Comments for the Center for Economic Justice

To the NAIC Annuity Suitability Working Group

Regarding Conflict of Interest and Care Obligation in the Annuity Suitability Model

July 22, 2019

The Center for Economic Justice submits the following comments regarding the questions posed to stakeholders.

Topic: Conflict of Interest

Question 1: What constitutes a material conflict of interest when recommending annuities?

A conflict of interest arises any time the annuity seller's interests (either company or individual sales rep) are adverse to the client's interests. The conflict is material if a client (or prospective client) would reasonably expect that the conflict might influence the recommendation. So, the fact that annuity sellers only get paid if they make a sale, get paid more to sell certain products over others, may be obligated to recommend one company's products before any others, qualify for trips and other awards based on the volume of their sales, earn certain benefits (e.g., health insurance coverage) based on the volume of their sales, would all constitute material conflicts of interest.

Question 2: When a material conflict of interest exists, how should an insurer and/or a producer avoid or otherwise reasonably mange the conflict?

First, while industry proposes that disclosure be the default or sole method of addressing material conflicts of interest, there is ample evidence that disclosure has not and cannot empower consumers to discipline insurers and producers regarding conflicts of interest created by sales compensation schemes. It is absurd to believe, let alone argue for, disclosure of compensation as a way to overcome the market forces generated by a compensation scheme that rewards a producer for a sale with a massive commission upon the sale, but little or no compensation for keeping the product in force.

Annuities are among the most complex insurance and financial products pitched as retirement investments. The problems with annuity disclosures and marketing materials, including tremendous complexity and misleading and deceptive illustrations, surely do not suggest that an additional – and, as currently envisioned, complex – compensation disclosure would cause a change in an insurers' or producers' conduct of care to the consumer.

Second, and following from the first point, insurers' should be required to design compensation schemes for producers that reinforce a best interest standard of care and 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. In addition, insurers should be prohibited from quotas, contests, rewards or benefits that undermine the best interest standard of care by encouraging sales of particular products over others.

This last point is the reason why 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.

Topic: Care Obligation

Question 1: Should the care obligation of a producer include "prudence"?

Yes. Absent the inclusion of prudence, the care obligation is limited to "diligence, care and skill." None of these descriptors address the actual consumer outcome. Adding "prudence" to the other three descriptors transforms the care obligation from something related only to the insurer or produce to something that considers the outcome for the consumer.

Annuities are overwhelmingly sold as retirement investments (as opposed to insurance). Annuities are among the most complex, opaque and high-cost investment sold to retail investors. The seller must have an obligation to fully understand the product and how it comports with the customer's interest because the customer is unlikely to be able to make an independent judgment – a judgment made impossible with misleading and deceptive illustrations and marketing materials.

Question 2: "Reasonable for an ordinary producer in a similar circumstance to recommend." Is this an appropriate standard for a producer when making a recommendation?

It is unclear why the working group is even considering the "everyone else is doing it" justification for practices harmful to consumers. "Reasonable for an ordinary producer in a similar circumstance to recommend" is not a consumer protection standard and enshrines common practices – even clearly harmful common practice – as the standard against which recommendations will be measured.

Further, such a standard is not tethered to the consumer outcome. Rather, poor industry practices, if practiced by most or all of the industry, would now become acceptable industry practices.

Question 3: "Provide an oral or written description of the basis of the recommendation to the consumer." When considering this requirement for a producer, is it appropriate to allow both oral and/or written descriptions?

The basis for the recommendation must be memorialized in writing. Otherwise, there will be no accountability for the seller to ensure they provide an appropriate discussion, and little likelihood that the investor will understand the disclosure if it is provided only orally. Best practice would be to provide it in writing and explain it orally.

Industry arguments for "flexibility" to provide only oral descriptions of the basis for the recommendation would be the loophole that eats the entire rule. If permitted at all, why wouldn't an insurer or producer resort to oral-only since such an approach is not only easier but also makes enforcement of the provision essentially impossible?