January 22, 2018

Via electronic mail to jmatthews@naic.org

Dean L. Cameron
Director, Idaho Department of Insurance
700 West State Street, 3rd Floor
P.O. Box 83720
Boise, ID 83720

Re: 11/24/17 Draft of Revisions to the NAIC Suitability in Annuity Transactions Model Regulation (#275)

Dear Director Cameron:

I am writing on behalf of the National Association of Insurance and Financial Advisors (NAIFA) to provide NAIFA's comments on the 11/24/17 draft of revisions (the "Draft") to the current NAIC Suitability in Annuity Transactions Model Regulation (the "Model"). Founded in 1890 as The National Association of Life Underwriters, NAIFA is the oldest, largest and most prestigious association representing the interests of insurance professionals from every Congressional district in the United States. Our mission – to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members – is the reason NAIFA has consistently and resoundingly stood up for agents and called upon members to grow their knowledge while following the highest ethical standards in the industry.

NAIFA commends the NAIC for re-establishing the Annuity Suitability Working Group for the purpose of reviewing and revising, as necessary, the current Model, and we appreciate your giving NAIFA the opportunity to testify on this topic at prior meetings of the Working Group as well as to discuss the draft revisions with members of the Working Group. While NAIFA believes the existing suitability standard is a strong standard of conduct that vigorously protects consumers through comprehensive rules-based regimes such as those found in both NAIC and FINRA regulations, NAIFA does support the Working Group's efforts to develop an appropriate best interest standard of conduct that would apply to recommendations and sales of annuity products. However, we do have several areas of concern and other comments that we would like to bring to your attention regarding the Draft. Our comments and concerns are as follows:

1. Section 1 A (Purpose): This section currently indicates that two standards of conduct are applicable to annuity sales—a suitability standard and a best interest standard. NAIFA believes that this dual-standard approach could be confusing and that it would be more accurate to view a determination of suitability as being one of the elements of determining if a recommendation or sale is in the consumer's best interest. NAIFA recommends that this section be revised to refer to only the best interest standard.

2. Section 2 (Scope): NAIFA recommends revising this section to read as follows: "Subject to the exemptions set forth below, this regulation shall apply to any recommendation or sale of an annuity." The reasons we recommend deleting references to "solicitation" and "negotiation" are:
    a. With our suggested language, the consumer would still receive the necessary information prior to the sale;
    b. Applying the regulation to pre-recommendation/pre-sales conversations that do not result in actual recommendations or sales could have a dampening effect on consumers receiving valuable advice, information and education, since producers will be required to navigate various potentially burdensome compliance requirements at very early stages of a process which may or may not end up with a recommendation or sale being made;
    c. Providing the required information may increase consumer confusion by having the consumer being given more information than is needed or relevant to the specific situation.

3. Sections 5 B ("Best interest" means…): Our concern with this section is that the subjective nature of the language used will lead to a "hindsight is always 20/20" type of after-the-fact analysis by regulators evaluating whether a recommendation or sale met the regulation's requirements. The fact that consumer complaints and regulator involvement will typically only occur when a consumer perceives she has been harmed may also serve to "color" the way a recommendation or sale is viewed, after the fact. Although section 5 B (1) does refer to determining compliance with the standard "at the time the annuity is issued", NAIFA recommends that additional language be added to advise regulators that any subsequent review of a recommendation or sale needs to be based only on the information and facts that were present at the time the recommendation or sale was made.

    NAIFA also recommends that section 5 B 2 be revised to clarify that recommending or selling proprietary products does not violate the best interest standard.

4. Section 5 J ("Material conflict of interest" means…): NAIFA has similar concerns with this definition as are discussed in item 3 above regarding the definition of "Best interest". The subjective nature of the standard will result in regulators analyzing whether or not a producer's financial interest did or did not affect the impartiality of the recommendation after the fact and after all the facts are in (rather than those existing at the time of the recommendation), with the ultimate determination being colored by the fact that in most cases the regulator is reviewing the matter because the consumer

has lost money or otherwise believes that he has been harmed. As we suggested in item 3 above, NAIFA recommends that additional language be added advising regulators that a subsequent determination of whether a "material conflict of interest" existed at the time of the recommendation or sale should only be based on the facts and information that were present at the time the recommendation or sale was made.

In addition, the particular wording used in section 5 J 1 ("…a financial interest of an insurance producer…") and 5 J 2 ("…financial incentives or rewards offered to or received by an insurance producer…") could be read to state that the mere fact that an agent is being compensated for selling an annuity equals a "material conflict of interest". This is particularly the case with section 5 J 2, which says that "financial incentives or rewards offered to or received by an insurance producer" constitute a material conflict of interest, *regardless of whether a reasonable person would expect it to impact the impartiality of the recommendation*. To address this concern NAIFA recommends that the following language be added to the end of section 5 J 1—"The typical compensation received by an insurance producer in connection with the marketing and sale of an annuity does not, in and of itself, constitute a material conflict of interest."

5. Section 5 J 2: NAIFA has two concerns with this provision. First, as a general matter we do not see the need for this section, since section 5 J 1 already defines "material conflict of interest" and ties this definition to whether or not the producer's financial interest affects the impartiality of the recommendation. This language already covers the subject matter of section 5 J 2. In addition, as mentioned above this section seems to state that financial incentives/rewards received by a producer or a direct interest/ownership in an insurer by a producer constitute a material conflict of interest *regardless* of whether a reasonable person would expect such incentives or ownership to affect the impartiality of the producer, which directly conflicts with the definition in section 5 J 1. Second, the latter part of this section appears to say that *any* interest or ownership in an insurer by a producer—for example, if the agent owns 50 shares of the insurer's stock, owns a policy from a mutual insurer, or the agent's father-in-law is an officer of the insurer--rises to the level of a material conflict of interest. At a minimum, some form of *de minimus* exemption is needed here.

   To resolve these concerns, NAIFA recommends that section 5 J 2 be deleted, section 5 J 1 be re-titled as section 5 J, and that the following language be added to the end of section 5 J:

   > "'The typical compensation received by an insurance producer in connection with the marketing and sale of an annuity does not, in and of itself, constitute a material conflict of interest.
   >
   > 'Material conflict of interest' may include financial incentives or rewards, other than the typical compensation received by an insurance producer in connection with the marketing and sale of an annuity, offered to or received by an insurance producer, or a direct interest or ownership in an insurer by an insurance

producer or an immediate family member of an insurance producer, subject to the following *de minimus* exemptions:…"

6. Section 5 M ("Reasonable cash compensation" means…): NAIFA recommends that this section also reference the time involved in providing consumer education and advice and the marketing and sale of the product as elements in the determination of what is reasonable cash compensation. NAIFA also opposes the inclusion of any specific limitations in the Model that would limit the type or amount of compensation that a producer may be paid.

   NAIFA therefore recommends that this section be revised to read as follows: "'Reasonable cash compensation' means cash compensation that reflects the complexity of the product and the time spent by the producer in educating the consumer, providing advice to the consumer and in the marketing and sale of the product."

7. Section 5 P 3: NAIFA recommends that this provision be deleted. The type of information it appears to reference is already covered under other provisions of section 5 P, and the specific wording used is overly vague and unclear.

8. Section 6 A: NAIFA recommends revising this section to read as follows:

   "In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the insurance producer, or the insurer where no producer is involved, shall only make a recommendation that is in the best interest of the consumer at the time it is made based on the suitability information provided by the consumer. "

9. Section 6 C 2 (Disclosure of producer compensation above 3%): NAIFA recommends deleting this provision from the Draft for the following reasons:
   a. NAIFA generally opposes requiring disclosure of producer compensation because, among other considerations, doing so i) conflicts with the producer's general privacy rights, ii) will result in consumers being overly focused on the agent's compensation rather than on other important factors, such as whether a products features and benefits are the right ones for the consumer's needs, and iii) the amount of compensation the producer will receive is ultimately not relevant to the consumer's decision-making process regarding whether the specific product at issue will meet the consumer's needs and objectives.
   b. There is no need for this provision, since the only regulatory concern it could be intended to address pertains to conflict of interest issues, and section 6 C 1 already requires producers to disclose material conflicts of interest. Imposing unnecessary restrictions on compensation is overly prescriptive, duplicative in terms of purpose and would interfere with customary business decisions and practices.

c. Producers are entitled to be compensated for their work. Disclosure of a single compensation amount for selling a particular product has little to do with, and sheds little light on, whether or not there exists a material conflict of interest or if the producer is acting in the consumer's best interest. To be at all meaningful in terms of helping the consumer determine if there is a material conflict of interest or if the producer is acting in the client's best interest, such a disclosure would need to set up some kind of a comparison between compensation alternatives and focus on any compensation differential that might exist between the sale of product A versus product B, rather than on the actual amount of compensation that would be paid—for example, the fact that the producer will receive 20% higher compensation for recommending product A over product B is what really matters here.

d. While this section purports to create a safe harbor from disclosing compensation of 3% or less, what it risks ending up doing is inappropriately implying that compensation above 3% is automatically a material conflict of interest that is not in the consumer's best interest. In addition, there is also the risk that this provision will drive insurers to set 3% as the industry compensation standard in order to avoid regulatory problems down the road. This amount is too low and does not reflect what is occurring in the marketplace.

Finally, while NAIFA strongly urges the Working Group to delete this provision, as an alternative <u>we recommend that the amount of compensation subject to disclosure be changed to first year compensation that is above 6%.</u> From speaking with NAIFA's policy formation leaders, first year compensation of 6% seems to be a rough demarcation line between generally appropriate compensation and situations requiring additional information and analysis to evaluate whether there is a material conflict and whether a recommendation was in the client's best interest. Setting the amount at 6% will help focus regulator attention on those situations where the existence of a material conflict might be more likely to be in question.

Furthermore, while commissions above 6% are not in and of themselves evidence of not acting in the client's best interest, cases with very large first year commissions are generally where problem transactions often are found. Bad actors often sell products with big upfront commissions that have long surrender periods that are not appropriate to the consumer's needs. Agents should be encouraged to retain and service annuities through the payment of trail commissions, and regulators <u>should not</u> create a situation where the payment of trail compensation would push the agent's total compensation over a too low and arbitrarily set threshold. Therefore, the focus of any required disclosure should be on what the agent will be paid in the first year.

To accomplish this, section 6 C 2 should be revised to read as follows: "The percentage or amount of cash compensation above six percent (6%), whether by commission or fee, the insurance producer would receive in the first year as a result of a contract for services, for advice or for the sale of a recommended annuity; and…".

10. Section 6 F: NAIFA's general concern with this section is that it imposes obligations and duties—to determine that an annuity is "reasonable"-- even when no recommendation is made, inaccurate information is provided by the consumer, or the consumer refuses to provide the necessary information. Under these circumstances, it could very well be difficult if not impossible to even determine if an annuity is "reasonable", and NAIFA believes that neither the producer nor the insurer should have any type of "standard of care" obligations in these situations. NAIFA recommends that the first paragraph of this section be revised to read as follows: "Neither an insurer nor a producer shall have any obligations to determine if an annuity is appropriate for, reasonable, suitable, or in the best interest of the consumer if any of the following situations occur:"

    In addition to the general concern discussed in the preceding paragraph, NAIFA has the following specific concerns regarding section 6 F:
    a. The introductory paragraph should reference the insurer and the producer, rather than only the insurer.
    b. What are the insurer and agent's obligations/responsibilities in situations where the consumer provides only some, but not all, of the requested suitability information?

11. Section 6 J 1 (Sales in compliance with FINRA requirements…): This section creates a safe harbor for sales made in compliance with "FINRA requirements pertaining to best interest standards…."FINRA does not currently have rules or requirements pertaining to a best interest standard; keeping the Draft's current language risks losing the existing safe harbor for compliance with current FINRA requirements.

12. Section 7 (Non-Cash Compensation Disclosure Requirement ): Similar to our position stated in item 9 above regarding the disclosure of producer compensation above 3%, NAIFA recommends that this section be deleted from the draft for the following reasons:
    a. NAIFA generally opposes requiring disclosure of producer compensation because, among other considerations, doing so i) conflicts with the producer's general privacy rights, ii) will result in consumers being overly focused on the agent's compensation rather than on other important factors, such as whether a products features and benefits are the right ones for the consumer's needs, and iii) the amount of compensation the producer will receive is ultimately not relevant to the consumer's decision-making process regarding whether the specific product at issue will meet the consumer's needs and objectives.
    b. There is no need for this provision, since the only regulatory concern it could be intended to address pertains to conflict of interest issues, and section 6 C 1 already requires producers to disclose material conflicts of interest. Imposing unnecessary restrictions on compensation is overly prescriptive, duplicative in terms of purpose and would interfere with customary business decisions and practices.
    c. The disclosure of non-cash compensation amounts at a time that would be meaningful to the consumer would be difficult if not impossible, since producers

generally don't know if they qualify for such compensation , or the amount, until sometime in the future (generally at year-end).

d. While this section purports to create a safe harbor from disclosing non-cash compensation of $100 or less, what it risks ending up doing is inappropriately implying that any non-cash compensation above $100 is automatically a material conflict of interest that is not in the consumer's best interest, which will drive the market to this floor amount.

Finally, while NAIFA strongly urges the Working Group to delete this provision, as an alternative we recommend that the scope of this section be limited to non-cash compensation that is based on the producer's volume of production in connection with a particular product the producer sells. Non-cash compensation which is based on a producer's volume of production of a company's overall line of products is not the area of real concern here, and any regulatory restrictions on compensation should be limited to the areas of greatest concern. In addition, the safe harbor amount should be increased to $500 or $1,000.

13. <u>Section 8 (Prohibited Practices):</u> NAIFA has two comments regarding this section:
    a. Section 8 (1) references compensation received in connection with making a recommendation rather than a sale; in addition, in light of various other requirements contained in the draft, language should be included stating that the regulation does not prohibit the payment of any type or specific amount of compensation to a producer. In order to address these issues, this section be revised to read: "…Shall receive no more than reasonable cash compensation in connection with the sale of a recommended annuity; provided, however, that nothing in this regulation shall be construed to prohibit the payment to a producer of any type or amount of compensation otherwise permitted under this state's insurance laws."
    b. Section 8 (3) should be deleted, as it is redundant and repetitive. The producer is already required to act in the "best interest" of the consumer, which by definition means putting the interest of the consumer first, which means that the recommendation is not based on the producer's own interest. If a recommendation or sale is in the consumer's best interest, then the transaction passes muster under the regulation, period—without regard to whether the producer also benefits.

We appreciate your consideration of this letter and our comments; please email or call me if you have any questions.

Sincerely,

Gary Sanders

Gary Sanders
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