Annuities Market Targeted in Biden’s 401(k) Junk-Fee Crackdown

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- Rhetoric targets fixed indexed retail life insurance products
- Proposal would subject more salespeople to tough standards

By Austin R. Ramsey

(Bloomberg Law) --

The Biden administration’s controversial new fiduciary investment advice proposal has in its cross hairs a $300 billion life insurance annuities market with deep ties to 401(k)s as a method for delivering steady retirement income.

Proposed US Labor Department rules the president unveiled last week would require a wider swath of the financial services industry to operate under strict fiduciary standards of conduct. The announcement reignited a simmering, decade-old showdown between Wall Street and DOL’s benefits regulator over its authority to control pension assets after they leave employer-sponsored plans.

As the dust settles and the breadth of the Employee Benefits Security Administration proposals (88 Fed. Reg. 75890–76045) become more clear, life insurers and their bread-and-butter fixed-indexed annuity products appear uniquely prone to additional regulatory scrutiny under the package, industry workers told Bloomberg Law.

Annuities protect retirees from burning through their savings too quickly, but have a bad reputation for predatory sales tactics, complex contracts, and hidden fees. Proponents say that’s an outdated way of thinking, and annuities have more recently emerged as a go-to solution for retirement plans seeking to redesign their 401(k)s in the image of increasingly rare traditional pensions.

Biden and the DOL seem intent on protecting workers and retirees from falling victim to the potential for “junk fees” they say annuities still pose, but the industry claims tougher standards threaten to price low- and middle-income consumers out of the market for good.

“You have this one agency within the federal government that has decided to put a target on the back of these products and argue that they are somehow in need of greater scrutiny than other options that are available,” said Jason Berkowitz, chief legal and regulatory affairs officer at the Insured Retirement Institute.

One-sided Rollout

President Joe Biden's announcement on Oct. 31 rolling out the fiduciary rulemaking project touched a nerve early on with insurers.

Fixed-indexed annuities that insure principle investments against losses in exchange for a cap on index-linked returns were largely grouped under Biden's "junk fees" idiom. Seniors especially are the target of "brokers selling bad annuities that work for the broker and not the client," the president said.

"It was myopic and one-sided," said Jeff Acheson, CEO Advanced Strategies Group LLC and president-elect of the American Retirement Association. "To me, it smacked of an institution trying to do policy, and it let the politics get involved and found a position that tied back to this initiative on 'junk fees.'"

But the rule itself is far more dangerous to the entire annuity industry, said Howard Bard, vice president and principal deputy general counsel at the American Council of Life Insurers. The proposal would classify a whole subset of the insurance broker-dealer space that considers itself exclusively salespeople as "investment advice fiduciaries," making the commissions they earn on sales illegal unless authorized under prohibited transaction exemptions.

It goes on to whittle down the exemptions available to just two, which are further modified in order to limit what forms of compensation are allowed at all.

"For 50 years, the industry has had different exemptions for different kinds of conditions," said Jennifer Eller, a principal at Groom Law Group Chartered. "Now, the department has funneled virtually all investment advice into two."

Changes to Prohibited Transaction Exemption 84-24 especially limit access to only independent insurance producers, and allow them a limited set of permissible forms of compensation. The exemption would require insurers that don't use independent producers to keep a close eye on salespeople, going so far as to require background checks.

Already the US Securities and Exchange Commission and the majority of states require investment advisers to follow some best-interest standard when recommending products. The exemptions the DOL has proffered would subvert some of the basic tenets of insurance regulation, which has historically been left up to the states, said Brad Campbell, former head of EBSA under President George W. Bush who is now a partner at Faegre Drinker Biddle & Reath LLP.

"The last time I looked, every state had licensing requirements for who is eligible to be an insurance agent, who can keep that license, how they can be disciplined for violating it," he said. "There's a lot of these kinds of duplicative provisions that don't play nice with other areas of the law in this package, and I'm hoping there's a lot of modification before we're done."

About-face Approach

The fiduciary proposal and Biden's remarks appeared to mark an about-face in the federal government's approach to annuities.

Congress seemingly embraced the lifetime income model in a pair of landmark retirement access bills passed in 2019 (Pub. L. No. 116-94) and 2022 (Pub. L. No. 117-328), paving the way for more insurers to tap worker 401(k)s.

The laws carved out a safe harbor to protect employers from absorbing too much risk when offering in-plan annuity options while nixing burdensome minimum distribution requirements for late-career annuity purchases.

"It feels very much like this is a broadside attack on the annuity industry, which is very out of sync with the fact that the Congress and the president in the last several years have pursued legislative changes that are designed to make these valuable products easier to access and easier for people to understand through SECURE and SECURE 2.0," Berkowitz said.

A recent Morning Consult survey found more than half of pre-retirees ages 45–65 report today's economy has them considering "a guaranteed lifetime income product that pays out like a pension."

Third-quarter fixed-income annuity sales are up 38% this year, according to estimates by LIMRA, an industry data group. Fixed contract sales have outpaced variable insurance products in the retirement sector since 2016 and accounted for $210 billion in sales in 2022 compared to $103 billion in variable annuities.

"It is disappointing that the Department of Labor has chosen to erroneously villainize these products, and the financial professionals who sell them, in order to advance a political narrative and push an unnecessary rule that will reduce access to retirement advice, especially to middle-class Americans," said Jim Poolman, executive director of the Indexed Annuity Leadership Council and former insurance commissioner for the state of North Dakota.

In states such as New York that have applied stricter standards on the insurance product sales they oversee, savers have suffered, said Marc Cadin, CEO of Finseca, a nonprofit trade group representing financial security professionals. Nearly half of the 20 largest individual life insurers in New York saw premium revenue declines in 2022, three years after the state's fiduciary-like insurance sales regulation took effect.

Carriers that saw the biggest dips included Equitable Holdings Inc., whose volume of business dipped 10% to $398 million, and Manulife John Hancock, with a 10% decline to $374.9 million, S&P Group Inc. data show.

The Labor Department didn't immediately respond to a Bloomberg Law request for comment Thursday. EBSA's Deputy Assistant Secretary for Program Operations Tim Hauser said at an American Law Institute conference Nov.3 that annuity products are "very, very hard" for many consumers to understand, and they sometimes threaten to lock money away for high fees.

"I've been in a room with folks from this industry talking about policy matters and it almost turns into a sales pitch," Hauser said. "I'm literally hearing from people, 'Tim, you don't understand, you can't lose with these things.' That's not true, folks."

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