

SUBMITTED ELECTRONICALLY: jmatthews@naic.org

February 15, 2019

NAIC Life Insurance and Annuities (A) Committee
c/o Jolie H. Matthews, Senior Health and Life Policy Counsel
National Association of Insurance Commissioners (NAIC)
Executive Office
Hall of the States Building, Suite 700
444 North Capitol Street, NW
Washington, D.C. 20001-1512

RE: Response to Request for Comment: Revised NAIC Model #275
Suitability in Annuity Transactions Model Regulation

Dear NAIC Life Insurance and Annuities (A) Committee Members:

NAFA, the National Association for Fixed Annuities,¹ is pleased to submit this letter in response to your request for comments regarding the revised NAIC Suitability in Annuity Transactions Model Regulation #275 (the “Suitability Model Regulation”), dated November 19, 2018 (the “Exposure Draft”).²

¹ NAFA, the National Association for Fixed Annuities, is the premier trade association exclusively dedicated to fixed annuities. Our mission is to promote the awareness and understanding of fixed annuities. We educate annuity salespeople, regulators, legislators, journalists, and industry personnel about the value of fixed annuities and their benefits to consumers. NAFA’s membership represents every aspect of the fixed annuity marketplace covering 85% of fixed annuities sold by independent agents, advisors and brokers. NAFA was founded in 1998. For more information, visit www.nafa.com.

² <https://mail.google.com/mail/ca/u/0/#>

NAFA appreciates the hard work of the NAIC Suitability Working Group (the “Working Group”) in reviewing and revising the Suitability Model Regulation, and we are especially pleased to have had the opportunity to engage with the members of the Working Group, along with other insurance trade associations and organizations, throughout this process. We understand that the Exposure Draft is still a work in progress, particularly in light of the NAIC’s expressed desire to coordinate with other regulatory bodies before finalizing any changes to the Suitability Model Regulation, and we look forward to continuing our conversations with our trade group partners, as well as the members of the NAIC Life Insurance and Annuities (A) Committee (“the Committee”).

As a general preliminary observation, NAFA is pleased that the Exposure Draft remains a model regulation focused on suitability in annuity transactions. This is particularly true in light of the initial draft revisions to the Suitability Model Regulation the Working Group released in December 2017, which included a new best interest standard of care – and, in fact, proposed renaming the Suitability Model Regulation to reflect that new standard. In the intervening months, however, as the Working Group continued to discuss how best to revise the current suitability model, the regulatory landscape changed dramatically, when, first, the U.S. Court of Appeals for the Fifth Circuit vacated the Department of Labor’s fiduciary rule in March 2018 and then, in May 2018, the Security and Exchange Commission (“SEC”) published its proposed Regulation Best Interest.³

NAFA agrees with the first Drafting Note to Section 1 of the Exposure Draft: the definition of “best interest” included in the SEC’s proposed Regulation Best Interest is circular, by defining best interest to include the term itself, without further definition. We also agree that, without greater clarity, it is impossible to discern whether the SEC’s proposed “best interest” is legally distinct from the suitability standard of conduct articulated in the Exposure Draft. Given the paradigm shift that occurred with the vacatur of the fiduciary rule and the lack of certainty regarding the SEC’s proposed best interest standard, NAFA supports the NAIC’s decision to refrain from using the phrase “best interest” in the current proposed modifications to the Suitability Model.⁴

³ <https://www.sec.gov/rules/proposed/2018/34-83062.pdf>

⁴ See Model #275 11-19-18 Exposure Draft, Section 1, Drafting Note.

Moreover, as we have argued in our previous two comment letters,⁵ the suitability regime provides meaningful consumer protection, an argument supported by data from the NAIC’s own reporting.⁶ Nevertheless, we recognize that the current Suitability Model Regulation can be enhanced – through greater disclosure requirements, as well as requiring communications regarding the rationale for making a particular annuity recommendation – to provide greater transparency in the sales process and to ensure that a consumer is equipped with all the necessary information when making a decision to purchase an annuity. NAFA supports such enhancements.

We also note that NAFA has signed onto the letter submitted on behalf of a number of insurance trade organizations (the “Industry Groups”). That letter reflects a broad consensus across several key topics and issues raised by the Exposure Draft. Rather than reiterating all of the comments and suggestions included in that letter, we herein adopt by reference the Industry Groups letter.

With these preliminary observations in mind, NAFA offers the following comments regarding the Exposure Draft.

1. A revised Suitability Model Regulation must be clear that insurance producers are not required to procure investment adviser or other securities licenses in order to comply with the regulation.

NAFA’s membership represents a unique aspect of the retirement and financial services industry: our member insurance companies and insurance and financial marketing organizations work with a vast network of independent insurance agents, a majority of whom are insurance-licensed only or whose businesses are primarily insurance focused. NAFA is proud to represent the independent distribution market for fixed insurance products, as we believe it serves consumers looking for personalized advice regarding protected retirement income. We have expressed concern from the beginning of the Working Group’s discussions regarding a revised Suitability Model – and during the lengthy deliberations over the U.S. Department of Labor’s fiduciary rule, as well – that any

⁵ https://nafa.com/wp/wp-content/uploads/2018/01/2018_0122_NAFA-Comment-Proposed-Revisions-to-the-NAIC-Suitability-in-Annuity-Transactions-Model-Regulation-275.pdf; https://nafa.com/wp-content/uploads/2018_0427_NAFA-Comment-Revising-NAIC-Suitability-in-Annuity-Transactions-MDL-275-1.pdf

⁶ https://eapps.naic.org/documents/cis_aggregate_complaints_by_coverage.

new or amended regulatory regime not inadvertently require producers who are insurance-licensed only to obtain additional securities licenses in order to comply with a new regulation.

NAFA has long supported Iowa Insurance Bulletin 11-4,⁷ issued after Iowa adopted the 2010 revisions to the Suitability Model Regulation, which set forth the permitted and prohibited activities for both insurance-only and securities-only persons; for insurance-only producers, the Bulletin provided critical guardrails to ensure that they could satisfy suitability responsibilities while acting within the scope of their insurance licenses, without crossing over into the realm of providing securities advice. Unfortunately, Tennessee was the only other state to adopt the Iowa Bulletin. Nevertheless, the rationale for issuing the Iowa Bulletin helps illustrate NAFA's concern for insurance-only professionals under a new Suitability Model Regulation: to the extent that the new standard is ambiguous or confusing, insurance producers will be detrimentally impacted.

To be sure, we don't believe forcing insurance-only professionals – even if inadvertently – to become licensed under securities laws or to abandon or change their business model is the intent of the NAIC under a revised Suitability Model Regulation, but we suggest that it would benefit the Exposure Draft to have greater clarity in this regard. It is critical that a revised Suitability Model Regulation make clear in its text or through a drafting note that insurance-only producers may satisfy the requirements of the regulation within the scope of their existing insurance licenses. Accordingly, **NAFA proposes adding a new subsection under Section 6.D.:**

- (4) The requirements under this section do not require producers to consider or recommend products outside the scope of their license or outside the scope of products they are authorized and licensed to sell.**

2. A revised Suitability Model Regulation must be clear that producers and insurers will not be considered fiduciaries under the regulation.

Here again, NAFA seeks clarity in the Exposure Draft to ensure that a revised standard of conduct does not imply or create a presumption that we do not believe the NAIC Working Group intended to imply or create: in this instance, that a producer – or insurer, where no producer is involved –

⁷ <https://iid.iowa.gov/documents/commissioners-bulletin/licensing-requirements-and-permitted-activities-insurance>

should be considered or treated as a fiduciary under a new Suitability Model Regulation.⁸ As we have suggested above, and in order to obviate any confusion or ambiguity on the matter, NAFA believes the best way to address this is to include clarifying language directly in the text of the regulation. And, because it logically falls under the general purpose of the regulation – where the Exposure Draft sets forth both what the regulation *is and is not* – **NAFA proposes a new, third subsection under Section 1.**

- C. Nothing herein shall be construed to create or imply a fiduciary obligation for a producer or insurer, nor impose a duty of loyalty on any producer or insurer under this regulation. Nor shall this regulation create or impose on a producer or insurer a continuing obligation to the consumer after a recommended annuity is purchased.**

The other area in the Exposure Draft where we believe the language creates ambiguity or confusion as it relates to potentially treating producers and insurers as fiduciaries is in Section 6.A.(2)(a), where it states that a producer or insurer complies with the requirements of subsection (1) by “[a]cting with reasonable, diligence, care, skill, and prudence.” The formulation of the phrase “reasonable diligence, care, skill, and prudence” sounds very much like the fiduciary language under the “Fiduciary Duties” section of the Employee Retirement Income Security Act (“ERISA”)⁹ – invoking these four words together creates almost a fiduciary catechism. NAFA is most concerned that administrative agencies and courts may interpret a revised Suitability Model Regulation that contains these four words in combination as creating a fiduciary obligation or duty for producers making annuity recommendations.

That being said, it is difficult to argue that producers shouldn’t act with reasonable diligence, care, or skill when making a recommendation to a prospective client to purchase an annuity. But, the term “prudence” is a legally-loaded one; indeed, the ERISA section referenced above is called “The prudent man standard of care.” **NAFA urges the removal of the word “prudence” from subsection 6.A.(2)(a)** of the Exposure Draft and believes that so doing satisfies the Working

⁸ We note that this point is also made in the Industry Groups letter, and we are in agreement with its inclusion in that letter; however, NAFA believes this is a critical issue and wishes to amplify our interest and concern by addressing it in our comment letter.

⁹ 29 U.S. Code § 1104(a)(1)(B), available at <https://www.govinfo.gov/content/pkg/USCODE-2011-title29/pdf/USCODE-2011-title29-chap18-subchapl-subtitleB-part4-sec1104.pdf>.

Group's desire to enhance the standard of conduct without creating a legal tripwire for producers who will only know *after the fact* when subject to administrative or legal action that they did not meet this amorphous and undefined new requirement of prudence.¹⁰

***3. Requirements pertaining to insurer supervision under a revised Suitability Model
Regulation must be limited to apply only to recommendations of an insurer's own products,
not to recommendations or compensation related to other insurers' products.***

As mentioned previously, the independent agent distribution model is important – not only to NAFA membership but also to sustaining a vibrant retirement savings marketplace where consumers have access to knowledgeable insurance professionals and annuity products that provide guaranteed, secure retirement income. NAFA believes the NAIC understands the importance of this business model, one that is unique within the financial services industry to annuity transactions. Independent insurance agents typically represent multiple insurance companies – an arrangement that is ultimately good for consumers as it provides a producer with a broader range of annuity products to consider recommending in order to best meet a particular consumer's financial needs and objectives. This arrangement does, however, present challenges for insurers in meeting supervisory compliance requirements under the Exposure Draft. It is only reasonable that an insurer be expected to supervise the annuity recommendations of its own products and the compensation paid to producers for the sale of its own products.

The Exposure Draft requires new consumer disclosures – something that NAFA generally supports as we believe this will lead to greater transparency in the sales process and ultimately better decision making by consumers – and includes a new requirement that insurers maintain “reasonable procedures” to assess whether a producer has made the requisite disclosures to a consumer. Although this sounds reasonable on its face, it is problematic for producers: because insurance companies do not control the activities of independent producers who sell products offered by multiple insurance companies, it is simply impossible for an insurer to warrant that a

¹⁰ Certain members of NAFA are also quite concerned about the requirement stating a producer “shall act in the interests of the consumer ... without placing the producer's or the insurer's financial interests ahead of the consumer's interests.” Sec. 6.A.(1). The concern is that, without additional clarification, these seemingly innocent but rather open-ended standards could be construed as creating strict liability or fiduciary duty.

producer has provided to the consumer all of the proper disclosure information, especially as some of the information may attend to pre-recommendation or pre-purchase disclosures.

For example, consider a producer who, after gathering all the consumer profile information and assessing the consumer's financial needs and objectives, recommends two different annuity products, each one offered by a different insurer with different benefits and features, but both consistent with the consumer's insurance needs and financial objectives in furtherance of the consumer's financial interest. In such a circumstance, a fair understanding of the Exposure Draft would require the producer to disclose to the consumer information related to both products, including information related to cash and non-cash compensation, limitations on the range of products the producer is authorized to sell, material conflicts of interest related to the recommended annuities, etc. An insurer has no way of knowing the precise features of another insurer's product offerings or how a producer might be compensated for the sale of those products. It is unreasonable to require an insurer to essentially warrant that the producer has provided to the consumer the required information related to another insurer's annuity; an insurer cannot know what it does not – and cannot – know.

NAFA recommends that the Exposure Draft be amended to include language that would, for the purpose of complying with the regulation, circumscribe any such supervisory process to apply only to the supervision or oversight of an insurer's own products and the compensation paid to producers selling its own products and **suggests the following drafting note under Section 6.H.(1)(f):**

Drafting note: This provision is not intended to require an insurer to warrant that a producer has disclosed the information required to be delivered to the consumer under this regulation and is not intended to require supervision of producer recommendations of products offered by other insurers, nor of compensation a producer may receive from sources other than the insurer.

To make this clarification consistent throughout the Exposure Draft, the record keeping requirements under Section 9.A. should be modified to reflect that retention of records related to disclosure should apply only to disclosures made by the regulated entity, whether it is an insurer, general agent, independent agency, or producer.

Accordingly, NAFA recommends that the language in **Section 9.A.** be amended to state:

- A. Insurers, general agents, independent agencies and producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer, disclosures made by such persons or entities to the consumer and other information used in making the recommendations that were the basis for insurance transactions ...**
- 4. *Final revisions to the Suitability Model Regulation must be deferred until other regulatory bodies have finalized their work to ensure that the NAIC’s goal of “harmonization” does not disadvantage independent distribution in the annuity market.***

One of the Committee’s two charges to the Working Group was to consider how to promote greater uniformity across NAIC member jurisdictions. To that end, the Working Group has consistently promoted coordination with the SEC to work toward a harmonized standard of conduct applicable to financial service professionals. However laudable this goal, coordinating the efforts of the NAIC to revise the Suitability Model Regulation with the SEC’s work on its regulation is difficult: ten months after the SEC proposed its Regulations Best Interest, it remains unclear what the final package of regulations will look like. Just this week, former SEC economists issued a public comment harshly critical of the proposed rule’s “weak and incomplete” economic analysis related to the client-adviser relationship,¹¹ creating even greater uncertainty about what the final contours of Regulation Best Interest might look like.

Yet even if we had greater clarity regarding the SEC proposal, harmonization should be approached with caution. Regulatory harmony between the standard of conduct required of insurance professionals in annuity transactions and the standards required of investment advisors and broker-dealers for securities sales comes with an important caveat: harmony is not the same as uniformity for all insurance and financial professionals.¹² There is a significant difference between state regulation of insurance annuity products and the regulation at both the state and federal level over securities products, just as there is a significant difference between the availability for dispute resolution through arbitration for security transactions – something

¹¹ <https://www.investmentnews.com/article/20190211/FREE/190219999/sec-advice-rule-proposal-assailed-by-former-agency-economists>.

¹² <https://nafa.com/wp-content/uploads/Iowa-Annuity-Regulation-Discussion-Draft-4-04-18.pdf>.

unavailable for disputed insurance annuity transactions. Revisions to the Suitability Model must ensure that it remain an insurance-focused regulation.

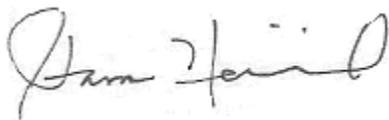
Accordingly, NAFA agrees with the Working Group that it is premature for the NAIC to finalize changes to the Suitability Model Regulation until it determines how the SEC will change the standards of conduct applicable to securities investment advisers, broker-dealers, and registered representatives.

Conclusion

NAFA commends the efforts of the NAIC to engage with the various industry and consumer group stakeholders over the past year-plus long process, and we look forward to working with members of the Life Insurance and Annuity (A) Committee as you continue to consider revisions to this model regulation. We, of course, hope to reserve our opportunity to provide additional comments.

On behalf of NAFA's members, again thank you for opportunity to submit these comments. Please do not hesitate to contact me if you would require any additional information.

Sincerely,



Pamela M. Heinrich
NAFA General Counsel

