IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, FINANCIAL SERVICES INSTITUTE, INC., FINANCIAL SERVICE ROUNDTABLE, GREATER IRVING-LAS COLINAS CHAMBER OF COMMERCE, HUMBLE AREA CHAMBER OF COMMERCE DBA LAKE HOUSTON AREA CHAMBER OF COMMERCE, INSURED RETIREMENT INSTITUTE, LUBBOCK CHAMBER OF COMMERCE, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, and TEXAS ASSOCIATION OF BUSINESS,

Plaintiffs,

v.

THOMAS E. PEREZ, SECRETARY OF LABOR, and UNITED STATES DEPARTMENT OF LABOR,

Defendants.

Civil Action No. 3:16-cv-1476-M
Consolidated with:
3:16-cv-1530-C
3:16-cv-1537-N

THE INDEXED ANNUITY LEADERSHIP COUNCIL PLAINTIFFS' REPLY BRIEF IN SUPPORT OF THEIR MOTION FOR SUMMARY JUDGMENT AND OPPOSITION TO DEFENDANTS' CROSS-MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

As plaintiffs explained, the Department's new fiduciary rule violates the plain meaning of ERISA and the Tax Code and was promulgated in violation of the APA. In its efforts to show otherwise, the government offers an untenable reading of the term "fiduciary," and repeatedly advances new justifications for the rule, in violation of basic precepts of administrative law.

As the Chamber plaintiffs demonstrated, neither ERISA nor the Code authorizes the Department to regulate advice incidental to one-time sales of annuities. Chamber Op. Br. § I. Moreover, as the IALC plaintiffs showed, even if the statute were ambiguous, the Department could regulate such advice only if it demonstrated that these sales occur in relationships of trust and confidence—a showing it did not even purport to make. IALC Br. § I.B.1. In response, the government now claims that Congress adopted an "artificial" definition of "fiduciary" that dispensed with the longstanding requirement that a fiduciary occupy a position of trust and confidence. But when Congress uses common law terms like "fiduciary," it is presumed to retain their settled meaning, and that presumption does not disappear simply because Congress modifies the common law in *some* respects. Here, ERISA's text, structure, and history confirm that, when Congress eliminated certain *formalities* of trust law, it did not jettison the defining attribute of a "fiduciary" relationship—namely, that it be one of trust and confidence.

The IALC plaintiffs also demonstrated that the fiduciary rule is arbitrary and capricious because, among other things, the Department (1) relied primarily on inapposite evidence concerning mutual funds to show the alleged harms from conflicted sales of fixed annuities; (2) failed to explain why state suitability standards and the enhanced protections of the new 84-24 exemption did not address these "harms"; (3) failed properly to assess the costs of its new regulation; and (4) drew an irrational distinction between fixed rate and fixed indexed annuities. In response, the government repeatedly violates the "elementary" rule that an agency decision

"must be upheld on the rationale set forth by the agency itself." *S.D. ex rel. Dickson v. Hood*, 391 F.3d 581, 601 (5th Cir. 2004) (citing, *inter alia*, *SEC v. Chenery Corp.*, 318 U.S. 80, 93–95 (1943)). Throughout its brief, the government ignores or retreats from the Department's stated rationales, distancing itself from evidence shown to be infirm and citing new evidence to minimize implementation problems that the Department never addressed. This impermissible revisionism simply confirms that the rule lacks the reasoned basis required by the APA.

For these reasons, and those set forth below and in IALC's opening brief, as well as in the opening and reply briefs of the Chamber and ACLI (which are incorporated by reference), the Court should grant plaintiffs' motions for summary judgment and vacate the rule.

ARGUMENT

I. THE DEPARTMENT'S NEW DEFINITION OF "FIDUCIARY" IS INVALID.

A. The New Definition Of A "Fiduciary" Is Inconsistent With The Plain Meaning Of ERISA And The Code.

As plaintiffs explained, the statute's plain meaning precludes regulation of advice incidental to one-time sales of annuities. But even if ERISA and the Code were ambiguous in this regard, they permit regulation of such advice only if it is provided in a relationship of trust and confidence—a showing the Department did not even purport to make with respect to sales of fixed annuities. IALC Br. 14–18. Unable to refute plaintiffs' showing, the government claims that Congress created a new, unheard of species of "fiduciary" that dispensed with the defining feature of fiduciary relationships. Opp. 42. This remarkable assertion is wrong.

First, the government's current claim contradicts the Department's own statements in the rulemaking. The Department acknowledged that its "new general definition of investment advice … could sweep in some relationships that are not appropriately regarded as fiduciary in nature and that the Department does not believe Congress intended to cover as fiduciary

relationships." AR 700; *see also* AR 3–4, 712. The *reason* these relationships were "not appropriately regarded as fiduciary," the Department explained, was that they do not involve trust and confidence. Thus, the Department proposed "carve outs" from its new definition to "avoi[d] burdening activities *that do not implicate relationships of trust.*" AR 4 (emphasis added). The carve-outs were "for communications that the Department believes Congress did not intend to cover as fiduciary 'investment advice' and that parties would not ordinarily view as communications characterized by *a relationship of trust or impartiality*." AR 712 (emphasis added).[1]

The government now claims that "most" of these discussions concerned the Department's "determination that [certain arm's-length transactions] do not present the same ills that ERISA was enacted to remedy." Opp. 43 n.40. But litigating counsel cannot alter the Department's clear explanation that the carved-out transactions were not fiduciary because they were "not … characterized by a relationship of trust or impartiality." AR 712. Nor can that explanation be ignored because the Department rejected a comment that the rule "would make fiduciaries of broker-dealers whose relationships with customers do not have the hallmarks of a trust relationship." AR 45 (cited at Opp. 43). In doing so, the Department did not disavow its recognitions that fiduciary relationships involve "trust and loyalty," AR 38; instead, it responded with the irrelevant observation that "ERISA attaches fiduciary status more broadly than trust law which generally reserves fiduciary status for express trustees." AR 45.

Nor can this new conception of a "fiduciary" be reconciled with Congress's use of the common law term "fiduciary" in ERISA. The government claims that, by eliminating the

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[1] *See also* AR 10 (prior rule did not ensure that "*trusted* advisers g[a]ve prudent and unbiased advice"); AR 35 (purpose of carve-out was "to avoid imposing ERISA fiduciary obligations on sales pitches that are part of arms' length transactions where neither side assumes that the counterparty to the plan is acting as an impartial or *trusted adviser*"); AR 38 (excluding "transactions between investment professionals or large asset managers who do not have a legitimate expectation that they are in a *relationship of trust and loyalty*") (emphases added).

requirement of a formal trust agreement, Congress adopted a "functional" definition of "fiduciary" that jettisoned the trust and confidence aspect of a traditional fiduciary relationship. Opp. 31–32. But even where Congress "abrogates the common law *in certain respects*," courts must "presume that Congress *retained all other elements of [the common law]* that are consistent with the statutory text." *Universal Health Servs., Inc. v. United States*, 136 S. Ct. 1989, 1999 n.2 (2016) (emphases added); *see also Neder v. United States*, 527 U.S. 1, 23–25 (1999) (although mail and wire fraud statutes "did not incorporate *all* the elements of common-law fraud," court "must *presume* that Congress intended to incorporate" the common law requirement of materiality "unless the statute otherwise dictates"); *Evans v. United States*, 504 U.S. 255, 260–61, 263–64 (1992) (although Congress expanded the category of people who could commit "extortion," it did not thereby eliminate other common law elements of the crime).

Here, requiring a relationship of trust and confidence is fully consistent with—indeed, compelled by—the statutory text. The first and third prongs of the statutory definition of a fiduciary state that a fiduciary is a person with authority, control, or responsibility over the management and disposition of plan assets or plan administration.[2] Persons afforded such broad powers are necessarily those in whom others repose special trust and confidence. Requiring those who render "investment advice" to likewise occupy positions of trust and confidence is thus entirely "consistent with" other statutory text. *Universal Heath Servs.*, 136 S. Ct. at 1999 n.2. And the text of the "investment advice" prong itself certainly cannot "fairly be described as a 'contrary direction.'" *Evans*, 504 U.S. at 264.

Moreover, ERISA's legislative history confirms that Congress was aware of and retained

[2] *See* 29 U.S.C. § 1002(21)(A) (defining a fiduciary as one who (i) "exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets," (ii) "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so," or (iii) "has any discretionary authority or discretionary responsibility in the administration of such plan").

the concepts of confidence and trust that have long attached to the term fiduciary. The government quotes selectively from this history to suggest otherwise. Opp. 42. But it fails to quote surrounding passages that make clear that Congress retained this aspect of the common law understanding of a "fiduciary." S. Rep. No. 92-1150, at 39 (1972) ("A fiduciary is one who occupies *a position of confidence or trust*. As defined by the amendments, a fiduciary is a person who exercises any power of control, management or disposition with respect to monies or other property of an employee benefit fund, or who has authority or responsibility to do so.");[3] 120 Cong. Rec. 3977, 3982–83 (1974) (Rep. Perkins) ("[a] fiduciary is one who occupies *a position or confidence or trust*" and the broad definition of fiduciary dispenses with "any requirement of *a written or other formal acknowledgement* of fiduciary status") (emphases added). As these passages make clear, the "relationship of trust or confidence" was the foundation for Congress's understanding of the "fiduciary" role in ERISA.

In short, there is no merit to the government's claim that the statutory definition of a "fiduciary" dispensed with its foundational requirement of trust and confidence.

B. The Department Acted Arbitrarily And Capriciously In Treating Those Who Provide Advice Incidental To Sales Of Fixed Annuities As Fiduciaries.

1. The Department failed to identify empirical evidence that parties to sales of fixed annuities are actually in relationships of trust.

Once the government's mistaken legal justification is set aside, it is clear that the Department acted arbitrarily and capriciously in imposing fiduciary duties on sellers of annuities, including fixed indexed annuities. Indeed, the government does not even attempt to dispute the IALC plaintiffs' showings that (1) absent special circumstances, a sale by an insurance agent does not create a fiduciary relationship; (2) there is no empirical evidence in the administrative

[3] *See also* H.R. Rep. No. 93-533, at 11 (1973) (containing materially identical language); S. Rep. No. 93-127, at 27 (1974) (same).

record demonstrating that sellers of annuities have relationships of special trust and confidence with their customers; (3) the knowledge and expertise of such sellers is irrelevant in determining the existence of such a relationship; (4) national advertising cannot create fiduciary relationships; and (5) the existence of suitability standards undermines rather than demonstrates the existence of a fiduciary relationship. IALC Br. 16–18. These failures are fatal.

The government asserts that, because the statute applies industry-wide, it does not require individualized showings of fiduciary relationships. Opp. 42–43. But this argument depends on the mistaken claim that a fiduciary relationship need not be one of trust and confidence. Because Congress used a term that requires such a relationship, the Department cannot offer a one-size-fits-all definition that ignores this foundational aspect of who can be a fiduciary. Indeed, this is why, for over 40 years, the regulatory definition of a fiduciary required consideration of the particular facts of a relationship—such as whether advice was provided "on a regular basis," 40 Fed. Reg. 50840, 50840 (Oct. 31, 1975)—to determine whether it was "fiduciary" in nature.

The government also disparages plaintiffs' showing that unilateral expectations cannot create fiduciary relationships. Opp. 43–44. Notably, however, it fails to refute that showing. Incorrect consumer beliefs may explain the Department's "dissatisfaction" with its prior definition of "fiduciary." Opp. 43. But Congress did not grant the Department plenary regulatory authority to impose heightened standards of care on *non-fiduciaries* based on its policy view. *See* IALC Br. 15–17. Instead, Congress authorized the Department to regulate *fiduciaries*, and the government has failed to establish that the one-time sale relationships at issue here are in fact fiduciary in nature. Accordingly, the rule must be set aside.[4]

[4] Had the Department shown that sellers of annuities who *are* in relationships of trust and confidence improperly seek to disavow that relationship, it could have addressed that issue by invalidating such disavowals. Instead, it imposed fiduciary duties on all sellers regardless of whether a legitimate relationship of trust and confidence exists.

2. The Department failed to justify changing the regulatory treatment of those who provide advice incidental to sales of fixed annuities.

The rule must also be set aside because the Department failed to substantiate its claim that commission-based sales of fixed annuities cause harms that justify upending "decades of industry reliance" on the prior rule. IALC Br. 18 (quoting *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2126 (2016)). The centerpiece of the Department's showing of harm consisted of evidence about the alleged underperformance of commission-based sales of *mutual funds*, not fixed annuities; the studies it cited attributed that underperformance to factors that do not exist for fixed annuities; and the Department assumed that fixed annuities would suffer a comparable underperformance based on a study that did not mention fixed annuities. *Id.* at 19. Faced with these fatal defects, the government impermissibly tries to revise the Department's rationale.

The government now claims that one study of mutual funds (the "CEM" study) did not quantify harms from frequent trades or timing errors, Opp. 79 n.79, and thus yielded results that may be "reasonably extended … to the annuity market." *Id.* at 79 (citing AR 437–39, 447–48, 474). But the CEM study is not even mentioned on the pages of the record where, according to the government, the Department extended the study's findings to justify regulation of fixed annuities. Instead, in claiming that "insurance products are also likely to be subject to underperformance due to conflicts," the Department cited the article by Evans and Fahlenbrach, AR 474, which does not mention fixed annuities. *See* AR 13451–93; *see also* IALC Br. 19. Moreover, the Department tied the underperformance identified by the CEM study to "a mutual fund company['s] … tradeoff between incentivizing its brokers … and investing sufficient resources in fund *management*." AR 489 (emphasis added); *see* AR 467 & n.350. This concern also does not apply to fixed annuities, which are "buy and hold" products and thus are not *actively managed*, IALC Br. 19—a proposition the government does not dispute.

Nor does it matter that the CEM study did not quantify any harms from other factors "such as frequent trades or timing errors." Opp. 79 n.79. The *Department* repeatedly cited these mutual-fund-specific factors to support the supposed causal connection between conflicts and underperformance. *See, e.g.*, AR 468, 469, 470, 474, 477, 487, 497. Government counsel cannot now reinterpret the record for purposes of judicial review. *See Dickson*, 391 F.3d at 601.

The government also claims that "insurance-related studies that could be applied by analogy" support the Department's finding of harm. Opp. 79. This theory fails for several reasons. First, when an agency "has relied on multiple rationales (and has not done so in the alternative), and [the Court] conclude[s] that at least one of the rationales is deficient," the agency's decision cannot stand unless it is "certain [the agency] would have adopted [the same ruling] even absent the flawed rationale." *Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 839 (D.C. Cir. 2006). Here, a central justification for heightened regulation of fixed annuities was the Department's extensive discussion of the asserted harms of commission-based sales of mutual funds, AR 465–83, and its assumption that such harms applied to fixed annuities as well, AR 474. There can thus be no "certain[ty]" that the Department would (or could) have attempted to justify such regulation "absent th[at] flawed rationale." *Nat'l Fuel*, 468 F.3d at 839.

Second, the government's "analogies" argument relies on *National Small Shipments v. Civil Aeronautics Board*, 618 F.2d 819 (D.C. Cir. 1980), *see* Opp. 79, a case in which a court deferred to an agency's *predictive* judgment about how deregulation would affect certain air carriers. 618 F.3d at 831. "Obviously," the court reasoned, the agency could not cite direct evidence of how deregulation would affect regulated carriers without first deregulating them. *Id.* at 831 n.27. Here, the Department claimed that *current* harms necessitate regulation. If fixed annuity sales were causing significant harms, the Department should have been able to cite direct

evidence of those harms, rather than relying on "analogies" to different products and markets.

Third, and in all events, studies of different insurance products in different countries do not support a finding of harms from fixed annuity sales in the United States, as "much depend[s] on … the particulars of the insurance markets examined," D. Schwartz & P. Siegelman, *Insurance Agents in the 21st Century: The Problem of Biased Advice*, 44 (IALC App. 175; AR 31679). The government cites studies regarding contingent commissions "in the commercial property-casualty insurance market." Opp. 79 n.80. But "no property/casualty insurance products are subject to suitability rules." *Insurance Agents in the 21st Century*, *supra*, at 60 (IALC App. 191; AR 31691). Likewise, the "study of life insurance sales in India," Opp. 79, found that agents often recommended "*unsuitable* products," AR 464–65 (emphasis added). Because fixed annuity sales in the United States *are* subject to robust suitability rules, *see infra* § II.A, studies of products not subject to such rules do not support the Department's claim of harms and "abuse," *see Desoto Gen. Hosp. v. Heckler*, 766 F.2d 182, 185–86 (5th Cir. 1985) (rule arbitrary and capricious because agency relied on study that did not support agency's conclusions); *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1151 (D.C. Cir. 2011) (similar). Indeed, one of the very studies that supposedly "support[s] DOL's analysis," Opp. 79 n.81, acknowledged that "suitability rules can help to meaningfully mitigate the risk of incompetent and self-interested advice," *Insurance Agents in the 21st Century*, *supra*, at 60 (IALC App. 191; AR 31690).[5]

Nor do insurer surveys, Opp. 79–80, or "state regulators' observations," *id.* at 80, support a finding of harm from fixed annuity sales. The Department did not claim that these surveys and observations were independently sufficient to justify its treatment of fixed annuities. *See Nat'l Fuel*, 468 F.3d at 839. And because this "evidence" predates current suitability standards, it

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[5] Although this article suggests that "the problem of biased advice by insurance agents is likely to be significant," AR 31677 (cited in Opp. 79 n.81), it focuses on other insurance products, contains no evidence of fixed annuity abuses, and, as noted, recognizes the general efficacy of suitability rules.

cannot support such treatment in any event.[6] Thus, for example, the Department cited a comment by the North American Securities Administrators Association (NASAA) to the SEC as part of a separate SEC rulemaking in 2008. AR 234 & n.23. But the abuse that comment identified concerned sales to "senior citizens for whom [fixed indexed annuities] are clearly *unsuitable*," AR 68639 (emphasis added)—a concern directly addressed by the later-adopted suitability rules.[7]

Unable to cite meaningful evidence of harms, the government attempts to shift the burden by arguing that plaintiffs "point to no evidence exonerating annuity markets of conflicts of interest or suggesting that such conflicts do not harm annuity investors." Opp. 80. As the government acknowledges, however, commenters did cite the low rate of complaints about fixed annuity products as evidence of the lack of harm. Opp. 81 n.83; *see* AR 42366–67, 42626, 47395, 52960. Although the Department itself cited alleged complaints when doing so suited its purposes, *see* AR 448, the government now claims "complaint data is not a reliable guide to the scope of the problem," Opp. 81 n.83. This about-face is understandable, since the rate of complaints remains very low, even after the "increas[e] in 2014." *Id.*; *see* DOL App. 75–76 (showing only 77 closed complaints about fixed indexed annuities in 2014, or "one complaint for every $633 million in FIA premium"). But the Department did not respond directly to this evidence, and counsel's "[p]ost-hoc explanations" cannot fill the gap. *Dickson*, 391 F.3d at 601.

More importantly, it is not plaintiffs' burden to prove the absence of harm. *See Nat'l Fuel*, 468 F.3d at 844. Where an agency has "staked its rationale in part on a record of abuse," a

[6] The government suggests that outdated surveys may provide relevant evidence of deeply embedded issues in the insurance industry. Opp. 80 n.82 (citing AR 464). But the Department said only that embedded issues might make it "difficult for insurance professionals to *voluntarily*" change their behavior. AR 464 (emphasis added). In most states, suitability standards are mandatory, and in others compliance is required to avoid federal securities regulation. *Infra* § II.A.

[7] The government cites a different NASAA comment that discusses abuse in rollovers and account transfers, Opp. 80 (citing AR 41538), but that discussion does not mention fixed annuities.

showing that the evidence does not support that claim renders the agency's rule arbitrary and capricious. *Id.* at 842–43.

II. THE DEPARTMENT ACTED ARBITRARILY AND CAPRICIOUSLY IN REVOKING THE 84-24 EXEMPTION FOR FIXED INDEXED ANNUITIES.

Even if the Department had the statutory authority and evidentiary basis to subject sellers of fixed annuities to fiduciary regulation, the rule's treatment of fixed indexed annuities would still be invalid. In its last-minute decision to revoke the 84-24 exemption for these products and move them into the BIC exemption, the Department failed to address "important aspect[s] of the problem," *Motor Veh. Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983), and to respond to "'relevant and significant' comments," *Del. Dep't of Nat. Res. & Envtl. Control v. EPA*, 785 F.3d 1, 15 (D.C. Cir. 2015). The revocation of the 84-24 exemption is thus invalid.

A. The Department Did Not Explain Why The Consumer Protections Afforded By State Law And The 84-24 Exemption Are Insufficient.

As numerous commenters explained, and as plaintiffs demonstrated in their opening brief, the sale of fixed indexed annuities is governed by a comprehensive set of state insurance laws designed to protect consumers. IALC Br. 4–5, 22. Among others, the National Association of Insurance Commissioners (NAIC) explained that states have "acted to implement a robust set of consumer protection and education standards for annuity and insurance transactions," they have "extensive enforcement authority," and they "have a strong record of protecting consumers, especially seniors, from inappropriate sales practices or unsuitable products." AR 42320.

The Department recognized that "[m]any commenters took the position that existing regulation of these products is sufficient," AR 237, but never explained why they were wrong. It stated that, "[a]s elaborated in Section 3.2.4 [of its regulatory impact analysis (RIA)], notwithstanding existing protections, there is convincing evidence that advice conflicts are inflicting losses on IRA investors." AR 426–27. But Section 3.2.4 of the RIA is where the

Department cited the inapposite Evans and Fahlenbrach article. *See* AR 474; *see also* IALC Br. 19. Contrary to the government's argument, therefore, there *is* a reason to expect that insurance suitability rules "substantially lower the risk of harm to investors from conflicted compensation observed in the mutual fund context," Opp. 80—whatever the validity of its mutual fund studies, the Department mustered no evidence of underperformance for fixed indexed annuities.

The Department stated that the suitability standard is "less exacting than the fiduciary duty." AR 427. But that does not explain why state suitability standards are *insufficient*, or why "more exacting" federal regulation is *necessary*. The Department did not, for example, cite evidence that significant numbers of retirement savers who purchase *suitable* fixed indexed annuities are nevertheless harmed by them. To the contrary, the insurance-specific evidence of consumer harms cited by the Department largely addressed issues arising from the lack of suitability regulation in other markets. *Supra* § I.B.2.

This same lack of understanding about the purpose and efficacy of state suitability rules appears in the government's brief. It stresses how surrender charges can cause a loss of principal if a fixed annuity is cancelled early, and claims that "surrender terms and minimum nonforfeiture provisions … take on added significance" for fixed indexed annuities, given their "complexity." Opp. 72, 74. Later, to illustrate the benefits of the BIC exemption, the government describes a customer who has few liquid assets and needs immediate access to them, yet is persuaded to buy an illiquid annuity with large surrender charges. Opp. 85. But suitability rules require an agent and insurance company to consider the consumer's age, income, intended use of the annuity, assets and liquid net worth, financial needs and experience, financial time horizon, liquidity needs, risk tolerance, and tax status. *See* IALC App. 218–19 §§ 5(I), 6(A). The rules do so to

prevent sales that must later be reversed. Neither the Department nor its counsel has explained why these protections (which would prohibit the government's hypothetical sale) are inadequate.

Instead, the government falls back to the claim that state insurance laws and their enforcement "vary significantly." Opp. 80. But the Department cited no evidence that any variance in state laws or their enforcement has harmed fixed indexed annuity buyers.[8] As commenters showed, and as plaintiffs explained, "virtually all fixed indexed annuity sales are as a legal or practical matter subject to requirements that are at least as stringent as the NAIC model regulations." IALC Br. 4. This is because fixed indexed annuity sales must comply with these requirements to qualify for the exemption from the federal securities laws created by the Harkin Amendment. Dodd-Frank Act, Pub. L. No. 111-203, § 989J, 124 Stat. 1376, 1949–50 (2010). The Department did not dispute that virtually all fixed indexed annuities are sold in compliance with the Harkin Amendment; in fact, it recognized that "most indexed annuities are not registered with the SEC." AR 237. Nor does the government's brief dispute this point, which eliminates any concern about lack of uniformity across state laws with regard to the standards governing fixed indexed annuity sales.

Indeed, like the Department's rule, the government's brief essentially ignores the Harkin Amendment, citing it only once, in a footnote. Opp. 10 n.11. The government highlights the "concern regarding FIAs" raised by the SEC and FINRA. Opp. 15. But it inexplicably ignores the fact that Congress responded specifically to those concerns when it enacted the Harkin Amendment and directed the SEC and FINRA *not* to regulate fixed indexed annuities as long as they are sold in compliance with the NAIC suitability standard. The Department never explained

[8] The government does not explain how state law protections for annuity buyers "provide opportunities for arbitrage, if not a race to the bottom." Opp. 81 (quoting, but not citing, AR 353). The quoted portion of the record simply discusses the general "debat[e concerning] the extent to which the federal government should be involved in regulating insurance," AR 353—a debate that Congress, as it did in the Harkin Amendment, has generally resolved in favor of state regulation. *See, e.g.*, AR 352–53 (discussing McCarran-Ferguson Act).

why Congress's determination, in a closely related context, that additional federal regulation is unwarranted does not apply equally here. Invoking concerns raised by other regulators while ignoring Congress's resolution of those very concerns is not rational decisionmaking. *See Shays v. FEC*, 414 F.3d 76, 100 (D.C. Cir. 2005) (agency acted arbitrarily and capriciously in failing to explain how its approach squared with Congress's treatment of "comparable subject-matter").

The government likewise has no persuasive answer to *American Equity Investment Life Insurance Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010), which invalidated the SEC's attempt to regulate fixed indexed annuities because the SEC had not adequately addressed the sufficiency of existing state law protections. *Id.* at 178–79. The government notes that the Securities Act's requirement to analyze "efficiency, competition, and capital formation" does not apply here. Opp. 72 n.72. But that is beside the point. The *APA* required the Department to consider each important aspect of the problem and to respond to significant issues raised by commenters, and thus the Department was statutorily required to consider the adequacy of existing protections. Because the Department provided no rational support for the conclusion that state law protections for fixed indexed annuities are inadequate, its decision to impose onerous federal regulation is no less arbitrary and capricious than the SEC's similar decision in *American Equity.*

In fact, the Department's error here was even worse because it layered the requirements of the BIC exemption on top of not only existing state law protections, but also the newly enhanced protections of the 84-24 exemption, under which fixed indexed annuity sales are subject to a federal best interest standard as well as state suitability standards. *See* IALC Br. 24. The government argues that the Department "did explain why it concluded it was important to provide for FIAs in the BIC Exemption." Opp. 81 n.84. But the Department simply invoked general concerns about "complexity" and "risk." AR 237. What is missing is any explanation of

why the incremental requirements of the BIC exemption, over and above the protections of the enhanced 84-24 exemption and state law, are necessary to address these concerns. Without more, the Department's bare assertion that the BIC exemption's conditions "are necessary," AR 238, is nothing more than the agency's "*ipse dixit*," *Bus. Roundtable*, 647 F.3d at 1155.

B. The Department's Analysis Of The Costs And Benefits Of Moving Fixed Indexed Annuities To The BIC Exemption Was Arbitrary And Capricious.

The rule is further arbitrary and capricious because the Department failed to reasonably account for the costs and benefits of moving fixed indexed annuities into the BIC exemption. IALC Br. 24–28. The government contends that "the APA, standing alone, does not require a detailed cost-benefit analysis."[9] Opp. 56 n.58. But that gets the government nowhere. Whether or not the Department was required to do a cost-benefit analysis, it did one, and it asserted that the rule's benefits outweigh its costs. If that analysis was arbitrary and capricious—and it was—the rule must be set aside. *See Am. Equity*, 613 F.3d at 177.

As plaintiffs showed, the Department ignored the costs the BIC exemption will impose on the fixed indexed annuity industry as a result of its heavy reliance on the independent agent distribution model. IALC Br. 25–26. Once again, the government attempts to shift the burden by arguing that plaintiffs "have not shown that it will be necessary to dismantle the independent agent distribution model." Opp. 68. But it is not plaintiffs' burden to make such a showing. Having been alerted to the importance of the issue (and indeed having itself flagged the importance of distribution models in its notice of proposed rulemaking), it was the Department's

[9] Neither of the Supreme Court cases the government cites stands for this proposition. In *Entergy Corp. v. Riverkeeper, Inc.*, 556 U.S. 208 (2009), the "only question presented" was "whether the EPA can use cost-benefit analysis" under a particular provision of the Clean Water Act. *Id.* at 226 n.8. And in *American Textile Manufacturers Institute, Inc. v. Donovan*, 452 U.S. 490 (1981), the Court held only that a particular provision of the Occupational Safety and Health Act precluded cost-benefit analysis. *Id.* at 512. By contrast, in *Michigan v. EPA*, 135 S. Ct. 2699 (2015), the Court held that "reasonable regulation"—the *sine qua non* of the APA—"ordinarily requires paying attention to the advantages *and* the disadvantages of agency decisions." *Id.* at 2707.

obligation to address the issue in the rule. *See State Farm*, 463 U.S. at 43. But the Department never grappled with the problem, or accounted for the costs it will impose on the industry.

The government argues that the Department "acknowledged and considered this distribution model throughout its analysis." Opp. 86 & n.92. But acknowledging that the independent agent distribution model exists is not the same thing as explaining how insurers can sell fixed indexed annuities through independent agents consistent with their supervisory obligations as the "financial institution" under the BIC exemption. That is the problem, and the Department nowhere even acknowledged it in the rule, let alone provided a solution.

The government offers up improper post hoc explanations suggesting there is no problem after all, because an insurer supervising independent agents "will need to ensure only that recommendations and sales concerning its own products meet the standards," and only that its own incentives do not create "a concern." Opp. 85–86. But these facile assurances do not explain how a company can ensure that the incentives for its products do not create conflicts of interest when the company does not know what other products the agent sells or the commissions she receives from other companies. How can company A ensure that the 6% commission it pays to an independent agent does not create an improper incentive for the agent to recommend A's product (which is suitable for the customer) over company B's product, which is slightly better for the customer but will yield a 5% commission? The government does not say.[10] And, more to the point, the Department did not say in the rule.

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[10] In answer to a similar question from Judge Moss, government counsel suggested that insurers know what commissions other companies pay. Tr. at 105, *Nat'l Ass'n for Fixed Annuities v. Dep't of Labor*, No. 16-1035 (D.D.C. Aug. 25, 2016) (NAFA Tr.). The only evidence counsel cited for this post hoc rationalization was testimony that commissions for fixed indexed annuities generally fall within a range of 6%–8%. *Id.* at 106. But a general range is of no use to an insurer in the situation described. In a post-argument notice, the government also cited the product report at AR 66971–67002, 67018–67023. But such reports reveal only what commissions companies have paid in the past. And none of this information solves the problem that insurers do not know what other products any given independent agent sells.

The government also has not shown that the "options" it now identifies—having agents affiliate with a broker or investment adviser,[11] contracting with IMOs to take on oversight work, or having IMOs seek to become "financial institutions," Opp. 86—are workable. The whole idea of *independent* agents is that they are not bound to any one institution. Relying on IMOs for oversight is likely a nonstarter for most insurers, because they would remain liable as the responsible "financial institution" for activities they cannot themselves oversee. And whether and on what conditions the Department will grant exemptions to IMOs to become "financial institutions" is entirely speculative.

Moreover, these "options" just show that, if the BIC exemption can be made to work for the independent agent model at all, it will only be by overhauling the model, at substantial expense to the industry.[12] Yet nowhere in its estimate of the cost of moving fixed indexed annuities to the BIC exemption did the Department account for these costs and disruptions. *See* AR 602. The government complains that plaintiffs "offered DOL no means to empirically quantify those costs." Opp. 68 n.68. But that is because the industry lacked notice that the Department was considering moving fixed indexed annuities into the BIC exemption. *See infra* § III. And the Department did not even account for these costs qualitatively; it ignored them.

The Department likewise ignored the costs to retirement savers. Commenters explained that the rule would limit the availability and raise the cost of fixed indexed annuities (for example, by leading insurers to raise the minimum amount required to buy one). *E.g.*, AR 42626. The Department ignored the harms this will cause to consumers for whom a fixed indexed

[11] The government's claim that 60% of *all* insurance agents are registered to handle securities, Opp. 86, says nothing about the percentage of *independent* agents who are registered, *see* AR 554 ("[r]eliable data are not available to estimate how many [independent agents] are not registered").

[12] The government acknowledged before Judge Moss that two "ways" that the fixed indexed annuity "industry can proceed" would require "dramatic shifts." NAFA Tr. 94, 103 (agents could become captive or could affiliate with a broker or investment adviser).

annuity is optimal, asserting that the rule would benefit consumers on net.[13] But even if that were true—and the Department certainly did not show that it is, *see* IALC Br. 27—it provides no basis to ignore the costs to consumers who will be hurt by the rule. The costs to those consumers belong on the same side of the ledger as the costs to the industry; pretending they do not exist because other consumers may benefit from the rule is not rational. *See* Opp. 68 n.67.

Given the significant flaws in the Department's analysis of the costs of subjecting fixed indexed annuities to the BIC exemption, and the lack of any substantial evidence or reason to believe that the BIC exemption will provide significant—or even any—incremental benefits to consumers over and above those afforded by state law and the 84-24 exemption, there is no rational basis to conclude that revoking the 84-24 exemption for fixed indexed annuities is cost-justified. Accordingly, both the Department's cost-benefit analysis and its bottom-line conclusion that benefits exceed costs are arbitrary and capricious, and the rule must be set aside.

C. The Department Drew An Arbitrary And Unjustified Distinction Between Fixed Indexed Annuities And Other Fixed Annuities.

The government fares no better in its attempt to defend the arbitrary distinction the Department drew between fixed indexed annuities and fixed rate annuities. *See* IALC Br. 28–31. The government does not dispute that the Department based its disparate treatment of fixed indexed annuities in part on characteristics that are true of fixed rate annuities as well.[14] That is irrational, and alone requires the rule to be set aside. *See, e.g.*, *PDK Labs. Inc. v. DEA*, 362 F.3d 786, 799 (D.C. Cir. 2004) (invalidating agency order that was based on totality of circumstances

[13] The government's claim that compliance with the BIC exemption will not "meaningfully limit investors' options for annuity purchases," Opp. 68, is yet another post hoc rationalization that does not appear in the rule. In the rule, the Department acknowledged that allowing fixed rate annuities to be sold under the 84-24 exemption as opposed to the BIC exemption would "promote access" to those annuities. AR 232.

[14] The government says that surrender terms and nonforfeiture provisions "take on added significance" given the "complexity" of fixed indexed annuities. Opp. 74. Whatever that means, it doesn't matter because the Department never said it in the rule; it simply ignored that these terms are common to all fixed annuities.

because some of the circumstances on which the agency relied were improper).

The government defends the Department's disparate treatment of fixed indexed annuities based on the "undisputabl[y] greater risk" they pose to retirement savers. Opp. 74. But like fixed rate annuities, fixed indexed annuities do not pose any risk to the owner's principal unless the annuity is surrendered early. And the supposedly unique "risk" of a fixed indexed annuity is counter-balanced by a "risk" associated with fixed rate annuities that the government ignores. Fixed indexed annuities offer the possibility that earnings will accumulate at a rate *greater* than that available under a fixed rate annuity, which protects against savings erosion from inflation. The trade-off for this benefit is the risk that the index rate will be less than the rate offered on a fixed rate annuity. The trade-offs, or "risks," for fixed rate annuities are exactly the opposite: owners assume the risk that their interest earnings could be lower than what they would receive with a fixed indexed annuity (and that their earnings will be eroded by inflation), in exchange for protection against the possibility of smaller earnings. There is no free lunch, and neither the Department nor government counsel explain why one set of trade-offs, or "risks," is "indisputabl[y] greater" than, or preferable to, the other.

The government claims that disparate treatment of fixed indexed annuities was necessary to "level [the] playing field" with variable annuities and mutual funds by avoiding "a regulatory incentive to preferentially recommend indexed annuities." Opp. 72–73. But this "creat[es] a regulatory incentive to preferentially recommend fixed rate over fixed indexed annuities," which also "directly compete against one another." IALC Br. 30. And contrary to the government's claim that the Department was not "pick[ing] and choos[ing] retirement products for American consumers," Opp. 77, the Department chose to "promote access" to fixed rate annuities because "[t]hese annuities provide payments that are the subject of insurance companies' contractual

guarantees and that are predictable" and because their terms "are more understandable to consumers," AR 232. These features, however, do not necessarily make fixed rate annuities *better* for savers than fixed indexed annuities. The Department's decision to create a "regulatory incentive" to recommend fixed rate annuities on this basis was arbitrary and capricious.

The government also contends that "commissions are typically higher for FIAs than for declared rate annuities." Opp. 74. But as the Department itself recognized, "[h]igher fees and commissions often might be justified as compensation for advisers' effort to recommend these more complex products and for insurers' assumption of various risks." AR 618.

In the end, the government's argument boils down to the "complexity" resulting from "the many variations and crediting options for FIAs." Opp. 73. But even if the terms of these products are somewhat more complex in this one regard, the Department did not base its decision on this factor alone. Instead, it invoked factors that apply equally to fixed rate annuities; it emphasized the "risks" associated with fixed indexed annuities while ignoring the corresponding risks of fixed rate annuities; and it provided no reasoned basis for creating a regulatory incentive to preferentially recommend fixed rate annuities. Consequently, the Department's decision to revoke the 84-24 exemption for fixed indexed annuities was arbitrary and capricious and cannot be sustained based solely on the "complexity" of fixed indexed annuities' crediting options. *See, e.g.*, *PDK Labs.*, 362 F.3d at 799; *Nat'l Fuel*, 468 F.3d at 839–40.

III. THE DEPARTMENT FAILED TO PROVIDE ADEQUATE NOTICE AND OPPORTUNITY TO COMMENT ON THE REVOCATION OF THE 84-24 EXEMPTION FOR SALES OF FIXED INDEXED ANNUITIES.

Finally, as plaintiffs have explained, the Department failed to provide adequate notice that it was considering revoking the 84-24 exemption for fixed indexed annuities. Instead, it proposed to revoke this exemption only for variable annuities, and made clear that the exemption

would remain available for all annuities (including fixed indexed annuities) that are not treated as securities. The government has failed to refute this showing.

The government initially asserts, without explanation, that it is "importan[t]" that the BIC exemption as proposed applied to all annuity transactions. Opp. 88. But the *availability* of the BIC exemption for all annuity transactions provided no notice that relief under the 84-24 exemption might be *revoked* for some annuities. Similarly, because the BIC exemption was available for all transactions, questions about whether it would work for annuities that are not securities did not alert parties to the possibility that a different exemption would be revoked for a subset of annuities that are not treated as securities.

The government's principal response is that its request for comments provided notice that fixed indexed annuities could be singled out and denied relief under the 84-24 exemption. But this claim completely ignores the relevant context. Before issuing the final rules, the Department never drew any distinctions between fixed rate and fixed indexed annuities. None of the three notices of proposed rulemaking refers to "fixed indexed annuities," "FIAs," "fixed rate annuities," or "FRAs." The 250-page draft RIA mentioned "indexed annuities" once, AR 897, and said nothing about their complexity. By contrast, the notice pertaining to the 84-24 exemption drew a sharp distinction between "variable annuity contracts and other annuity contracts that are securities" and "insurance and annuity contract that are not securities." AR 789–90. The draft RIA drew the same distinction, AR 871, and discussed certain issues pertaining to variable annuities, AR 904, 915–16. Moreover, the draft RIA described *all* annuities, fixed or variable, as "complex." AR 903.

It was against this backdrop that the Department stated that it "*believe[d]* that some of the transactions involving IRAs that are currently permitted under PTE 84-24 should instead occur

under the [BIC exemption], specifically, transactions involving variable annuity contracts and other annuity contracts that are securities under federal securities law." AR 789 (emphasis added). "*On the other hand*," it went on, "the Department *has determined* that transactions involving insurance and annuity contracts that are not securities can continue to occur under [the 84-24] exemption, with the added protections of the Impartial Conduct Standards." AR 790 (emphases added). It then "request[ed] comment on this approach," and whether it "strikes the appropriate balance and is protective of the interests of the IRAs." *Id.*; *see also* AR 747.

Nothing in this request made it "readily apparent," *United Steelworkers of Am., AFL-CIO-CLC v. Schuykill Metals Corp.*, 828 F.2d 314, 318 (5th Cir. 1987), that the Department was thinking about severing fixed indexed annuities from other non-security annuities and moving them to the BIC exemption. Even if a general question of the sort the Department posed could otherwise provide adequate notice, *but cf. Prometheus Radio Project v. FCC*, 652 F.3d 431, 450 (3d Cir. 2011), such a question cannot provide notice of an outcome that (1) the Department expressly said it had already "*determined*" it would not make, (2) draws a distinction the Department had *never previously mentioned*, and (3) relies on a criterion (complexity) that the Department had previously ascribed to *all* annuities.

The comments the government cites, Opp. 89 & n.94, do not show otherwise. The IALC comment addressed whether the BIC exemption was workable for non-securities annuities, AR 42541, and nowhere addressed the possibility that the 84-24 exemption would be revoked for fixed indexed annuities, *see* AR 42540 (emphasizing that the Department *retained* the 84-24 exemption for fixed annuities, including fixed indexed annuities). The government cites some comments urging that all annuities be included in the 84-24 exemption, Opp. 23 n.25, or that all annuities be excluded from it, *see* AR 39096 (University of Miami Investor Rights Center);

AR 39270, 39272 (Prof. Rhoades) (both cited in Opp. 23 n.24). But in a proceeding in which "over 3,000 individual comment letters" were filed, Opp. 17, the government cites just *one letter* in which a commenter urged the Department to treat fixed indexed annuities differently from other fixed annuities, *see* Opp. 23 n.24 (citing AR 46847–53 (Fund Democracy)).

This isolated exception proves that it was *not* "readily apparent" that the Department was thinking of abandoning its securities/non-securities distinction and moving fixed indexed annuities into the BIC exemption, and the "comments received" did not "reflect[] such an understanding." *United Steelworkers*, 828 F.2d at 318. If the Department had provided meaningful notice of such an outcome, it "would doubtless have triggered an avalanche of comments, in contrast to the mere [handful of] pages that … actually" addressed the concept. *Allina Health Servs. v. Sebelius*, 746 F.3d 1102, 1108 (D.C. Cir. 2014). Indeed, when IALC learned, the day before the end of the comment period, that the Department might be considering different treatment for fixed indexed annuities, it put together comments based on this limited information in a single day. IALC Br. 33–34. The government contends there is nothing improper about this last-minute meeting. Opp. 90. But the *propriety* of the meeting is irrelevant; IALC's reaction to that meeting shows that, if the Department had provided adequate notice, it would have received many comments addressing the distinction it ultimately (and irrationally) drew between fixed rate and fixed indexed annuities.[15]

[15] Nor could the meeting itself provide the missing notice. The government touts the meeting as proof of its "diligence" in discussing its change of heart with market participants before the comment period closed, Opp. 90, but alerting some subset of interested parties does not satisfy the APA's notice requirement, *MCI Telecomms. Corp. v. FCC*, 57 F.3d 1136, 1143 (D.C. Cir. 1995); *Sprint Corp. v. FCC*, 315 F.3d 369, 376 (D.C. Cir. 2003). And doing so on the next to the last day of the comment period hardly advances the purposes of the notice requirement. *See First Am. Disc. Corp. v. Commodity Futures Trading Comm'n*, 222 F.3d 1008, 1015 (D.C. Cir. 2000); *Prometheus*, 652 F.3d at 450 ("[T]he opportunity for comment must be a meaningful opportunity. That means enough time with enough information to comment ….") (citation omitted); *Royer v. Fed. Bureau of Prisons*, 934 F. Supp. 2d 92, 102 (D.D.C. 2013) ("[I]mplicit in the requirement for notice and an opportunity to comment" is the "requirement for *timely* notification ….") (emphasis in original).

The reaction of the trade press confirms this point. Industry media outlets understood the proposal as retaining the 84-24 exemption for all fixed annuities and revoking it only for variable annuities. Nick Thornton, *DOL's proposal significantly affects annuities*, BenefitsPro, June 4, 2015 ("Fixed annuity contracts can be exempted from prohibited transaction regulations because they are not regarded as securities."); Cyril Tuohy, *Fiduciary Rule Divides Fixed and Variable Annuity Worlds*, InsuranceNewsNet, July 30, 2015. And when the final rule issued, multiple news reports described DOL's treatment of fixed indexed annuities as a surprise. *See* Kerry Petcher, *Surprise: DOL Rule Targets Indexed Annuities*, Retirement Income J., Apr. 7, 2016; Anna Prior & Leslie Scism, *Rules for Indexed Annuities Face an Unexpected Tightening*, Wall St. J., Apr. 6, 2016; Cyril Tuohy, *Annuity Industry Caught Off-Guard by DOL Rule*, InsuranceNewsNet, Apr. 6, 2016. *See Valley Cmty. Pres. Comm'n v. Mineta*, 373 F.3d 1078, 1089 n.2 (10th Cir 2004) (later-arising evidence bearing on decision's propriety may be reviewed). The government's claim that the Department provided adequate notice of how it would treat fixed indexed annuities simply ignores reality. Because the Department failed to provide notice and opportunity to comment on the revocation of the 84-24 exemption for fixed indexed annuities, the rule should be vacated.

CONCLUSION

For these reasons and those set forth in IALC's opening brief and the briefs of the Chamber and ACLI, this Court should vacate and enjoin enforcement of the entire rule, the BIC exemption, and other related exemptions. Alternatively, the Court should vacate at least the portion of the new fiduciary definition that reaches advice incidental to one-time sales of fixed annuities, and the revisions to the 84-24 exemption insofar as they exclude fixed indexed annuities.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on September 16, 2016, I caused the foregoing to be electronically filed using the CM/ECF system, which will automatically send email notification of such filing to all attorneys of record.

s/ Joseph R. Guerra

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