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NAIC Life Insurance and Annuities (A) Committee Ends 2019 With a Big Bang

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On December 30, 2019, the Life Insurance and Annuities (A) Committee approved a revised Suitability in Annuity Transactions Model Regulation (Revised Suitability Model), ending a flurry of activity over the past year. The Revised Suitability Model must be approved by all voting members of the NAIC and then adopted by individual states before it will apply to annuity transactions. Commissioner Ommen, chair of the committee, explained that the Revised Suitability Model aligns the state standard of conduct with the SEC's Regulation Best Interest and provides more than suitability but does not impose a fiduciary standard.

In with the new year is a best interest standard of care that comprises four components:

- Care Obligation
- Disclosure Obligation
- Conflict of Interest Obligation
- Documentation Obligation

Invited to the gala are all producers who have "exercised material control or influence in the making of a recommendation and ha[ve] received direct compensation as a result of the recommendation or sale, regardless of whether the producer has had any direct contact with the consumer." These producers are subject to the Revised Suitability Model requirements, in recognition that a producer with the consumer relationship may consult with another producer who provides the recommendation.

The Revised Suitability Model enhances the requirement that insurers establish and maintain a supervision system reasonably designed to achieve compliance with the Revised Suitability Model. It also invites other “comparable standards” as safe harbors that are deemed to satisfy the requirements of the Revised Suitability Model.

Below is a summary of the four component obligations, the insurers’ supervision requirement, the safe harbor, and certain notable items.

Care Obligation

The Care Obligation requires four acts, exercised with reasonable diligence, care, and skill, as follows:

1. Know the consumer’s financial situation, insurance needs, and financial objectives;
2. Understand the available recommendation options after making a reasonable inquiry into available options;
3. Have a reasonable basis to believe the recommended option effectively addresses the consumer’s financial situation, insurance needs, and financial objectives over the life of the product, as evaluated in light of the consumer profile information; and
4. Communicate the basis or bases of the recommendation.

The Care Obligation contains 10 additional provisions explaining what is, and what is not, required to satisfy these four acts. In general, the producer must consider the totality of the consumer's information — which the producer has made reasonable efforts to obtain — against the totality of the products available to be sold by the producer, and must conclude that the annuity effectively addresses the consumer’s financial situation, insurance needs, and financial objectives, and that the consumer would benefit from certain features of the annuity.

Items of Note:

- The importance of the factors relevant in determining whether an annuity effectively addresses a consumer's financial situation may vary based on the facts and circumstances of a particular case.
- The recommendation does not have to be the annuity with the lowest one-time or multiple occurrence compensation structure.

Disclosure Obligation

The Disclosure Obligation sets forth three disclosure requirements:

1. Prior to any recommendation, an "Insurance Agent (Producer) Disclosure for Annuities" form setting forth:
    - The scope and terms of the producer's relationship with the consumer and the producer's role in the transaction.
    - The products the producer is licensed and authorized to sell.
    - The insurers for whom the producer may sell products.
    - The sources and types of cash and non-cash compensation to be received by the producer and from whom the producer will receive the compensation.
    - Notice of the consumer's right to request more information on the cash compensation to be received.
2. If requested by the consumer or the consumer's designated representative, a reasonable estimate of the cash compensation to be received and whether the compensation amount is a one-time or multiple occurrence amount.
3. Prior to or at the time of the recommendation, disclosure of the various features of the annuity.

Items of Note:

- The Insurance Agent (Producer) Disclosure must be provided at the outset of the relationship so the consumer can decide whether to provide his or her information.
- To ensure the consumer receives the disclosure, the signature page should not appear on a separate page.

Conflict of Interest Obligation

The Conflict of Interest Obligation requires a producer to:

1. identify, and
2. either:
    a. avoid, or
    b. reasonably manage and disclose

material conflicts of interest, including material conflicts of interest related to an ownership interest.

Items of Note:

- "Material conflict of interest" means a financial interest of the producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation, but does not include cash compensation or non-cash compensation.

In addition, as part of the Best Interest Obligation, in making a recommendation, a producer must act without placing the producer's or the insurer's financial interest ahead of the consumer's interest.

- Insurers are required to eliminate sales contests, sales quotas, and bonuses that are based on the sales of specific annuities within a limited period of time.

Documentation Obligation

The Documentation Obligation varies, as follows:

- If a recommendation was made – the producer must make a written record of any recommendation and the basis for the recommendation.
- If the consumer refused to provide some or all of the consumer's information – a signed "Consumer Refusal to Provide Information" form at the time of the sale.
- If the consumer purchased an annuity that was not recommended – a signed "Consumer Decision to Purchase an Annuity NOT Based on a Recommendation" form at the time of the sale.

Items of Note:

- Even if a transaction is not based on a recommendation, an insurer's issuance of the annuity must be reasonable under all circumstances actually known to the insurer at the time the annuity is issued.
- Insurers must establish and maintain reasonable procedures to identify and address suspicious consumer refusals to provide consumer profile information.

Insurer Supervision

The insurer supervision requirements were enhanced by requiring insurers to establish and maintain reasonable procedures in three additional areas:

1. To assess whether a producer has provided to the consumer the information required by the Revised Suitability Model.
2. To identify and address suspicious consumer refusals to provide consumer profile information.
3. To identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific annuities within a limited period of time.

The Revised Suitability Model also makes clear that the insurer's system of supervision does not need to include a "comparison to options available to the producer or compensation relating to those options other than annuities or other products offered by the insurer."

Safe Harbor

Under the Revised Suitability Model, the safe harbor was expanded beyond compliance with FINRA's suitability and supervision requirements. The safe harbor applies to "all recommendations and sales of annuities made by financial professionals in compliance with business rules, controls and procedures that satisfy a comparable standard even if such standard would not otherwise apply to the product or recommendation at issue." The financial professionals that fall within the safe harbor are:

- A registered broker-dealer or a registered representative of a broker-dealer;
- A registered investment adviser or an investment adviser representative associated with the registered investment adviser; or
- Specified plan fiduciaries under the Employee Retirement Income Security Act of 1974 or the Internal Revenue Code.

The Revised Suitability Model notes that each state must determine whether to extend the safe harbor to state-registered broker-dealers and investment advisers.

While the safe harbor applies, an insurer is still obligated not to issue an annuity unless there is a reasonable basis to believe the annuity would effectively address the particular consumer's financial situation, insurance needs, and financial objectives. The NAIC Executive Committee and Plenary will consider the adoption of the Revised Suitability Model on February 13, 2020.

Now that the festivities are complete, it is time for insurers to start considering their New Year's resolutions to modify their existing policies and procedures for the new requirements of the Revised Suitability Model.

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