

# Is It Time to Harvest the NAIC Suitability in Annuity Transactions Model Regulation?

November 26, 2018

At the NAIC Fall 2018 National Meeting, state regulators continued plowing through the Suitability in Annuity Transactions Model Regulation (Model 275) (Suitability Model). During its November 15 meeting, the Annuity Suitability (A) Working Group (Suitability WG) continued to fertilize the Suitability Model with a goal of elevating the standard of care for annuity sales to ensure consumers understand the products they are purchasing and any conflicts of interests and producers do not place their financial interests ahead of consumers' needs and objectives. During its November 16 meeting, the Life Insurance and Annuity (A) Committee ((A) Committee) sought to further enrich the Suitability Model by seeking additional input on the draft revisions to the Suitability Model. In the end, the (A) Committee agreed to harvest [a draft of the revised Suitability Model](#) for comments to be received by February 15, 2019.

## Suitability WG

At its November 15 meeting, the Suitability WG continued to further cultivate the Suitability Model. Several changes discussed sought to prune the Suitability Model, cleaning up language that was viewed as duplicative. The following two changes, however, are more substantive and the first change garnered debate among the Suitability WG and interested parties:

- the considerations in making a suitability determination
- the definition of recommendation

In addition, the Suitability WG agreed to add a new drafting note that clarifies the current status of the Suitability Model.

## Considerations in Making a Suitability Determination

The Suitability WG discussed adding in Section 6.D. provisions regarding the considerations in making a suitability determination. The Suitability WG members and interested parties agreed to add as Section 6.D.(3) that the person making the recommendation would need to consider:

The consumer profile information and product costs, rates, benefits and features ... [which are] generally relevant in making a suitability determination, [and that] the level of importance of each factor may vary depending on the facts and circumstances of a particular case. However, each factor shall not be considered in isolation.

Thus, the Suitability WG acknowledged that the importance of the factors vary based on individualized facts and circumstances. James Regalbuto, Deputy Superintendent for life insurance at the New York Department of Financial Services, noted that it is important for the recommender to comprehensively consider these factors and use judgment in making a recommendation.

Division arose as to whether Section 6.D. should expressly acknowledge that a suitability determination may not result in the annuity with the lowest one-time or multiple occurrence compensation structure. Mr. Regalbuto noted that all things being equal, the annuity recommended should be the lowest cost. He objected to including language in the Suitability Model that there are situations where the recommender does not need to offer the lowest cost option. Birny Birnbaum, Executive Director for the Center for Economic Justice, requested the Suitability WG revisit its decision to allow the producer's interest to be considered, and thought the language under consideration would not come into play. Suitability WG Vice Chair Doug Ommen noted that the purpose of this language was to avoid favoring one commission structure over another. In a straw vote, the Suitability WG agreed to add as Section 6.D.(2):

The requirements under this section do not mean the annuity with the lowest one-time or multiple occurrence compensation structure shall necessarily be recommended, but the recommendation shall be diligently focused on whether the product costs, rates, benefits, features and other contractual provisions of the annuity are consistent with the actual financial situation, objectives and needs of the particular consumer.

## **Definition of Recommendation**

Jodi Lerner, Senior Staff Counsel of the California Insurance Department, asked the Suitability WG to reconsider the definition of recommendation. In particular, California was concerned that the October 23 draft had defined a recommendation to mean:

***individualized*** advice provided by a producer, or an insurer where no producer is involved to an individual consumer that results in results in a purchase, an exchange or a replacement of an annuity in accordance with that advice.

Ms. Lerner raised the concern that inclusion of "individualized" narrowed the scope of the entire regulation, leaving open the possibility that several product options could be presented to a consumer, allowing the producer to let the consumer pick from the options and then claim no recommendation had been made. Vice Chair Ommen explained the word individualized was meant to clarify that only information presented directly to the consumer would constitute a recommendation as opposed to general forms of communication. To address California's concern and to add clarity on the extent of generic information, the Suitability WG agreed to the following definition of recommendation:

“Recommendation” means advice provided by a producer, or an insurer where no producer is involved, to an individual consumer that results in a purchase, an exchange or a replacement of an annuity in accordance with that advice. Recommendation does not include general communication to the public, generalized customer services assistance or administrative support, general educational information and tools, prospectuses, or other product and sales material.

### **New Suitability Model Status Drafting Note**

Ohio proposed a new drafting note to be added at the beginning of the Suitability Model. The drafting note is based on the belief that the Suitability Model is a strong standard that can be measured and objectively applied, along with the desire of the Suitability WG to harmonize the Suitability Model with standards to be adopted by the Securities and Exchange Commission (SEC). The Suitability WG discussed that the SEC's Regulation Best Interest uses, but fails to define, the term "best interest." In a straw vote, the Suitability WG agreed to add the following drafting note:

Drafting Note: The NAIC acknowledges that the goal of the U.S. Securities and Exchange Commission's (SEC) April 2018 proposals is to move toward a harmonized best interest standard of conduct for broker-dealers and agents that substantially raises the professional obligations for recommendations, while preserving and differentiating the fiduciary standard for investment advisers. As of the November 2018 Draft of the amended Suitability in Annuity Transactions Model Regulation (#275), the SEC's proposed use of the term "best interest" in the actual text of the SEC's Regulation Best Interest proposal appears to describe "best interest" as including "best interest" without further definition and is not distinguished from the investment adviser fiduciary. The SEC has received many public comments on use of the phrase "best interest" and may provide greater clarity in its final rule. While the NAIC fully supports a similar goal of a harmonized standard of conduct, and has a strong preference to remain consistent with FINRA rules in connection with a recommendation of variable annuities, the NAIC is not yet convinced that this November 2018 Draft of the amended Suitability in Annuity Transactions Model Regulation (#275) is legally distinct from the enhanced standards that are intended by the SEC. Until such time the NAIC can evaluate any distinction in the text of the SEC proposal between a "best interest" recommendation and investment adviser fiduciary duties, and the SEC and FINRA have finalized relevant terms, definitions and related requirements, the NAIC would opt to refrain from using the phrase "best interest" in Section 6A(1) of the proposed modifications to the Suitability in Annuity Transactions Model Regulation (#275).

### (A) Committee

At the November 16 (A) Committee meeting, Director Dean Cameron, Chair of the Suitability WG, reported on the status of the draft Suitability Model and recommended the (A) Committee expose the current draft Suitability Model. Director Cameron noted that the current draft Suitability Model is not intended to be a final version and is merely a work in progress. He further noted that the Suitability Model cannot be finalized until the SEC and Department of Labor have further developed their standard of care rules. Director Cameron suggested that exposure by the (A) Committee would allow more comments to be made, including by regulators who are not part of the Suitability WG.

California and New York asserted that the draft Suitability Model was not yet ready to be harvested for exposure. Both believe the Suitability WG must first finalize and approve the draft Suitability Model before the (A) Committee could take action. New York Financial Services Superintendent Maria Vullo contended that draft Suitability Model was not yet fully ripe for picking as there are still many issues that need to be addressed. A vote to delay the harvest was rejected and instead the (A) Committee voted to expose the draft Suitability Model until February 15, 2019.

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