the insurer. Fixed Annuity Contracts includes fixed rate annuity contracts and fixed indexed annuity contracts.**

(e) "Financial Institution" means an insurance intermediary that has a direct written contract regarding the distribution of Fixed Annuity Contracts with both (i) the insurance company issuing the Fixed Annuity Contract and (ii) the Adviser or another intermediary (sub-intermediary) that has a direct written contract with the Adviser, and that also:

(1) Satisfies the applicable licensing requirements of the insurance laws of each state in which it conducts business;

(2) Has financial statements that are audited annually by an Independent certified public accountant;

(3) Maintains, to satisfy potential liability under ERISA or the Code as a result of this exemption, or any contract entered into pursuant to Section II(a), in an aggregate amount which must be at least 1% of the average annual amount of premium sales of Fixed Annuity Contracts sold by the Financial Institution to Retirement Investors pursuant to this exemption over its prior three fiscal years:

(A) Fiduciary liability insurance that:

(i) Applies solely to actions brought by the Department of Labor, the Department of Treasury, the Pension Benefit Guaranty Corporation, Retirement Investors or plan fiduciaries (or their representatives) relating to Fixed Annuity Contract transactions, including but not limited to actions for failure to comply with the exemption or any contract entered into pursuant to Section II(a);

(ii) does not contain an exclusion of Fixed Annuity Contracts;

(iii) has a deductible that does not exceed 5% of the policy limits; and

(iv) does not exclude claims coverage based on a self-insured retention or otherwise specify an amount that the Financial Institution must pay before a claim is covered by the fiduciary liability policy;

(B) cash, bonds, bank certificates of deposit, U.S. Treasury Obligations that are unencumbered and not subject to security interests or other creditors, or

(C) a combination of (A) and (B); and

(4) Has transacted sales of Fixed Annuity Contracts averaging at least \$1.5 billion in premiums per fiscal year over its prior three fiscal years;

(f) "Independent" means a person that:

(1) Is not the Adviser, the Financial Institution or any Affiliate relying on the exemption;

(2) Does not have a relationship to or an interest in the Adviser, the Financial Institution or Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in this exemption; and

(3) Does not receive or is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the Adviser, Financial Institution or Affiliate in excess of 2% of the person's annual revenues based upon its prior income tax year.

(g) “Individual Retirement Account” or “IRA” means any account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an ☐ individual retirement account described in section 408(a) of the Code and a health savings account described in Code section 223(d).

(h) A “Material Conflict of Interest” exists when an Adviser or Financial Institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.

(i) “Plan” means any employee benefit plan described in section 3(3) of ERISA and any plan described in section 4975(e)(1)(A) of the Code.

(j) “Proprietary Product” means a product that is managed, issued or sponsored by the Financial Institution or any of its Affiliates.

(k) “Related Entity” means any entity other than an Affiliate in which the Adviser or Financial Institution has an interest which may affect the exercise of its best judgment as a fiduciary.

(l) A “Retail Fiduciary” means a fiduciary of a Plan or IRA that is not described in section (c)(1)(i) of the Regulation (29 CFR 2510.3 (/select-citation/2017/01/19/29-CFR-2510.3)-21(c)(1)(i)).

(m) “Retirement Investor” means—

(1) A participant or beneficiary of a Plan subject to Title I of ERISA or described in section 4975(e)(1)(A) of the Code, with authority to direct the investment of assets in his or her Plan account or to take a distribution,

(2) The beneficial owner of an IRA acting on behalf of the IRA, or

(3) A Retail Fiduciary with respect to a Plan subject to Title I of ERISA or described in section 4975(e)(1)(A) of the Code or IRA.

(n) “Third-Party Payments” include sales charges and insurance commissions when not paid directly by the Plan, participant or beneficiary account, or IRA; gross dealer concessions; revenue sharing payments; distribution, solicitation or referral fees; volume-based fees; fees for seminars and educational programs; and any other compensation, consideration or financial benefit provided to the Financial Institution or an Affiliate or Related Entity by a third party as a result of a transaction involving a Plan, participant or beneficiary account, or IRA.

## Section IX—Transition Period for Exemption

(a) In general. ERISA and the Internal Revenue Code prohibit fiduciary advisers to Plans and IRAs from receiving compensation that varies based on their investment advice. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. This transition period provides relief from the restrictions of ERISA section 406(a)(1)(D), and 406(b) and the sanctions imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1) (D), (E), and (F) for the period from April 10, 2017, to August 15, 2018 (the Transition Period) for Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive such otherwise prohibited compensation subject to the conditions described in Section IX(d).

(b) Covered transactions. This provision permits Advisers, Financial Institutions, and their Affiliates and Related Entities to receive compensation as a result of their provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) to a Retirement Investor regarding Fixed Annuity Contracts during the Transition Period.

(c) Exclusions. This provision does not apply if:

(1) The Plan is covered by Title I of ERISA, and (i) the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan, or (ii) the Adviser or Financial Institution is a named fiduciary or plan administrator (as defined in ERISA section 3(16)(A)) with respect to the Plan, or an Affiliate thereof, that was selected to provide advice to the Plan by a fiduciary who is not Independent;

(2) The compensation is received as a result of investment advice to a Retirement Investor generated solely by an interactive Web site in which computer software-based models or applications provide investment advice based on personal information each investor supplies through the Web site without any personal interaction or advice from an individual Adviser (*i.e.*, “robo-advice”); or

(3) The Adviser has or exercises any discretionary authority or discretionary control with respect to the recommended transaction.

(d) Conditions. The provision is subject to the following conditions:

(1) Before receiving compensation in reliance on the exemption in this Section IX, the Financial Institution notifies the Department of its intention to rely on this exemption and makes the following representation to the Department: “[Name of Financial Institution] is presently taking steps to put in place the systems necessary to comply with Section I of the Best Interest Contract Exemption for Insurance Intermediaries, and fully intends to comply with all applicable conditions for such relief after the expiration of the transition period.” The notice will remain in effect until revoked in writing by the Financial Institution. The notice need not identify any Plan or IRA. The notice must be provided by email to *e-BICE@dol.gov* (*mailto:e-BICE@dol.gov*).

(2) The Financial Institution and Adviser adhere to the following standards:

(i) When providing investment advice to the Retirement Investor, the Financial Institution and the Adviser(s) provide investment advice that is, at the time of the recommendation, in the Best Interest of the Retirement Investor. As further defined in Section VIII(c), such advice reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party;

(ii) The recommended transaction does not cause the Financial Institution, Adviser or their Affiliates or Related Entities to receive, directly or indirectly, compensation for their services that is in excess of reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).

(iii) Statements by the Financial Institution and its Advisers to the Retirement Investor about the recommended transaction, fees and compensation, Material Conflicts of Interest, and any other matters relevant to a Retirement Investor's investment decisions, are not materially misleading at the time they are made.

(3) Disclosures. The Financial Institution complies with applicable disclosure obligations under state insurance law with respect to the sale of the Fixed Annuity Contract, and provides to the Retirement Investor, prior to the transmittal of the annuity application to the insurance company, a single written disclosure that clearly and prominently:

(i) Affirmatively states that the Financial Institution and the Adviser(s) act as fiduciaries under ERISA or the Code, or both, with respect to the recommendation;

(ii) Sets forth the standards in paragraph (d)(1) of this Section and affirmatively states that it and the Adviser(s) adhered to such standards in recommending the transaction;

(iii) Describes the Financial Institution's Material Conflicts of Interest; and

(iv) Discloses to the Retirement Investor whether the Financial Institution offers Proprietary Products or  receives Third Party Payments with respect to any Fixed Annuity Contract recommendations; and to the extent the Financial Institution or Adviser limits Fixed Annuity Contract recommendations, in whole or part, to Proprietary Products or investments that generate Third Party Payments, notifies the Retirement Investor of the limitations placed on the universe of investment recommendations. The notice is insufficient if it merely states that the Financial Institution or Adviser "may" limit investment recommendations based on whether the investments are Proprietary Products or generate Third Party Payments, without specific disclosure of the extent to which recommendations are, in fact, limited on that basis.

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(v) The disclosure may be provided in person, electronically or by mail. It does not have to be repeated for any subsequent recommendations during the Transition Period.

(vi) The Financial Institution will not fail to satisfy this Section IX(d)(3) solely because it, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the required information, provided the Financial Institution discloses the correct information as soon as practicable, but not later than 30 days after the date on which it discovers or reasonably should have discovered the error or omission. To the extent compliance with this Section IX(d)(3) requires Financial Institutions to obtain information from entities that are not closely affiliated with them, they may rely in good faith on information and assurances from the other entities, as long as they do not know, or unless they should have known, that the materials are incomplete or inaccurate. This good faith reliance applies unless the entity providing the information to the Adviser and Financial Institution is (1) a person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution; or (2) any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution.

(4) The Financial Institution approves in advance all written marketing materials used by Advisers after determining that such materials provide a balanced description of the risks and features of the annuity contracts to be recommended;

(5) The Financial Institution designates a person or persons, identified by name and title or function, responsible for addressing Material Conflicts of Interest and monitoring Advisers' adherence to the Impartial Conduct Standards and the person approves, in writing, recommended applications for Fixed Annuity Contracts involving Retirement Investors prior to transmitting them to the insurance company; and

(6) The Financial Institution complies with the recordkeeping requirements of Section V(b) and (c).

Signed at Washington, DC, this *12th* day of *January*, 2017.

Lyssa Hall,

Director of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor.

## Footnotes

1. See *Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice*, 81 FR 20946 ([/citation/81-FR-20946](#)).

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2. Code section 4975(c)(2) authorizes the Secretary of the Treasury to grant exemptions from the parallel prohibited transaction provisions of the Code. Reorganization Plan No. 4 of 1978 (5 U.S.C. app. at 214 (2000)) (the Reorganization Plan) generally transferred the authority of the Secretary of the Treasury to grant administrative exemptions under Code section 4975 to the Secretary of Labor. To rationalize the administration and interpretation of dual provisions under ERISA and the Code, the Reorganization Plan divided the interpretive and rulemaking authority for these provisions between the Secretaries of Labor and of the Treasury, so that, in general, the agency with responsibility for a given provision of Title I of ERISA would also have responsibility for the corresponding provision in the Code. Among the sections transferred to the Department were the prohibited transaction provisions and the definition of a fiduciary in both Title I of ERISA and in the Code. ERISA's prohibited transaction rules, 29 U.S.C. 1106 (<https://api.fdsys.gov/link?collection=uscode&title=29&year=mostrecent&section=1106&type=usc&link-type=html>)-1108, apply to ERISA-covered plans, and the Code's corresponding prohibited transaction rules, 26 U.S.C. 4975 (<https://api.fdsys.gov/link?collection=uscode&title=26&year=mostrecent&section=4975&type=usc&link-type=html>)(c), apply both to ERISA-covered pension plans that are tax-qualified pension plans, as well as other tax-advantaged arrangements, such as IRAs, that are not subject to the fiduciary responsibility and prohibited transaction rules in ERISA. Specifically, section 102(a) of the Reorganization Plan provides the Department of Labor with "all authority" for "regulations, rulings, opinions, and exemptions under section 4975 [of the Code]" subject to certain exceptions not relevant here. Reorganization Plan section 102. In President Carter's message to Congress regarding the Reorganization Plan, he made explicitly clear that as a result of the plan, "Labor will have statutory authority for fiduciary obligations. . . . Labor will be responsible for overseeing fiduciary conduct under these provisions." Reorganization Plan, *Message of the President*. This exemption would provide relief from the indicated prohibited transaction provisions of both ERISA and the Code.

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3. For purposes of the proposed exemption, "IRA" means any account or annuity described in Code section 4975(e)(1)(B) through (F).

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4. By using the term “Adviser,” the Department does not intend to limit the exemption to investment advisers registered under the Investment Advisers Act of 1940 or under state law. For purposes of this proposal, an Adviser is an employee, independent contractor, or agent of an insurance intermediary that satisfies the definition of Financial Institution in the proposed exemption.

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5. ERISA section 404(a).

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6. ERISA section 406. ERISA also prohibits certain transactions between a plan and a “party in interest.”

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7. ERISA section 409; see also ERISA section 405.

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8. Code section 4975.

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9. 29 CFR 2510.3 (/select-citation/2017/01/19/29-CFR-2510.3)-21(b)(1).

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10. See 81 FR 20946 (/citation/81-FR-20946) (April 8, 2016).

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11. Subsequent to the issuance of these regulations, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2010), divided rulemaking and interpretive authority between the Secretaries of Labor and the Treasury. The Secretary of Labor was given interpretive and rulemaking authority regarding the definition of fiduciary under both Title I of ERISA and the Internal Revenue Code. *Id.* section 102(a) (“all authority of the Secretary of the Treasury to issue [regulations, rulings opinions, and exemptions under section 4975 of the Code] is hereby transferred to the Secretary of Labor”).

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12. 29 CFR 2550.408 (/select-citation/2017/01/19/29-CFR-2550.408)b-2(e); 26 CFR 54.4975 (/select-citation/2017/01/19/26-CFR-54.4975)-6(a)(5).

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13. 81 FR 21089 (/citation/81-FR-21089) (April 8, 2016), as corrected at 81 FR 44784 (/citation/81-FR-44784) (July 11, 2016).

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14. The amended exemptions are Prohibited Transaction Exemption (PTE) 75-1; PTE 77-4; PTE 80-83; PTE 83-1; PTE 84-24, and PTE 86-128. See 81 FR 21208 (/citation/81-FR-21208); 21139; 21147; and 21181 (April 8, 2016).

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15. Class Exemption for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters, 49 FR 13208 (April 3, 1984), as amended, 71 FR 5887 (/citation/71-FR-5887) (February 3, 2006), as amended 81 FR 21147 (/citation/81-FR-21147) (April 8, 2016).

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16. The definition of “fixed rate annuity contract” in PTE 84-24, as amended, is “a fixed annuity contract issued by an insurance company that is either an immediate annuity contract or a deferred annuity contract that (i) satisfies applicable state standard nonforfeiture laws at the time of issue, or (ii) in the case of a group fixed annuity, guarantees return of principal net of reasonable compensation and provides a guaranteed declared minimum interest rate in accordance with the rates specified in the standard nonforfeiture laws in that state that are applicable to individual annuities; in either case, the benefits of

*which do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model. A Fixed Rate Annuity Contract does not include a variable annuity or an indexed annuity or similar annuity.”*

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17. See 81 FR at 21067.

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18. See *id.*; *id.* at 21083.

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19. See *id.* at 21067.

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20. *If an IMO is not an affiliate or related entity, or otherwise a party in interest or disqualified person with respect to the plan or IRA, the IMO's receipt of payments as a result of an Adviser's advice would not be a prohibited transaction requiring compliance with an exemption.*

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21. See FAQs about Conflict of Interest Rules and Exemptions, Part I, FAQs 22 and 23, <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf> (<https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf>).

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22. *In general, as noted in the Department's FAQs Part I, the Financial Institution can comply with its obligations to pay no more than reasonable compensation by being attentive to market prices and benchmarks for the services; providing the investor proper disclosure of relevant costs, charges, and conflicts of interest, prudently evaluating the customer's need for the services; and avoiding fraudulent or abusive practices with respect to the service arrangement. See FAQs about Conflict of Interest Rules and Exemptions, Part I, FAQ 33, <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf> (<https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf>).*

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23. *Relief is also proposed from ERISA section 406(a)(1)(D) and Code section 4975(c)(1)(D), which prohibit transfer of plan assets to, or use of plan assets for the benefit of, a party in interest (including a fiduciary).*

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24. See Regulatory Impact Analysis for the Regulation, p. 8, available at [www.dol.gov/ebsa](http://www.dol.gov/ebsa) (<http://www.dol.gov/ebsa>).

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25. See Best Interest Contract Exemption, 81 FR 21001 (/citation/81-FR-21001), 21017 (April 8, 2016).

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26. See *id.* at 21067.

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27. “Equity-Indexed Annuities: A Complex Choice” available at [https://www.finra.org/investors/alerts/equity-indexed-annuities\\_a-complex-choice](https://www.finra.org/investors/alerts/equity-indexed-annuities_a-complex-choice) ([https://www.finra.org/investors/alerts/equity-indexed-annuities\\_a-complex-choice](https://www.finra.org/investors/alerts/equity-indexed-annuities_a-complex-choice)).

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28. *Id.*

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29. SEC Office of Investor Education and Advocacy Investor Bulletin: Indexed Annuities, available at <https://www.sec.gov/investor/alerts/secindexedannuities.pdf> (<https://www.sec.gov/investor/alerts/secindexedannuities.pdf>).

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30. *Id.*

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31. See NASAA Statement on SEC Equity-Indexed Annuity Rule (December 17, 2008) available at <http://www.nasaa.org/5611/statement-on-sec-equity-indexed-annuity-rule/> (<http://www.nasaa.org/5611/statement-on-sec-equity-indexed-annuity-rule/>).

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32. See Regulatory Impact Analysis for the Regulation, p. 8, available at [www.dol.gov/ebsa](http://www.dol.gov/ebsa) (<http://www.dol.gov/ebsa>).

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33. See Final Amendment to PTE 84-24, 81 FR 21147 (/citation/81-FR-21147), 21176 (April 8, 2016) (definition of "Fixed Rate Annuity Contract").

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34. See 81 FR 21067 (/citation/81-FR-21067).

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35. See *id.*

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36. Under section VIII(f), "Independent" means a person that: (1) Is not the Adviser, the Financial Institution or any Affiliate relying on the exemption; (2) Does not have a relationship to or an interest in the Adviser, the Financial Institution or Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in this exemption; and (3) Does not receive or is not projected to receive within the current federal income tax year, compensation or other consideration for his or her own account from the Adviser, Financial Institution or Affiliate in excess of 2% of the person's annual revenues based upon its prior income tax year.

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37. If an intermediary is not an affiliate or related entity, or otherwise a party in interest or disqualified person with respect to the plan or IRA, the intermediary's receipt of payments as a result of an Adviser's advice would not be a prohibited transaction requiring compliance with an exemption.

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38. Unlike the Best Interest Contract Exemption, this proposal does not contain provisions addressing relief in the event of the failure to enter into a contract. See Best Interest Contract Exemption, section II(a)(1)(iii). This provision was included in the Best Interest Contract Exemption to address concerns voiced generally in the context of mutual fund transactions. Commenters raised concerns that it would be possible for a Retirement Investor to receive advice from an Adviser to enter into a transaction but fail to open an account with the particular Adviser or Financial Institution, yet nevertheless follow the advice in a way that generates additional compensation for the Financial Institution or an affiliate or related entity. The Department does not anticipate that such concerns are present in the context of the annuity transactions covered in this proposal and has therefore not included provisions in this proposal to parallel section II(a)(1)(iii) of the Best Interest Contract Exemption; however, the Department requests comment on this approach.

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39. See <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf> (<https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf>). This is a broader requirement for the elimination or mitigation of conflicts of interest than would apply to an individual insurance company relying on section II(d)(3) of the Best Interest Contract Exemption. As discussed above (and in the Department's FAQ 22), the insurer's responsibility under the Best Interest Contract Exemption is to oversee the recommendation and sale of its products, not recommendations and transactions involving other insurers. Thus, under the Best Interest Contract Exemption, the insurance company has an obligation to ensure that it and its affiliates and related entities do not use or create inappropriate incentives, but it does not have an obligation to control the compensation incentives independently created by other insurance companies or parties. The different business model of IMOs and other intermediaries, however, enables them to broadly eliminate differential compensation that is not tied to neutral factors based upon differences in the services provided by the Adviser. This exemption requires them to eliminate such differentials and to avoid misaligned incentives with respect to all the independent agent's recommendations.

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40. Several applicants indicated an interest in offering Advisers product-neutral incentives based solely on levels of sales activity. If this exemption is granted, entities relying on it would be subject to Section II(d)(3), under which Financial Institution must prohibit the use of quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the best interest of the Retirement Investor. The extent to which such incentive programs satisfy the requirements of Section II(d) of the exemption (or the Best Interest Contract Exemption) would be based on all the factors surrounding the incentive programs. The Department has provided guidance on related issues in the context of compensation grids that escalate based on sales volume. See FAQs about Conflict of Interest Rules and Exemptions, Part I, FAQ9, <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf> (<https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf>). These principles would apply equally to Financial Institutions under this proposed exemption, if granted. In particular, the Department cautions against compensation and other incentives that are disproportionate and can undermine the best interest standard and create misaligned incentives for Advisers to make recommendations based on their own financial interest, rather than the customer's interest in sound advice.

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41. Similarly, provisions applicable to "bank networking arrangements" are not included in this proposal, although they are in the Best Interest Contract Exemption. See Best Interest Contract Exemption, sections II(i) and VIII(c). Bank networking arrangements are defined to involve only banks or similar financial institutions, or savings associations and are therefore considered inapplicable to insurance intermediaries.

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42. Annuity Disclosure Model Regulation, National Association of Insurance Commissioners (2015), available at <http://www.naic.org/store/free/MDL-245.pdf> (<http://www.naic.org/store/free/MDL-245.pdf>).

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43. See Section IV(b)(3).

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44. 81 FR 21002 (/citation/81-FR-21002) (April 8, 2016).

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45. 81 FR 21002 (/citation/81-FR-21002) (April 8, 2016) as corrected at 81 FR 44773 (/citation/81-FR-44773) (July 11, 2016).

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46. In the preamble to the Best Interest Contract Exemption, the Department stated that “[i]f parties wish to expand the definition of Financial Institution to include marketing intermediaries or other entities, they can submit an application to the Department for an individual exemption, with information regarding their role in the distribution of financial products, the regulatory oversight of such entities, and their ability to effectively supervise individual [a]dvisers' compliance with the terms of this exemption. See 81 FR at 21067.

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47. The statistics presented here are for all FIAs, and not just FIAs sold to or held in IRAs.

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48. The RIA is available at [www.dol.gov/ebsa](http://www.dol.gov/ebsa) (<http://www.dol.gov/ebsa>).

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49. LIMRA U.S. Individual Annuity Yearbook—2015.

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50. LIMRA U.S. Individual Annuity Sales—Fixed annuity breakout, 2015 Year-end Results  
[http://www.limra.com/uploadedFiles/limra.com/LIMRA\\_Root/Posts/PR/\\_Media/PDFs/2015-Top-20-Fixed-Breakout.pdf](http://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/_Media/PDFs/2015-Top-20-Fixed-Breakout.pdf)  
([http://www.limra.com/uploadedFiles/limra.com/LIMRA\\_Root/Posts/PR/\\_Media/PDFs/2015-Top-20-Fixed-Breakout.pdf](http://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/_Media/PDFs/2015-Top-20-Fixed-Breakout.pdf)).

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51. LifeHealthPro Editors, August 16, 2016, “Fixed indexed annuities break quarterly sales record” Available at <http://www.lifehealthpro.com/2016/08/16/fixed-indexed-annuities-break-quarterly-sales-reco?slreturn=1476799732> (<http://www.lifehealthpro.com/2016/08/16/fixed-indexed-annuities-break-quarterly-sales-reco?slreturn=1476799732>).

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52. LIMRA Individual Annuity Yearbook 2015.

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53. DOL's own calculations based on LIMRA U.S. Individual Annuity Yearbook 2014.

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54. Joe Simonds, “Warning: Why FMOs will be extinct soon,” Lifehealthpro (Dec. 5, 2012); available at: <http://www.lifehealthpro.com/2012/12/05/warning-why-fmos-will-be-extinct-soon> (<http://www.lifehealthpro.com/2012/12/05/warning-why-fmos-will-be-extinct-soon>).

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55. *Ibid.*

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56. Cyril Tuohy, June 10, 2016, [Insurancenewsnet.com](http://insurancenewsnet.com) “Insurance Marketing Organizations Feel The DOL's Freezer Burn” Available at <http://insurancenewsnet.com/innarticle/wholesalers-mull-future> (<http://insurancenewsnet.com/innarticle/wholesalers-mull-future>).

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57. Warren Hersch, August 12, 2016, LifeHealthPro.com “Unchartered waters: Why this IMO is seeking FI status under DOL rule.” Available at <http://www.lifehealthpro.com/2016/08/12/unchartered-waters-why-this-imo-is-seeking-fi-stat> (<http://www.lifehealthpro.com/2016/08/12/unchartered-waters-why-this-imo-is-seeking-fi-stat>) Arthur Postal, August 10, 2016 LifeHealthPro.com “IMOs take on enhanced sales role under the new DOL rule” available at <http://www.lifehealthpro.com/2016/08/10/imos-take-on->

*enhanced-sales-role-under-the-new-dol?ref=related-embedded*

(<http://www.lifehealthpro.com/2016/08/10/imos-take-on-enhanced-sales-role-under-the-new-dol?ref=related-embedded>).

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58. Cyril Tuohy, June 10, 2016, *InsuranceneWSnet.com* “Insurance Marketing Organizations Feel The DOL’s Freezer Burn” Available at <http://insuranceneWSnet.com/innarticle/wholesalers-mull-future> (<http://insuranceneWSnet.com/innarticle/wholesalers-mull-future>).

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59. Cyril Tuohy, June 10, 2016, *InsuranceneWSnet.com* “Insurance Marketing Organizations Feel The DOL’s Freezer Burn” Available at <http://insuranceneWSnet.com/innarticle/wholesalers-mull-future> (<http://insuranceneWSnet.com/innarticle/wholesalers-mull-future>).

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60. Greg Iacurci, June 23, 2016, *Investment News*, “Indexed annuity distributors weigh launching B-Ds due to DOL fiduciary rule” available at <http://www.investmentnews.com/article/20160623/FREE/160629957/indexed-annuity-distributors-weigh-launching-b-ds-due-to-dol> (<http://www.investmentnews.com/article/20160623/FREE/160629957/indexed-annuity-distributors-weigh-launching-b-ds-due-to-dol>).

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61. Warren Hersch, September 16, 2016, “Not ready to become a DOL compliance FI? Go partner with one” Available at <http://www.lifehealthpro.com/2016/09/16/not-ready-to-become-a-dol-compliant-fi-go-partner?t=diversity-market> (<http://www.lifehealthpro.com/2016/09/16/not-ready-to-become-a-dol-compliant-fi-go-partner?t=diversity-market>).

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62. See *Market Synergy Preliminary Injunction Memo filed June 17, 2016, in the United States District Court for the District of Kansas*.

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63. In some cases, the information presented here is supported by sources beyond the applications, but in all cases the information is consistent with information provided in the applications.

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64. *Individual Exemption Application of Advisors Excel*.

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65. *Advisors Excel and Annexus reported \$5 billion and \$ 4 billion sales in FIAs respectfully according to the their individual exemption applications and Annexus reported \$4 billion sales in the article by Greg Iacurci, June 23, 2016, Investment News, “Indexed Annuity Distributors Weigh Launching B-Ds Due to DOL Fiduciary Rule” available at <http://www.investmentnews.com/article/20160623/FREE/160629957/indexed-annuity-distributors-weigh-launching-b-ds-due-to-dol> (<http://www.investmentnews.com/article/20160623/FREE/160629957/indexed-annuity-distributors-weigh-launching-b-ds-due-to-dol>).*

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66. *LIMRA Individual Annuity Yearbook 2015*.

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67. *Individual Exemption Application submitted by Advisors Excel*.

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68. Warren Hersch, September 7, 2016, *LifeHealthPro*, “Eye on the Future: Futurity First Readies Advisors for DOL Rule” Available at <http://www.lifehealthpro.com/2016/09/07/eye-on-the-future-futurity-first-readies-advisors> (<http://www.lifehealthpro.com/2016/09/07/eye-on-the-future-futurity-first-readies-advisors>).

advisors). Warren Hersch, September 16, 2016, "Not Ready to Become a DOL Compliance FI? Go partner with One" Available at <http://www.lifehealthpro.com/2016/09/16/not-ready-to-become-a-dol-compliant-fi-go-partner?t=diversity-market> (<http://www.lifehealthpro.com/2016/09/16/not-ready-to-become-a-dol-compliant-fi-go-partner?t=diversity-market>).

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69. Warren Hersch, September 16, 2016, "Not Ready to become a DOL Compliance FI? Go Partner with One" Available at <http://www.lifehealthpro.com/2016/09/16/not-ready-to-become-a-dol-compliant-fi-go-partner?t=diversity-market> (<http://www.lifehealthpro.com/2016/09/16/not-ready-to-become-a-dol-compliant-fi-go-partner?t=diversity-market>).

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70. Individual Exemption Applications of M&O Financial, Application of ECA Marketing and Warren Hersch, September 16, 2016, "Not Ready to Become a DOL Compliance FI? Go Partner with One" Available at <http://www.lifehealthpro.com/2016/09/16/not-ready-to-become-a-dol-compliant-fi-go-partner?t=diversity-market> (<http://www.lifehealthpro.com/2016/09/16/not-ready-to-become-a-dol-compliant-fi-go-partner?t=diversity-market>).

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71. Individual Exemption Application of Saybrus Partners, Inc. and Warren Hersch, August 12, 2016, LifeHealthPro.com "Unchartered Waters: Why This IMO is Seeking FI Status under DOL Rule." Available at <http://www.lifehealthpro.com/2016/08/12/unchartered-waters-why-this-imo-is-seeking-fi-stat> (<http://www.lifehealthpro.com/2016/08/12/unchartered-waters-why-this-imo-is-seeking-fi-stat>).

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72. Greg Iacurci, June 23, 2016, Investment News, "Indexed Annuity Distributors Weigh Launching B-Ds Due to DOL Fiduciary Rule" available at <http://www.investmentnews.com/article/20160623/FREE/160629957/indexed-annuity-distributors-weigh-launching-b-ds-due-to-dol> (<http://www.investmentnews.com/article/20160623/FREE/160629957/indexed-annuity-distributors-weigh-launching-b-ds-due-to-dol>).

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73. Cyril Tuohy, August 9, 2016, [insurancenewsnet.com](http://insurancenewsnet.com) "AmeriLife Files for FI Status Under DOL Fiduciary Rule" Available at <http://insurancenewsnet.com/innarticle/amerilife-files-fi-status-dol-fiduciary-rule> (<http://insurancenewsnet.com/innarticle/amerilife-files-fi-status-dol-fiduciary-rule>).

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74. Individual Exemption Application of InsurMark.

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75. The Department provides a detailed discussion of the cost and benefits associated with the Best Interest Contract Exemption in its regulatory impact analysis for the Regulation and exemptions, which was published on the Department's Web site at the same time that the Regulation and exemptions were published in the **Federal Register** and is available at <https://www.dol.gov/ebsa/pdf/conflict-of-interest-ria.pdf> (<https://www.dol.gov/ebsa/pdf/conflict-of-interest-ria.pdf>).

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76. The Department's individual exemption procedure is described in 29 CFR 2570.30 (/select-citation/2017/01/19/29-CFR-2570.30) through 2570.52.

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77. The proposed exemption would apply to commissions and other compensation received by an insurance agent, IMO insurance intermediary, insurance companies and any other affiliates and related entities, as a result of a plan's or IRA's purchase of Fixed Annuity Contracts.

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78. Cyril Tuohy, August 9, 2016, *insuranceneedsnet.com* “6 IMOs Apply for ‘Financial Institution’ Status Under DOL Rule,” Available at <http://insuranceneedsnet.com/innarticle/six-imos-apply-for-dol-fi-status> (<http://insuranceneedsnet.com/innarticle/six-imos-apply-for-dol-fi-status>) Cyril Tuohy, August 17, 2016, *insuranceneedsnet.com* “Allianz FMO Proposes FINRA-Style Oversight of Insurance Agents” Available at <http://insuranceneedsnet.com/innarticle/fmo-proposes-finra-based-supervision-structure> (<http://insuranceneedsnet.com/innarticle/fmo-proposes-finra-based-supervision-structure>).

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79. There are several other additional conditions that would apply, such as: (i) The IMO must approve written marketing materials used by Advisers (Section II(d)(4)); (ii) the IMO's compliance officer designated pursuant to Section II(d)(2) must approve recommended annuity applications prior to their submission to the insurance company (Section II(d)(5)); (iii) the IMO must provide, and require Advisers to attend, annual training on compliance with the exemption (Section II(d)(8)), and IMOs must meet the requirement of Section IV, because they limit product recommendations based on third-party payments. For purposes of this analysis, the Department has focused its discussion in the regulatory impact analysis on the conditions that it believes would have the most significant impact.

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80. The Department notes that these insurance costs discussed here are not a cost of this proposal but part of the baseline reflected in the Department's Regulatory Impact Analysis of the final rule.

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81. NAIC Financial Statement Filing and Step through Guidance, Available at [http://www.naic.org/industry\\_financial\\_filing.htm](http://www.naic.org/industry_financial_filing.htm) ([http://www.naic.org/industry\\_financial\\_filing.htm](http://www.naic.org/industry_financial_filing.htm)).

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82. In the application for the individual exemption, Advisors Excel disclosed its sales in FIA as \$5 billion in 2015. Annexus reported \$4 billion sales in FIA in 2015 according to Investment News article by Greg Iacurici on Jun 23, 2016.

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83. LIMRA Individual Annuity Report 2015.

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84. LIMRA “Individual Annuity Sales—Fixed Annuity Break-Out: 2015 Year-End Results” Available at [http://www.limra.com/uploadedFiles/limra.com/LIMRA\\_Root/Posts/PR/\\_Media/PDFs/2015-Top-20-Fixed-Breakout.pdf](http://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/_Media/PDFs/2015-Top-20-Fixed-Breakout.pdf) ([http://www.limra.com/uploadedFiles/limra.com/LIMRA\\_Root/Posts/PR/\\_Media/PDFs/2015-Top-20-Fixed-Breakout.pdf](http://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/_Media/PDFs/2015-Top-20-Fixed-Breakout.pdf))

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85. In the application for exemption, InForce Solutions states its annual sales in FIAs exceed \$2.8 billion; Futurity First Financial reported \$2.5 billion sales in FIA in 2015 according to an article “IMOs Dance with DOL on Fiduciary Deadline” by John Hilton on October 19, 2016. Available at <http://insuranceneedsnet.com/innarticle/1050689> (<http://insuranceneedsnet.com/innarticle/1050689>).

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86. Total combined sales from these four IMOs are \$14.3 billion. FIA sales by independent agents are approximately \$34.1 billion in 2015. Thus \$14.3 billion FIA sales generated by these four IMOs are about 42% of \$34.1 billion FIA sales by independent agents.

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87. Kristen Beckman, July 29, 2016, LifeHealthPro, “Futurity First Financial Acquired Nationwide Annuity IMO” available at <http://www.lifehealthpro.com/2016/07/29/futurity-first-financial-acquires-nationwide-annui> (<http://www.lifehealthpro.com/2016/07/29/futurity-first-financial-acquires-nationwide-annui>).

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88. According to data from the National Telecommunications and Information Agency (NTIA), 33.4 percent of individuals age 25 and over have access to the internet at work. According to a Greenwald & Associates survey, 84 percent of plan participants find it acceptable to make electronic delivery the default option, which is used as the proxy for the number of participants who will not opt out that are automatically enrolled (for a total of 28.1 percent receiving electronic disclosure at work). Additionally, the NTIA reports that 38.9 percent of individuals age 25 and over have access to the internet outside of work. According to a Pew Research Center survey, 61 percent of internet users use online banking, which is used as the proxy for the number of internet users who will opt in for electronic disclosure (for a total of 23.7 percent receiving electronic disclosure outside of work). Combining the 28.1 percent who receive electronic disclosure at work with the 23.7 percent who receive electronic disclosure outside of work produces a total of 51.8 percent who will receive electronic disclosure overall.

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89. According to data from the NTIA, 72.4 percent of individuals age 25 and older have access to the Internet. According to a Pew Research Center survey, 61 percent of internet users use online banking, which is used as the proxy for the number of Internet users who will opt in for electronic disclosure. Combining these data produces an estimate of 44.1 percent of individuals who will receive electronic disclosures.

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90. For a description of the Department's methodology for calculating wage rates, see <http://www.dol.gov/ebsa/pdf/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-august-2016.pdf> (<http://www.dol.gov/ebsa/pdf/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-august-2016.pdf>).

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91. This rate is the average of the hourly rate of an attorney with 4-7 years of experience and an attorney with 8-10 years of experience, taken from the Laffey Matrix. See [http://www.justice.gov/sites/default/files/usao-dc/legacy/2014/07/14/Laffey%20Matrix\\_2014-2015.pdf](http://www.justice.gov/sites/default/files/usao-dc/legacy/2014/07/14/Laffey%20Matrix_2014-2015.pdf) ([http://www.justice.gov/sites/default/files/usao-dc/legacy/2014/07/14/Laffey%20Matrix\\_2014-2015.pdf](http://www.justice.gov/sites/default/files/usao-dc/legacy/2014/07/14/Laffey%20Matrix_2014-2015.pdf)).

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92. The Department obtained the sales information about seven IMOs from their exemption applications and media reports. All these seven IMOs met \$1.5 billion premium threshold and altogether reported approximately total \$20.45 billion sales in 2015. Some IMOs reported sales from only FIAs, while other IMOs reported sales from FIAs and fixed-rate annuities. According to the LIMRA U.S. Individual Annuity Year book 2015, \$38.4 billion total premiums—\$34.1 billion in FIAs and \$4.3 billion in fixed-rate annuities—were sold through the independent agent distribution channel in 2015. This implies that approximately \$17.95 billion FIA and fixed-rate annuity sales (\$38.40-\$20.45) were generated by other entities/agents. Assuming that \$17.95 billion sales were generated by IMOs, not by agents without any IMO affiliation and assuming that each IMO equally generated \$1.5 billion sales, the Department estimates that twelve (\$17.95 billion/\$1.5 billion) IMOs potentially would be eligible to use the exemption. Thus, in total, 19 (12+7) IMOs would potentially use the exemption. Although the Department recognizes that exemption-eligible IMOs would have all different sales records, in order to estimate the upper-bound number of potentially eligible IMOs, the Department assumed that IMOs equally generate \$1.5 billion sales, the minimum premium sales threshold, for \$17.95 billion sales. This approach reflects the Department's conservative approach to estimating the compliance costs associated with the proposed class exemption. The Department welcomes any comments and information about the number of IMOs meeting the minimum sales threshold condition set forth in the exemption.

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93. *These estimates are based on LIMRA data on the number of fixed indexed annuity policies sold in 2015 to ERISA covered plans and IRAs and the market share held by independent agents, who might seek exemptive relief.*

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94. *The Department estimates that approximately 28.7 percent of advisory relationships are new each year. (According to an analysis of Form 5500 Schedule C data conducted by Brightscope, Inc. and provided to the Department, 66,962 plans reported advisers in 2012, 22,302 plans changed advisers from 2012 to 2013, and 16,196 plans changed advisers from 2013 to 2014.  $[(22,302 + 16,196)/2]/66,962 = 28.7$  percent.)*

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95. *The Department estimates that approximately 20 percent of advisory relationships are new each year. (2012 Cerulli data show that 20 percent of households opened a new account as a result of a new contact.)*

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96. *Only two applicant IMOs disclosed both sales and revenue information in their applications. One IMO reported that \$37.7 million in revenues were generated from \$1.55 billion sales in fixed rate annuities and FIAs in 2015. Another IMO reported that revenues of \$125 million were generated from \$2.1+ billion sales in various insurance products in 2015. The IMO applicant with the largest reported revenue exceeds the SBA size threshold by three times. The Department notes that the even the IMO with the smaller revenue comes extremely close to meeting the SBA size threshold. Furthermore, it reports only the subset of its entire revenues—revenues from fixed rate annuities and FIAs only. Most IMOs sell other types of insurance products such as life insurance. If it includes the revenues from other sources, the IMO with the smaller revenue is very likely to exceed the threshold set by the SBA. Thus, the Department believes that IMOs satisfying all conditions of this exemption are likely to have revenue that meets or exceeds the SBA size threshold. However, the Department is uncertain regarding why two IMOs with similar sales generate quite different levels of revenues and welcomes any comments regarding how IMOs generate revenue from sales of fixed annuity products.*

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