



June 11, 2019

Submitted Electronically to jmatthews@naic.org

The Honorable Jillian Froment
Director, Ohio Department of Insurance
Chair, NAIC Annuity Suitability (A) Working Group

Subject: Request for Comments re Best Interest Standard of Conduct in Annuity Transactions

Dear Director Froment:

The following is submitted on behalf of the undersigned trade groups in response to your request for comment on how “best interest” should be defined to provide an objective standard for oversight if the Suitability in Annuity Transactions Model Regulation (Model Regulation) is modified to require “best interest” as the appropriate standard of conduct. The undersigned remain committed to a harmonized best interest standard of care across all regulatory platforms. We appreciate the NAIC’s ongoing efforts to achieve such harmonization.

The undersigned and our members are still digesting the final Regulation Best Interest (Reg BI), published by the Securities and Exchange Commission (SEC) last week. Further review may lead us to develop and offer additional comments. That said, the comments below reflect our initial review of Reg BI, and use the Iowa Insurance Division’s proposed modifications to the current draft of proposed revisions to the Model Regulation (the Iowa Draft), submitted to the Annuity Suitability Working Group (Working Group) on 5/30/19, as the basis for our response as to how “best interest” should be defined for the purposes described above.

As a threshold matter, the undersigned support a transactional best interest standard of conduct for annuities, that would provide a clear objective standard for compliance and regulatory oversight of the best interest obligations under the Model Regulation. Accordingly, we support the proposed new framework for Section 6, reflected in the Iowa Draft and in alignment with Reg BI, that would define how to “act in the best interest of the consumer” by providing four “buckets” of obligations (the care, disclosure, conflict of interest, and documentation obligations) that must be satisfied to meet the Best Interest Obligations.

We submit the following more specific comments and questions regarding key issues relating to the definition of “best interest,” as proposed in the Iowa Draft:

Best Interest Obligations (Section 6.A.)

To avoid ambiguity regarding when a producer or insurer complies with the Best Interest Obligations, the sentence providing that a producer or insurer “is *deemed to comply* with this section by satisfying the following obligations ...” (*Italics added.*) should be clarified to provide that a

producer or insurer “...*complies* with this section ...” by satisfying the care, disclosure, conflict of interest and documentation obligations.

Care Obligation (Section 6.A.(1))

“Best Suited”

A fundamental requirement of the Care Obligation is in Section 6.A.(1) that provides “the recommended option “ ... would be *best suited* over the life of the product as evaluated in light of the consumer profile information and under the present circumstances known at the time of the recommendation.” (*Italics added*) However, it is unclear what “best suited” means.

Further, different standards for recommended annuities are used in different provisions of Section 6.A.(1). Section 6.A.(1) and Section 6.A.(1)(d) use the “best suited” standard. However, Section 6.A.(1)(e) refers to “whether an annuity addresses the consumer’s insurance needs and financial objectives,” Section 6.A.(1)(g) refers to whether an annuity as a whole “would address the consumer’s needs and financial objectives,” and Section 6.A.(1)(k)(ii) refers to a replacing product that “would substantially benefit the consumer.”

If the “best suited” standard is retained, we urge clarification of its meaning. We also urge use of a consistent standard for recommended annuities throughout Section 6.A.(1).

The undersigned support a standard for recommended annuities that would require furtherance of the consumer’s insurance needs and financial objectives, based upon the facts disclosed by the consumer or known at the time of the recommendation by the producer or insurer (in line with the definition of “Suitable,” in Section 5.O., proposed to be deleted in the Iowa Draft.)

Accordingly, we urge inclusion of a definition of “Best suited” in the Model Regulation. We suggest that the term “Suitable” be retitled as “Best suited,” defined using the current definition of “Suitable,” modified to require a recommendation of an annuity *to further,* rather than “be consistent with,” the consumer’s insurance needs and financial objectives.

“Prudence”

Another important issue relating to the Care Obligation, as proposed in the Iowa Draft, is the use of the term “prudence” in the requirements for the producer or insurer to exercise “reasonable diligence, care, skill and prudence” in Section 6.A.(1) and to act “with ordinary prudence” in Section 6.A.(1)(h). In the final Reg BI, the SEC revised its proposed Care Obligation to remove the term “prudence.” The SEC concluded that the inclusion of this term would create legal uncertainty and confusion and would be redundant of the requirement to exercise “diligence, care, and skill.”

To avoid legal uncertainty and redundancy and to align the Model Regulation more closely with Reg BI, the undersigned urge modification to the Care Obligation, as proposed in Section 6.A.(1) of the Iowa Draft, to remove any requirement to exercise or act with “prudence.”

Disclosure Obligation (Section 6.A.(2))

For clarification purposes and to make the Model Regulation more closely align with Reg BI, the undersigned suggest that: (i) the disclosure requirements relating to cash compensation would be more appropriately included under the Disclosure Obligation rather than under the Conflicts of Interest Obligation, as currently proposed in Section 6.C.(3) of the Iowa Draft; and (ii) an express disclosure requirement relating to conflicts of interest be included under the Disclosure Obligation, in contrast with the proposed deletion of such a requirement in Section 6.C.(3)(iii) of the Iowa draft.

Cash Compensation

Including the required disclosures relating to cash compensation under the Disclosure Obligation, rather than the Conflict of Interest Obligation, not only may be more appropriate for the reasons stated above, it also would eliminate any suggestion that routine receipt of cash compensation constitutes a conflict of interest. To achieve this, the language of Section 6.A.(3)(b) of the Iowa Draft may simply be deleted and reinserted into Section 6.A.(2).

Regardless of the location of the cash compensation disclosure requirements, it is important that the current language of the last sentence of Section 6.A.(3)(b)(i) of the Iowa Draft be modified to: (i) delete the phrase “To satisfy the requirement of this paragraph,”; and (ii) add the phrase “upon request of the consumer” so that this provision reads: “Upon request of the consumer, the producer shall disclose:”

The undersigned support the requirement in Section 6.A.(3)(b)(i) for disclosure of a “description of the sources and types of cash compensation to be received by the producer...” However, as indicated in previous comments, the requirement for the producer to disclose “a reasonable estimate of the amount of cash compensation ...” gives rise to significant concern. Such information will not necessarily increase transparency or a consumer’s understanding of a recommendation regarding the purchase, exchange, or replacement of an annuity, and actually may serve to unnecessarily confuse the consumer, particularly if the consumer has not asked for the information.

Conflicts of Interest

For clarification purposes and to make the Model Regulation more closely align with Reg BI, the undersigned suggest modification to Section 6.A.(2) of the Iowa draft to:

- (i) Add an express disclosure requirement relating to conflicts of interest under the Disclosures Obligation; and
- (ii) Use language substantially similar to that of Reg BI to require disclosure of “[a]ll material facts relating to conflicts of interest that are associated with the recommendation.”

In addition, in Section 5.J., we suggest that the term “Material conflict of interest” and its definition be deleted, and the term “Conflict of interest,” defined as “an interest that might incline a producer, or insurer where no producer is involved – consciously or unconsciously – to make a recommendation that is not disinterested” be inserted in lieu thereof, in line with Reg BI.

Conflict of Interest Obligation (Section 6.A.(3))

The undersigned still are considering the proposed Conflict of Interest Obligation in the Model Regulation in light of Reg BI’s Conflict of Interest Obligation.

However, as discussed above, at this time, the undersigned do suggest including the disclosure requirements relating to cash compensation, with the modification to Section 6.A.(3)(b)(i), also discussed above, under the Disclosure Obligation, in Section 6.A.(2), rather than under the Conflict of Interest Obligation, as currently proposed in Section 6.A.(3)(b) of the Iowa Draft.

Supervision System (Section 6.C.)

In line with our comments relating to the Care Obligation, it is important that Section 6.C.(1), Section 6.C.(2)(d) and Section 6.C.(2)(e) of the Iowa Draft be modified as necessary so that the referenced standard for recommended annuities is consistent with that required under the Care Obligation in Section 6.A.(1).

The undersigned also urge modification to Section 6.C.(2)(e) of the Iowa Draft to substitute the proposed requirement for the insurer to have procedures to detect recommendations that are

not “in compliance with subsections A, B, D, and E,” which gives rise to concern for a number of reasons, with a requirement for procedures to detect recommendations that do not meet the standard required under the Care Obligation in Section 6.A.(1) (in line with the current requirement of the Model Regulation).

As in previous comments, the undersigned urge deletion of Section 6.C.(2)(f) in the Iowa Draft. It is appropriate for an insurer to be responsible for its compliance with the requirements of the Model Regulation and for compliance with requirements, including those relating to the provision or disclosure of information to the consumer, by producers in connection with recommendations of the insurer’s annuity products. However, it is not possible for an insurer to oversee and ensure compliance with the disclosure or other requirements of the Model Regulation by producers acting in connection with other insurers’ products.

Unfair Trade Practices (Section 6.D.)

The proposed header for Section 6.D. of the Iowa Draft “Unfair Trade Practices” is likely to give rise to confusion in light of the NAIC Model Unfair Trades Practices Act. The undersigned suggest consideration of an alternate header such as “Prohibited Practices/Conduct.”

Safe Harbor (Section 6.E)

The undersigned suggest that the first sentence of Section 6.E.(1) of the Iowa Draft be clarified to read as follows: “Sales made in compliance with SEC and FINRA rules pertaining to best interest, suitability and supervision of annuity transactions shall satisfy the requirements under this regulation.”

Importantly, the second sentence of Section 6.E.(1) of the Iowa Draft, that would condition the safe harbor for FINRA broker dealers on their compliance “with the business rules, controls and procedures at least as effective as those required under the Model Regulation,” is likely to create significant ambiguity as to when the safe harbor may be relied on. The undersigned urge: (i) deletion of this sentence; and (ii) reinsertion of the current language of the Model Regulation that reads: “This subsection applies to FINRA broker-dealers sale of annuities if the suitability and supervision is similar to those applied to variable annuity sales.”

Application to Every Producer (Section 6.F.)

Neither the rationale nor need for Section 6.F. (that would extend producer requirements in the Model Regulation to every producer who has materially participated in the making of a recommendation), suggested for possible inclusion in the Iowa Draft, is clear. The undersigned urge that this provision not be included in the Model Regulation.

The undersigned submit the following additional comments with respect to a few of the other sections of the Model Regulation as proposed to be modified by the Iowa Draft:

Purpose (Section 1)

To bolster the statement in Section 6.A.(1)(c), that the requirement under Section 6.A. does not create a fiduciary obligation and to avoid any question as to the overall intent of the Model Regulation, the undersigned urge modification to Section 1.B. of the Iowa Draft to expressly provide that nothing in the regulation shall be construed to create a fiduciary duty.

Definitions (Section 5)

In the definition of "Consumer profile information," in Section 5.C., the intended meanings of the phrases "debts and other obligations" and "willingness to accept non-guaranteed elements in the annuity" In paragraphs (3) and (11) are unclear. Clarification of the intended meanings of these phrases would be appreciated.

Training (Section 7)

The undersigned also would appreciate clarification from the Working Group regarding the intended impact on training requirements of the new requirements of the Model Regulation as proposed to be modified.

Compliance Mitigation; Penalties (Section 8)

As noted above in our comments relating to Section 6.C.(2)(f), while it is appropriate for an insurer to be responsible for its compliance with the Model Regulation and for compliance by producers in connection with recommendations of the insurer's annuity products, it is not possible for an insurer to oversee and ensure compliance with the requirements of the Model Regulation by producers acting in connection with other insurers' products.

The undersigned urge modification to Section 8.A. of the Iowa Draft to read as follows: "An insurer is responsible for compliance with the requirements of this regulation by the insurer and the producer in connection with the insurer's annuity products."

The undersigned appreciate the Working Group's consideration of our views and would be glad to answer any questions.

Sincerely,

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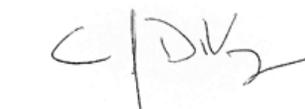
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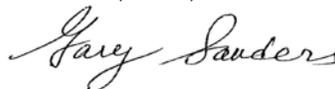
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