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Michael T. McRaith
Director, Federal Insurance Office
Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: Public Input on the Report to Congress on How to Modernize and Improve the System of Insurance Regulation in the United States

Docket Number: 2011-26776

Dear Director McRaith

The National Association of Insurance and Financial Advisors (“NAIFA” or the “Association”) appreciates the opportunity to offer the following comments on the Federal Insurance Office (“FIO”) forthcoming study on how to modernize and improve the system of insurance regulation in the United States. As the Administration continues implementing broad financial services and insurance reform it is essential that it recognize and respond to 21st century marketplace demands for life insurance companies, producers, and reinsurers whose business models reflect the tradition of state regulation of insurance yet also call for oversight beyond the confines of the state insurance regulatory regime. We offer these comments in the hope that it marks the beginning of a continuing dialogue between NAIFA and FIO.

Background on NAIFA and its Members

Founded in 1890 as the National Association of Life Underwriters, NAIFA comprises more than 600 state and local associations representing the interests of approximately 200,000 agents and their associates nationwide. NAIFA members

focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. The Association’s mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

NAIFA is the nation’s largest financial services membership association. Our goal is to ensure that middle-market investors continue to have access to professional services and advice and have a choice of financial products that meet their financial needs and objectives. Virtually all NAIFA members sell life insurance. In addition, nearly two-thirds of NAIFA members are licensed as registered representatives of broker-dealers (“Registered Representatives”) to sell securities to their clients (primarily mutual funds and/or variable annuities). Of our members who deal in securities, approximately 41 percent are “dually-registered” as Registered Representatives and investment adviser representatives (“IAR”) for their corporate registered investment adviser (“RIA”). Approximately two-thirds of all NAIFA members, and 93 percent of our dual-registered members, provide retirement planning services.

Community-based NAIFA members, many of whom are small business owners, provide affordable financial services to middle-market investors. This is attested to by Life Insurance and Market Research Association (“LIMRA”) data NAIFA has collected over the past eighteen months.¹ An analysis of two surveys—one involving over 1,000 demographically representative consumers and the other of over 3,300 NAIFA members—shows that consumers with household incomes in the middle-market range represent the core client base of NAIFA members. The survey found that on average NAIFA members report that 58 percent of their clients have annual household incomes under \$100,000, and 77% of their clients have under \$150,000 in household income. Most of these consumers have limited funds to invest, suggesting a need for affordable financial advice. Indeed, approximately one-third of consumers surveyed who reported earning \$50,000 - \$99,999 said they have less than \$50,000 invested; half of all respondents said they could afford to invest no more than \$1,200 a year.

¹ See **Appendix I**.

These consumers that NAIFA members serve every day rely on the honest, trustworthy guidance of their financial advisors to help manage risk and plan for retirement. Without personalized advice from financial professionals who have earned their trust over many years of service, these investors would be forced to utilize impersonal, “one-size-fits-all” advice from firms that do not tailor their advice to the specific needs of individual clients. In contrast, NAIFA members develop and maintain long-term relationships of trust with their clients. NAIFA members are Middle America and serve Middle America. Because they must take the time to get to know and understand their clients’ personal and financial goals, our members are able to offer a broad range of services that middle-market investors truly need and value.

Principles for 21st Century Insurance Regulation

NAIFA supports state regulation of the business of insurance and efforts to improve the state-based system of insurance regulation. We recognize, however, that the state system has flaws and challenges. We feel that improvements are essential, and we believe the Federal Insurance Office has an important role to play in efforts to modernize and reform insurance regulation.

On the domestic front, FIO has a dual focus – on both the federal government and the States. NAIFA believes it is critical that FIO use its role as the insurance expert in the federal regulatory structure to (a) educate all levels of the federal government – from the Treasury Department, to the Securities and Exchange Commission (SEC), to the Department of Labor (DOL) – about the insurance industry, how it works, and how it interacts with other financial sectors; (b) work as an intermediary to assist the federal agencies, the States and the insurance industry when regulatory matters arise that involve federal regulators who may not know the business of insurance or the nature and extent of state insurance regulation; and (c) as part of your monitoring activities, review and analyze state regulatory requirements, not just the information arising out of the current Report, but on an on-going basis, and work with the States to eliminate redundant or inconsistent regulatory requirements.

NAIFA strongly urges the FIO to use its authority and “bully pulpit” to actively pursue these objectives. As we will discuss in the remainder of this letter, there are specific issues at play today where we believe your office can and should incite federal pressure for state regulatory change and improvements. Necessary changes will make the regulatory system work better for all concerned – including consumers, regulators and industry.

NAIFA’s Recommendations

NAIFA members have debated long and hard regarding the proper role of the federal government in insurance regulation. As noted above, NAIFA members are long-time supporters of state regulation and remain steadfastly committed to this tradition. Having said that, NAIFA recognizes that there are shortcomings to the current regulatory structure. Unnecessary distinctions among the States and inconsistencies within states on issues such as licensing, product approval, and consumer protection, thwart competition, reduce predictability, and add unnecessary expenses to the cost of doing business. All of this ultimately harms consumers.

We continue to work with the States to make improvements. We recognize that reform is critical to protect consumers and to ensure a strong and healthy insurance marketplace; and we believe that fixing the problems with the insurance regulatory system ultimately will enable the insurance industry to provide better and greater choices for consumers, without sacrificing consumer protection.

Despite solid efforts made by the States to improve the current regulatory system, it has become increasingly clear that the state system can be improved. NAIFA believes it is imperative that the problems and inefficiencies in the state regulatory system be corrected quickly, and supports continued efforts on the part of the States and the federal government in the reform process. As discussed in further detail below, this includes the FIO, NARAB II, and an optional federal charter that, *only* if properly crafted, could improve the regulation of our industry.

The insurance regulation status quo is detrimental to consumers and NAIFA members. All regulatory reform options should be on the table, and NAIFA is willing to consider a breadth of alternatives, both federal and state, in our desire to fix the problems confronting us. In other words, NAIFA favors reform, improvement, and progress over the status quo.

Toward that end, NAIFA is open to considering federal efforts to improve the insurance regulatory system, while continuing to work through the National Association of Insurance Commissioners (NAIC) and at the state level to achieve the necessary regulatory improvements. Below are our views regarding specific proposals and issues:

1) Producer Licensing

Insurance agents and brokers are required to be licensed in every state in which they conduct business. In order to obtain and maintain licenses, producers must comply with different and often inconsistent standards in numerous states and contend with duplicative licensing processes. For NAIFA members, particularly those that place and service group health and group life benefits, which necessitates doing business across state lines, multi-state licensing obligations impose costly and time-consuming burdens.

Multi-state licensing has improved within the last 15 years. In 1999, the NARAB provisions of the Gramm-Leach-Bliley Act (GLBA) successfully pushed the States to enact producer licensing reforms.² In 2000, the NAIC adopted the Producer Licensing Model Act (PLMA)³, which provides for a system of reciprocal licensing in the States pursuant to the NARAB requirements. The PLMA has been enacted in some form in over 40 states in the District of Columbia.

NAIFA has supported the NAIC's producer licensing reform efforts at every step of the way and NAIFA members are, in large part, responsible for enactment of the PLMA in the States. In addition,

² 15 U.S.C. §§ 6751-6766 (2006).

³ Nat'l Ass'n of Ins. Comm'rs ,Producer Licensing Model Act (year), summary,available at http://www.naic.org/committees_index_model_description_i_q.htm

NAIFA was involved in the development of the National Insurance Producer Registry (NIPR), which operates the electronic database of producer information that has made licensing significantly faster and easier, electronically “smoothing over” many of the differences in the States’ application requirements. A NAIFA representative currently serves on NIPR’s Board and has held the position of Vice President for four years.

While the passage of NARAB gave the States the needed incentive to streamline the insurance producer licensing system, it did not go far enough. Today, there are approximately 40 states that the NAIC has deemed “reciprocal” for NARAB purposes. Although other states have adopted portions of the PLMA, there remain a significant number of states—including the largest markets in the country: California, Florida and New York—that are not reciprocal. Moreover, reciprocal states sometimes have similar legal requirements but different standards for licensure, thus creating a patchwork of approaches across the country.

It is clear that without Congressional action – without the pressure that comes from federal law – the NAIC will be unable to attain its stated goal of reaching full licensing reciprocity among the States. Therefore in order to fully implement the promise of GLBA and fully streamline multi-state licensure, NAIFA supports congressional legislation that aims to modernize the current system of insurance agent licensing as it applies to those who are registered in multiple states. Legislation creating a national producer licensing body, the National Association of Registered Agents & Brokers Reform Act (“NARAB II”), passed the House in recent years with strong bipartisan support from the members of the House Financial Services Committee. Similar legislation was reintroduced this year by Rep. Randy Neugebauer (R-TX) and Rep. David Scott (D-GA) and once again has significant bipartisan support⁴.

NAIFA supports the enactment of NARAB II because it would allow insurance producers who are licensed to operate in multiple states to comply with a single set of non-resident licensing and continuing education rules. The need to streamline the non-resident licensing process is important for NAIFA members who frequently relinquish clients when they move to another state because of the

⁴ H.R. 1112, 112th Cong. (2011)

burdens imposed by multistate licensing. NAIFA members are in the business of helping individuals and families address their basic financial security needs and prepare for retirement by helping them secure risk transfer based products such as life insurance, annuities and other retirement products, long-term care, disability income coverage, medical and hospital insurance. The relationships our members have with their clients are based on a trust developed through years of providing important guidance and assistance in preparing for life's inevitable risks of dying too soon, living too long, becoming sick or disabled and/or needing long-term care.

For many NAIFA members, however, the varying licensing compliance requirements from state-to-state make it unnecessarily burdensome to follow a client to another state when he or she moves. As a result, NAIFA members must hold licenses in multiple states and frequently must refer their clients to another agent. Enactment of NARAB II is necessary because, in today's increasingly mobile world, it is a disservice to insurance consumers to have a regulatory system in place that makes it difficult for a consumer to retain their trusted agent when they move to another state.

Importantly, NARAB II would not reduce the standards for agents to be licensed; rather it would allow producers who are licensed and operate in multiple states to comply with a single set of non-resident licensing and continuing education rules. NARAB II builds on a foundation incorporated in the GLBA more than a decade ago.

2) Stranger-Originated Life Insurance (“STOLI”)

NAIFA was one of the first organizations to raise concerns about STOLI schemes, and we have been actively engaged in efforts in the States to enact legislation designed to protect consumers by restricting and, hopefully, eliminating STOLI transactions. In STOLI transactions, investors or middlemen approach consumers—generally senior citizens—and encourage them to purchase life insurance policies they otherwise would not buy solely to sell the policies to investors. The sooner the policyholder dies, the greater the investor's profit. Further, seniors caught in STOLI schemes face potential legal and tax liability.

NAIFA believes that STOLI represents a threat to both consumers and the life insurance industry. First, the transaction is initiated for the benefit of an investor who has no relation to the insured person, and once the transaction is completed, neither the insured nor his or her beneficiaries will have any further interest in the policy or annuity's benefits. Second, STOLI exposes consumers to unexpected taxes, loss of privacy, and inability to obtain needed life insurance in the future.

STOLI transactions are not initiated for a typical or historically legitimate insurance purpose, which revolves around protecting the long-term interests of the insured and parties associated with the insured, such as families, businesses, business associates, and charities. Rather, a STOLI is initiated by investors with no relationship to the insured for the purpose of turning a profit on their investment. It is initiated with resources provided by those who have no insurable interest in or continuing interest in the well-being of the insured yet who will control the ownership and benefits of the product in the future. This undermines the integrity of life insurance and flouts the public policy concerns regarding wagering on human life that have been voiced by state legislatures and the U.S. Supreme Court.

It is for these reasons that NAIFA became the first organization to formally adopt and announce organizational policy opposing STOLI transactions. It is NAIFA's belief that STOLIs are contrary to established public policy and could potentially undermine the intended use of life insurance and annuity products to the great detriment of the insurance industry and the American public which relies on our products for protection and financial security.

Although NAIFA opposes STOLI transactions, we do not oppose legitimate life settlements, which involve the sale of existing life insurance policies that were initially purchased for appropriate and legitimate insurance purposes. NAIFA believes that a viatical or life settlement may be appropriate in instances where the insured has carefully evaluated his or her unique circumstances and determined that the sale of the policy in the secondary market is in his or her interests. Toward that end, NAIFA

supports state-level adoption of the NAIC's Viatical Settlements Model Act⁵ as an appropriate approach for establishing standards and operating procedures for regulating viatical and life settlements. While not all states have adopted the NAIC model, thirty states have adopted anti-STOLI measures designed to protect consumers by limiting or prohibiting the spread of STOLI transactions while not impacting the legitimate life settlement market. Specifically:

- 11 state laws contain the limited five-year moratorium on certain settlements which forms the basis of the NAIC's Viatical Settlements Model Act;
- 12 state laws are based on the National Conference of Insurance Legislators' Life Settlements Model Act⁶ (which contains a limited two-year settlement moratorium); and
- 7 states have enacted some other form of anti-STOLI legislation.

3) *DOL/SEC Fiduciary Standard of Conduct*

The common thread among all NAIFA members is that they are first and foremost insurance professionals. Thus the approach taken by NAIFA members when providing financial advice always includes an assessment of risk management in order to provide the client options for mitigating potential market declines or unexpected life events and contingencies.⁷ The SEC and the DOL are each considering expanding "fiduciary" regulations to certain activities in which NAIFA members engage. NAIFA believes these proposals would impose legal frameworks that fundamentally misfit the roles that NAIFA members play in assisting retail investors with managing their financial futures. These issues are emblematic of the shortcomings of the status quo regarding federal regulation of our industry, and FIO could certainly play a role in (a) better informing SEC and DOL regulators on the intricacies of the insurance business, and (b) ensuring that the two agencies coordinate with one another and not impose redundant and/or inconsistent requirements on financial professionals

⁵ Nat'l Ass'n of Ins. Comm'rs, Viatical Settlements Model Act (year), summary *available at* http://www.naic.org/committees_index_model_description_i_q.htm

⁶ Nat'l Conference of State Legislatures, Life Settlements Model Act (2007), *available at* <http://www.ncoil.org/other/MLRlife.html>

⁷ Anecdotally, given the events associated with the current poor economic conditions, NAIFA members have recognized an uptick in clients asking for products that guarantee against market declines – particularly as they approach retirement.

SEC Fiduciary Standard

Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”)⁸ required the SEC to conduct a study (the “Study”) to gather necessary information to evaluate whether a uniform standard of care for broker-dealers and investment advisers would be sound policy. Section 913(c) specified 14 issues the SEC had to consider in conducting the Study, including:

- The effectiveness of existing legal or regulatory standards of care for broker-dealers and investment advisers for providing personalized investment advice and recommendations to retail customers;
- Whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for broker-dealers and investment advisers;
- Whether the existence of different standards of care applicable to broker-dealers and investment advisers is a source of confusion for retail customers regarding the quality of personalized investment advice that retail customers receive;
- The substantive differences in the regulation of broker-dealers and investment advisers, when providing personalized investment advice and recommendations about securities to retail customers;
- The potential impact on retail customers, including the potential impact on access of retail customers to the range of products and services offered by broker-dealers, of imposing upon broker-dealers the investment advisers’ standard of care for providing personalized investment advice about securities to retail customers of investment advisers, as interpreted by the SEC and the courts;

⁸ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

- The varying level of services provided by broker-dealers and investment advisers to retail customers and the varying scope and terms of retail customer relationships of broker-dealers and investment advisers with such retail customers;
- The potential impact upon retail customers that could result from potential changes in the regulatory requirements or legal standards of care affecting broker-dealers and investment advisers, including any potential impact on access to personalized investment advice and recommendations about securities; and
- The potential additional costs and expenses to (a) retail customers regarding, and the potential impact on the profitability of, their investment decisions, and (b) broker-dealers and investment advisers resulting from potential changes in the regulatory requirements or legal standards affecting broker-dealers and investment advisers relating to their obligations, including duty of care, to retail customers.

In January 2010, the SEC staff released the Study, which recommended creating a common fiduciary standard of care for broker-dealers and investment advisers. Significantly, the Study found that investors “generally were satisfied with their financial professionals.”⁹ The staff recommendation for a uniform fiduciary standard of care is not premised upon investors being disserved by the current standards, but rather investors being confused by the current standards.¹⁰ NAIFA supports clarification to ensure client understanding of the different rules and business models of investment advisers and broker-dealers. However, any clarification or modification to the standard of care applicable to broker-dealers should not come at the cost of decreasing investors’ satisfaction with or access to their financial professionals. Thus, if the SEC

⁹ SEC, *Study on Investment Advisers and Broker-Dealers*, v (Jan. 2011), available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

¹⁰ *Id.* (“Many retail investors and investor advocates [stated] that retail investors do not understand the differences between investment advisers and broker-dealers or the standards of care applicable to broker-dealers and investment advisers.”)

is intent on developing a uniform standard of care for both broker-dealers and investment advisers, it is imperative that the SEC first examine whether a uniform standard can be imposed in a manner that does not decrease investors' satisfaction with or access to financial professionals.

In considering the Study's recommendation of a fiduciary standard for broker-dealers, it is important to note that the plain language of section 913 makes clear that any uniform fiduciary duty that is ultimately promulgated by the SEC be "no less stringent than" the general fiduciary duty currently applied to investment advisers, and need not be the same standard as is currently applied to investment advisers. In addition, Dodd-Frank appropriately includes exceptions providing that broker-dealer commission compensation and the sales of proprietary products would not automatically violate a possible uniform standard.

Dodd-Frank recognized that broker-dealers provide different professional services and operate under different business models than investment advisers. While broker-dealers primarily sell products to investors and offer routine financial advice incidental to the sale of such products, investment advisers primarily manage portfolios and engage in providing more comprehensive financial advice. Indeed, if Congress intended the SEC to duplicate the Advisers Act standard and apply it to broker-dealers, it could have simply repealed the current broker-dealer exemption found in the Advisers Act— an approach Congress rejected. Any new standard contemplated by Congress or regulators should recognize and adapt to the differences between broker-dealers and registered investment advisers or else risk adverse, unintended consequences, namely, limiting the products and services available to middle-market investors.

Simply applying the existing investment adviser fiduciary standard to broker-dealers would not be appropriate. For one thing, the Advisers Act was not designed to regulate broker-dealer activity. More specifically, it was not designed to apply to the incidental advice broker-dealers and their representatives routinely offer to their clients. Further, the case law regarding investment advisers' fiduciary duty was developed in the context of a business model that is inapplicable to broker-dealers. If the fiduciary duty applicable to investment advisers is imposed on broker-dealers without accounting for

the different business models and clientele of each respective profession, the case law—to say nothing of SEC guidance documents—could be misinterpreted and misapplied in a number of ways that would disadvantage the broker-dealer business model with no corresponding benefit to middle-market investors.

There are further adverse, unintended consequences that would result from the application of the current investment adviser fiduciary standard to broker-dealers. Because broker-dealers would be forced to adjust their operations and compliance programs to an additional regulatory framework, fewer clients would ultimately receive professional service and advice. As compliance costs and the potential for liability increases, it would become economically unfeasible for financial professionals to work with less affluent clients.

According to the LIMRA study referenced above, NAIFA members report that 58 percent of their clients have less than \$100,000 in household income per year, while only 11 percent of their clients earn \$250,000 or more in household income per year. NAIFA members serve these middle-market clients despite substantial regulatory burdens. Broker-dealers and their Registered Representatives today devote considerable time and resources to complying with numerous federal and state regulations. They have an obligation to recommend only those investments and overall financial strategies that are suitable for their clients. The suitability requirements compel a Registered Representative to have an “adequate and reasonable basis” for any recommendation that he or she makes. Whether a recommendation is “reasonable” relates to the specific securities or strategies recommended, and Registered Representatives are further obligated to determine “customer-specific” suitability, taking into account every client’s particular financial situation, needs, and other security holdings. NAIFA members have an obligation to investigate and obtain comprehensive information about their clients’ unique circumstances in determining the courses of action they recommend.

Thus, a wholesale application of the current Advisers Act duty to broker-dealers could negatively impact product access, product choice, and affordability of customer services for those consumers who are most in need of these services. NAIFA’s survey research shows that, if a universal fiduciary

standard of care is imposed, many members would be feel compelled to discontinue providing many important services to middle-market investors, who make up the majority of their clients. According to the survey, which polled more than 3,300 NAIFA members, most members involved in securities activities are concerned that the additional regulatory requirements and potential legal implications of a fiduciary standard could significantly increase their compliance costs. If costs were to go up by 15 percent, 65 percent of our members said they would need to take actions that would limit their client's access to financial advice. For example:

- 31% say they would limit their practice to affluent clients only;
- 20% would not offer securities to their clients; and
- 14% would increase fees for their clients

These results would not be in the best interests of investors, and certainly would not further the regulators' goal of enhancing consumer protections. It is crucial that middle-market investors be able to obtain personalized financial advice so they can plan adequately for their futures. Without their financial advisors, many investors would have nowhere to turn when they need reassurance in a shaky market, assistance in rebalancing their portfolios, or understanding the investment choices available. NAIFA is concerned that the SEC Study unduly discounts the risk that the additional regulatory burdens imposed on financial professionals by the Study's recommendations could result in investors having fewer financial advisors to choose from, having less access to products and services, and having to pay more for the services they do receive.

In recommending the adoption of a new uniform fiduciary standard, the Study not only discounts the very real possibility of these negative consequences, but does not adequately articulate or substantiate the problems that a uniform fiduciary standard would solve. The Study does not claim that retail investors are systematically being harmed or disadvantaged under the fiduciary or suitability standard, and therefore it lacks a basis to conclude that a uniform standard or harmonization would enhance investor protection. NAIFA supports efforts to determine if problems exist and wants to be part of the dialogue on how best to fix any identified problems. We are, however, concerned that proceeding

down a regulatory path without a stronger empirical and analytical foundation could lead to the unintended consequences described above.

For these reasons, NAIFA urges FIO to encourage the SEC to more thoroughly consider the impact that an SEC-imposed uniform fiduciary standard would have on middle class Americans' access to sound financial advice. We agree with SEC Commissioner Paredes and former Commissioner Casey that further analysis of investor returns (controlling for risk and investor characteristics) generated under the two existing regulatory regimes would be fruitful, as would a survey of investors to obtain a general overview of the characteristics of investors who invest through a broker-dealer as compared to those who invest on the basis of advice from an investment adviser.¹¹ Finally, should the Commission impose a uniform fiduciary duty, it must account for the unique attributes of the broker-dealer business model, provide new guidance documents for industry, and be sufficiently clear and comprehensible so broker-dealers can adjust their business practices with minimal disruption. This should include, for example, a clear definition of "personalized investment advice" so broker-dealers (and their customers) adequately understand their legal responsibilities and obligations, as well as clear guidance regarding disclosure that would satisfy the uniform fiduciary standard of guidance. Further, any new disclosure should be informed by investor testing, which is required by Section 912 of Dodd-Frank when the SEC is developing new rules.

DOL Fiduciary Standard

In October 2010, the DOL proposed an expanded definition of "fiduciary" under the Employee Retirement Income Security Act ("ERISA") and the tax code that includes anyone who receives compensation in any way connected with providing individualized investment advice to employee benefit plans, plan participants, or individual retirement arrangement ("IRA") owners. In sharp contrast to the protections for commission-based compensation in Dodd-Frank, a fiduciary under ERISA or parallel sections of the tax code cannot receive commission-based compensation unless the DOL grants a "prohibited transaction exemption" ("PTE"), which usually includes numerous conditions and

¹¹ Press Release, SEC, Statement Regarding Study on Investment Advisers and Broker-Dealers (Jan. 21, 2011), *available at* <http://www.sec.gov/news/speech/2011/spch012211klctap.htm>.

requirements. ERISA fiduciaries are also subject to personal liability for failing to act solely in the interests of participants and beneficiaries.

Under regulations that have been in place since 1975, someone who gives investment advice to an employee benefit plan and does not have discretionary control over the plan will be subject to the ERISA fiduciary standard only if a 5-part test is met.¹² The test has essentially allowed advisers and clients to choose whether advice will be provided on a non-fiduciary or fiduciary basis. The DOL's proposed redefinition turned this situation on its head, and presumes that any person is a fiduciary who provides investment information to a plan, participants, or IRA owners, unless an exception applies.

The DOL proposal contained numerous flaws. The inclusion of IRAs in the proposal was particularly egregious because IRAs are not even subject to ERISA.¹³ Further, the DOL did *no* cost analysis for IRAs. Nor did the proposal contain any examination of the critical distinction between employer-provided plans, where participants have limited investment choices as determined by their employers, and IRAs, where consumers have complete control to choose and change their IRA service providers. Moreover, no recent act of Congress authorized the proposed new definition, and the DOL has not provided any quantifiable data about the problem it sought to solve.

Fortunately, the DOL withdrew its proposal in September. NAIFA believes that DOL should wait for the SEC to complete its process—authorized by the Dodd-Frank Act—of considering new regulations for all persons licensed to sell securities or provide investment advice. When the congressionally-authorized SEC rulemaking process is complete, *then* DOL should reassess whether any of the agency's concerns remain.

¹² 29 CFR 2510.3–21(c)(1) (2011).

¹³ Under a 1978 Executive Order, the Secretary of Labor has authority to *interpret* a section of the Internal Revenue Code that substantially mirrors the fiduciary duties laid forth ERISA, except that IRAs and some other tax-advantaged savings vehicles are covered in addition to the employer-provided plans that actually are regulated by ERISA. Even though the Department of Labor was granted this interpretive authority over IRA fiduciary standards, it cannot enforce these requirements through ERISA legal remedies – these regulations for IRAs are only enforceable through excise tax penalties.

If DOL re-issues the proposal, as noted above, the agency should ensure that it does not impose redundant or inconsistent regulatory requirements. Further, it should exclude IRAs from any regulation. Unlike employer-provided plans, IRAs can be transferred to new banks or brokerages at any time, giving consumers complete power to select their service providers and compare costs and benefits. DOL's initial proposal contained no data on why sweeping new regulations on IRAs are needed or what it would cost for providers and consumers. There is no justification for imposing these costly new regulations on IRAs, nor are they compatible with the structure of the IRA market.

Finally, if a new standard is put in place, the seller's exception should be robust, clear, and workable. The original proposal would have excluded investment sellers from fiduciary status if the recipient of advice knows that the person providing the advice has "adverse" interests. This exception is not sufficiently clear or accurate to be usable. Advisers cannot be required to prove what their clients know or should know, and it is inaccurate to describe their receipt of commissions as creating an "adverse" relationship.

4) Annuity Suitability

Annuities can provide a guaranteed income that cannot be outlived, and as such are a valuable component in the financial plans of tomorrow's retirees. In order to ensure retirees receive the appropriate products for their specific financial circumstances, NAIFA strongly supports the NAIC Suitability in Annuities Transactions Model Regulation¹⁴.

In 2006, the NAIC adopted its original Suitability in Annuities Transactions Model. This Model Regulation was adopted by 38 States. In 2010, a revised Model Regulation was adopted incorporating some important changes which more closely align the NAIC model with some key provisions of FINRA's suitability and supervision rules (FINRA Rule 2310 and FINRA Conduct Rule 3010)¹⁵. Additional information such as age, income, financial situation and needs, among others must now be

¹⁴ Nat'l Ass'n of Ins. Comm'rs, Suitability in Annuities Transactions Model Regulation (2011), available at http://www.naic.org/documents/committees_models_table_of_contents.pdf.

¹⁵ Nat'l Ass'n of Securities Dealers Rules 3010, 2310 available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3717.

gathered in order to determine the suitability of a recommendation. The revised Model Regulation also enhances the monitoring and supervision requirements of insurers.

As the revised Model Regulation took shape NAIFA played a leading role in the drafting and inclusion of a provision that required additional training for insurance producers who engage in the sale of annuity products. To date, 19 states have adopted the revised Model Regulation.

NAIFA's support for the uniform adoption and implementation of the Model Regulation is intended to send a strong statement about the importance of annuities to Americans' retirement security, as well as the importance of matching suitable products with the needs of the consumer.

5) Annuity Disclosure

NAIFA strongly believes in providing consumers with all the relevant information they will need to make appropriate decisions on the products that best fit their financial needs. With this position in mind NAIFA has been a strong advocate for the NAIC Annuity Disclosure Model Regulation,¹⁶ which was adopted in 1996. Since its adoption by the NAIC 23 states have adopted the NAIC Annuity Disclosure Model Regulation.

Over the last several years the NAIC's Annuity Disclosure Working Group has reviewed and considered changes to the Annuity Disclosure Model Regulation. The purpose for this review was to improve the disclosure of information provided for annuity products, both generally and specifically, and to provide insurers uniform guidance in developing disclosure information and documents and monitoring distribution thereof in order to better inform annuity consumers about the annuity product purchased and how it works.

On October 12, 2011, regulators in the NAICs' Executive Committee & Plenary voted unanimously to adopt the amendments that were the final recommendations from the Working Group.

¹⁶ Nat'l Ass'n of Ins. Comm'rs, Annuity Disclosure Model Regulation (2011), *available at* http://www.naic.org/documents/committees_models_table_of_contents.pdf

The most prominent amendment to the model regulation is the addition of standards for annuity illustrations, which are provided to the customer to show how the product has performed. For fixed indexed annuities, insurers would have to show how a given index has performed over the last 10 years, as well as the index's best and worst historical performance over a decade.¹⁷

NAIFA supports the revised NAIC Model Regulation and believes that uniform adoption of the NAIC Model will ensure that consumers have the relevant information they need in order to make the right annuity purchase decision.

6) *Regulating the Use of Senior-Specific Designations*

In recent years, legislators, regulators and the media raised concerns that some senior citizens are being misled and harmed by the use of certain designations and certifications by insurance agents and advisors that may imply the existence of a level of expertise in senior affairs and financial matters that, in fact, does not exist. These types of allegations are potentially damaging to NAIFA members because they affect the reputation of all agents and advisors and could compromise the public's trust in our members.

NAIFA was an active and early supporter of efforts at the NAIC and NASAA to establish model regulations designed to stop the use of misleading senior-specific designations. The models, both which were adopted by the NAIC and NASAA in 2008, established standards of whether the use of a particular designation indicates or implies, in a way that misleads the consumer, that the advisor has special certification or training in advising seniors that the advisor does not, in fact, possess.

The NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations¹⁸ applies to the sale of insurance-related products; the NASAA Model Rule on the Use of

¹⁷ Press Release, Nat'l Ass'n of Ins. Comm'rs, NAIC Adopts Amendments to Bylaws, Annuity Disclosure Model (Oct. 12, 2011), available at http://www.naic.org/Releases/2011_docs/NAIC_adopts_amendments_to_bylaws_and_annuity_disclosure_model.htm.

¹⁸ Nat'l Ass'n of Ins. Comm'rs, Model Regulation on the Use of Senior-Specific Certifications and Professional Designations (year), available at http://www.naic.org/committees_index_model_description_i_q.htm

Senior-Specific Certifications and Professional Designations¹⁹ covers sales of securities and other investment-oriented products. If both models were to be adopted by a state, the state would have a consistent regulatory program in place to address the use of senior-specific designations in the marketing of both insurance and investment products.

Currently a significant number of states have adopted some form of prohibition on the use of senior specific designations. Specifically:

- 29 states have adopted the NAIC Model;
- 27 states have adopted the NASAA model;
- 6 states have independent prohibitions against using misleading designations toward seniors; and
- Kentucky has a specific list of designations that are approved by the Department of Insurance.

While NAIFA believes the States have made great strides in addressing this issue, not all states have adopted legislation or regulations to ensure senior consumers are not misled by persons holding themselves out to have specific training which may not exist. That is why NAIFA supported the inclusion of language in Dodd-Frank to establish an incentive grant program for the States to adopt the NAIC and NASAA models.²⁰

Section 989A of Dodd-Frank established a Federal grant program to be managed by the Office of Financial Literacy at the Consumer Financial Protection Bureau. States that are eligible to apply for the maximum \$500,000 grant must adopt at least the minimum requirements of the NAIC and NASAA senior specific designation models. The States must also adopt the minimum requirements of the NAIC's revised Suitability in Annuity Transactions Model Regulation. The States are eligible to apply

¹⁹ Nat'l Ass'n of Ins. Comm'rs, Model Rule on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities] *available at* <http://www.nasaa.org/wp-content/uploads/2011/08/8-MDL-278.pdf>

²⁰ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Title XI, Subtitle I, Section 989a, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

for a lesser \$100,000 grant if they adopt either the NASAA model law or the NAIC senior designation model in addition to the annuity suitability model.

NAIFA therefore encourages the FIO to use its voice to encourage the States to adopt the requisite model acts in order to apply for the Federal grants that would provide an important consumer protection for senior consumers.

7) Interstate Compact

NAIFA was an early supporter of the establishment of the Interstate Insurance Product Regulation Commission (IIPRC)²¹ or “Compact”. The Compact became operational in 2006 in when it was adopted by 26 states (states with over 40 percent of the premium volume for the covered products). The Compact accepted its first product filings in June 2007 and approved them within 30 days of submission. NAIFA has been represented on the Industry Advisory Committee to the Compact since its inception.

The Compact’s goal is to get insurance products to market faster by allowing companies to file new products in one place for approval in every state that enacts the Compact law. The Compact gives insurers who offer products in more than one state a more efficient product approval process than the current multi-state system and to make new products available for sale to consumers sooner. This goal has been largely successful as 41 states have now joined the Compact. This represents more than three-quarters of all states and almost 70 percent of the nationwide premium volume for asset-based insurance products.

The Compact is beneficial to consumers because new products no longer need to satisfy different rules and be approved by multiple states. Insurance products get to market faster because insurers can file new products in one place for approval in every state that enacts the Compact law. For states that

²¹ Interstate Ins. Prod. Regulation Comm’n, About the IIPRC, <http://www.insurancecompact.org/about.htm> (last visited Dec. 16, 2011).

are members of the Compact, this has been a vast improvement as insurers no longer have to wait months or years for product approval.

The efficiency of having one point-of-filing for the review of insurance products sold nationwide, rather than redundant, inconsistent state-by-state review, also frees up insurance department resources to address other pressing issues affecting policyholders and the industry. Further, the Compact ensures that consistently high product approval standards apply uniformly across the country. Each state that agrees to the Compact appoints a member to the IIPRC which adopts the standards to review life insurance, annuity, disability income and long-term care insurance products. The standards adopted apply uniformly to all compacting states.

NAIFA is disappointed that some of the nation's largest states have not joined the Compact -- California, New York, and Florida have yet to become Compacting states. Without the inclusion of these large premium volume states in the Compact, the goal of true to speed-to-market for asset based insurance products will not be achieved.

Both the NAIC and the National Conference of Insurance Legislators (NCOIL) continue to encourage states to join the Compact. NCOIL passed a resolution at its 2011 Annual Meeting encouraging those states which have not joined the Compact to do so.²² NAIFA and its state associations will be using our efforts to support legislation in those states in the coming year.

8) *Optional Federal Charter*

Direct federal regulation of insurance could be appropriate for many insurers and producers who work on a multi-state or international level, for whom a single regulator makes sense economically and in terms of consumer protection. Therefore, in 2008 the NAIFA National Council voted to support the concept of the optional federal charter ("OFC") for insurers and insurance producers provided only that

²² Press Release, Nat'l Conference of Ins. Legislators, NCOIL Reaffirms Support for Life Compact (Nov. 20, 2011), available at www.ncoil.org/HomePage/2011/11242011IIPRCPR.pdf.

it meets certain specific conditions outlined by three overarching themes.

Theme 1: True Agent Choice

An agent must have a true choice between federal or state licensure and no company shall discriminate against an agent based on their choice point of licensure. Further, an OFC must address producer regulation for all major lines of insurance.

Theme 2: Enhanced Consumer Protections

An OFC must include enhanced consumer protections so that insurance consumers are not negatively impacted by a new federal insurance regime. Further federal insurance regulation shall:

- Encompass the NAIC's model Unfair Trade and Unfair Claims Settlement Practices Acts
- Adhere to generally accepted replacement regulations
- Include file and use of rates with appropriate regulator review and approval of products
- Maintain ability of insurers to share loss, underwriting and trending data
- Not exceed the 2004 NAIC standard for insurance commission disclosure
- Ensure adequate solvency standards for insurers
- Include regulator responsiveness and accessibility to consumers

Theme Three: Single Federal Voice & Preserve State Regulation

An OFC must preserve and not supplant state regulation of insurance regulation for those agents and companies that choose to remain state regulated. Our 2008 policy also called for the creation of a body of expertise on insurance to weigh in with Congress and the Administration on insurance policy matters that are national in scope. NAIFA believes the creation of the FIO fulfills the federal insurance expertise condition.

With regard to preserving state regulation, any federal insurance legislation shall:

- Provide a single, comprehensive regulatory structure for all producers who opt for federal regulation
- Provide producers with a position at the table when new regulations are being considered by the national insurance regulator
- Allow for creation of a new self-regulatory organization (SRO) to address insurance and/or securities issues
- Allow for increased efficiencies and cost savings for producers
- Create a federal insurance regulator who is the sole regulator of insurance for federally licensed entities -- not any other federal body
- Be cost neutral to the states
- Promote cooperation between state and federal regulators
- Not impede the operation or expansion of the Interstate Insurance Product Regulation Commission (Interstate Compact) or other efforts to improve state insurance regulation
- Fully preserve McCarran-Ferguson antitrust exemption for state regulation of insurance.

Conclusion

NAIFA was and is a strong supporter of the creation of the FIO. We believe the FIO should play an important role in advising the various aspects of the Federal government on insurance matters that impact consumers, producers, companies, and ultimately the economy. We are pleased to see the FIO involved in the ongoing evolution of the regulation of insurance, and appreciate its consideration of these comments. Please feel free to reach out to us to discuss any of these issues at any time.

Sincerely,



William R. Anderson
Senior Vice President
Government Relations

Appendix 1 [LIMRA STUDY RESULTS]