INDEXED ANNUITY
LEADERSHIP COUNCIL

January 22, 2018

The Honorable Dean L. Cameron
Idaho Department of Insurance
Chair, NAIC Annuity Suitability (A) Working Group

The Honorable Doug Ommen
Iowa Insurance Division
Vice Chair, NAIC Annuity Suitability (A) Working Group

Via Email to: jmatthews@naic.org

Re: Draft Proposed Revisions to Suitability in Annuity Transactions Model Regulation

Dear Director Cameron and Commissioner Ommen:

The Indexed Annuity Leadership Council ("IALC")[1] appreciates the opportunity to comment on the NAIC Annuity Suitability (A) Working Group ("Working Group") exposure draft revisions to the Suitability in Annuity Transactions Model Regulation (#275) ("Suitability Model"). We have had the opportunity to meet with certain members of the Working Group to provide our initial feedback on the Working Group's draft and look forward to continued constructive discussions in the future. We also appreciate and commend the Working Group's efforts to continue coordination with federal regulators regarding the standard of care owed to consumers, including ongoing discussions with the DOL and the SEC.

The IALC has carefully reviewed the Working Group's exposure draft revisions to the Suitability Model and we have three main discussion points that are set forth below. We welcome the opportunity to continue discussions around these three points as well as any other provisions the Working Group may wish to discuss.

DISCUSSION

1. The duty of an insurance carrier to establish a system of supervision surrounding a "best interest" standard of care must be limited in scope to the insurance carrier's own annuity products and not the universe of products a producer could have recommended.

Today, carriers have a robust system of supervision in place to inform and train producers on suitability requirements, provide and require specific product training as a precursor to any recommendation of a carrier's products, and review each transaction to ensure a reasonable basis

[1] The IALC is made up of Allianz Life Insurance Company of North America, American Equity Investment Life Insurance Company®, Athene USA, Midland National Life Insurance Company, National Life Group®, and North American Company for Life and Health. It was established in 2011 with a mission to educate the public (including regulators) about the benefits of FIAs, which offer principal protection and a predictable, guaranteed retirement income, and can contribute balance to retirement savers' long-term financial plans.

exists for suitability prior to issuance.

IALC supports incorporation of a "best interest" standard of care into the above principles. However, there are potential challenges and unintended consequences to adding in the phrase "and in the best interest of a consumer" after the word "suitable" throughout Section 6, particularly as it applies to carrier supervision in Section 6.H. Simply put, carriers are not in a position to review or assess whether a recommended product is truly in the "best interest" of a consumer without knowing the universe of products the producer *could have* recommended to the consumer. An *independent* producer is just that – independent – and may be authorized to sell any given number of other carriers' annuities and potentially other classes of retirement products. A carrier likely does not have full knowledge of a given producer's shelf of products and thus should only be required to scrutinize a product recommendation based on information it has available to it – namely, the carrier's own shelf of products and the suitability profile information provided.

We recommend adding new language which would specifically provide that a carrier is only responsible for its own product shelf in its "best interest" review of a transaction. This new language would fit cleanly within Section 6.H(3), which already provides that a carrier is "not required to include in its system of supervision an insurance producer's recommendations to consumers of products other than the annuities offered by the insurer." The new provision could read:

> "(3) An insurer is not required to *consider or have knowledge of other insurers' annuity products that an insurance producer could have recommended to a consumer nor* include in its system of supervision an insurance producer's recommendations to consumers of products other than the annuities offered by the insurer *that the insurance producer is authorized to recommend*" (new language italicized).

We believe this approach provides the most clarity around this important issue and would help eliminate potential compliance difficulties.

Relatedly, IALC also wanted to seek clarification from the Working Group on Section 6.E, which requires that "an insurer shall not issue an annuity recommended to a consumer unless there is a *reasonable basis to believe the annuity is suitable* based on the consumer's suitability information" (emphasis added). Note that this language does not include the additional "and in the best interest of a consumer" language that the Working Group added throughout the rest of Section 6. One potential rationalization for this decision is that the Working Group understood the carrier's dilemma outlined in preceding paragraphs and simply intended to require the carrier to review the individual *transaction* under today's suitability bar, while also implementing a revised system of supervision that incorporates the best interest standard of care at the producer level. Meanwhile, the carrier's supervision requirement as to determining whether the transaction should be issued is still limited to suitability – or, stated another way – limited to today's standard of review that would not implicate the unintended consequences outlined above surrounding a carrier's "best interest review." If this was indeed the Working Group's intent, we would request additional clarification providing as much. However, incorporating the specific language outlined above in Section 6.H(3) would provide the most clarity around this important issue and eliminate potential compliance difficulties.

2. The definitions of Cash Compensation, Reasonable Cash Compensation, Non-Cash Compensation and the disclosures of each should be revised to reflect a more uniform approach consistent with the DOL Fiduciary Rule in order to avoid conflicting standards.

<u>Cash Compensation Disclosure</u>

Under Section 6.C(2), a producer is required to disclose "the percentage or amount of cash

compensation above three (3) percent, whether by commission or fee, the insurance producer would receive as a result of a contract for services for advice or for the sale of a recommended annuity." IALC supports the Working Group's efforts to encourage transparency and require disclosure of producer compensation. In fact, most producers who recommend FIAs are already disclosing total cash compensation today in compliance with the transition period version of Prohibited Transaction Exemption (PTE) 84-24 under the Department of Labor (DOL) Fiduciary Rule. We recommend that the Working Group's draft follow PTE 84-24 and require full disclosure of producer compensation rather than disclosure of compensation only over a certain percentage. This will provide more information to the consumer about the producer's compensation rather than less, and will negate the potential assumption that any compensation over the 3% threshold would be "per se unreasonable." Moreover, it will result in additional uniformity.

Reasonable Cash Compensation

Similar to above, in the spirit of uniformity with the current regulatory environment, IALC recommends the definition of reasonable cash compensation be revised to mirror more closely the current approach under the DOL Fiduciary Rule. As revised, the Working Group's new definition of reasonable cash compensation is "cash compensation that reflects the time and complexity of the product and the transaction involved and is not connected to volume of production." The IALC urges the Working Group to revise this definition to reflect and consider a "market based standard" for the type of product recommended. The industry has already undertaken a significant review of compensation practices based on marketplace benchmarking in order to comply with the DOL Fiduciary Rule, and many changes have already been made as a result of these reviews. A new and different standard would result in additional confusion and questions around compliance under both regimes. In addition, the language tying reasonableness around value of production also conflicts with DOL Fiduciary Rule guidance, which has previously clarified that tiered compensation arrangements are permitted so long as they avoid incentivizing producers to give advice that may have a disproportionate impact on their overall compensation (e.g., tiers or steps should be infrequent and provide for modest increases).[2] A suggested revised definition of "reasonable cash compensation" follows for the Working Group's consideration:

> M. "Reasonable cash compensation" means cash compensation that is not excessive as measured by, inter alia, the market value of the annuity product transaction, the market pricing of services provided, the scope of any monitoring, and the complexity of the product. The reasonableness of compensation depends on the particular facts and circumstances at the time of the recommendation. No single factor is dispositive in determining whether compensation is reasonable.

We believe this approach captures the important elements the Working Group added around time and complexity while achieving uniformity with the current DOL Fiduciary Rule standard of reasonable compensation.

Non-Cash Compensation

As stated above, many producers complying with the DOL Fiduciary Rule's PTE 84-24 are already disclosing material conflicts of interest associated with a particular recommendation. The IALC supports disclosure, but has concerns around the Working Group's proposed language in Section 7's Non-Cash Compensation Disclosure Requirement. First, the language provides that the producer must disclose non-cash compensation "that is tied to the sale of annuities." IALC's concern is that this standard is much broader than disclosure of non-cash compensation that is "tied to the recommendation." For instance, would the current language result in the required disclosure of non-cash compensation offerings from Carrier X when Carrier Y's product was the

[2] See DOL Conflict of Interest FAQs (Part I – Exemptions), Q9, published October 27, 2016

ultimate recommendation (because it is still arguably "tied to the sale of annuities?") Due to this uncertainty around "tied to the sale of annuities," IALC would recommend limiting this disclosure only to the non-cash compensation applicable to the given recommendation. This disclosure scope would still capture the Working Group's apparent intention to require disclosure of any intermediary non-cash compensation that is carrier or product agnostic (e.g., marketing credit for the sale of any annuity product, not just limited to Carrier X).

In addition to the above, IALC has general concerns around the specificity required to comply with Section 7's disclosure of "information regarding the non-cash compensation…" While we read this language to require a generalized disclosure of the types of non-cash compensation that could be paid to the producer as a result of the transaction, the language that follows regarding the "$100 per producer per year" threshold raises the question of whether specific dollar figures must be included as part of the "disclosure of information." To require this amount of specificity may prove exceedingly difficult, if not impossible, for the producer to disclose with complete accuracy. In some cases, the producer may not know the value of such non-cash compensation – and if the producer estimates the value and is later proved incorrect, is the producer (or carrier) in noncompliance? In other cases, the potential credit or value arising from non-cash compensation may not be payable at all unless other conditions are satisfied. Further illustrating the need for a generalized disclosure is that carriers are likely to require proof of such disclosures as part of an enhanced system of supervision and to further compliance with Section 9's recordkeeping requirements. If the carrier takes receipt of the non-cash compensation disclosure, is the carrier required to review it for its veracity? As stated above, many FIA carriers work solely with independent distribution, which may be authorized to sell multiple carriers' products and also affiliate with one or more intermediaries. As such, the carrier cannot possibly know all of the producer's affiliations nor have full knowledge of all potential non-cash compensation arrangements he or she may have in place (other than the non-cash compensation arrangement the carrier itself may have with the producer). A generalized disclosure would help solve for this concern.

3. The scope of the Suitability and Best Interest Standard of Conduct in Annuity Transactions Model Regulation should be limited to the annuity recommendation, not pre-recommendation conduct unassociated with the recommendation or transaction.

In Section 2, the Working Group has revised the language to incorporate new terms of art that effectively expand the scope of the Suitability and Best Interest Standard of Conduct in *Annuity Transactions* Model Regulation. By adding in the terms "solicitation" and "negotiation" to the scope of the Suitability Model, the Working Group is inviting in pre-recommendation conduct to serve a role in the ultimate compliance with a transaction-based or recommendation-based rule. While the term "solicitation" is not defined in this Suitability Model, it is defined in the Producer Licensing Model Act (Model 218): "'Solicit'" means attempting to sell insurance or asking or urging a person to apply for a particular kind of insurance from a particular company." While this does not on its face include advertising or marketing (pre-recommendation conduct), there are multiple instances throughout Model 218 referencing inquiries by interested parties about what constitutes advertising versus solicitation. There are clearly open questions about where the line should be drawn between marketing/advertising and the ultimate "ask" or "urge." However, there is little room for argument about when a "recommendation" starts. As defined in the Suitability Model, a recommendation "results in a purchase, exchange or replacement of an annuity in accordance with that advice." We believe that the scope of the revised Suitability Model should be limited to such "recommendation," just as it was in the original Suitability Model.

Similarly, "negotiation" has a mirrored definition in Model 218 as well. It means "the act of conferring directly with or offering advice directly to a purchaser or prospective purchaser of a particular contract of insurance concerning any of the substantive benefits, terms or conditions of the contract, provided that the person engaged in that act either sells insurance or obtains

insurance from insurers for purchasers." The term "negotiation" makes sense in Model 218, as there obviously has to be a line drawn for conduct requiring an insurance producer license, and the act of negotiation should certainly require it. However, in the Suitability Model as we know it today, the act of negotiating does not always result in an ultimate recommendation that would trigger the scope. A parallel can be drawn to the DOL Fiduciary Rule, where "investment advice" on qualified money triggers a heightened fiduciary standard, but, and here's the kicker, *only* when it results in a "recommendation" (for a fee or other compensation). As a result, even the DOL Fiduciary Rule requires the ultimate "recommendation" to take place in order for the conduct standard to trigger, and we believe it should be the same for the Suitability in Annuity Transactions Model Regulation. To require otherwise would open the scope much more broadly and create confusion not only for producer conduct but also carrier systems of supervision. Put another way, carriers couldn't possibly know if producers complied with a best interest approach to negotiation because without the actual recommendation, the carrier's supervision may not activate (because no product has been selected).

In addition to the above "solicitation" and "negotiation" additions, the Working Group also potentially expanded the scope of the Suitability Model through its Section 8 "Prohibited Practices" section. IALC recognizes that these Prohibited Practices were intended to mirror the DOL Fiduciary Rule's Impartial Conduct Standards (which we are complying with today). However, as explained above, we believe the regulation of conduct that is not tied directly to the ultimate recommendation is better regulated under a different set of rules. One example is Section 8(2): "An insurance producer…[s]hall not make any materially misleading statements regarding the annuity transaction…" While we agree with and support the actual language and purpose, we are concerned its inclusion in the Suitability Model operates to expand the rule's scope to pre-recommendation conduct if it is not tethered to the actual recommendation. Because the language as stated is tied instead to "the annuity transaction" (and because this is not a term of art or defined), it could bring in statements dating back to early marketing materials or the "solicitation" and "negotiation" outlined above. It should also be noted that two other NAIC model regulations – the Unfair Trade Practices Act (Model 280) and the Advertisements of Life Insurance and Annuities Model Regulation (Model 570) – already put in place restrictions on misleading statements related to advertising. If the Working Group's aim is to prohibit misleading statements and promote a best interest recommendation while also not expanding the scope of the Suitability Model, we would recommend tying the prohibition on materially misleading statements to the ultimate recommendation rather than "the annuity transaction."

CONCLUSION

The IALC remains most appreciative of the NAIC and Working Group's efforts to coordinate with federal regulators while promoting the effective state-based regulation of insurance products. We welcome additional conversations around this comment letter or any other provision in the Suitability Model. Thank you for the opportunity to provide these comments, and we look forward to continued discussions.

Sincerely,

Jim Poolman, Executive Director
JimPoolman@indexedannuityinsights.com