



Kevin T. Reynolds  
Senior Vice President  
Chief Legal Officer

July 20, 2015

**Sent via electronic mail to: ori@dol.gov**  
**and first class U.S. mail**

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attn: Fiduciary Definition Hearing, Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

**Subject: Proposed Department of Labor Revisions  
Conflict of Interest Rule Hearing**

To whom it may concern:

On behalf of the Penn Mutual Life Insurance Company (Penn Mutual) and its wholly owned subsidiary broker-dealer, Hornor, Townsend & Kent, Inc., member FINRA/SIPC (HTK), we offer comment on the Proposed Rule and prohibited transaction exemptions promulgated under Sections 3(21)(A)(ii) and 2510.3-21 of the Employee Retirement Income Security Act (collectively, the "Proposal"). Penn Mutual and HTK may be referred to individually or collectively as the "Company" throughout this letter.

Established in 1847, Penn Mutual is a mutual life insurance company, manufacturing and selling life insurance and annuity products through multiple financial services organizations, including through our wholly-owned broker-dealer, HTK. Penn Mutual and HTK are licensed in all 50 states and the District of Columbia. We are active participants in the financial services industry, distributing securities, insurance, and annuity products to the public through Penn Mutual's licensed insurance agents and HTK's registered representatives (hereinafter referred to collectively as "financial professionals").

The Company applauds and fully supports the Department's efforts to increase protections to investors and to ensure that financial professionals always act in the best interest of their customers. However, the Proposal, as presently drafted, has numerous deficiencies that would radically alter the way insurance, annuities and securities are sold and advice is provided in the financial services, and particularly retirement, arena. We believe these deficiencies could result in limiting access to essential guaranteed income products, and advice regarding them, on which our individual and small business customers rely.

Many of our customers are investors with small retirement balances who need quality advice from experienced financial professionals skilled in the marketplace of securities, insurance, and annuities products. We are quite concerned about the unforeseen negative consequences of the Proposal on these customers. We anticipate that the Proposal will substantially complicate the relationship between the investor and his financial professional, while increasing compliance and related business costs. This could set into motion an exodus of financial professionals from the small balance retirement marketplace. Once the individual personal financial professional leaves this market place, companies who service it will follow suit. In the end, it is the consumer, including small business owners trying to plan for their

retirement and the retirement of their employees, who will suffer the unintended consequences of the Proposal.

More specifically, in its present form, the Proposal:

- Will create confusion in the minds of the public about what the word “fiduciary” means, to whom it applies, and whether the standard of care for a “fiduciary” is absolute, particularly when customers receive multiple products and services from their financial professionals.
- Could cause the investing public to wrongly believe that “low cost is best” in disregard of the market place reality that commissions help pay for the financial and retirement planning services that investors want from their financial professionals.
- Overlooks the unique, long-term nature of insurance and annuity products, whose commitments and guarantees may last for decades.
- Would impose significant, redundant and expensive compliance burdens on insurers and broker-dealers, which will result in an increased cost of services to the consumer.
- Creates an unworkable regime of action steps including a contract and “conflicts of interest” warnings that defy the manner in which the customer and financial professional conduct business, while ultimately failing to help educate the investor about effective retirement planning.

We therefore respectfully submit this comment letter, highlighted several of our specific areas of concern, in the hope that the Department will redraft and revise the Proposal from its present form.

#### **1. Expansion of the DOL’s Proposal “Fiduciary” Definition as Applied to “Insurance Affiliated Broker-Dealers”**

The Proposal’s definition of “fiduciary” will replace the DOL’s traditional five-part test.<sup>1</sup> The new definition is so broad as to include numerous transactions that were not intended by the statutes or regulations. The Proposal does not take into account the way insurance companies market and do business with their customers. Moreover, it appears to assume that a consumer is incapable of telling the difference between advice and a sales and marketing effort. For example, under the present definition, “individualized” advice could include information provided in sales calls or a marketing brochure that merely may have a customers’ name in the salutation. In addition, the advice is not limited to a contemporaneous transaction, so that it could conceivably be linked to an action taken by an investor months after the actual advice was rendered, and after market conditions had changed.

The change in definition extends the application of the prohibited transaction provisions of Title 1 of ERISA to IRAs and variable life and annuities contracts by rescinding the PTE 84-24 exemption for insurance and annuity contracts transactions. Non-discretionary investment advice provided to IRA

---

<sup>1</sup> Under the new DOL definition, a person will be deemed a “fiduciary” if he: (1) renders investment advice for a fee or other compensation, direct or indirect; (2) provides investment management recommendations or appraisals to an employee benefit plan, a plan fiduciary, participant, or beneficiary, or an individual retirement account (“IRA”) owner; and (3) either (a) acknowledges the fiduciary nature of the advice or (b) acts pursuant to an agreement, arrangement, or understanding that the advice is individualized to the recipient.

owners involving variable or other annuity contracts that would constitute “securities” under federal securities laws will no longer be afforded the protection of PTE 84-24. Similarly, PTE 86-128 will no longer be available when financial professionals working with IRA owners execute securities transactions with broker/dealers with whom they are associated.

These deficiencies will have real-life consequences for the consumer and the financial professional alike.<sup>2</sup> While Penn Mutual shares the Department’s goal of ensuring that the American investing public receives advice that is in their best interest, we are concerned that, in its definitions, the Proposal creates risks and uncertainties for insurers and their financial professionals that may result in less, not more, investment and annuity information being disseminated to the consumer. At a time when investing consumers need more education and information, we believe the Proposal will have the opposite effect. We therefore urge the Department to analyze and revise the key definitions of the Proposal to bring it more in line with the existing regulatory scheme.

## **2. An Additional Compliance Regime Without Demonstrable Benefit to the Consumer**

We acknowledge the Department’s attempt to mitigate the challenges presented by the new fiduciary standard by creating the Best Interest Contract Exemption (“BICE”) that would replace PTE 84-24 and PTE 86-128. However, BICE, as presently conceived, contains numerous flaws.

The requirements necessary to satisfy the BICE exemption are so ambiguous that it would be difficult for any fiduciary to be certain that he or she was in compliance. For instance, the use and meaning of “reasonable compensation” is not explained with reference to the BICE. Nor does the BICE take into account charges assessed to insurance products by insurance companies, which charges include the costs of guarantees unique to those products.

The BICE is based on the ERISA “prudent man” standard, traditionally a highly litigated and disputed legal standard. This standard has been referred to by a court as one of the highest duties known in the law. Yet, financial professionals will now be asked to wade into these uncertain waters, possibly exposing themselves to regulatory actions and lawsuits.

BICE imposes two incompatible standards of “impartial conduct,” one based on compliance and one based on contract. The burdens of meeting these two requirements may well result in financial professionals leaving the retirement marketplace rather than risk the liabilities created by noncompliance. The end result will be a limitation of consumer choice in finding a financial professional, as less become available.

### **a. Contractual Issues**

With respect to BICE contractual requirements, the concept is technically unworkable and incompatible with customer business practices. BICE requires the contract to be signed by the investor and the financial professional *prior to* any discussion about the substance of rights and duties of each party or whether, in fact, the investor wants to work with the financial professional. Such a requirement negates

---

<sup>2</sup> For example, the Proposal removes annuities compensation from PTE 84-24 which Penn Mutual believes needs to be reinserted, because ambiguities will only serve to drive financial professionals out of the retirement market place to the detriment to the American consumer.

the “meeting of the minds” necessary for a binding contract. It is akin to an individual walking into a store and being required to sign a contract prior to even being allowed to look at the merchandise for sale. This is simply not the way business is done. We believe the imposition of a contract at the outset of a relationship will only create doubt and confusion in the mind of the consumer, before he even receives basic information from a financial professional.

In addition, the BICE contract can, and most probably will, subject a financial professional to the requirements of the Investment Advisers Act of 1940, inevitably triggering additional fees to investors. The admission of fiduciary status is likely to cause the broker-dealer to fall outside of the current ’40 Act exception for non-fiduciary, “incidental” advice<sup>3</sup> and obligate the financial professional to monitor that advice on an ongoing basis. This will cause investors to pay additional fees for such monitoring, which the investor neither expects nor wants to pay.

Finally, there is the problematic scope of the BICE disclosures. The proposed disclosure is so broad that it could include “spread revenue,” namely earnings by financial institutions in a wide range of products including bank deposits, corporate bonds, and fixed accounts within both fixed and variable annuity products. It is virtually impossible for a firm to determine the exact amount of spread revenue it has earned over any particular period. Also, it will be extremely difficult if not impossible for firms to identify the total indirect compensation paid by each retirement investor on its platform.<sup>4</sup>

#### **b. Compliance Issues**

The compliance burdens of the BICE will impact not just the financial professional, but also the firm’s compliance and supervision departments. While firms perform a number of these functions already, the will now need to be performed under the new and uncertain standard of Department of Labor fiduciary review.

Some of the extra tasks companies will need to perform to claim the BICE exemption include, but are not limited to:

(1) Firms will need to create new contracts for potential investors;<sup>5</sup>

---

<sup>3</sup> The Investment Advisers Act of 1940 (the “’40 Act”) specifically excludes registration as an investment adviser those individuals, companies who provide investment advice that is solely *incidental* to the practice of their profession.

<sup>4</sup> Finally, the website disclosure would require the development of a website that includes specific information related to every investment available on the financial institution’s platform. This website will require:

- Significant infrastructure development in order to meet website, point-of-sale, and annual reporting disclosures.
- Significant record retention requirements relating to (a) website development, (b) initial and ongoing disclosures, (c) system changes to capture newly required information; and, (d) significant accompanying training.

<sup>5</sup> The cornerstone of the BICE Exemption is the requirement that a written contract contain all of the following:

- Acknowledgement of the Fiduciary and his firm’s fiduciary status.
- Acknowledgement of the Fiduciary and his firm’s commitment to basic standards of impartial conduct.
- Warranties that the firm has adopted written policies and procedures designed to mitigate conflicts of interest and ensure adherence to standards of impartial conduct.
- Warranties compliance with applicable federal and state laws.
- Disclose of material conflicts of interest (including third party payments) and information about fees.

- (2) Firms will need to provide supervision and compliance to monitor the new BICE contracts;
- (3) Firms will need to establish policies and procedures to manage their BICE conflicts of interest; and
- (4) Compliance and supervision departments will need to monitor and supervise their financial professionals' management of their own conflicts of interest under the BICE standard.

These extra compliance and supervision steps will result in increased cost to the financial professional and his company. In turn, at least some portion of these costs will be passed on to investors. The Proposal, as a whole, but the BICE procedures in particular, fall considerably short of an objective cost-benefit analysis that is required of rulemaking of this type. The BICE mandate fails to "strike the right balance," and fails to develop a more affordable, less intrusive rule to achieve the same ends, after giving careful consideration to benefits and costs. In overstating the benefits to the investor, the Proposal understates the costs to the financial professional, the individual investor and small businesses. Little, if any, consideration appears to have been given to the financial effect of the Proposal on small retirement plans and their marketplace.

### **3. Concerns from a Co-Regulator**

The concern that the Proposal will adversely affect investors by financial professionals leaving the business is not that of Penn Mutual's alone. It has been raised by Richard Ketchum, Chairman and Chief Executive Officer of FINRA, who has predicted that the Proposal will likely cause broker/dealers to curtail, or even discontinue, sales of individual retirement accounts.

Mr. Ketchum has stated that the Proposal provides insufficient workable guidance either to the firm or the judicial arbiter on how to manage conflicts in most firms' present business models. While acknowledging the merit of the Department's concerns regarding conflicts, Mr. Ketchum believes that uncertainties stemming from contractual analysis and the shortage of useful guidance will lead many firms to close their IRA business entirely or substantially constrain the clients that they will serve.<sup>6</sup>

Mr. Ketchum has stated that the DOL Proposal would create a prejudice against financial products with higher fees, even if these products are the best recommendation for a client.<sup>7</sup>

---

Finally, the contract may not include disclaimers or limitations of liability for violations of the contract, or a waiver of the investor's right to participate in a class action.

<sup>6</sup> Source: Richard G. Ketchum, Chairman and Chief Executive Officer, **Remarks From the 2015 FINRA Annual Conference**, Washington, DC (27 May 2015), <https://www.finra.org/newsroom/speeches/052715-remarks-2015-finra-annual-conference>.

<sup>7</sup> According to Mr. Ketchum:

"While right directionally, I have practical concerns with the Labor proposal in a number of areas. First, the warranty and contractual mechanism employed by Labor used to address their limited IRA enforcement jurisdiction, appears to me to be problematic. In one sweeping step, this moves enforcement of these provisions to civil class action lawsuits or arbitrations where the legal focus must be on a contractual interpretation. I am not certain how a judicial arbiter would analyze whether a recommendation was in the best interests of the customer "without regard to the financial or other interests" of the service provider. I'm not sure, but I suspect, a judicial arbiter might draw a sharp line prohibiting most products with higher

A similar tocsin has been sounded throughout the financial services industry that the Proposal, as drafted, will drive financial professionals in the small retirement balance marketplace out of business, ultimately to the harm and detriment of the lower-wealth investor who, more than anyone else, needs their expertise. As a participant in the financial services industry, Penn Mutual supports the need for more public education and clear disclosure that actually benefits investors in a meaningful way, rather than an approach that will in fact harm the intended beneficiaries of the Proposal.

#### **4. The Better Option for Insurers and Their Affiliated Broker-Dealers**

The Proposal fails to consider the fact that there already exists regulatory oversight conducted by strong and effective regulators at the state, federal, and self-regulatory organization levels. Insurers and their affiliated broker-dealers are already comprehensively regulated by the SEC, FINRA, and state securities and insurance regulators. Adding another regulator to the mix will prove duplicative and unduly burdensome. For companies smaller than Penn Mutual and HTK, another level of regulation may well drive them out of the industry, thereby bringing Mr. Ketchum’s prediction closer to reality.

The better option for the industry would be to allow existing regulators – the SEC and/or FINRA – to arrive at a definition of “fiduciary” and corresponding regulatory scheme that are both meaningful for investor protection and workable for securities industry practitioners. FINRA already has promulgated Rule 2111 (relating to suitability), and Securities Industry and Financial Markets Association (“SIFMA”), has proposed amendments to the Rule that substantially preserve the traditional compliance regime for suitability while providing revisions that incorporate the essential concept of the customer’s best interests. This includes establishing a “best interests standard”, while addressing the critical issue of management of investment-related fees and material conflicts of interests. In addition, the standard provides for relevant required disclosures at key points in time, including: account opening; on an annual basis; through web pages; and updates at times relevant to the broker-dealer and investor.<sup>8</sup> Moreover, the SIFMA proposed amendments to Rule 2111 (converting “suitability” to “best interests of the customer”) offer an implied definition of “fiduciary” that should prove meaningful for investor protection.

We do not argue that the SIFMA proposed amendments to FINRA Rule 2111 mark the end of debate over “fiduciary duty” applicable to broker-dealers and their registered representatives. However, we do maintain that the solution to establishing a “best interest” standard should begin and remain with a proposal that does not unnecessarily restructure the insurance and securities industries. Penn Mutual

---

financial incentives no matter how sound the recommendation might be. Similarly, I’m not sure how a judicial arbiter would evaluate which compensation practices “tend to encourage” violations of the exemption. It would appear likely, however, that firms would be required to demonstrate, at least, that any higher compensation was directly related to the time and expertise necessary to provide advice on the product, as specifically suggested by DOL. To say the least, making that case is not a simple proof standard.”

Source: Richard G. Ketchum, Chairman and Chief Executive Officer, **Remarks From the 2015 FINRA Annual Conference**, Washington, DC (27 May 2015), <https://www.finra.org/newsroom/speeches/052715-remarks-2015-finra-annual-conference>.

<sup>8</sup> SIFMA, **Proposed Best Interests of the Customer Standard for Broker-Dealers** (Preamble). <https://owa.pennmutual.com/owa/attachment.aspx?attach=1&id=RgAAAAB6xACVx%2bpuTqs3WDG831EiBwAiXJwb7PTMSI4hx1ddGDM6AAA%2fcS%2bAAAiXJwb7PTMSI4hx1ddGDM6AAAtDowRAAAJ&attid0=BAAAAAAA&attcnt=1>

respectfully maintains that revisions to the duties and responsibilities of insurance agents and their registered representatives should be developed and implemented by the current regulatory regime authorized by Congress and the states.

## 5. Conclusion

Recent years have witnessed the decline of traditional employer-sponsored pension plans. These plans are practically non-existent for the Baby Boom generation as they cross the threshold of becoming seniors and retirees who need income protection through alternative vehicles like annuities and other guaranteed lifetime income products. The need to save for retirement in 401(k) and other defined contribution plans as well as IRAs has never been greater.

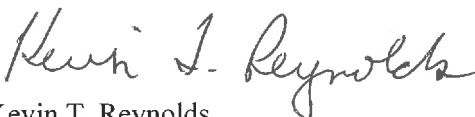
Annuities serve as an efficient means to convert one's savings into a "personal pension plan" that can supplement Social Security and thereby ensure that investors can have a reasonably secure retirement. America's life insurance industry is the critical source for manufacturing annuities, and its financial professionals are the foremost educators regarding these products. Without the benefit of financial professionals, consumers may delay the tasks of educating themselves about annuities and their value proposition, not to mention the variety of annuity options. Penn Mutual believes that the Proposal in its present form will substantially reduce the availability of financial professionals who can provide that education.

As a practical matter, implementing a compliance and supervision program overseen by the Department of Labor would effectively require financial services companies like Penn Mutual and HTK to create new procedures, technology and personnel dedicated to monitoring and supervising the DOL's rules, separate and apart from the SEC, FINRA, and the state securities and insurance regulators. In our view, this is unnecessary. There already exists a very reasonable proposal for establishing the parameters of fiduciary responsibility, which is both meaningful for investor protection and workable for financial services practitioners. The mechanism for adopting and implementing this standard through rule adoption is available via the SEC and FINRA without adding an additional regulatory authority. Existing SEC / FINRA codes of conduct can and should be modified towards the goal of arriving at a universal "fiduciary" standard that is both relevant to insurance and securities products and is in line with actual practice.

We therefore urge the Department to heed the comments of the numerous participants in the financial services industry in response to this Proposal and allow the traditional regulators of this marketplace to craft meaningful solutions. In the alternative, we urge the Department to substantially modify the present form of the Proposal so that a meaningful and workable Rule can be established for the industry.

Thank you for your consideration of Penn Mutual's position in this matter.

Respectfully submitted,



Kevin T. Reynolds  
Chief Legal Officer