

August 7, 2018

Via E-Mail

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Via email to: rule-comments@sec.gov

Re: File No. S7-07-18
SEC Release No. 34-83062
Regulation Best Interest

Dear Mr. Fields:

The Committee of Annuity Insurers (the "Committee") is pleased to submit this letter in response to the request for comments in Release No. 34-83062 (the "Proposing Release") issued by the U.S. Securities and Exchange Commission (the "SEC" or the "Commission"), proposing Regulation Best Interest ("Regulation BI").¹

OVERVIEW OF THE COMMITTEE

The Committee is a coalition of life insurance companies formed in 1981 to address legislative and regulatory issues relevant to the annuity industry and to participate in the development of federal policy with respect to securities, regulatory, and tax issues affecting annuities. The Committee's current 31 member companies represent over 80% of the annuity business in the United States. Most of the Committee's members also have affiliated broker-dealers and/or investment advisers that distribute and/or sell registered insurance products (including proprietary and/or non-proprietary products) or provide advice in connection with such products as well as other securities. A list of the Committee's member companies is available at <https://www.annuity-insurers.org/>.

For over 35 years, the Committee has been actively involved in shaping and commenting upon many elements of the federal securities regulatory framework as it applies to annuity products registered with the SEC under the Securities Act of 1933 and, with respect to variable annuities, also regulated under the Investment Company Act of 1940. The Committee also routinely comments on issues that affect broker-dealers registered with the SEC under the Securities Exchange Act of 1934, particularly those sales practices issues that have a specific impact on the marketing and sale of annuities.

EXECUTIVE SUMMARY OF THE COMMITTEE'S COMMENTS

¹ *Regulation Best Interest*, 83 Fed. Reg. 21574 (May 9, 2018). All citations in this letter to the Proposing Release are to the version published in the Federal Register.

Regulation BI would require broker-dealers, as well as any persons associated with broker-dealers, when making recommendations of any securities transaction or investment strategies to retail customers, to act in the best interest of the retail customer at the time the recommendation is made. In addition, the broker-dealer's or associated person's recommendation must not place the interests of the broker-dealer or associated person ahead of the retail customer's interests. Regulation BI further provides that this best interest obligation would be satisfied if the broker-dealer and associated person making the recommendation satisfy the Disclosure Obligation, the Care Obligation and the Conflict of Interest Obligation outlined in the regulation.

The Committee supports and commends the SEC for taking the lead on the standard of conduct issue and for crafting an approach that on the whole addresses the core principles outlined in the Committee's October 19, 2017 letter to Chairman Jay Clayton. Regulation BI offers retail customers the benefits of an enhanced standard for investment recommendations and sets forth a framework designed to preserve retail customer choice among distribution channels, products, services and form of compensation. Regulation BI would also allow broker-dealers to continue to offer proprietary products. Moreover, we commend Chairman Clayton for recognizing that it is critical for the SEC to work with other regulators (including state insurance regulators) to develop a workable standard of conduct framework across the various regulatory regimes applicable to broker-dealers.

At the same time, the Committee believes that certain adjustments are necessary in order for Regulation BI to achieve the Commission's stated goals and to be truly workable for broker-dealers and beneficial for retail customers. The Committee therefore offers the comments below with a view to advancing the adoption of Regulation BI.

- **Annuities Not Fully and Fairly Presented in the Proposing Release.** The Committee urges the SEC to correct the implications in the Proposing Release that annuities are merely alternatives to mutual funds or other investment accumulation products and only should be considered in limited instances. Assuming that the Commission moves forward with adopting Regulation BI, we ask that the adopting release for final Regulation BI explicitly acknowledge that annuities, given their lifetime income guarantees, uniquely serve retail customers' needs for guaranteed lifetime income, and are not simply an alternative accumulation product that should be compared to mutual funds or other investments. Without this acknowledgement, we are concerned that broker-dealers will shy away from recommending annuities as part of retail investors' investment portfolios under a Regulation BI regime out of concerns that the Commission views annuities as simply a higher-cost version of a mutual fund.
- **The Role of Cost in Determining Best Interest Recommendations is Over-Emphasized.** Certain statements in the Proposing Release regarding factors relevant to determining whether a recommendation meets the Care Obligation could contribute to a misunderstanding and mis-application of Regulation BI's best interest standard. These statements can be read as indicating that the most appropriate and least risky way to satisfy the Care Obligation is to recommend the lowest cost product available to the broker-dealer, regardless of the significant differences in benefits and features of different investments. Such a reading could lead to the unintended consequence of reducing retail customer access to higher cost investments that provide unique additional benefits, such as annuities, thus resulting in retail customers' losing access to guaranteed lifetime income products. The Committee urges the SEC when adopting Regulation BI to provide clear and unequivocal guidance in the adopting release establishing that cost is not the determinative factor, or even the necessary starting point, in determining whether an investment or investment strategy recommendation meets the Care Obligation. Rather, the most critical factor – and the starting point – for determining which investment or investment strategy is in a retail

customer's best interest is whether the recommended investment or investment strategy meets the retail customer's needs. Cost, of course, is a relevant factor that must be considered where substantially similar products may serve a retail customer's needs. However, it should not be the necessary starting point for the Care Obligation determination. Related, to better ensure that retail customer needs are being addressed, the SEC should broaden the definition of retail customer investment profile to ensure that it captures a retail customer's needs for lifetime guaranteed income.

- **Conflict Mitigation.** Regulation BI's Conflict of Interest Obligation requires broker-dealers either to (a) eliminate or (b) disclose and mitigate "financial" incentive conflicts. The Committee offers a number of comments concerning the conflict mitigation provision of the Conflict of Interest Obligation, including a request that the SEC provide unequivocal guidance in the adopting release that conflict mitigation, in appropriate circumstances, can be satisfied through the use of existing broker-dealer supervisory procedures in place today.

The Committee's comment letter is divided into five main parts:

- **Part I** provides information about annuity products specifically and urges the SEC to provide additional background on annuity products in the adopting release for final Regulation BI, which will serve to correct certain ambiguous statements in the proposing release.
- **Part II** provides comments regarding the role of cost in determining whether recommendations meet the Care Obligation and outlines changes to Regulation BI and clarifications the SEC should make in the adopting release for final Regulation BI in order to serve the stated goals of the SEC in advancing Regulation BI.
- **Part III** provides comments regarding the Conflict of Interest Obligation's requirement for a broker-dealer to mitigate conflicts. In this part, we urge that, among other things, the SEC provide clear guidance that, in appropriate circumstances, a broker-dealer would satisfy its duty to mitigate conflicts using existing supervisory processes now in place without having to resort to "levelized" commissions or "neutral factors."
- **Part IV** provides comments regarding the Disclosure Obligation's requirement to provide disclosure of matters "associated with the recommendation."
- **Part V** provides comments regarding the "retail customer" definition in Regulation BI.

Part I. ANNUITIES AND LIFETIME INCOME GUARANTEES

Critical Retail Customer Needs Are Met by Annuities. Annuities are vital to the retirement security of millions of Americans. Other than Social Security and defined benefit plans, annuities are the only means that Americans have to guarantee they will not outlive their retirement income.² However, in light of the burgeoning retirement income crisis,³ which has been

² See generally, J. BROWN, O. MITCHELL, J. POTERBA, AND M. WARSHAWSKY, *THE ROLE OF ANNUITY MARKETS IN FINANCING RETIREMENT* (MIT Press, 2001).

³ Increasingly fewer Americans will have access to pensions in retirement, an evolving and fundamental change to the U.S. retirement system that effectively shifts responsibility for retirement savings from employers to individuals.

- Approximately 80% of current retirees (overwhelmingly those generations before Baby Boomers) receive some income from a pension plan, and of those retirees, 40% get most of their income from their pension. INSURED RETIREMENT INSTITUTE, *IT'S ALL ABOUT INCOME: INAUGURAL STUDY ON THE AMERICAN RETIREMENT EXPERIENCE (2016)*[hereinafter IRI Study 2016]. In stark contrast, 75% of Baby Boomers and GenXers (generally considered to cover the age group that spans from

exacerbated by the decline in the number of employers offering defined benefit plans and the continuing strain that an aging population places on Social Security, it will be even more important to ensure that Americans have ready access to annuities in the decades to come.

Retail investors who are saving for retirement must consider numerous uncertainties. Perhaps most importantly, they must estimate the amount of savings that will be necessary to financially support themselves throughout retirement, which often can span two or three decades or more. Estimating how much to save is complicated by multiple factors. It involves making assumptions about longevity as well as market projections regarding the long-term rate of return that an individual will likely be able to achieve on his or her savings. If the rate of return actually realized is lower than expected, if it is insufficient to keep pace with inflation, or if the individual lives longer than expected, an individual's retirement security may be in significant jeopardy. Indeed, longevity risk—or the risk that an individual will outlive his or her assets—is a paramount concern for anyone saving for retirement.

Investments in equity securities and similar assets (including mutual fund or ETF shares) can help retail customers pursue higher rates of return and may help address longevity risk, but these investments generally provide no guaranteed protection from market volatility and risk of loss, and they do not provide any form of lifetime income guarantees. Annuities, however, are the only investments in the market that include insurance protection against longevity risk by providing retail customers with a guaranteed source of lifetime income. In addition, annuities can protect against other significant risks to which individuals are exposed before and during retirement, including inflation risk, investment risk, interest rate risk, and mortality risk. Because annuities allow individuals to acquire insurance against longevity risk and other risks in a single product, they have been critically important to the retirement savings of countless retail investors and will continue to be attractive investments for retail investors who are seeking a secure retirement.⁴

Forms and Features of Annuities. Annuities come in a wide variety of forms to meet varying consumer needs, and annuity insurers have continued to produce numerous innovations in annuity products to meet the changing needs and demands of a diverse and aging population.

35-69) do not expect to receive any income from a pension in retirement. In keeping with this seismic shift away from reliance on pension-generated retirement income, even fewer Millennials (ages 18-34) expect to have access to any pension income in retirement. INSURED RETIREMENT INSTITUTE, *THE LANGUAGE OF RETIREMENT* (2017).

- It does not appear that the growing number of retirees without pensions will be able to instead rely on Social Security for adequate retirement income. The Social Security Administration itself has stated that, absent changes by Congress, Social Security will pay only 75% of promised benefits starting in 2035. See BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, *2017 ANNUAL REPORT 5* (2017), <https://www.ssa.gov/OACT/TR/2017/tr2017.pdf>. Not surprisingly, 80% of respondents to one study do not believe Social Security will provide them with sufficient retirement income. IRI Study 2016, *supra* note 3.).

While 401(k) plans are widely perceived as a retirement savings replacement for pensions, 401(k) plans alone are not capable of filling the looming retirement gap.

- Not all Americans have access to employer-sponsored 401(k) plans. Indeed, only 14% of employers offer retirement plans. Ben Steverman, *Two-Thirds of Americans Aren't Putting Money in Their 401(k)*, BLOOMBERG (Feb. 21, 2017, 4:00 AM), <https://www.bloomberg.com/news/articles/2017-02-21/two-thirds-of-americans-aren-t-putting-money-in-their-401-k>.
- Two-thirds of all American workers do not contribute anything to a 401(k) plan. *Id.*

Furthermore, retail customers' need for access to guaranteed lifetime income continues to grow as advances in medicine, nutrition, and education all lead to Americans enjoying longer lifespans.

⁴ As of December 31, 2017, there were nearly \$2 trillion of assets under management in deferred variable annuities alone. See INSURED RETIREMENT INSTITUTE, *IRI ISSUES FOURTH QUARTER 2017 ANNUITY SALES REPORT* (2017), <http://www.irionline.org/newsroom/newsroom-detail-view/iri-issues-fourth-quarter-2017-annuity-sales-report>.

All annuities, including *immediate annuities*⁵ and *deferred annuities*,⁶ share the basic “payout” feature that allows an individual to convert a lump sum of money into a stream of periodic payments that are guaranteed to continue for one or more lives or another specified duration.⁷ Unlike immediate annuities, deferred annuities also include an “accumulation” feature that precedes the payout phase and facilitates retirement savings by allowing an individual to receive credited interest and/or investment gains on amounts invested in his or her contract, depending on the type of deferred annuity.⁸ In addition to their accumulation and payout features, deferred annuities virtually always include guaranteed death benefits and may also include innovative guaranteed “living benefits” that provide other forms of financial and insurance guarantees throughout an individual’s life.

Due to their unique structure and benefits, deferred annuities in their various forms are distinctly suited to help retail customers both accumulate assets and obtain guaranteed income for life. To help further explain the structure and benefits of deferred annuities, provided below is additional information about (i) the accumulation phase under the different forms of deferred annuities; (ii) the payout phase generally; (iii) death benefits; and (iv) living benefits. Also provided below is a description as to why deferred variable annuities are particularly unique compared to other investments that are available to retail customers.

Accumulation Phase. During the accumulation phase of a deferred annuity, an individual may grow his or her “account value” through credited interest or investment gains. The manner in which account value is credited with interest or investment gains (or losses) depends on the type of deferred annuity. There are many forms of deferred annuities, each of which has unique characteristics designed for the needs and risk tolerances of particular retail customers. Certain deferred annuities generally are securities, such as *variable annuities*⁹ and registered *index-linked annuities*.¹⁰ Other deferred annuities generally are not securities, such as *deferred fixed annuities*¹¹ and *fixed indexed annuities*.¹² However, all deferred annuities share an important investment feature: their accumulation phases allow investors to accumulate assets for retirement on a tax-deferred basis.

⁵ An immediate annuity is often purchased with a single premium, and the periodic payments commence within a short time (typically a year or less) after the premium is paid. There is no “accumulation phase” where the premium is credited with interest or earnings prior to periodic payments commencing.

⁶ A deferred annuity can be purchased with a single premium or multiple premiums, and the periodic payments are scheduled to commence at a specified future date.

⁷ The period during which an individual receives annuity payments is often referred to as the “payout phase.”

⁸ The period during which an individual may accumulate assets under a deferred annuity is often referred to as the “accumulation phase.”

⁹ A variable annuity provides an account value that typically is invested in mutual funds or other securities and reflects the investment gains and losses on those assets. This form of annuity provides access to equity-based returns, which presents market risk, but which also provides the opportunity to accumulate more retirement savings over the long term.

¹⁰ A deferred registered index-linked annuity provides an account value that will reflect the positive or negative performance of one or more market indices, such as the S&P 500 Index, and therefore typically neither the principal nor a minimum interest rate is guaranteed. However, losses are generally buffered or subject to a floor or participation rate, limiting the owner’s exposure to market losses while providing access to equity-like returns.

¹¹ A deferred fixed annuity provides an account value that is credited with interest at a guaranteed minimum rate. Additional interest may be credited based on the current interest rate environment. Deferred fixed annuities generally are appropriate for individuals with low tolerances for market volatility. Some deferred fixed annuities contain market value adjustment features that adjust the amounts payable on certain withdrawals or surrenders to reflect changes in prevailing interest rates. When deferred fixed annuities have this feature, they generally are registered as securities.

¹² A deferred fixed indexed annuity provides an account value that is credited with interest based on the positive performance of one or more market indices, such as the S&P 500 Index. This form of annuity provides assurances against market losses but also access to equity-like returns.

Furthermore, throughout the accumulation phase, investors may access all or a portion of their account values through withdrawals. While withdrawals may be subject to surrender/contingent deferred sales charges or tax penalties depending on the circumstances, the ability to take withdrawals provides a source of liquidity for investors as their financial needs or goals change, and is another feature of deferred annuities that retail customers find attractive.

Payout Phase. When individuals who own deferred annuities are set to begin receiving a stream of guaranteed income under their contracts, their account values are applied to a payout option. All individual deferred annuity contracts include guaranteed "annuity purchase rates." Guaranteed annuity purchase rates represent an insurance guarantee that payments will continue for life using established mortality tables to calculate the amounts paid. For fixed payouts, each dollar of account value applied to a payment option will produce at least a specified dollar amount of periodic income payment for life varying with the age at which the payment option is elected.¹³ (The older the individual, the higher the income payment per dollar applied.) For variable payouts, the payments also continue for life, but the amount of the periodic income payments vary to reflect current investment rates of return. Typically, when the deferred annuity owner is ready to apply the account value to a payment option, the resulting payments will be calculated at the greater of the contract's guaranteed annuity purchase rates or the purchase rates the insurance company is currently offering.

An individual virtually always has the ability to elect a payout option based on his or her personal needs and goals. The most widely available forms of payout options include:

- Traditional life-contingent annuity payments, under which the life insurance company guarantees regularly-scheduled periodic payments for as long as a single individual lives or two individuals live.
- Life with period certain annuity payments, under which the life insurance company guarantees periodic payments that will continue for at least a specified period, such as for 10, 15 or 20 years. For example, a payout option can provide for payments that will continue for the longer of an individual's life or 10 years. If the individual lives for more than 10 years after payments have commenced, the payments will continue for the rest of his or her life. But if the individual dies before the 10-year period has expired, his or her heirs will receive the remaining payments, either in a lump sum or as continued installments.

The lifetime guarantees offered by annuities during the payout phase are sometimes compared to "life expectancy" distributions generated through the systematic sale or redemption of mutual fund shares from an individual account, such as a custodial or brokerage account. Such distributions, whether taken over life expectancy or in some other form attempting to mimic an annuity, cannot provide the same guarantees and benefits to retirees as a lifetime annuity. Periodic payments over life expectancy generated through redemptions of mutual fund shares from an account, such as an IRA, provide less retirement income than a lifetime annuity purchased with an equal sum and earning an equal return. Moreover, for those individuals who live long lives, such periodic withdrawals from an account will result in dramatically decreasing income payments in the later years of life when income is likely to be needed the most, whereas lifetime annuity payments will not decrease.¹⁴

Death Benefits. Virtually all deferred annuities provide death benefits, and it is very common for those benefits to guarantee a return at least equal to the premiums made under a contract.

¹³ Guaranteed annuity purchase rates may have significant future value. If medical advances result in a material increase in longevity, that increase in longevity would reduce the annuity purchase rates currently offered by an insurance company (i.e., each dollar applied to a life-contingent payment option would produce a lower dollar amount of periodic income for life). However, that increase in longevity cannot reduce annuity purchase rates locked in at the time a deferred annuity contract is issued.

¹⁴ See Jeffrey R. Brown, *The New Retirement Challenge* (Sept. 2004).

Optional "enhanced" death benefits also are available, and include a variety of designs that may result in a higher death benefit. Death benefits under a variable annuity indirectly facilitate a more financially secure retirement for annuity owners because they allow owners to invest in equity markets without fear of leaving dependents and other beneficiaries with inadequate assets should the owner die unexpectedly during a downturn in the financial markets.

Living Benefits. In response to consumer interest in new forms of guaranteed insurance benefits, annuity insurers have developed innovative "guaranteed living benefit" features that are often offered in conjunction with deferred annuities. Living benefits can be categorized as accumulation benefits and distribution benefits, as discussed further below.

- Accumulation benefits. Many annuity products offered today include additional features that allow individuals to benefit from increases in the equity markets while limiting (either partially or completely) their downside risk to market losses. For example, guaranteed minimum accumulation benefits or "GMABs" offered under some variable annuities guarantee a minimum rate of return before annuity payments commence. These and similar features encourage individuals to invest in assets that are more likely to provide higher returns, while reducing or eliminating the risk of investment losses.
- Distribution benefits. Distribution benefits may be sub-categorized into guaranteed minimum income benefits and guaranteed withdrawal benefits, each of which provides protection against market risk and longevity risk.
 - A guaranteed minimum income or "GMIB" benefit is designed to provide the annuity owner with a base amount of lifetime income when he or she retires, regardless of how the account value within the contract has performed. This feature can be included within a fixed annuity or a variable annuity. The typical GMIB provides that if the individual annuitizes the contract on a life-contingent basis (with or without a period certain), the resulting annuity payments will be calculated using the greater of the contract's account value or a specified benefit base.
 - Guaranteed withdrawal benefits provide that each year during a specified duration, a guaranteed minimum amount will be available to withdraw from the annuity's account value, irrespective of the actual balance at that time. The guarantee can be scheduled to last for a specified period (such as 10 years) or for the entire life of one or two individuals. The earlier iterations of these benefits are typically called guaranteed minimum withdrawal benefits or "GMWBs," while the more recent iterations are typically called a guaranteed lifetime withdrawal benefits or "GLWBs." In either design, the guaranteed minimum withdrawal amount is normally determined as a percentage of a specified benefit base.

Variable Annuities Also Offer Unique Investment Features. As previously noted, a retail customer owning a variable annuity has an account value during the accumulation phase that is invested in underlying mutual funds or other assets and reflects the investment gains and losses on those assets. However, variable annuities include other features (in addition to guaranteed lifetime income features) that make variable annuities unlike any other investments that may be available to a retail customer, including mutual fund shares. For example:

- Owners of variable annuity contracts accumulate assets under their contracts on a tax-deferred basis.
- Variable annuities offer a wide variety of investment options, such as underlying mutual funds with different investment objectives and strategies, all within a single product. While the precise number of investment options varies by contract, variable annuities typically offer dozens of investment options, it not being uncommon for there to be 60 to 100 such options in a single contract.

- Many variable annuities offer a fixed account option that functions in the same way as a deferred fixed annuity, thereby providing an additional option for the owner as his or her tolerance for investment risk changes over time.
- Owners of variable annuities may transfer their account values between investment options generally without charge and without tax consequences. Many variable annuities include popular features such as dollar cost averaging, automatic rebalancing and asset allocation programs, all of which provide owners with significant flexibility in the management of their account values.
- Virtually all variable annuities include death benefits.

It should also be emphasized that the variable annuities available in the market today include different benefits and features. Retail customers have a wide variety of choice with respect to variable annuities. For instance, variable annuities often differ with respect to (i) the number of investment options offered; (ii) the investment objectives, investment strategies and investment advisers of the underlying mutual funds; (iii) the availability of a fixed-income investment option; (iv) the availability and types of optional benefits such as guaranteed living benefits and enhanced death benefits; and (v) the payout options that may be selected upon annuitization. A retail customer's ability to select from a wide range of variable annuities is important, as it allows the retail customer to purchase the variable annuity best suited for his or her personal financial needs and goals.

Costs for Annuity Benefits. As explained above, annuities offer features and benefits simply not available in other investments. These additional features and benefits understandably come with a cost: if compared to other non-annuity investment products, annuities will reflect a cost structure that necessarily will be more than a non-annuity investment product because more benefits are provided by the annuities. Moreover, financial professionals who recommend annuities incur additional costs. These financial professionals must satisfy licensing, education and qualification requirements in addition to those that generally apply to registered persons associated with broker-dealers. These include (i) state insurance producer licenses; (ii) continuing education requirements mandated by states; and (iii) continuing education requirements imposed by the insurers who appointed them.

Proposing Release Fails to Acknowledge Unique Annuity Features and Benefits. The Proposing Release fails to acknowledge the essential, unique features of annuity products. Rather, the Proposing Release presents annuities merely as alternatives to pure investment products. For example, the Proposing Release states that "it may be consistent with a retail customer's investment objectives—and in many cases, in a retail customer's best interest—for a retail customer to allocate investments across a variety of investment products . . . such as some actively managed mutual funds, variable annuities, and structured products."¹⁵ While the Committee certainly agrees with the Commission's assessment that an investment in a variable annuity (and, the Committee assumes, an annuity in general) may be in a retail customer's best interest, the Committee believes that the Commission has not properly and clearly acknowledged the important and unique role that annuities serve for retail customers. Rather, annuities are presented merely as a non-traditional asset class serving to provide for diversification of assets from more traditional asset classes such as mutual funds. This creates a presumption against the sale of annuities and in favor of more "plain-vanilla" investments, a presumption that can be overcome only where a broker-dealer determines that a retail customer desires diversification.

But, as explained above, other than Social Security and defined benefit plans, annuities by virtue of their lifetime income guarantees are the only means that retail customers have to guarantee

¹⁵ Proposing Release at p. 21612. See *also* Proposing Release at p. 21587 ("This proposal is not meant to effectively eliminate recommendations that encourage diversity in a retail customer's portfolio through investment in a wide range of products, such as actively managed mutual funds, variable annuities, and structured products.").

that they will not succumb to longevity risk by outliving their retirement savings. The availability of annuities in the retail market is becoming increasingly important in light of many factors, including reduced coverage by employer-sponsored defined benefit plans and the limited availability of annuity options in defined contribution plans. The importance of annuities to those saving for retirement, and the unique features of variable and other annuities, supports the Committee's belief that more particularized consideration should therefore be given to how the Commission portrays annuities in the Adopting Release.

Adopting Release Must Recognize Uniqueness of Annuities. The Committee is concerned that the manner in which annuities are portrayed in the Proposing Release is not consistent with the Commission's general stated goal of preserving retail consumer choice and access – specifically, to annuity products. Annuities are not merely alternative assets that can facilitate diversification. Variable annuities are not an alternative to mutual funds. Variable annuities provide retail customers with distinct benefits and offer distinct features that cannot be obtained through investments in mutual funds, such as:

- guaranteed lifetime income upon annuitization;
- accumulation of assets on a tax-deferred basis;
- the ability to transfer accumulated assets among investment options without tax consequences and without charge;
- guaranteed death benefits (including potentially enhanced death benefits); and
- the ability to elect guaranteed living benefits (*i.e.*, GMABs, GMIBs, GMWBs or GLWBs).

Indeed, access to guaranteed lifetime income is the unique feature of all annuities — immediate annuities and all deferred annuities — that distinguishes them from any other investment product available to retail customers.

Given these considerations, the Committee urges the Commission to use the adopting release for final Regulation BI as an opportunity to correct any misimpression in the Proposing Release that annuities are mere alternatives to mutual funds or any other investment product. In this regard, we urge that the Commission expressly acknowledge in the Adopting Release that annuities uniquely serve retail customers' needs for guaranteed lifetime income and that they are not merely a product that can serve retail customers' desires to allocate across a broad range of investment products.

Part II. The Role of Cost in the Best Interest Analysis

A. Care Obligation

Regulation BI's Care Obligation. Regulation BI provides that the best interest standard will be satisfied if, among other things, the broker-dealer, or natural person associated with the broker-dealer, complies with the Care Obligation when making a recommendation to a retail customer. The Care Obligation, among other things, requires the person making the recommendation to have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks and rewards associated with the recommendation.¹⁶

Proposing Release Unduly Emphasizes Cost Factor. The provisions of Regulation BI do not elaborate on factors relevant to a determination that a recommendation complies with the Care Obligation. However, as noted above, the Proposing Release does discuss factors relevant to this determination, and, while mentioning several factors, emphasizes cost over the others. The

¹⁶ See paragraph (a)(2)(ii)(B) of Regulation BI.

emphasis on cost and, in particular, various statements in the Proposing Release could be construed as effectively creating a presumption against higher cost products that must be overcome in order to establish that a recommendation is in a retail customer's "best interest." In other words, these statements may be misread or misapplied as requiring that cost be the starting point in any analysis of whether an investment or investment strategy recommendation is in the "best interest" of the retail customer. Taken to the extreme, these statements may even suggest that the only way to satisfy the Care Obligation is to recommend the lowest cost product. The Committee has the following more specific concerns.

Retail Customer's Needs, not Investment Costs, Should be Paramount. First, the Committee believes that the starting point should be the retail customer's need, not the cost. The analysis should start with determining the product that best fits the retail customer's need, and then turn to the other factors. Such an emphasis would be more consistent with the overall objective of Regulation BI – to shift the focus to what is best for the retail customer, given the retail customer's situation – and would minimize the likelihood of recommending cheaper, but less effective, investments. We urge the Commission to emphasize the importance of the retail customer's needs in the adopting release for Regulation BI.

Proposing Release Suggests Unfair Cost Comparison to Mutual Funds. The Committee also is concerned about the import of statements in the Proposing Release suggesting that annuities are similar to mutual funds and therefore their relative costs always need to be considered when a broker-dealer recommends an annuity product. For example, the Proposing Release notes that "when a broker-dealer recommends a *more expensive* security or investment strategy over another ***reasonably available alternative*** offered by the broker-dealer, the broker-dealer would need to have a reasonable basis to believe that the higher cost of the security or strategy is justified . . . based on other factors."¹⁷ We acknowledge that this statement suggests that cost is a consideration when there is a "reasonably available alternative." However, as noted above in Part I of our letter, the Committee is concerned with statements in the Proposing Release implying that annuities and mutual funds could be viewed as "reasonably available alternatives" for one another. To the extent such an implication is perceived as the Commission's view, the higher cost of annuities vis-à-vis mutual funds would be justified only where the presumption against the higher cost can be overcome. Given these concerns, and consistent with our comments in Part I, the Committee urges the Commission to acknowledge when adopting final Regulation BI that mutual funds and other investment products are not "reasonably available alternatives" to an annuity.

Proposing Release Fails to Recognize Substantial Differences Among Annuity Products. Lastly, the Committee is concerned about the Proposing Release's failure to recognize the substantial differences among the features and associated costs of annuities. The different forms of annuities in the market serve a spectrum of risk tolerances and goals, and may be best suited for different groups of retail customers needing some form of longevity protection. Moreover, even when comparing the same type of annuities, their benefits and features can differ significantly. For example, and as previously discussed, retail customers have a wide variety of choice with respect to the benefits and features offered by variable annuities. The different forms of annuities, and the differences among the same types of annuities, all help serve the spectrum of risk tolerances and goals among retail customers needing some form of longevity protection. These product differences also generally correspond to differences in cost. Yet, because the facts and circumstances of each retail customer are so particular, the lowest cost annuity does not necessarily serve the best interest of a retail customer. The adopting release for final Regulation BI should acknowledge that the lowest cost annuity does not necessarily serve the best interest of those retail customers who are in need of guaranteed lifetime income

¹⁷ Proposing Release at p. 21588. See also *id.* at n. 105-106 and accompanying text (second emphasis added).

and should emphasize that, even when deciding among the annuities available for investment, cost is only one factor to be considered.

B. Retail Customer Investment Profile

Retail Customer Investment Profile. Paragraph (b)(2) of Regulation BI requires the retail customer investment profile to include the following: the retail customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the retail customer may disclose to the broker-dealer or natural person associated with the broker-dealer in connection with making a recommendation. Notably, the investment profile requirements do not mention retirement or lifetime income needs, nor do the requirements explicitly contemplate that a broker-dealer could request additional information in determining what investment recommendation would be in the retail customer's best interest.

The Investment Profile Information Should Include Lifetime Income Needs. As noted above, Regulation BI does not include lifetime income needs in the investment profile information on which a best interest determination is to be evaluated. Regulation BI's "Investment Profile" information focuses solely on investments and accumulation: there is no recognition of longevity risks or retirement income needs, key concerns for most retail customers. Given that a best interest recommendation is to be evaluated against the retail customer investment profile information, it is critical that this profile information include all information relevant to a retail customer's key concerns. To that end, the "Investment Profile" provisions should be amended to capture retail customer needs relating to longevity concerns and lifetime income needs. One simple way to do this is by including "longevity protection needs" and other information that a broker-dealer determines is relevant. If these changes were made, the definition would read as follows: "Retail Customer Investment Profile includes, but is not limited to, the retail customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, **longevity protection needs**, and any other information the retail customer may disclose to the broker, dealer or a natural person **or that the broker-dealer determines is relevant.**"

Part III. Conflict of Interest Obligation

The Commission is proposing two requirements in the Conflict of Interest Obligation: that a broker-dealer entity: (1) establish, maintain, and enforce written policies and procedures reasonably designed to identify, and disclose, or eliminate, all material conflicts of interest that are associated with recommendations covered by Regulation BI; and (2) establish, maintain, and enforce written policies and procedures reasonably designed to identify, and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.¹⁸ For ease of reference, we refer to the first requirement as the "disclosure requirement" and the second one as the "mitigation requirement." While Regulation BI does not itself elaborate upon the term "financial incentives," the Proposing Release explains that the Commission "preliminarily believe[s]" that material conflicts of interest involving financial incentives generally would include essentially all forms and types of compensation received by a broker-dealer.

The Committee believes there are critical issues related to the Conflict of Interest Obligation that need to be resolved as Regulation BI advances. Our comments are grouped into two categories: (a) the scope of financial incentives considered to be conflicts subject to the mitigation requirement and (b) the mitigation measures suggested by the SEC in the Proposing Release.

¹⁸ See section (a)(2)(iii) of Regulation BI.

A. Scope of Financial Incentive Conflicts

The Committee offers the following comments regarding the scope of the types of incentives which are deemed to be “financial incentives.”

The Proposing Release’s List of “Financial Incentives” is Overly Broad. The Proposing Release sets forth an illustrative list of material conflicts of interest arising from “financial incentives” associated with a recommendation. The Commission states that in its preliminary view these conflicts would include, but not be limited to, “compensation practices established by the broker-dealer, including fees and other charges for the services provided and products sold; employee compensation or employment incentives (*e.g.*, quotas, bonuses, sales contests, special awards, differential or variable compensation, incentives tied to appraisals or performance reviews); compensation practices involving third-parties, including both sales compensation and compensation that does not result from sales activity, such as compensation for services provided to third-parties (*e.g.*, sub-accounting or administrative services provided to a mutual fund); receipt of commissions or sales charges, or other fees or financial incentives, or differential or variable compensation, whether paid by the retail customer or a third-party; sales of proprietary products or services, or products of affiliates; and transactions that would be effected by the broker-dealer (or an affiliate thereof) in a principal capacity.”¹⁹

While the Committee generally supports the concept of managing conflicts arising from financial incentives such as sales contests and quotas, the Proposing Release uses a far broader definition of “financial incentive” than commonly understood, with the effect that all compensation is considered a “financial incentive” subject to the mitigation requirement. For example, the illustrative list of material conflicts of interest above includes, among other things, the “receipt of commissions or sales charges.” The Committee believes that the illustrative list is overbroad, as it would have the effect of requiring broker-dealers to either eliminate base commissions – a nonsensical result (which even the Proposing Release recognizes²⁰) – or mitigate them. The implication is that all compensation received by a broker-dealer is inherently conflicted and must be mitigated. Such a conclusion is totally at odds with the Commission’s overarching objective in Regulation BI of preserving retail customer choice between broker and adviser accounts.²¹

Moreover, although the Commission suggests a non-exhaustive list of potential practices that broker-dealers can implement in order to mitigate “financial incentive” conflicts of interest,²² it provides no guidance concerning how a firm can “mitigate the conflict” presented by a base commission, long the convention in broker-dealer industry with respect to annuity sales, and more generally the convention with securities traded on a broker basis or distributed in a best efforts offering. The Committee also notes that under existing federal securities laws and rules of self-regulatory organizations, commissions are already subject to “fair and reasonable” compensation standards (discussed more fully below) that serve to mitigate the conflicts of interest associated with them.²³ Accordingly, we believe that the appropriate way to address conflicts arising from base commissions is simply to require disclosure of these commissions, as is currently the case under applicable law.²⁴ In other words, the disclosure requirement, not the

¹⁹ Proposing Release at p. 21618.

²⁰ See Proposing Release at p. 21619 (“The absolute elimination of some particular conflicts could mean a broker-dealer may not receive compensation for its services, which is not the Commission’s intent.”).

²¹ See, *e.g.*, Proposing Release at p. 21575 (“Our goal in designing proposed Regulation BI is to enhance retail customer protection, while preserving, to the extent possible, access and choice for retail customers who prefer the ‘pay as you go’ model for advice from broker-dealers, as well as preserve retail customer choice of the level and types of advice provided and the products available.”).

²² See Proposing Release at p. 21621.

²³ See, *e.g.*, FINRA Rules 2121 (Fair Prices and Commissions), 2122 (Charges for Services Performed), and 2341 (Investment Company Securities). See *also* Exchange Act Sections 10(b) and 15(c).

²⁴ See Exchange Act Rule 10b-10, which generally requires a broker-dealer effecting customer transactions in securities (other than U.S. savings bonds or municipal securities) to provide written notification to the

mitigation requirement, should apply to customary compensation paid in connection with a securities transaction.

Financial Incentive Conflicts Should be Limited to Quotas and Bonuses. In the Committee's view, financial incentive conflicts should be limited to compensation that is based on a contingency and that is in addition to base compensation, such as meeting a quota, qualifying for a bonus as a result of reaching a production threshold, or tied to narrow measures, such as a single type of security or for a short duration. These are the types of compensation that historically have been viewed as "financial incentives" and as to which firms have applied various practices to address potential conflicts.

B. Mitigation Measures

We offer the following comments regarding the mitigation requirement applicable to conflicts considered to be arising from financial incentives.

SEC Should Confirm that Existing Supervisory Practices are Adequate Mitigation Measures. The Proposing Release suggests a non-exhaustive list of potential practices that broker-dealers can implement in order to mitigate "financial incentive" conflicts of interest,²⁵ notes a number of measures commonly in place today,²⁶ and states that it believes broker-dealers could comply with the policies and procedures requirement of Regulation BI by adjusting their current systems of supervision and compliance, as opposed to creating new systems.²⁷ In particular, the Proposing Release mentions FINRA rules relevant to the supervision of recommendations,²⁸ as well as the practices outlined in FINRA's Report on Conflicts of Interest.²⁹ However, the Proposing Release also mentions several practices that generally have not been used (or not proven to be operationally feasible, such as leveled commissions, use of time and complexity neutral factors, and advisory fee offsets), creating uncertainty regarding whether (a) existing supervisory practices are sufficient mitigation measures and (b) whether broker-dealers should further mitigate financial incentive conflicts beyond current practices. The Proposing Release leaves broker-dealers unsure whether the use of existing supervisory practices would be sufficient to satisfy the mitigation requirement with respect to "financial incentive" conflicts of interest, or whether firms would need to adopt the alternative measures mentioned in the Proposing Release in order to satisfy the mitigation requirement.

Without further guidance, firms and regulators will struggle to determine what would be viewed as sufficient "mitigation" of financial incentive conflicts. Moreover, given the plurality and diversity of current compensation arrangements (discussed below), the alternative measures suggested in the Proposing Release simply are not workable. Given these considerations, the Committee urges the Commission to explicitly articulate a presumption that existing compliant supervisory practices with respect to recommendations, such as product training, trade review, trade exception reporting and other risk-based processes, are a sufficient mitigation measure for financial incentive conflicts under Regulation BI's mitigation requirement. By way of support, we offer the following examples of supervisory processes in place today that are designed to mitigate conflicts caused by financial incentives involving variable annuities:

customer, at or before completion of the transaction, disclosing information specific to the transaction, including, among other things, the broker-dealer's compensation, as well as any third-party remuneration it has received or will receive.

²⁵ See Proposing Release at p. 21621.

²⁶ See Proposing Release at n. 315.

²⁷ See Proposing Release at p. 21618.

²⁸ See, e.g., FINRA Rules 2111 (Suitability), 2330 (Members' Responsibilities Regarding Deferred Variable Annuities), 2320 (Variable Contracts of an Insurance Company), and 3110 (Supervision).

²⁹ See FINRA Report on Conflicts of Interest (Oct. 2013), available at <https://www.finra.org/sites/default/files/Industry/p359971.pdf>.

- new product review committees that, among other things, identify and address risks and conflicts presented by a new product;
- product training for associated persons;
- product disclosures;
- suitability and other transaction reviews of recommendations;
- surveillance systems designed to identify high rates of annuity replacements;
- heightened review of annuity recommendations made to senior retail investors; and
- total production and equal weighting requirements for non-cash incentive compensation.

In explicitly articulating a presumption that under appropriate circumstances, existing supervisory practices for recommendations can be sufficient mitigation measures for financial incentive conflicts under Regulation BI, the Commission would effectively clarify and remove any doubt that the mitigation requirement for “financial incentive” conflicts of interest does not impose a *per se* requirement to “levelize” broker-dealer compensation or use a “time and complexity” compensation formula – alternative measures discussed in the Proposing Release.

Mitigation Requirements Should Apply Only at the Level of the Person Making the Recommendation. In the Proposing Release, the Commission begins its discussion of the Conflict of Interest Obligations under Regulation BI by noting that, “[u]nlike the Disclosure and Care Obligations, which apply to a broker or dealer and to natural persons who are associated persons of a broker or dealer, the proposed Conflict of Interest Obligations apply solely to the broker or dealer entity, and not to the natural persons who are associated persons of a broker or dealer.”³⁰ However, the Proposing Release’s illustrative list of material conflicts of interest arising from “financial incentives” generally appears to relate to compensation arrangements at the level of the associated person making a recommendation subject to Regulation BI, and not at the level of the firm. Moreover, most of the suggested mitigation measures pertain to compensation at the associated person level. Given this, the Committee believes that it is not clear whether the “financial incentive” conflicts of interest subject to the mitigation requirement would be limited to those that exist at the level of the associated person making a recommendation subject to Regulation BI, or also at the broker-dealer level. Because of the plurality and diversity of current compensation arrangements discussed below, the Committee urges the Commission to limit the mitigation requirement to conflicts at the level of the person (either the associated person or the broker-dealer) making a recommendation subject to Regulation BI.

Use of Compensation Grids for Associated Persons Should Be Permissible. The Proposing Release indicates that broker-dealers “generally should consider incorporating” a series of different practices that all pertain to the maintenance and operation of a compensation grid for associated persons.³¹ The Proposing Release’s focus on compensation grids has raised concerns that compensation grids could be viewed as inherently problematic and a compensation structure that should be discarded. Compensation grids are not inherently problematic and, to the contrary, provide useful mechanisms for ensuring fair treatment of associated persons and aligning the interests of broker-dealers, associated persons and retail investors. The Committee urges the Commission to confirm in the adopting release for Regulation BI that compensation grids for associated persons will continue to be permissible under Regulation BI.

Third Party Compensation Should Not Require “Heightened Mitigation Measures.” The Proposing Release states that “heightened mitigation measures,” including “enhanced supervision,” may be appropriate for third party compensation arrangements.³² For the reasons discussed below, the Committee believes that existing disclosure and supervisory practices more than adequately address third party compensation arrangements, and that no heightened

³⁰ Proposing Release at n. 289.

³¹ Proposing Release at p. 21621.

³² See Proposing Release at pp. 21620-21621.

mitigation measures, such as enhanced supervision, beyond what is currently in place are necessary to mitigate these types of “financial incentive” conflicts of interest.

The Proposing Release overlooks the reality that most investments designed for retail customers are made available in the context of public and private offerings, which have long utilized what is now called a “third party” compensation arrangement. This structure serves a number of consumer-friendly purposes, including that retail customers are treated fairly and are able to “buy in” at the same price regardless of the firm through which they purchase the investment. This structure also simplifies the process for charging and collecting compensation for services. In the case of annuities, this structure allows for a retail customer’s entire investment amount to be applied to the investment, without any deduction for sales compensation, subject to a surrender charge if the annuity is surrendered or a portion withdrawn during a surrender period. These arrangements are not “hidden” from retail customers: these compensation arrangements are required to be disclosed in prospectuses, and many firms provide comprehensive disclosure of their arrangements to their customers at account opening or on their websites. FINRA non-cash compensation rules apply to most of these offerings, and are considered to significantly curtail or eliminate potential conflicts arising from third party compensation arrangements.

In short, existing disclosure and supervisory practices adequately address these arrangements; these arrangements should not be called out as warranting further “heightened mitigation measures” and “enhanced supervision,” in comparison to other compensation arrangements. Given this, the Committee urges the Commission to clarify in the adopting release for Regulation BI either that third party compensation does not require “heightened mitigation” or “enhanced supervision” beyond current requirements or, alternatively, that existing requirements and practices exemplify “heightened mitigation” and “enhanced supervision” for the conflicts associated with third party compensation arrangements.

“Levelizing” Broker-Dealer Compensation is Not a Viable Mitigation Measure. As noted above, the Commission suggests a non-exhaustive list of potential practices that broker-dealers can implement in order to mitigate “financial incentive” conflicts of interest.³³ One of the suggested practices is the “levelizing” of broker-dealer compensation arrangements in order to mitigate “financial incentive” conflicts of interest. We respectfully submit that this suggestion reflects a lack of understanding regarding the plurality and diversity of compensation arrangements and related potential conflict situations for many broker-dealers, and overlooks the adverse consequences of solutions that may seem superficially attractive.

Broker-dealer compensation arrangements may include: (i) brokerage commissions on traded securities paid by the customer; (ii) markups or markdowns in the case of principal transactions reflected in the purchase or sale price paid by the customer; (iii) spreads in certain public offerings; (iv) selling compensation paid by issuers in private and public offerings; (v) fees paid for ongoing servicing and administrative relationships; and (vi) account fees and charges. These compensation arrangements reflect different services and functions and the pricing of the compensation for these services and functions is based on years of industry experience with providing the services and performing the functions. Moreover, these compensation arrangements historically have been subject to “fair and reasonable” standards under FINRA rules and thus current compensation practices can be presumed to be the result of operating under those standards. Such rules include FINRA Rules 2121 (Fair Prices and Commission), 2122 (Charges for Services Performed), 2341 (Investment Company Securities) and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements). These rules and related rule material outline relevant factors to consider in light of the differences in the services and functions. The services and functions cannot be viewed as similar in nature, such that the compensation therefor can be “levelized”: doing so would ultimately mean that some retail

³³ See Proposing Release at p. 21621.

investors would be charged more than what is reasonable, and others less, simply to maintain a "levelized" fee structure.

Time and Complexity Neutral Factors are Not Operationally Feasible. Another mitigation measure suggested in the Proposing Release is "minimizing compensation incentives for employees to favor one type of product over another, proprietary or preferred provider products, or comparable products sold on a principal basis – for example, establishing differential compensation criteria based on neutral factors (e.g., the time and complexity of the work involved)."³⁴ This suggestion is based on a suggestion put forth by the U.S. Department of Labor in its preamble to the Best Interest Contract Exemption,³⁵ which when fully implemented, would have effectively required level commissions, and permitted differential compensation only where the differential could be justified based on time and complexity. However, the neutral factors suggested by the Commission – time and complexity – have never been recognized as factors for determining "fair and reasonable" broker-dealer compensation arrangements for different products and services and do not provide a workable framework for mitigating financial incentives.

Offsetting Broker-Dealer Compensation Against Advisory Fees is Problematic. The Proposing Release suggests that a broker-dealer could eliminate a material conflict of interest associated with recommending mutual funds managed by an affiliate by "crediting fund advisory fees against other broker-dealer charges."³⁶ This suggested method for elimination of material conflicts of interest relating to affiliated mutual funds presents a number of problematic issues. First, this proposed example conflates the investment adviser and broker-dealer services provided by affiliated entities, and assumes that the broker-dealer is not entitled to compensation for its services simply because it is affiliated with the investment adviser. Second, an offset could create a "differential compensation" arrangement for the broker-dealer between affiliated and non-affiliated funds (for which the broker-dealer could be paid). Third, an offset also could suggest that the investment adviser's compensation is partly for distribution.

This example is exacerbated in the context of variable annuities, which permit a retail customer to allocate contract value among a number of underlying funds, some of which may be proprietary and some of which may be unaffiliated. It would not be practicable to apply an offset in this case. Finally, any such offset could very well be viewed as a "rebate" under state insurance laws, which in most states prohibit rebating practices in connection with insurance. Given these concerns, the Commission should clarify in the adopting release for final Regulation BI that offsetting broker-dealer compensation against advisory fees is likely not a realistic means of mitigating or eliminating a material conflict of interest in light of applicable laws.

Part IV. Disclosure Obligation

The Disclosure Obligation requires the broker-dealer or associated person, prior to or at the time of making a recommendation, to reasonably disclose to the retail customer, "the material facts relating to the scope and terms of the relationship with the retail customer, including all material conflicts of interest that are associated with the recommendation."³⁷ On its face, the Disclosure Obligation appears to call for a disclosure particularized to the person making the recommendation and the recommendation itself, and does not appear to allow for a disclosure covering the range of possible recommendations that the broker-dealer or associated person could make to retail customers.

³⁴ *Id.*

³⁵ See Dep't of Labor, Emp. Benefits Sec. Admin., "Best Interest Contract Exemption," 81 Fed. Reg. 21002, at 21037 (Apr. 8, 2016).

³⁶ See Proposing Release at p. 21619.

³⁷ Proposing Release at p. 21599.

The Disclosure Obligation Should Allow Use of a Comprehensive Disclosure. The Committee urges the Commission to modify the text of the Disclosure Obligation or otherwise clarify in the adopting release for Regulation BI that a broker-dealer could satisfy the Disclosure Obligation through the use of a disclosure describing the products and services available to its retail customers and related conflicts of interest, and that a broker-dealer or associated person need not provide a disclosure particularized to a recommendation. Developing particularized disclosures is simply not operationally feasible. Moreover, retail investors would benefit from disclosure that can situate a particular investment recommendation within the products and services offered to retail customers by that broker-dealer.

Part V. Retail Customer Definition

Regulation BI would define the term “retail customer” as “a person, or the legal representative of such person, who (1) receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer or a natural person who is an associated person of a broker or dealer, and (2) uses the recommendation primarily for personal, family, or household purposes.”³⁸ According to the Proposing Release, the SEC believes that this definition excludes recommendations that are related to business or commercial purposes.

SEC Should Clarify that Retail Customer Does Not Include Retirement Plan Representative. As noted above, the “retail customer” definition would include the “legal representative” of a person. The reference to “legal representative” has created an ambiguity in the context of plan representatives for employer-sponsored retirement plans, specifically, whether they could be considered to be “representatives” of the plan participants who in turn could be considered “retail customers.” Proposed Regulation BI is silent with respect to whether representatives of employer-sponsored retirement plans would be considered “retail customers.” Our understanding is that the SEC did not intend to extend Regulation BI to a broker-dealer’s recommendations to the designated plan representatives for a retirement plan, when acting in their capacity as plan representatives, nor to other professionals providing services to a plan, simply because the participants in the plan might be “retail customers.” The Committee urges the SEC to clarify that the term “representative” as used in the retail customer definition would not include plan representatives nor would it include other plan fiduciaries, such as those who determine the investments and administer the plan, or other entities and professionals charged with designing the plan and advising the plan fiduciaries, including the sponsoring employer and the plan’s retained consultants and advisers.

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³⁸ Proposing Release at p. 21595.

The Committee appreciates the opportunity to comment on the SEC's proposed Regulation BI. Please do not hesitate to contact Clifford Kirsch [REDACTED] or [REDACTED] [REDACTED] or Susan Krawczyk [REDACTED] or [REDACTED] [REDACTED] with any questions or to discuss this comment letter. The Committee would be happy to provide any additional information to the Commission or discuss any of the issues or concerns identified in this letter if that would be helpful.

Respectfully submitted,

THE COMMITTEE OF ANNUITY INSURERS

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