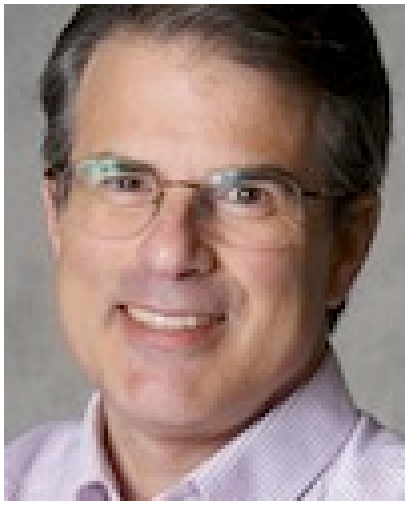
Four Little Words, Many Billions of Dollars

By Kerry Pechter *Thu, Jul 2, 2015*

A phrase in the DOL's new Best Interest exemption could make it very hard for broker-dealer reps to accept commissions on the sale of variable annuities and proprietary mutual funds to IRA owners.



A few words can be worth billions of dollars. In the case of the Labor Department's proposed conflict-of-interest regulation, that's literally true. The content of a short phrase in the rule could stop commission-paid broker-dealer reps from continuing to sell to a market they covet: the $7 trillion (and growing) IRA rollover market.

The decisive words are "act without regard to." They appear in a sentence of the proposed regulation's so-called Best Interest Contract Exemption: "Further, under the best interest standard, the Adviser and Financial Institution must *act without regard to* the financial or other interests of the Adviser, Financial Institution or their Affiliates or any other party." (Italics added.)

Given the fact that those entities are in business to make money, that phrase presents real problems. Even though the DOL claims that banning commissions was never its goal, annuity industry lawyers believe those words would make it effectively impossible for registered reps and insurance agents to accept commissions from manufacturers for selling variable annuities or mutual funds to IRA owners.

In short, the phrase is a deal breaker. Unless those words are changed to something the industry prefers, such as, "while taking into account the fact that," said Steve Saxon of the Groom Law Firm (below at left) at the Insured Retirement Industry conference Monday, he would advise his industry clients to "fight this regulation at all costs." That raises the question: Will the DOL back down and relax the language in the proposal to preserve business as usual?

Not since the battle over SEC rule 151A during the latter years of the George W. Bush presidency, when the fixed indexed annuity industry successfully used the courts to stop the SEC from defining FIAs as securities and regulating them as such, has there been such a bitter contest over the way annuities should be regulated.

Another potential deal breaker involves the proposal's apparent attempt to force sellers of securities products, including variable annuities, to a higher standard of sales conduct (the proposed Best Interest standard) while allowing sellers of insurance products, such as fixed annuities, to meet the current standard, as described in Proposed Transaction Exemption 84-24, which allows commissions. This would put variable annuities at a distinct disadvantage.

The variable annuity industry and its attorneys are going to fight this, perhaps as energetically as they fight the "without regard to" language. "All annuities should be covered by 84-24," Saxon said. "We've relied on that [exemption] since the 1970s." Said Abigail Pancoast, chief counsel of retirement plan services at Lincoln Financial Group, "The DOL needs to hear from us that VAs with guarantees are more like fixed annuities than like securities."

During the conference, Saxon was asked what he thought the public policy objective was behind the DOL's proposal. "It's all about control," he said. "This is the clearest way for the DOL to get Title I [of ERISA] to apply to the IRA space. But they're not going to get a deal on this regulation if they make it unworkable. It has to be made workable so the industry can sell proprietary products."

Saxon was asked if the DOL might simply wanted to make the rollover IRA market less expensive, more objective and more transparent for tax-deferred account holders. He responded indirectly.

"They're frustrated," he said. "For 40 years they've lost case after case trying to assert that the fiduciary standard applies to IRAs. There's a contradiction in what they want. They really want the money to stay in the 401(k) plans. But the reality is that the money has moved to the IRAs. I have to advise my clients to fight this regulation at all costs and to support legislation that opposes it."

The future of the proposal may depend on which party wins the White House in November 2016. The DOL says it expects the final version of the proposal to be published in the spring of 2016. That would be eight months after the public hearings on the matter that the DOL has scheduled for mid-August—the heart of vacation time. Opponents of the rule hope to slow or stop the process with legislation in the Republican-controlled Congress, but such legislation would face a certain president veto.

© 2015 RIJ Publishing LLC. All rights reserved.