



September 22, 2015

Office of Exemption Determinations  
Employee Benefits Security Administration  
Attention D-11712 & D-11850  
U.S. Department of Labor  
200 Constitution Avenue NW, Suite 400  
Washington, DC 20210

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

Re: ZRIN: 1210-ZA25; D-11850: Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption 84-24

Dear Assistant Secretary Borzi:

The Indexed Annuity Leadership Council (“IALC”) welcomes the opportunity to supplement our July 20<sup>th</sup> comment letter and August 12<sup>th</sup> testimony regarding the Department’s proposed regulation revising the definition of “fiduciary” under the Employee Retirement Income Security Act of 1974 (ERISA) and the related Prohibited Transaction Exemptions (PTEs).

As I testified, each of the issues we raised and the recommendations offered in our July 20<sup>th</sup> letter are important to make PTE 84-24 function as we believe is intended and to provide the necessary clarity that is important for compliance purposes. However, we want to underscore the need for the final rule to address the types of compensation that are covered under the PTE and to provide a stronger context to our suggestion that certain types of compensation be permitted to qualify under the PTE.

***I. Reasonable Compensation***

During the hearing I testified that commission rates were relatively standard between six and eight percent. Those percentages are for a fixed annuity product with a long term and that usually includes additional benefits such as, lifetime income benefit, long-term care, and terminal-illness riders. Products with shorter terms or fewer features may have lower commission rates. Additionally, I failed to add to my description of commission rates that some insurance companies make the commission payment upfront when the contract is signed, while others spread out the payment over a period of years (usually 1 to 3 years). In either case the total commission is within the ranges I described for such a product.

Our comment letter suggested adding more clarity to the final rule's definitions so that total compensation, including commissions, when reflecting prevailing industry compensation levels would not be considered unreasonable. We continue to believe this change is important.

We have heard from many insurance agents that they understand that commission rates generally fall within a narrow band--that there is not great variance among and between carriers as to total compensation that is paid on the sale of a similar fixed annuity policy. However, they have raised concerns about whether the PTE limitation on compensation may be intended to allow the Department to reduce their total compensation levels by claiming that total compensation that is within current industry practices exceeds reasonable levels. We believe that insurance agents more than earn their compensation and that the commission rates that fall within prevailing industry ranges are in fact reasonable. And while we do not ascribe any motive to the PTE's limitation other than to minimize conflicted advice that might arise from compensation levels that exceed industry norms, we believe that the additional clarity we suggested will ease the fears that we have heard expressed.

As the data we already submitted demonstrates, the distribution channel for fixed annuities relies significantly on independent insurance agents who manage their own businesses. These small businesses have a host of overhead expenses that must be recovered from the commissions and other compensation they earn. These costs can include rent, accounting, insurance, marketing, utilities, taxes, compliance, and many more items. These insurance agents spend considerable time and effort working with potential and existing clients to help them choose appropriate policies that address their individual circumstances.

When measured against investment advisory fees that typically range between 1 and 1 ½ percent assessed annually on the total assets under management paid by the consumer along with any additional imbedded fees on the investment products acquired, a one-time commission of 6 to 8 percent paid by the insurance company for a long-term policy compares more than favorably.

Given the competitive market place for fixed annuities the market sets compensation levels. The suggested modification regarding the definition of "reasonable compensation" offered in our previous comment letter reflects the fact that compensation rates are established in a competitive market. Specifically, in that letter we suggested including a safe harbor in the final regulation that would provide that compensation is reasonable if it satisfies the regulations under the tax code regulations relating to compensation for personal services (26 CFR 1.162-7) which is referenced in ERISA Section 408(c)(2) (§2550.408c-2(b)(5)). Those regulations provide that it is in general "just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances." That standard is more definitive in the context of fixed annuity sales and reflects the market described above.

## *II. Incentive Payments*

Our prior comment letter and testimony also requested that the final rule provide a clearer definition of “insurance commission.” In that regard we have urged the final rule to be broad enough to encompass all taxable compensation and retirement and welfare benefits. However, with respect to marketing payments and incentive payments we urged the Department to restrict such payments to those that are based solely on aggregate sales instead of banning them.

While our comment letter addressed the fact that insurance agents sometimes receive retirement and health care coverage and marketing allowances from insurance companies that should not be lost as a result of the PTE’s restrictions on compensation, we want to offer additional information and justification for also including incentive and marketing payments that are based solely on aggregate sales.

The use of incentive payments, including non-cash awards, is not limited to the sale of insurance products. In fact, such practices are prevalent across all business types and sizes. Recent published research<sup>1</sup> has reported that nearly 75% of all U.S. businesses use non-cash awards to recognize and reward key audiences. These incentive awards are estimated at nearly \$77 billion annually, including more than \$22 billion in travel awards. While not exclusively so, these awards are frequently used to motivate and reward sales forces in all industry sectors.

There is no basis for concluding that a non-cash or cash incentive award based on total aggregate sales of a particular insurance company creates any more of a conflict than a commission payment. It may make for better headlines, but it does not create a greater conflict.

The PTE as proposed mitigates the potential for conflicted advice when any form of a payment is received from a third party by (1) requiring full and complete disclosure, and (2) prohibiting total compensation that is in excess of reasonable levels. We have suggested adding an additional restriction for incentive and marketing payments that limits such payments to programs that are based on total aggregate sales. This approach will prevent incentive programs that encourage recommending a particular feature or rider to a consumer that may not be in their best interest. It is an approach that has been adopted successfully by FINRA<sup>2</sup> and the MSRB<sup>3</sup>.

The Securities and Exchange Commission approved amendments to NASD Rules 2820 (Variable Contracts of an Insurance Company) and 2830 (Investment Company Securities) in July 1998. These rules imposed new requirements on non-cash compensation arrangements that greatly restricted the direct or indirect payments of non-cash compensation. However, such payments were permitted to the extent that they were made as part of an incentive program that was based on total aggregate sales. More recently, FINRA in April 2014 requested comment on the impact of the non-cash compensation rules to determine their effectiveness at stemming conflicts. In December 2014 FINRA released an initial assessment

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<sup>1</sup> Incentive Federation, IFI Cross-Section Research Report, “U.S. Business Use of Incentive Travel Awards,” 2014.

<sup>2</sup> FINRA Rule 3220, “Influencing or Rewarding Employees of Others” 2008.

<sup>3</sup> Municipal Securities Rulemaking Board, Rule G-20, “Gifts Gratuities and Non-Cash Compensation,” <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-20.aspx> (last visited September 14, 2015).

of its findings.<sup>4</sup> It concluded: “[m]ost stakeholders agreed that the gifts and non-cash compensation rules have been effective at addressing the problems they were intended to mitigate, stating that the concerns about ... conflict of interest that existed several years ago are not present today.”

In practice, incentive and marketing payments do not function as an incentive to sell products that would otherwise not serve the best interest of a consumer. Instead, they are tools for insurance companies to support the educational and marketing function of insurance agents, and to create good will and reward top producers by insurance companies. The limitation we are suggesting will further ensure that such payments do not create incentives that work against the best interest of consumers.

Given the success of the FINRA approach to preventing conflicts with respect to incentive payments we believe that the Department should incorporate the approach into its final rule for both incentive and marketing payments as we suggested in our prior comment letter.

### III. Conclusion

Again, we appreciate the tremendous effort that the Department has invested in developing the proposed regulation and the accompanying PTEs. We believe that with some modifications as discussed in our comment letter of July 20 and our testimony the interests of employee benefit plan participants and IRA owners can be better protected while not impairing their opportunity to purchase fixed annuities when appropriate to meet their retirement needs. We hope that this second comment letter helps to amplify the rationale behind a couple of the recommended changes that we previously offered. We would be happy to discuss our suggestions or answer any questions you may have.

Sincerely,



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<sup>4</sup> FINRA, Retrospective Rule Review Report, “Gifts, Gratuities and Non-Cash Compensation,” December 2014.