



February 15, 2019

Submitted Electronically to jmatthews@naic.org

The Honorable Doug Ommen
Commissioner, Iowa Insurance Division
Chairman, NAIC Life Insurance and
Annuities (A) Committee
Two Ruan Center
601 Locus, 4th Floor
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The Honorable Stephen C. Taylor
Commissioner, D.C. Department of Insurance,
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Vice Chairman, NAIC Life Insurance and
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1050 First Street, NE, Suite 801
Washington, D.C. 20002

Re: Suitability in Annuity Transactions Model Regulation
Exposure Draft dated November 19, 2018

Dear Commissioner Ommen and Commissioner Taylor:

The undersigned organizations (collectively, the “Industry Groups”) appreciate the opportunity to provide comments regarding the November 19, 2018 draft revisions (the “Exposure Draft”) to the National Association of Insurance Commissioners (the “NAIC”) on the Suitability in Annuity Transactions Model Regulation (#275) (the “Suitability Model”). While this letter sets forth the key points on which the Industry Groups have reached consensus with respect to the Exposure Draft, this letter does not discuss or address all of the issues that are or may be of concern to individual organizations. In light of this, several of the Industry Groups will also be submitting separate comment letters to share their respective views on the Exposure Draft.

At the outset, the Industry Groups want to commend you and the NAIC for your commitment to collaborating with the Securities and Exchange Commission (the “SEC”) on your respective efforts to develop enhancements to the standard of conduct applicable to financial professionals. As the primary regulators for the insurance and securities industries, continued coordination with the SEC as this effort moves forward is essential to achieving regulatory consistency, reducing redundancy, and minimizing compliance burdens.

In this regard, we want to reiterate our previous recommendation that the NAIC defer any discussions about the safe harbor included in Section 6.H of the current version of the Suitability Model.

Modifications to this provision will certainly be needed at the end of this process, but at this stage, there is simply no way to craft those modifications. Once the SEC finalizes its proposed regulation and the Financial Industry Regulatory Authority (“FINRA”) provides some insight into its plans for any rule changes to harmonize with the SEC’s final rules, the NAIC will be better positioned to determine how this safe harbor should be formulated going forward.

We also want to express our appreciation for the open and inclusive approach the NAIC has taken to this effort. All stakeholders have had and continue to have an opportunity to participate in the process. With this in mind, we respectfully urge individual insurance regulators to take part in the NAIC’s efforts to enhance the Suitability Model rather than crafting their own enhanced standard of conduct laws or rules. Similarly, regulators should be reminded not to use the Exposure Draft or any other interim working drafts as the basis for their own legislative or regulatory proposals; rather, regulators should wait for the NAIC to officially adopt final revisions to the Suitability Model before considering whether to implement those revisions in their states.

The NAIC’s Annuity Suitability (A) Working Group spent a considerable amount of time over the past 12-15 months working through the wide variety of issues implicated in the effort to enhance the standard of conduct applicable to insurance producers and insurers when they recommend annuity products to their clients. The Industry Groups shared our views on those issues with the Working Group and, in some cases, the Exposure Draft reflects our comments. We continue to have the following concerns, however:

1. The exemption for retirement plans should not be limited to “annuities that are not individually solicited.”
2. The Suitability Model should not be expanded to apply to in-force transactions by defining “consumer” to include existing annuity owners.
3. The NAIC should take appropriate steps to avoid misinterpretation or misapplication of the enhanced standard of conduct contemplated by the Exposure Draft.
4. The Exposure Draft should take a more streamlined approach to compensation disclosure.
5. The Suitability Model should apply only to producers who directly recommend annuities to their clients and should not be extended to cover others who participate in making recommendations.

These concerns are explained more fully below, along with our recommendations to address them.

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1. The Exemption for Retirement Plans Should Not Be Limited to “Annuities That Are Not Individually Solicited.”

The Suitability Model has, since its initial adoption in 2003, included an exemption for annuity contracts used to fund various types of retirement plans, such as 401(k) and 403(b) plans. Similar exemptions are found in countless other insurance laws and regulations. These exemptions are intended, in large part, to recognize that federal law expressly preempts the states from regulating retirement plans covered by the Employee Retirement Income Security Act of 1974 (“ERISA”). The policy basis behind these exemptions is that retirement plan sponsors, in most cases, have a federal (ERISA) or state fiduciary or similar obligation to plan participants. As just one example, most public employer plans reflect significant employer involvement in selecting and monitoring available plan investments and are subject to open procurement processes and extensively involve input from plan consultants and advisors. Moreover, in the retirement space today, plan sponsors also retain services from registered investment advisers and/or broker-dealers to provide in-plan investment advice to plan participants. In providing these services, investment advisers and broker-dealers (who in many cases are also affiliated with insurers) are also subject to fiduciary obligations under federal securities rules, in many cases, as well as under ERISA, where applicable.

The existing Suitability Model recognizes the unique role of plan sponsors by providing a broad exemption for contracts used to fund most retirement plans.¹ However, the Exposure Draft would significantly limit eligibility for this exemption to “annuities that are not individually solicited.” The fact that an annuity is individually solicited under an employer plan does not in any way undermine the protections described above. Making this change would effectively add an unnecessary and duplicative additional layer of regulation to the retirement plan space, and would be contrary to the NAIC’s stated goal of consistency between federal and state regulation. For example, if an ERISA plan sponsor retains its retirement plan provider to provide investment advice to plan participants, and the participant can invest in group annuity contract investments, the retirement plan provider associate would already be subject to ERISA fiduciary responsibilities as well as the applicable standards of conduct established by SEC and FINRA. Bringing insurance suitability regulation into the retirement plan market would disrupt the previously harmonized balance between state insurance regulation and retirement plans and would cause significant confusion for plan sponsors, service providers, and most dramatically, participants.

We understand that certain members of the Working Group believe the exemption, in its current form, impairs their ability to pursue cases against alleged bad actors in certain cases. This is certainly not our intended outcome, and we would be happy to further discuss those concerns and explore solutions to ensure that our regulators can take the steps necessary to protect consumers. However, the approach

¹ The Suitability Model does, however, include an important exclusion from this exemption for non-profit 403(b) plans that are not “established or maintained by the employer.” We agree that the Suitability Model should apply to such plans to protect their participants.

taken in the Exposure Draft would have the unintended and untenable consequence of extending state insurance regulation into the retirement plan space. The result – requiring firms offering individually solicited annuities to build a new process that would likely be both costly and redundant of existing protections, would ultimately impact retirement savers themselves through potentially higher costs and reduced availability of such contracts. Accordingly, we strongly urge the NAIC to return to the original scope of the exemption, and work with the industry to develop alternative ways to address any remaining concerns.

Industry Groups’ Recommendation: The NAIC should revert back to the formulation of this exemption in the current version of the Suitability Model.

2. The Suitability Model Should Not Be Expanded to Apply to In-Force Transactions by Defining “Consumer” to Include Existing Annuity Owners.

The Exposure Draft would add a definition of “consumer” to the Suitability Model. This definition is unnecessary and, as currently formulated, would create significant challenges for the industry and for regulators.

In our view, a regulation should only define a commonly used term if it is necessary to ascribe a specialized meaning to that term as used in the regulation. This is not the case with the term “consumer,” which has a generally understood meaning and is not used in some special way in the regulation.

By providing a definition, however, the Exposure Draft necessarily requires us to carefully consider the implications of that definition in the context of the regulation. In this case, the definition of “consumer” as “the owner or prospective owner of an annuity contract” would effectively extend the requirements of the Suitability Model to recommendations related to in-force annuity contracts. As several of the Industry Groups explained in oral testimony to the Working Group last year, we do not believe such an expansion of the Suitability Model is necessary given the lack of evidence of any consumer harm resulting from recommendations made with respect to in-force annuities.

If the NAIC believes such consumer harm is occurring and cannot be adequately addressed under existing laws and rules, it should undertake a more comprehensive study of the issue and carefully consider whether and how to modify the Suitability Model to better protect consumers. The Industry Groups would welcome the opportunity to participate in such an effort if the NAIC deems it necessary. However, we strongly oppose the expansion of the Suitability Model to cover in-force recommendations by simply defining consumer to include owners of annuity contracts in addition to prospective owners. This change would create significant confusion and uncertainty, as it fails to provide any clarity as to how the industry should implement it. For example, insurance companies’ current systems cannot determine whether an in-force transaction requested by an annuity owner was recommended by a producer. We do not believe it is feasible to expect insurers to investigate every

customer initiated in-force transaction to determine if a recommendation was made. Additionally, most annuity contracts would not permit the insurer to reject or delay a requested transaction while it attempts to determine whether the transaction was recommended.

Industry Groups' Recommendation: The NAIC should either remove the definition of "consumer" from the exposure draft entirely or, alternatively, remove the term "owner" from the definition.

3. The NAIC Should Take Appropriate Steps to Avoid Misinterpretation or Misapplication of the Enhanced Standard of Conduct Contemplated by the Exposure Draft.

This letter does not address the formulation of the standard of conduct in the Exposure Draft. Instead, several of the Industry Groups will offer their thoughts on how the standard should be crafted in their own separate comment letters. We would, however, like to encourage the NAIC to clarify that the revisions to the Suitability Model do not establish a fiduciary standard. We do not believe the Working Group intended to establish a fiduciary standard for producers, or insurers where no producers are involved, under which a producer or insurer would have any ongoing obligation to a client after a recommended transaction is consummated. Moreover, we believe the Working Group understood that, in practice, no particular annuity product is always the "best product" or the "cheapest product" for all consumers.

Industry Groups' Recommendation: The NAIC should expressly state that the applicable standard of conduct:

(a) Does not treat producers (or insurers, where no producers are involved) as fiduciaries;

(b) Does not impose ongoing duties on producers (or insurers, where no producers are involved); or

(c) Does not require producers (or insurers, where no producers are involved) to identify and recommend only the "best" or "cheapest" products.

4. The Exposure Draft Should Take a More Streamlined Approach to Compensation Disclosure.

The Industry Groups are generally supportive of the new requirements contemplated by Section 6.C of the Exposure Draft that producers provide their clients with information about (a) the scope and terms of the relationship between the client and producer, (b) limitations on the products the producer can sell, (c) non-cash compensation to be received by the producer, and (d) material conflicts of interest. We are concerned, however, that many consumers will be overwhelmed and/or confused by the extensive, detailed information producers would have to give them about the cash compensation they will receive.

While financial regulation is premised on the belief that "sunlight is the best disinfectant" and that mandatory disclosures are necessary to inform decisionmakers, research has demonstrated that

consumers are too often blinded by the light. Psychological research has shown that when consumers are faced with the difficult task of sorting through detailed information, their cognitive performance tends to decline making them unable to utilize the disclosed information properly. In short, more information is not always better, particularly when that information is peripheral to the decision at hand.

The SEC has recognized the problems associated with information overload and has taken steps to mitigate its consequences by adopting a layered disclosure framework, as embodied in proposed Regulation Best Interest and proposed Form CRS. The layered disclosure framework has been endorsed over the years by SEC Commissioners on both sides of the political aisle, including former Chairman Mary Jo White, who recognized that the “ever-increasing amounts of disclosure make it difficult for an investor...to ferret out the information that is most relevant.”² Instead of burying consumers in an avalanche of information, layered disclosure recognizes that some information is inherently material to consumer decisions (e.g., the type of compensation a producer will receive), while other information is not inherently material but should be available on demand (e.g., the frequency of trail commission payments).

To be fair, we recognize the difficulty inherent in crafting disclosure requirements that strike the right balance between too much information and not enough information. In this case, however, we believe the Exposure Draft errs too far on the side of too much information. For the vast majority of consumers, it would be sufficient to explain how the producer would be compensated and how the amount of compensation is determined, rather than how much compensation is paid. Put another way, consumers should understand (a) that compensation will be paid, (b) whether and on what basis the amount of compensation on a particular product might rise or fall, (c) how the amount of compensation may vary among different products, (d) what benefits, services, and value the producer will provide, and (e) how to get more information, if so desired.

The Exposure Draft, however, seems to be premised on the notion that all consumers would want more information, and therefore requires that all consumers be provided with a reasonable estimate of the amount of compensation the producer will receive, whether compensation will be paid once or on multiple occasions, and if paid over time, the frequency and amount of those payments. In our view, this information is not generally relevant to a consumer’s decision about whether to work with a particular producer or whether to purchase an annuity product from that producer, and therefore, we do not believe this information should automatically be provided to every consumer. We acknowledge, however, that some consumers may want this additional level of detail, and therefore, we would not oppose a requirement to provide this information upon request.

² Speech by SEC Chairman Mary Jo White, *The Path Forward on Disclosure* (October 15, 2013), available at https://www.sec.gov/news/speech/spch101513mjw#_ftnref7.

We have two additional comments regarding the treatment of compensation under the Exposure Draft. First, we are concerned that the terms “cash compensation” and “non-cash compensation,” as currently defined in the Exposure Draft, could be interpreted as including common employee benefits such as health insurance and access to a retirement savings plan. We do not believe this was the Working Group’s intent, and we therefore ask that these types of employee benefits be expressly excluded from the definitions.

Second, we do not believe the Working Group intended to favor any particular compensation arrangement over another. The current Suitability Model allows for a flourishing competitive marketplace in which producers and insurers employ different compensation models to meet customer demands. In seeking to provide greater protections for consumers, the NAIC should take care not to disrupt the diverse business models that provide Americans access to critical retirement savings products. To achieve this goal, the Exposure Draft should expressly state that it does not favor one compensation model over another.

Industry Groups’ Recommendation: The NAIC should:

- (a) require disclosure of the information described in Section 6.C(3)(b) only upon request by the consumer;***
- (b) revise the definitions of “cash compensation” and “non-cash compensation” to expressly exclude employee benefits such as health insurance and access to a retirement savings plan; and***
- (c) expressly clarify that neither the form or type of compensation or compensation arrangement nor the particular type of annuity distribution model (e.g., proprietary or third-party distribution) would be dispositive in assessing whether a producer has satisfied the requirements of the Suitability Model.***

5. The Suitability Model Should Apply Only to Producers Who Directly Recommend Annuities to Their Clients and Should Not Be Extended to Cover Others Who Participate in Making Recommendations.

The Exposure Draft includes a note to the Working Group regarding a suggestion by New York to apply the requirements of the Suitability Model to every producer who has materially participated in the making of a recommendation and received compensation because of the transaction. The Industry Groups are unclear as to the issue New York is attempting to address with this proposal. We believe this language is unnecessary and would cause undue confusion.

Industry Groups’ Recommendation: The NAIC should omit New York’s proposed language from the Suitability Model.

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Thank you again for the opportunity to provide these comments. If you have questions about anything in this letter, or if we can be of any further assistance in connection with this important regulatory effort, please feel free to contact any of the undersigned individuals.

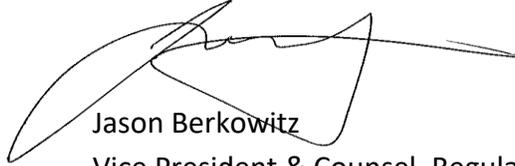
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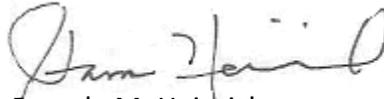
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