Fiduciary rule may be long-run “negative” for life insurers: Fitch

By Editorial Staff *Thu, Apr 7, 2016*

The new regulations could have a "negative impact on the sale of certain annuity products, drive changes in product offerings, distribution strategies and compensation structures and lead to increased operational costs,” a Fitch release said.

Fitch Ratings issued the following statement late Thursday afternoon, April 7, 2016:

The US Department of Labor’s (DOL) finalized ruling, which now includes fixed index annuities (FIAs) along with variable annuities (VAs) under the new best interest standards, will mostly affect FIA writers, according to Fitch Ratings.

The DOL Wednesday issued its Conflict of Interest Rule, also referred to as the fiduciary rule. The inclusion of FIAs under the more onerous requirements of the Best Interest Contract was unexpected. As such, Fitch believes FIA writers are not as prepared as VA writers, who have already spent considerable time and effort preparing for the new standards. FIA writers also tend to be less diversified, so many of the negative aspects of the new regulations will have a greater impact on them.

Final regulations are less onerous than expected, which should diminish the negative impact on VA sales relative to initial expectations. Fitch expects the new regulations to drive changes in product offerings over time, to lead to changes in distribution strategies and compensation structures and to increase litigation risks and operational costs for companies.

However, Fitch believes that, over the longer term, both FIA and VA writers will be able to adapt to the new standards due to the relative attractiveness of these products in a low interest rate environment. Additionally, the longer phase-in period may lessen the disruption to the sales process that was envisioned and may dampen the impact of the unexpected inclusion of FIAs.

The following appeared Thursday morning in RIJ:

The US Department of Labor (DOL) proposal promoting new “best interest” standards that provide protections primarily to individual and small business investors related to retirement accounts and annuities could affect US individual annuity sales, according to Fitch Ratings.

The proposal—whose final version was made public Wednesday—is viewed as “credit neutral” to US life insurers, Fitch said. The ratings agency expects the bulk of the final DOL regulations will remain largely as proposed, with some more minor changes in procedure likely.

But Fitch said the new regulations “could have a material negative impact on the sale of certain annuity products, drive changes in product offerings, distribution strategies and compensation structures and lead to increased operational costs to comply with the new standard,” a Fitch release said.

[Fitch released its report a few days before the publication of the final version of the fiduciary rule this week. In the original version, it assumed that indexed annuities would have an advantage over variable annuities. But in the final rule, sellers of variable and indexed annuities were required to use the BICE.]

The DOL regulations ultimately aim to reduce potential conflicts of interest between selling agents and the retail investor and to broaden the scope of individuals covered under the Employee Retirement Income Security Act of 1974 (ERISA).

Although Fitch does not expect the potential reduction in revenue to hurt the industry’s overall credit profile, the potential adoption of such a fiduciary standard applied to a broader set of products sold by US life insurers would be a credit negative in the long run.

Under the new DOL proposal, a best interest fiduciary standard would apply to retirement plans with less than 100 participants or $100 million in plan assets, an individual plan participant or an IRA owner.

As a fiduciary, an advisor is prevented from receiving commissions on product sales unless the advisor commits to following a best interest fiduciary standard and to adhering to certain compliance policies, procedures and disclosures of fees and potential conflicts (known as the Best Interest Contract, or BIC).

As the new proposal doesn’t apply to retirement plans with more than 100 participants or plans with at least $100 million in assets (which have fiduciaries with financial expertise), the employer-sponsored group business for midsized or large companies will not be affected under the new proposal.