Comments for the Center for Economic Justice

To the NAIC Annuity Suitability Working Group

Regarding Conflict of Interest in the Annuity Suitability Model

July 26, 2019

The Center for Economic Justice submits the following comments regarding the issues discussed during the July 23, 2019 call of the working group.

During the call, the Chair identified three categories of conflict of interest and, based on our understanding of the discussion, suggested different treatment of different types of conflict of interest. For example, commissions might be disclosed as part of the initial client relationship disclosure, but not identified or presented as a conflict of interest. In contrast, a producer with a financial interest in the company offering the annuities available to the producer might be required to disclose such ownership interest as a conflict of interest.

CEJ writes to expand upon the comments we made during the July 23, 2019 call.

The materiality of the conflict of interest for commissions and ownership is primarily a function of the specific nature of the compensation rather than the category of compensation. For example consider two types of commission structures – the first pays 10% of initial premium to the producer and the second pays 1% of annual premium for the first 15 years the annuity is in force. While both represent a conflict of interest, the first is a much more severe conflict than the second and, consequently, a simple disclosure that the producer receives a commission would be wholly inadequate.

Let's now consider two types of producer ownership of the issuing insurer – in the first instance, the producer's 401k or retirement account includes stock of the insurer representing ownership of 0.0001%. In the second instance, the producer (or agency or IMO) has a 20% ownership of the insurer or the insurer is a captive affiliate of the IMO. Again, while both represent a conflict of interest, the second is much more severe.

The purpose of these examples is to demonstrate that any type of compensation may create a material conflict of interest and there shouldn't be any *a priori* conclusions about whether any particular type of compensation is a material conflict of interest.

Our main points for the working group's consideration are:

Arguments that producers don't consider compensation when making recommendations are without merit and refuted by the fact that insurers design compensation structures specifically to affect producer behavior and by the history of life insurance and annuity sales abuses driven by compensation structures that reward sales over the interest of consumers.

Similarly, arguments that requirements to manage and/or disclose conflicts of interest will drive producers out of the market are without merit. If the conflict of interest is so great that mere disclosure will drive consumers away, such a compensation structure will surely lead to sales that are not in the consumer's best interest. If the conflict of interest is modest – e.g., we receive a 1% commission for each of the first 15 years the policy is in force or my retirement account includes stock in the issuing company –we have seen no evidence that such disclosure will thwart legitimate recommendations in the best interest of consumers.

Disclosure is not an appropriate blanket solution for certain categories of compensation-based conflicts of interest. While disclosure is the default regulatory response to a market failure, it is very unlikely – actually, impossible – that additional disclosures beyond the lengthy and complex disclosures already associated with annuities will empower a consumer sufficiently to discipline the *insurer's* compensation practices.

The general requirement for insurers and producers should be to eliminate or manage conflicts of interest that would otherwise undermine the best interest standard of care. Towards this end,

- Insurers and IMOs should be required to design compensation schemes for producers that reinforce a best interest standard of care and the insurers and IMOs should be prohibited from using compensation schemes that undermine such a standard of care. For example, commission-based compensation should be designed to reward producers for sales that remain in force – consistent with the investment nature of the annuity products – as opposed to compensation that rewards producers only for sales.

- Insurers' or IMO's use of quota quotas, contests, rewards or benefits tied to sales of specific products or encouraging the sale of particular products over others should be prohibited. This is not the type of conflict of interest that a producer can "manage" or that disclosure would meaningfully address.[1]

[1] As noted in our July 22, 2019 comments to the working group, the best interest standard of care should be defined to require the producer or insurers to consider only the interest of the consumer. The compensation of the producer or profitability to the insurer should not be a factor in making a recommendation to the consumer. The proposal for an insurer or producer putting the consumer's interest above its/her/his interest is simply faux regulation and phony consumer protection. Compliance would require an insurer or produce and enforcement would require a regulator to measure and compare the relative interests of the consumer and insurer or producer. No one has offered how such measurement might be accomplished – because it is not a feasible exercise.

- Contingent benefits beyond contests, bonuses and quotas, such as a producer who sells primarily auto and home insurance but whose appointment requires minimum sales of life insurance and annuities or whose health, disability or retirement benefits depend upon certain sales are material conflicts of interest.

- Disclosure should be permitted as a method for managing a conflict of interest only if such disclosure is tested and proven to be meaningful and useful for a consumer. Generally, conflict of interest disclosures should be direct – e.g., I'm required to sell five annuity contracts a month or I risk losing my appointment with Acme Insurance Company."

- We've previously offered comments on disclosure of producer compensation and have urged simpler disclosures focusing on comparative compensation across products that may be recommended. We noted that the entirety of a producer's compensation may consist of a variety of cash and benefit provisions, some of which are contingent upon a variety of factors. As such, if there is a requirement for disclosure of compensation, the insurer and IMO should be the ones required to produce the disclosure, subject to limitations set out in the model. The disclosure requirements of the producer should be limited to the list of conflicts of interest and the compensation information provided by the insurer(s). As others have suggested, the working group should consider a template for compensation disclosure. However, disclosure of compensation cannot be seen as managing all types of compensation-related conflicts of interest. Eliminating or managing such conflicts through compensation design by the insurer or IMO is a necessary requirement.

- The consumer protections in the model should be based on the greatest impact and not eviscerated to account for very limited circumstances or situations. Stated differently and with a hackneyed cliché, the tail of some producers selling a tiny portion of annuities should not wag the dog of the overwhelming volume and size of annuity sales.