

**Comments of NAIC Consumer Representatives and Consumer and Worker Advocates  
to the NAIC Annuity Suitability Working Group**

**Regarding “Best Interest” Amendments to the  
NAIC Suitability in Annuity Transactions Model Regulation**

**July 31, 2017**

The undersigned submit the following comments to the working group as it considers amending the Suitability in Annuity Transactions Model to incorporate a “Best Interest” standard. As consumer and worker advocates who have worked to ensure fair treatment of consumers purchasing retirement income products, we offer the following key principles to improve the current NAIC model:

1. The standard of care for consumers should be a fiduciary standard that obliges the insurer or producer to act in the best interest of the consumer.
2. The best interest standard provisions must be stronger than the current suitability standard. Relabeling “suitability” as “best interest” would be a sham.
3. The best interest standard must include substantive prohibitions on conflicts of interest as opposed to “managing” or “disclosing” conflicts of interest. The current model does not address conflicts of interest for insurers or producers.
4. Regulators should recognize the role of the producer compensation structure in aligning or misaligning insurer and producer interest with the best interest of consumers. An enhanced Suitability in Annuity Transactions Model should restrict practices which create conflicts of interest that are inconsistent with a best interest standard of care.
5. The application of the enhanced model should be broadened to investment-type life insurance products. The same standard of care – best interest of the consumer – is clearly as appropriate for investment-type life insurance – for example, indexed universal life – as it is for annuity products. A uniform standard of care across all types of investment products means both consistent consumer protection and a level regulatory framework preventing one type of investment product from regulatory arbitrage.
6. The model should be amended to require good consumer outcomes and not simply specify a set of procedures that are untethered from actual consumer outcomes.
7. Improved information and presentation of material aspects of products is possible due to insights from behavioral economics and digital technology. The working group should consider improvements in the annuity and life insurance disclosure models that complement and reinforce a best interest standard in the annuity suitability model.

## “Best Interest” Standard for Annuity Sales

The undersigned organizations believe all investment advice should be subject to a fiduciary duty that includes obligations for the insurer and producer to act in the best interest of the consumer and to rein in conflicts of interest that could undermine that standard. Strengthening and broadening the scope of the NAIC Suitability Model to cover recommendations of annuities and any other insurance products typically marketed as investments would greatly benefit those consumers who purchase such products outside the tax advantaged retirement accounts covered by the Department of Labor’s conflict of interest (or “fiduciary”) rule. We write to provide our views on the key components such a standard would have to incorporate to win broad support from our organizations.

To earn our support, the best interest standard must meet the following criteria.

**1. The “best interest: standard must be measurably higher than the existing suitability standard.**

The existing model requires an insurer or producer making a recommendation to ensure the recommended product is suitable for the consumer by gathering and analyzing sufficient information about the client to be able to determine what types of investment would be appropriate for the client, in light of the client’s age, investment goals, financial situation, time horizon, risk tolerance and other such factors. Once the insurer or producer has completed that analysis, the insurer or producer is generally free to recommend any of the options that are “suitable,” even though there may be substantial differences in cost and quality among the “suitable” options. This includes being allowed to recommend the least suitable option, even if suitable alternatives are available that would cost the consumer considerably less or better meet the consumer’s needs. The same insurer or producer operating under a fiduciary/best interest standard must take the analysis a step further and must seek to determine which of the available options would be best for the client and recommend that option.<sup>1</sup> In short, the insurer or producer must put the client’s interests in the driver’s seat, rather than giving priority to any competing interests of the producer, insurance company, affiliate, or other party.

We note that the current model is based on a suitability standard, but does not define a suitable recommendation. Rather, the current model requires an insurer or producer to collect and consider certain information about the consumer – “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” or “the insurance producer . . . shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer.” To correct this shortcoming while raising the standard, the model should be amended to both define the fiduciary/best interest standard and require the insurer and producer to adhere to that standard.

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<sup>1</sup> Available option does not mean every possible investment available in the marketplace. Instead, it means those that the agent has available to recommend. Thus, the standard is compatible with sale from a limited menu of investment options, as long as those limitations are clearly disclosed at the outset of the relationship, as discussed further below.

We would strenuously object to simply replacing “suitable for” with “in the best interest of” in the model as such a change would be non-substantive, would not strengthen consumer protection and would not improve the model.

**2. The “best interest” standard must include meaningful restrictions on conflicts of interest.**

One of the most significant differences between a suitability standard and a best interest standard lies in how the standards deal with conflicts of interest for the insurer or producer. Specifically, a true best interest standard imposes a heightened obligation to eliminate or avoid conflicts of interest – obligations not present under the suitability standard.

Regulators should recognize the role of the producer compensation structure in aligning or misaligning insurer and producer interest with the best interest of consumers. An enhanced Suitability in Annuity Transactions Model should prohibit or, if not prohibited, minimize the impact on recommendations, of compensation practices which create conflicts of interest that are inconsistent with a best interest standard of care.

Regulators should also recognize the opportunities and limits of consumer disclosures in addressing conflicts of interest. For example, a consumer may be effectively informed – where “effectively informed” means empowered to use the information to discipline market participants – of the facts that the producer is paid through commissions or sells from a limited menu of products. Other types of conflicts of interest are so great – and reflect sufficiently powerful market forces – that disclosure, no matter how well crafted, is insufficient to protect the consumer. Conflicts that cannot be addressed through disclosure alone include practices – such as paying differential compensation or using sales quotas or contests to promote the sale of particular products – that encourage recommendations based on factors other than the consumers’ best interest.

To the degree that any conflicts exist, they must be subject to appropriate oversight reasonably designed to ensure that they are not permitted to influence recommendations. Regulators must utilize economic and other analyses of product markets to evaluate the potential effectiveness of disclosures to empower consumers.

**3. The “best interest” standard requires more than procedural requirements for information collection and documentation. It requires good consumer outcomes and routine regulatory monitoring of consumer outcomes.**

Compliance with the best interest standard must be more than a check-the-box exercise. In addition to requiring avoidance of conflicts, it must include a requirement to engage in a prudent process and document the basis on which the insurer and producer concluded the product recommended was the best of the available options for the customer. (Where the producer has disclosed that she sells from a limited menu of investments, the “available options” would be those that she has previously disclosed she has available to sell.)

Whether a producer has made a best interest recommendation is determined based on the prudent expert standard. Would an independent expert, one whose judgement is not clouded by conflicts of interest, have reached the conclusion that the recommendation was reasonable (i.e., that it was consistent with the best interests of the customer) under the circumstances and based on a prudent process? An insurer and producer who can demonstrate that they engaged in a prudent process, based the recommendation on reasonable assumptions, charged reasonable fees, made no misleading statements, operated in an environment in which conflicts of interest were minimized and any remaining conflicts were carefully controlled, and documented the basis on which they reasonably concluded the recommended investment was the best available option for the customer would generally be viewed as meeting the best interest standard.

Regulators must monitor the market to ensure that this process is being followed and that it results in appropriate outcomes for investors.

### **Industry Proposal Inadequate**

If the NAIC were to develop a best interest standard for annuity sales that meets these criteria, it would greatly enhance protections that apply when annuities are sold outside of retirement accounts. Such an approach would be generally consistent with the Department of Labor’s fiduciary rule, thus enhancing uniformity of standards that apply to retirement and non-retirement accounts. Better yet would be to apply this strong, pro-investor best interest standard to all insurance products that are marketed as investments, including, for example, universal life insurance policies and indexed universal life policies.

Unfortunately, the model proposed by ACLI fails to meet any of these key criteria. It fails to define the proposed best interest standard in a way that draws a clear distinction between best interest and suitability. In fact, the ACLI proposal specifically uses language drawn from FINRA guidance on its suitability standard to define best interest. The inference that ACLI is advocating a standard that is no stronger than the existing suitability standard is reinforced by their failure to include any meaningful restrictions on conflicts of interest in its proposed approach. Instead, the ACLI proposal would give firms a choice of disclosing, managing, or avoiding conflicts. The predictable outcome is industrywide practice of addressing conflicts through disclosure alone, despite overwhelming evidence that such an approach is ineffective in protecting consumers from the harmful impact of conflicts. This would be unacceptable even if ACLI proposed an approach to disclosure that ensures timely presentation of key information in an accessible format. But they do not. Instead, their proposal would likely result in boilerplate disclosures provided too late in the engagement to be useful to the consumer. In short, the ACLI proposal does not contain any meaningful improvements in the existing suitability standard and is far weaker than the protections afforded by the DOL fiduciary rule.

If NAIC were to adopt a standard along the lines advocated by ACLI, it would do a huge disservice to vulnerable consumers, who need and deserve true best interest advice, not just a sales pitch dressed up as advice. Under no circumstances should NAIC adopt a watered down standard along these lines that gives lip service to best interest but without including the components – especially real limits on conflict of interest – that are essential to make that standard a reality.

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