Office of Management and Budget reviewing proposed exemption under DOL fiduciary rule for some indexed annuity distributors

Some indexed annuity distributors are poised to get a shot in the arm from the proposal, which would make it easier for independent agents to sell the annuities under the rule.

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The Labor Department has submitted for review a proposal that would seemingly ease the compliance process for some distributors selling fixed indexed annuities under the fiduciary rule.

The Department of Labor sent its proposal, titled "Exemption for Insurance Intermediaries," to the Office of Management and Budget for review on Dec. 29.

The proposal, if accepted by the OMB, would likely grant a class exemption under the fiduciary rule's best-interest contract exemption to independent marketing organizations (IMOs), which market insurance products to independent insurance agents.

Independent agents are by the far the largest distribution channel for indexed annuities — representing roughly 60% of sales — and the fiduciary rule, as currently written, is projected to be hugely disruptive to this channel.

The rule, implementation of which begins in April, requires brokers and agents to give investment advice that's in clients' best interests. Indexed annuities sold on commission will need to be sold under the BICE, which requires a "financial institution" to execute a best-interest contract with an investor.

However, the rule doesn't qualify independent marketing organizations as a financial institution — only insurance companies, broker-dealers, banks and registered investment advisers are able to sign the contract with an investor.

That creates a big hurdle for IMOs to continue selling indexed annuities, in part because most insurance companies are loath to step in and execute the contract on behalf of independent insurance agents, according to Bruce Ashton, partner at Drinker Biddle & Reath.

The DOL left open the possibility for IMOs to submit individual requests for an exemption that would grant them "financial institution" status. Roughly 20 IMOs have applied thus far, but none have been granted to date.

The proposed class exemption, however, could offer this status to IMOs, putting them among the ranks of B-Ds, insurance companies, banks and RIAs, assuming they meet certain conditions.

One such condition could potentially be having a certain amount of capitalization, according to Michael Hadley, a partner at Davis & Harman.

Michael Trupo, a DOL spokesman, declined to discuss specifics of the proposal sent to OMB. He said it will need to go through a public comment process before it's finalized.

In answers to frequently asked questions about the rule issued in October, the DOL said if it "grants an individual exemption to an IMO … any other IMO that satisfies the definition and the conditions of the new exemption could also act as a financial institution under the BIC Exemption. Alternatively, the Department may propose a class exemption for IMOs."

Indexed annuities were projected to have their best sales year on record in 2016. However, sales were expected to plummet 30%-35% this year, largely because the rule's treatment of IMOs would morph how they're able to conduct business in qualified accounts, according to Limra, an insurance industry group.

Although a class exemption would be good news for independent agents and insurance companies, the "part of the news that's disconcerting is not having any better sense of the timing," according to Mr. Ashton.

"We don't know how long it will stay at OMB and how long, when it comes back from OMB, it will take for DOL to issue it," he said.

The time frame for finalizing ERISA exemptions is shorter than an official rule-making process, such as that of the fiduciary regulation, Mr. Ashton said, adding he guesses the DOL is pushing "really hard" to issue the proposal before Jan. 20, when the Trump administration takes office.