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FILED ELECTRONICALLY

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

Re: Interim Final Regulations under ERISA Section 408(b)(2)

Dear Sir or Madam:

We are writing on behalf of the Committee of Annuity Insurers (the "Committee") to comment on the interim final regulations under section 408(b)(2) of the Employee Retirement Income Security Act of 1974 ("ERISA"), which were published by the Department of Labor (the "Department") on July 16, 2010. The Committee is a coalition of life insurance companies formed in 1982 to participate in the development of federal policy with respect to annuities. The Committee's current 31 member companies represent more than 80% of the annuity business in the United States. A list of the Committee's member companies is attached.

The Committee's members are among the largest issuers of annuity contracts to employer-sponsored retirement plans subject to ERISA. As such, the Committee's members have a keen interest in the regulations, which impose disclosure requirements on "covered service providers" to retirement plans to assist plan fiduciaries in assessing the reasonableness of services contracts or arrangements. This comment letter focuses on the extent to which insurers are covered service providers by reason of issuing an annuity contract to a covered plan.[1] It also identifies issues that are unique to insurers who are treated as covered service providers.

Life insurance companies play a central role in our nation's employment-based retirement system. Generally speaking, the different roles that issuers of annuity contracts play can be placed into three broad categories. First, insurers issue annuity contracts to plans as

[1] It should be noted, however, that the same issues typically arise for issuers of life insurance contracts to retirement plans, and that the clarifications requested should also apply to life insurance contracts.

investments. These annuity contracts may, for example, be held by a defined benefit plan to support scheduled pension payments or offered as an investment or distribution option in an individual account plan. In this circumstance, under a typical structure, the trustee for the plan is the named owner of the contract. The beneficiary of the contract is the plan, although the covered lives may be participants or beneficiaries. These contracts may be fixed or variable contracts; they may be deferred annuities or annuities that are currently in pay status. These contracts are often the same contracts that are issued by insurers to non-plan purchasers (sometimes referred to as "nonqualified contracts").

Second, annuities may serve as plan funding vehicles. That is, in lieu of a trust, an employer may make contributions directly to an annuity contract. In this regard, annuity contracts are generally exempt from the trust requirement under section 403(b) of ERISA. The tax rules also permit the use of an annuity in lieu of a trust in a 401(a) plan and explicitly require the use of an annuity contract as a funding vehicle for a 403(a) or 403(b) plan (with custodial accounts also permitted in the case of a 403(b) plan). In these non-trusteed arrangements, the insurer may not provide services beyond those that are inherent in the annuity contract. The services inherent in the contract would, however, ordinarily include administration of distributions from the contract and may include accounting for participant and beneficiary interests.

Third, in addition to issuing annuity contracts, insurers may provide services directly to retirement plans. For example, an insurer, an affiliate or a subcontractor may provide Form 5500 preparation, nondiscrimination testing and plan document preparation services. These additional services would typically be covered by a services agreement running between the plan and the service provider. In such a case, the insurer would ordinarily be a bundled service provider. That is, the insurer would only offer the plan-level services in connection with its annuity contracts; it would not typically offer the services apart from the annuity contracts. There are also arrangements where the insurer provides some plan-level services while a third-party administrator provides other services, for example, enrollment and investment education or advice services.

As we consider the interim final regulations, we believe that these different types of arrangements should be analyzed separately. The regulations focus on whether a person provides "covered services," and the relevant services are very different depending on the type of arrangement. We also believe that it is critical to have clear rules for annuity contracts and issuers. As the Department has recognized, plans are increasingly looking to offer lifetime income options, particularly in individual account plans.[2] Clear rules will help responsible plan fiduciaries to understand these arrangements, and may facilitate the use of guaranteed income products in retirement plans. We discuss below the issues that arise for insurers with an eye to the different types of services arrangements involving issuers of annuity contracts.

[2] 75 Fed. Reg. 5253 (Feb. 2, 2010) (request for information on whether and, if so, how, by regulation or otherwise, it would be appropriate to facilitate access to lifetime income options); 75 Fed. Reg. 48,367 (Aug. 10, 2010) (notice of hearing on certain issues related to lifetime income options in retirement plans).

1. Final regulations should clarify the circumstances in which a plan investment in an annuity contract causes the issuer to be a covered service provider.

One fundamental issue that should be addressed clearly in the final regulations is the extent to which an annuity contract issued to a plan will cause the issuer to be a covered service provider. As we understand the different categories of covered service providers, we believe that the mere issuance of an annuity contract to a covered plan will cause the insurer to be a covered service provider in only certain circumstances, discussed below. There are three categories of covered service providers under the interim final regulations, discussed separately below.

a. <u>Category One – Fiduciary Service Providers</u>

The first category deals with persons who provide services to a plan as an ERISA fiduciary or as a registered investment adviser, or to a plan investment as an ERISA fiduciary.[3] An insurer will clearly not be acting as a fiduciary or a registered investment adviser solely by reason of issuing a contract to a plan. An insurer may be a covered service provider by reason of providing fiduciary services to a plan investment. This will turn on whether the insurer provides services as a fiduciary to an investment contract that holds plan assets and in which the covered plan has a direct investment.[4]

b. <u>Category Two – Platform Providers</u>

The second category treats a person who provides recordkeeping or brokerage services to a participant-directed individual account plan as a covered service provider, if one or more designated investment alternatives will be made available in connection with such recordkeeping or brokerage services.[5] We refer to such persons as "platform providers." The regulations define recordkeeping services broadly to include "services related to plan administration and monitoring of plan and participant and beneficiary transactions . . . and the maintenance of covered plan and participant and beneficiary accounts, records, and statements." The regulations specifically state as examples of recordkeeping services the administration and monitoring of loans, withdrawals and distributions. The basic question is whether the administration inherent in an annuity contract may cause an issuer to be a covered platform provider.

The Committee believes that an insurer should not be treated as a covered platform provider merely by reason of issuing an annuity contract to a participant-directed plan as a plan investment if there is a third-party recordkeeper, and we urge the Department to clarify this

[3] DOL Reg. § 2550.408b-2(c)(1)(iii)(A).

[4] This will ordinarily occur only when an insurer is a fiduciary with respect to the non-registered separate account investments under a variable contract. More specifically, if a variable contract invests in unregistered investments, then the contract and the separate account investments of the contract may be plan assets. However, to the extent the assets in the separate account are registered investment companies (*i.e.*, mutual funds), the underlying assets of the funds are not plan assets.

[5] DOL Reg. § 2550.408b-2(c)(1)(iii)(B).

point. An annuity contract will almost invariably involve services that may be considered recordkeeping services under the broad definition in the regulations, for example, maintaining beneficiary records and participant and beneficiary accounts. However, to the extent that an annuity contract, such as a variable annuity contract with a guaranteed lifetime withdrawal benefit or a deferred fixed annuity, is offered as a designated investment option under a third-party recordkeeper's platform, the issuer of the investment option does not make the designated investment alternative available to the plan. In such a setting, the responsibilities associated with disclosing the fees and expenses associated with the annuity contract would fall on the plan's recordkeeper who is making the contract available as an investment option.

We recognize, however, that the analysis is different if there is no third-party recordkeeper making the annuity contract available as an investment option. As mentioned above, it is not uncommon for an annuity contract to fund in whole or in part a participant-directed individual account plan, such as a 401(k) or 403(b) plan, without additional centralized recordkeeping provided by an unrelated third party. The issuer may provide only those services that are inherent in the contract or may provide additional services typically detailed in a separate services agreement. As we understand the regulations, it appears that the insurer would be treated as a platform provider in such a context solely by reason of issuing an annuity contract to a participant-directed individual account plan. Such an insurer appears to fall within the four corners of the definition of a platform provider. In this regard, as mentioned above, the contract will invariably provide administration related to distributions and withdrawals, and may include services related to plan loans and hardship withdrawals, each of which would be considered recordkeeping services under the interim final regulations. Further, in the absence of a plan-level recordkeeper that is offering the annuity contract, it appears that the insurer makes the contract available as a designated investment alternative. Taken as a whole, we understand the regulations to treat an annuity contract itself as a services arrangement, notwithstanding that all of the services may be inherent in the annuity contract. It is, however, not entirely intuitive to treat an annuity contract as a services agreement, at least where the only services are the same services that are provided to non-plan purchasers, and we urge the Department to make this point more explicit.

One wrinkle that arises frequently with annuity contracts is shared responsibility for recordkeeping services. It is not uncommon in the context of plans funded through annuity contracts for there to be more than one person providing recordkeeping services within the meaning of the interim final regulations. For example, a broker may have assisted the plan fiduciary in the selection of an annuity contract and may provide ongoing plan document preparation, nondiscrimination testing and Form 5500 preparation services. The insurer may provide other recordkeeping services, for example, maintaining participant and beneficiary accounts, processing distribution elections and administering plan loans.

We appreciate that both parties may be covered service providers under other provisions of the interim final regulations, but we believe that only one person should be viewed as making the designated investment alternative available and, therefore, as a platform provider. Any other approach would be anomalous because it would impose a duty on both parties to provide the responsible plan fiduciary with information about the expenses associated with the plan's designated investment alternatives. Thus, the final regulations should clarify that only one

person is treated as making a single investment alternative available. While it is possible for different persons to make different investment alternatives available, for example, in a 403(b) plan that permits contributions to more than one vendor, a single investment should not be viewed as made available by two service providers. Thus, in the example above, the broker who assists in the selection of the contract would be viewed as the person making the contract available as an investment alternative and, therefore, as the platform provider.

Taken together, we suggest two clarifications to the rules applicable to a covered platform provider. First, the final regulations should provide that an insurer is not a covered platform provider merely by reason of issuing an annuity contract to a participant-directed plan as a plan investment if there is a third party who is responsible for providing recordkeeping services with respect to the annuity investment. Second, the final regulations should state that there is only one platform provider with respect to a single designated investment alternative, even if more than one person provides recordkeeping services in connection with the investment alternative.

c. Category Three – Indirect Compensation Recipients

The third and final category of covered service providers applies to a person who provides any services within a list of enumerated service categories, if the service provider, an affiliate, or a subcontractor reasonably expects to receive indirect compensation.[6] The underlying notion is that the enumerated services are central to the administration of plans and the disclosure of any indirect compensation will assist plan fiduciaries in evaluating the reasonableness of compensation and any potential conflicts of interest. The list of covered services includes "insurance" as well as "actuarial" services.

The Committee recommends that the Department clarify in the final regulations that an insurer is not a covered service provider under the third category merely because it receives premiums in connection with an annuity contract issued to a covered plan. The instructions to the Schedule C, which closely track the disclosure requirements of section 408(b)(2) by imposing a parallel disclosure requirement in the context of annual reporting on the Form 5500, explicitly create such a rule by providing as follows:

> The investment of plan assets and payment of premiums for insurance contracts, however, are not in and of themselves payments for services rendered to the plan for purposes of Schedule C reporting and the investment and payment of premiums themselves are not reportable compensation…

2010 Instructions to the Form 5500 Annual Return/Report of Employee Benefit Plan at 25.

We are not aware of any reason for a different rule in the context of section 408(b)(2), and we believe that the same substantive rule should be included in the final regulations. We also interpret the interim final regulations to imply this substantive rule. The issue arises only because of the absence of an explicit rule addressing the treatment of insurance premiums and

[6] DOL Reg. § 2550.408b-2(c)(1)(iii)(C).

because it is possible to stretch the interim final regulations to treat an insurer as providing "insurance" services and to treat amounts that an insurer earns in connection with insurance as a form of indirect compensation. Such an interpretation would be misguided for a number of reasons.

First, an issuer of an annuity contract is not providing insurance or actuarial services in the sense intended by the interim final regulations. Insurance services should be understood to refer not to the issuance of insurance but rather to insurance-related services, like insurance brokerage. That is, insurance services are distinct from the act of providing insurance.[7]

Second, it would make little sense to treat the payment of premiums as a payment for services to be rendered to a plan. An issuer who receives premiums from a plan is not receiving a payment for the performance of services, but rather a payment for insurance. We appreciate that an annuity contract may include services incidental to the insurance coverage, for example, tax reporting and withholding on distributions from a contract that serves as a plan funding vehicle. However, services that are both inherent to the contract and incidental to the insurance coverage should not be considered services subject to reporting, and certainly should not be considered "insurance" services within the meaning of the interim final regulations.

Under this analysis, it would be clear, for example, that a deferred fixed annuity contract issued to fund a defined benefit plan described in section 402(e) of the Internal Revenue Code of 1986 (formerly section 412(i)) would not give rise to a disclosure obligation, provided that the issuer does not provide any enumerated services to the plan, such as actuarial services, outside of the contract and does not receive indirect compensation in connection with such additional services.

A related issue is the extent to which an issuer of an annuity contract investment option, such as a deferred variable annuity option offered on a trusteed 401(k) platform with third-party recordkeeping, should be treated as a covered service provider solely by reason of amounts the insurer deducts from the separate account investments in the contract. As discussed above, such an insurer may be viewed as receiving indirect compensation but should not be viewed as providing covered services within any of the enumerated categories. The interim final regulations do not treat service providers to investments as covered service providers, unless the service provider is an ERISA fiduciary to an investment that is holding plan assets, and issuers of annuity contract investments should be treated in the same manner.

We also note that issuers of annuity contracts that are offered as investment alternatives on a recordkeeper's platform may pay compensation to the plan's recordkeeper to compensate it for its services. These payments are indirect compensation to the recordkeeper. The insurer should not be viewed as receiving indirect compensation as a result of amounts it deducts from a contract and pays to the recordkeeper. Such an analysis would comport with the treatment of an investment fund that makes a payment to a plan recordkeeper, such as a 12b-1 fee paid by a

[7] One might also consider insurance as involving actuarial services. However, we believe that actuarial services refer to services provided by an actuary to a plan, not to the actuarial services inherent in an insurance contract.

mutual fund investment alternative to a recordkeeper. A service provider to the mutual fund who remits a payment to a recordkeeper is not treated as a covered service provider under the interim final regulations by reason of its remittance role, and a similar analysis should apply to the issuer of an annuity contract. It would, however, be helpful if this point is clarified in the final regulations.

In view of the foregoing, we suggest two changes to the rules affecting covered service providers described in this third category. First, the final regulations should reiterate the language from the Schedule C instructions previously quoted, and, second, the preamble to the final regulations should confirm that the issuance of insurance is not considered the provision of insurance services. Then the only circumstances in which an annuity contract may cause the issuer to be a covered service provider is if (i) the issuer is an ERISA fiduciary with respect to the underlying assets of the contract, *e.g.*, if the issuer serves as the investment manager to a non-registered separate account investment, or (ii) the contract is issued to a participant-directed individual account plan and there is no intervening recordkeeper making the contract available as an investment alternative. Of course, an issuer may provide separate services outside of the annuity contract, in which case the issuer may be a covered service provider under the general rules discussed above.

2. The Department should provide transition relief for issuers of individual annuity contracts which do not receive contributions after the effective date of the interim final regulations.

Some insurers issue individual annuity contracts to participants and beneficiaries in covered plans.[8] Under the broad definition of a platform provider, it appears that an issuer of individual annuity contracts may be considered as making available an investment option, even though the issuer is only issuing contracts directly to a plan. However, the use of individual contracts raises unique issues under the regulations.

The responsible plan fiduciaries may not have any retained contractual rights under the contracts, and the issuer may have a very attenuated, if any, relationship with the fiduciary. The relationship may be very thin, for example, where the employer is no longer making contributions to the contract. In such a context, it would be anomalous for the issuer to provide the required disclosures under the interim final regulations to the responsible plan fiduciary since the fiduciary has no retained discretionary authority or control over the contracts. Moreover, the cost of identifying and locating the responsible plan fiduciary may be disproportionate to any perceived benefit associated with disclosure.

This issue arises most frequently in the context of section 403(b) plans, which, as the Department is aware, have historically operated more as individual retirement arrangements than employer-maintained plans. The Department provided relief from the 2009 Form 5500 reporting requirements for individually-owned 403(b) annuity contracts in certain circumstances, and the

[8] Insurers may also issue group annuity contracts with individual certificates that are the substantive equivalent of individual annuity contracts. Such individual certificates should be treated in the same manner as individual annuity contracts.

Committee believes that relief is appropriate in the context of section 408(b)(2) as well.[9] Given that the interim final regulations are scheduled to be effective July 16, 2011, we urge the Department to provide such relief prior to that date.

We also urge the Department to provide broader relief than was provided from the Form 5500 annual reporting requirement. The relief from the Form 5500 has had only limited utility, in large part because the relief was conditioned upon all of the rights and benefits under the contract being legally enforceable against the insurer by the individual owner of the contract without any involvement by the employer. Many issuers and employers had entered into information sharing arrangements, or other similar arrangements in which the employers authorized transactions, in order to satisfy the applicable tax rules. These arrangements arguably provided the employer with enforceable rights, since an employer's failure to authorize a transaction could have the effect of denying a participant access to a contractual right. We believe that a broader exclusion is justified in the context of section 408(b)(2) since the fundamental purpose underlying the section's disclosure regime is to provide the responsible plan fiduciary with the ability to evaluate a services arrangement. The goal is to ensure prudent arrangements.

In the context of individually owned annuity contracts where the employer does not have the ability to replace the issuer and the issuer is no longer receiving contributions, this purpose is entirely inapplicable. That is, the responsible plan fiduciary does not have the ability to modify or terminate the services arrangement. As a result, the disclosure requirements should be inapplicable. Accordingly, we urge the Department to provide relief from the interim final regulations where an annuity contract is issued by a provider that, as of the effective date of the interim final regulations, is no longer authorized to receive contributions under the plan and the employer does not have discretionary control over the asset, specifically, the ability to exchange the contract for another contract or custodial account.

3. Final regulations should clarify the meaning of an investment that provides a fixed rate of return.

Platform providers generally have a duty to disclose to the responsible plan fiduciary basic investment information associated with the investment options covered by the recordkeeping services. As a practical matter the issuer of a designated investment alternative will need to provide the requisite information to the platform provider. One required element of disclosure is the investment's annual operating expense. This element is waived for investments that provide a fixed rate of return, which is not defined or discussed in the preamble to the interim final regulations.

We urge the Department to clarify the definition of a fixed rate of return. The regulations do not define the term. It seems apparent that the rule was meant to encompass guaranteed investment contracts ("GICs"), general account investments, deferred fixed annuities and stable

[9] Field Assistance Bulletin 2009-02 (July 20, 2009), as supplemented by Field Assistance Bulletin 2010-01 (Feb. 17, 2010).

value contracts. These contracts, however, may credit excess interest or reset the interest crediting rate on a periodic basis so that the rate could be characterized as other than fixed.

In our view, if an investment is backed by the insurer's general account, the regulations should not require development of an annual operating expense for the investment. Put simply, these investments do not have annual operating expenses. One logical approach would be to define the class of investments for which an annual operating expense is not required as any investment that is a guaranteed benefit policy within the meaning of section 401(b)(2) of ERISA. A guaranteed benefit policy is defined as "an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account."[10] Applicable case law reflects that a general account investment will be looked through only to the extent that the insurer is effectively passing through its investment results, which should serve as an appropriate measure of the circumstances in which disclosure of an investment's annual operating expenses should be required.[11]

4. Final regulations should confirm that the obligation to provide information necessary for reporting purposes does not override the general disclosure timing rules for the Schedule A to the Form 5500.

The interim final regulations state that, upon request, a covered service provider must provide the responsible plan fiduciary with any information "required for the covered plan to comply with the reporting and disclosure requirements of Title I of [ERISA] and the regulations, forms and schedules issued thereunder."[12] Compliance with a request is due not later than 30 days following receipt of a written request.

The Committee suggests that the Department clarify the interaction between the time line for reporting generally and a request for information. Service providers often provide information necessary for annual reporting within a specified schedule following the end of the plan year. For example, many providers offer Schedule A information within 120 days of the end of the plan year. We believe that a responsible plan fiduciary cannot force a service provider to provide information on a shorter time line by making an affirmative request under the interim final regulations because the information is not "required" at that time for reporting and disclosure purposes. Moreover, it would obviously be impractical if a plan makes a request for Schedule A information immediately following the end of the plan year and before the provider has compiled the information. Accordingly, we suggest that the response date should be reasonably in advance of the date by which the plan must comply with the applicable reporting

[10] ERISA § 401(b)(2)(B).

[11] *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 510 U.S. 86 (1993). *See also Peoria Union Stock Yards Co. Ret. Plan v. Penn Mut. Life Ins. Co.*, 698 F.2d 320 (7th Cir. 1983).

[12] DOL § 2550.408b-2(c)(1)(vi)(A).

and disclosure requirement.[13] This would strike a balance between ensuring that the requisite information is provided and allowing the provider the opportunity to develop the information in a timely manner.

5. The Department should consider appropriate relief with respect to clarifications applicable to the interim final regulations.

We also recommend that the Department promptly issue either formal or informal guidance addressing these issues. Specifically, to the extent that modifications to the interim final regulations clarifying the open issues are not practical before the effective date of the interim final regulations, we request that informal guidance be issued.

* * *

Should any questions arise in connection with our comments, or if the Committee can be of any assistance to the Department in its consideration of this important issue, please contact Jason Bortz or Joseph McKeever, both of Davis & Harman LLP. They can be reached by phone at 202-347-2230, or *via* electronic mail at jkbortz@davis-harman.com or jfmckeever@davis-harman.com, respectively.

Sincerely,

Jason K. Bortz

Joseph F. McKeever, III
by HRS

Attachment

[13] Consider, for example, the Schedule A, which the insurer generally must provide within 120 days after the end of the plan year. If the Schedule A information were somehow lost or the insurer inadvertently failed to provide the information, the plan fiduciary could request the information and the failure to provide the information could result in a prohibited transaction. However, there would be no prohibited transaction if the insurer provided the information reasonably in advance of the due date for filing the Form 5500 (the end of the seventh month following the end of the plan year absent an extension).