NAIC Annuity Suitability Working Group
ACLI Response to the Request for Comments
July 10, 2019

Topic: Conflict of Interest

Question 1 What constitutes a material conflict of interest when recommending annuities?

In the most recent NAIC draft, "material conflict of interest" is defined as "a financial interest of the producer, or the insurer where no producer is involved, in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation." We believe that the current draft provides a workable definition of "material conflicts of interest."

To align more closely with the SEC's Regulation Best Interest ("Reg. BI"), a "conflict of interest" could be defined to mean any interest that might incline a producer to make a recommendation that is "not disinterested" or "an interest that might incline a producer to make a recommendation that puts the interest of the producer ahead of the interest of the consumer." In other words, a "conflict of interest" is an interest other than an interest of the consumer that may lead a producer to recommend one annuity product over another solely for the benefit of the producer or a related person. Under the SEC formulation, "material facts" about "conflicts of interest" must be identified and, if not eliminated, must be disclosed. A fact is material if there is a substantial likelihood that a reasonable consumer would consider it important in making an investment decision with respect to the recommendation.

When recommending an annuity that meets the consumer's financial needs and objectives over another annuity, there may be a conflict of interest if the cash or non-cash compensation the producer would receive varies among the annuities considered, as compensation to be received can differ based on the type of annuity product recommended and even among similar products given that producers may be authorized to sell the products of more than one insurer. It is important to note that when the annuities considered are from different insurers, neither insurer would be in a position to be aware of nor confirm compliance with addressing such potential conflict of interest.

Question 2 When a material conflict of interest exists, how should an insurer and/or a producer avoid or otherwise reasonably mange the conflict?

Because producers can sell annuities offered by multiple insurers, the producer should be required to disclose prior to or at the time of the recommendation that (1) the producer is paid by the insurer whose product they recommend, and (2) the amount of compensation the producer will receive will depend upon the type of annuity product recommended and the insurer that would issues it. By the producer making this disclosure, consumers can then ask for more information about the producer's compensation if they so desire. To further mitigate conflicts of interests and to more closely align with the SEC's Regulation Best Interest, the standard of care obligation should include a requirement that a producer have a reasonable basis to believe that the recommendation does not place the financial or other interest of the producer ahead of the interest of the consumer.

While commissions may vary by annuity product, an insurer should be required to avoid sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of a specific annuity product of the insurer within a limited period of time. As with the approach taken by the SEC, the NAIC should clarify that this prohibition: (1) does not apply to compensation practices based on, for example, sales of general product categories (mutual funds, variable annuities, etc.), total products sold, or asset growth or accumulation, and customer satisfaction; (2) would not prevent firms from offering only proprietary products, placing material limitations on the menu of products, or incentivizing the sale of such products through its compensation practices, so long as the incentive is not based on the sale of a specific annuity product of the insurer within a limited period of time; and (3) is not intended to prohibit the receipt of employee benefits by statutory employees. Finally, an insurer also should take reasonable steps to prohibit their distribution partners from providing sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of a specific annuity product of the insurer within a limited period of time.

Producers should identify and be aware of differences in compensation among similar annuity products which the producer is authorized and licensed to recommend or sell. The producer should be required to disclose material facts about conflicts of interest. A fact is material if there is a substantial likelihood that a reasonable consumer would consider it important in making an investment decision with respect to the recommendation. As noted above, an insurer is not and cannot be in a position to confirm whether compensation offered on other insurers' products differ from the compensation the insurer pays on its own products.

Topic: Care Obligation

Question 1 Should the care obligation of a producer include "prudence"?

We recommend that the term "prudence" not be included in the care obligation. The SEC made a decision to exclude this term in Regulation Best Interest and we think their reasoning is sound, i.e., the inclusion of "prudence" may create legal uncertainty and confusion, and the remaining obligations, "diligence, care, and skill," convey the importance of conducting a proper evaluation of any annuity recommendation under an objective standard of care.

Question 2 "Reasonable for an ordinary producer in a similar circumstance to recommend." Is this an appropriate standard for a producer when making a recommendation?

(See Iowa Section 6A(1)(d)) It should be sufficient when a producer meets the overall requirements of the Regulation, has a "reasonable basis" for the recommendation, and the recommendation meets the stated insurance needs and financial objectives of the consumer. There is no need to make a comparison as to what some other producer might have recommended in similar circumstances. As this is more art than science, it would not be unusual for two producers to make different recommendations based upon the same facts and circumstances. From a compliance perspective, it would be difficult for an insurer or a commissioner to assess an annuity application or sale as to whether other producers would or would not have made the same recommendation. A comparison of what two different producers would do in similar situations is more aligned with litigation (a "battle of the experts") than a regime based on review, supervision, and regulatory examination. In other words, whether there is a "reasonable basis" for a producer's recommendation rests on the facts and circumstances known to the producer at the time the recommendation was made, including matching the recommended annuity to the consumer's stated profile information, and the process the producer followed to come to that recommendation.

Question 3 "Provide an oral or written description of the basis of the recommendation to the consumer." When considering this requirement for a producer, is it appropriate to allow both oral and/or written descriptions?

While this is a good practice, it would be difficult to supervise or prescribe. Documentation practices would likely vary greatly. Those charged with supervision would not know whether a pertinent fact revealed in a conversation between the consumer and the producer did not get recorded, whether intentional or not.