MEMORANDUM

TO: File No. S7-07-18
FROM: Geeta Dhingra, Division of Trading and Markets
RE: Meeting with Representatives of Lincoln Financial Group
DATE: September 27, 2018

On Tuesday, September 25, 2018, representatives of the Securities and Exchange Commission (“SEC”) participated in a meeting with representatives of Lincoln Financial Group (“Lincoln”). The SEC representatives were Jennifer Juergens, James McLoughlin, and Iulian Obreja from the Division of Economic and Risk Analysis; Paul Cellupica, Sara Cortes, Parisa Haghshenas, and Gena Lai from the Division of Investment Management; and Bradford Bartels, Roni Bergoffen, Geeta Dhingra, Dan Fisher, Lourdes Gonzalez, and Emily Westerberg Russell from the Division of Trading and Markets. The Lincoln representatives were Carrie Chelko, Paul Chryssikos, Will Fuller, and Abbie Pancoast.

The participants discussed, among other things, the SEC’s proposed Regulation Best Interest. At the meeting, the Lincoln representatives distributed the attached document.
Protecting the long-term interest of Main Street investors

Insurance products issued by:
The Lincoln National Life Insurance Company
Lincoln Life & Annuity Company of New York
The long-term interest of Main Street investors

“Our analysis starts and ends with the long-term interests of the Main Street investor.”

“. . . [H]ow does what we propose to do affect the long-term interests of Mr. and Ms. 401(k)? Are these investors benefiting from our efforts? Do they have appropriate investment opportunities? Are they well informed? . . .

[W]hat can the Commission do to cultivate markets where Mr. and Ms. 401(k) are able to invest in a better future?”

Jay Clayton, Chairman of the SEC (July 12, 2017)
The foundation for retirement is weakening

Americans could once plan a retirement by relying on a stable three-pillared foundation comprising Social Security, company pensions, and personal savings. But this foundation is weakening and faces an uncertain future.

Social Security is being strained by longer life spans and rising costs.

Employer pensions in the private sector are disappearing.

Americans are expected to self-fund a large part of their retirement.
Today’s retirement reality is being challenged

76 million baby boomers are entering retirement at a rate of 10,000 a day.¹

A 65-year-old married couple has²

- A 73% chance that one will live to age 90
- A 47% chance that one will live to age 95

About 1/2 of working-age households are at risk of being unable to maintain their standard of living in retirement.³

Only 15% of Americans have a pension today.⁴

For all other U.S. retirement savers, an individual annuity is their only chance to access guaranteed retirement income.

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¹ 2018 IRI Retirement Factbook, Insured Retirement Institute.
The entire financial life cycle needs to be considered

The financial life cycle of Main Street investors starts with budgeting, savings and accumulation. However, as Main Street investors approach retirement, they need to turn their savings into income to cover their living expenses.

Main Street investors need advice, not just on how much to save and where to invest the savings, but on how to plan for income to cover their basic needs in retirement and protect loved ones.
Are we asking the right questions?

Regulations require the creation of an investment profile. Shouldn’t we have an income profile?

**FINRA Rule 2111 investment profile**
- What is your investment objective?
- What is your risk tolerance?
- What is your tax status?
- What investments do you currently have?
- What is your investment experience?
- What is your investment time horizon?
- What are your liquidity needs?

**Income profile is also needed**
- What is your income objective in retirement?
- What is your time horizon until drawing income?
- What is your risk tolerance for fluctuations or decreases in your income?
- What sources of income will you have, guaranteed and non-guaranteed?
- How long will you need your income to last?
- Do you want or need income for your spouse or partner?

7 in 10 retirees with a formal retirement income plan say their retirement expenses were as they expected.

Source: LIMRA 2018

Regulations should give equal weight to investment and income profiles.
Advisors play a vital role in helping Main Street investors successfully navigate financial life cycle risks, allowing them to maintain their lifestyle in retirement and know that they will not outlive their retirement income.

Individuals with a financial advisor are on track to replace 87% of their current income in retirement compared to 57% for those without an advisor.

75% of retirees with formal income plans completed them with advisors.

7 in 10 who own an annuity feel confident that they will NOT run out of money by age 90, compared to 57% of retirees without an annuity.

Source: Empower Institute, 2016 Lifetime Income Score VI: Optimism and Opportunity. Source: LIMRA 2018
Investors should be able to choose how they pay for advice

Commissions often make the most sense for long-term investments

**Fee-based**
- $100,000 investment product
- 1% annual compensation
- Guarantee purchases are long-term buy and hold investments

**Commission-based**
- $100,000 insurance product
- 5.25% up-front, 0.25% ongoing
- Commissions may be a better value for investors

Cumulative Advisor Compensation

- **Fee-based**
  - $1,000
  - $5,250
  - $12,500
  - $30,000

- **Commission-based**
  - $30,000
  - $12,500

Fees are often higher for account balances under $1 million, impacting Main Street investors.

Commissions align to the cycle of advice for insurance products

**Investor education**
- Analyze financial situation
- Complete investment and income profile
- Retirement income education

**Personalized advice**
- Prepare personalized plan
- Present custom guaranteed income projections
- Lincoln provided 1.4 million illustrations over the last 5 years

**Legal contract**
- Review the guarantees
- Provide full disclosure of all fees
- Free look period allows investor to cancel contract

**Ongoing advice**
- Review & reevaluate plan
- Emphasis on income needs
- Less focused on investment advice

Regulations should hold commissions and fees to the same process and standard.
Investors should be able to choose insurance products

Insurers play an important role in investors’ security

Investors face daunting market, longevity, and survivorship risks in retirement. Insurers help increase their retirement security by assuming a portion of this risk for an affordable cost.

Investors face risk that they can transfer to insurers.

**LONGEVITY RISK**

- **There is a 50% chance** that retirees will outlive their assets.
- **More than 40% of retirees underestimate** their life expectancy.

**SURVIVORSHIP RISK**

- Chance that one member of a couple, at age 65, will live to...
  - Age 85: 89%
  - Age 90: 73%
  - Age 100: 20%

**GUARANTEED LIFETIME INCOME**

- Lincoln guarantees future income payments on policies worth $76.2 billion.
- In 2017 alone, Lincoln paid over $6.0 billion in income and death benefits to investors.

**SURVIVOR DEATH BENEFITS**

- Lincoln guarantees minimum death benefits on policies worth $123.6 billion.

Regulations should not disadvantage lifetime income products.

¹Hearing before U.S. Senate Special Committee on Aging, 111th Congress, "Lifetime Income Options for Retirement," 2010.
How income guarantees benefit investors

83% of retirement savers who purchase a variable annuity do so with the intent of using the annuity as a source of secured retirement income.

Investor transfers longevity, survivorship, and market risks to insurance company.

Pays for lifetime income guarantee via a rider charge.

Lincoln’s joint life lifetime income cost to investor: 1.17% average.

Lifetime income guarantees remove the possibility of outliving retirement assets.

0% Annuity Saver

50% Mutual Fund Saver

Case study: DOL regulation

Perceived bias against insurance products and commissions, and a favorability toward fees

The DOL regulation increased investor confusion by layering on a new standard of care and limited investor choice as to advice and products.

Investors are losing access to advice and products

The introduction of the DOL regulation resulted in a **31%** DROP in industry sales of variable annuities from $140 billion in 2014 to $96 billion in 2017.*

**THE CONSEQUENCE:**
Reduced investor access to guaranteed lifetime income solutions.

**1,800 ORPHANED ACCOUNTS**
In Q2 2017, Lincoln saw a significant spike in ORPHANED ACCOUNTS, to 1,800, the largest number since the financial crisis of the late 2000s.

- Nearly 50% of distribution partners have REDUCED their annuity offerings and/or carriers.
- 95% of firms surveyed have **LIMITED** investor access to advice for retirement accounts in response to the DOL rule.
- 53% of firms have **REDUCED** investors’ access to typical retirement products, including annuities, impacting 22.8 million ACCOUNTS.
- The drop in industry sales of variable annuities resulted in a **DROP** in industry sales of $140 billion in 2014 to $96 billion in 2017.*
- In Q2 2017, Lincoln saw a significant spike in ORPHANED ACCOUNTS, to 1,800, the largest number since the financial crisis of the late 2000s.

*Study Conducted for SIFMA by Deloitte & Touche LLP: The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors, August 9, 2017.

*Source: LIMRA 2018
Anna and Don Smith

Anna and Don Smith are a retired bookkeeper and IT professional, both age 65. The Smiths have $350,000 in retirement savings. They want to maintain $200,000 in savings that they can access at any time. Their only current source of guaranteed income, Social Security benefits, will provide $2,570 per month.

FINRA Rule 2111 investment profile: The Smiths

☐ What is your investment objective? Income
☐ What is your risk tolerance? Low
☐ What is your tax status? Retired, low bracket
☐ What investments do you currently have? IRA, cash savings, mutual funds
☐ What is your investment experience? 20 years
☐ What is your investment time horizon? Less than 1 year
☐ What are your liquidity needs? Need to have money available for emergencies
**Income profile: The Smiths**

- What is your income objective in retirement? **Reliable income**
- What is your time horizon until drawing income? **Less than 1 year**
- What is your risk tolerance for fluctuations or decreases in your income? **Low**
- What sources of income will you have, guaranteed and non-guaranteed? **Social Security and savings**
- How long will you need your income to last? **For life**
- Do you want or need income for your spouse or partner? **Yes**

*The Smiths were asked the right questions.*
Establishing a harmonized best interest standard of care

“If you have a portfolio with a few stocks, a couple of mutual funds in a 401(k), and an annuity, then your relationship with your investment professional could be subject to regulation by the SEC, FINRA, the Department of Labor, state insurance regulators, state securities regulators, state attorneys general and, if the investment professional is associated with a BD or IA or both that is part of a bank, federal and/or state banking regulators.”

Jay Clayton, Chairman of the SEC (May 2, 2018).
Establishing a harmonized best interest standard of care

The Commission should finalize Regulation Best Interest as soon as possible

Key considerations should include the following:

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<td>1</td>
<td>Compensation should be based on the benefits received and services performed, and commissions and fees should be held to the same standard and process.</td>
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<td>Any consideration of what’s in an investor’s “best interest” should include an analysis of the investor’s lifetime income needs.</td>
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<td>This regulation should serve as the template for standard-of-care regulations promulgated by the States and FINRA.</td>
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All contract and rider guarantees, including those for optional benefits, fixed subaccount crediting rates, or annuity payout rates, are subject to the claims-paying ability of the issuing insurance company. They are not backed by the broker-dealer or insurance agency from which this annuity is purchased, or any affiliates of those entities other than the issuing company affiliates, and none makes any representations or guarantees regarding the claims-paying ability of the issuer.

For educational purposes only.