

**DEPARTMENT OF INSURANCE****Legal Division, Enforcement Bureau**

45 Fremont Street, 21st Floor  
San Francisco, CA 94105

Jodi S. Lerner  
Staff Counsel  
TEL: 415-538-4122  
FAX: 415-904-5490



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Director Dean Cameron  
Idaho Department of Insurance  
Chairman, NAIC Annuity Suitability (A) Working Group

Commissioner Doug Ommen  
Iowa Insurance Division  
Vice Chairman, NAIC Annuity Suitability (A) Working Group

**SUBJECT:** November 24, 2017 Draft Amendments to the Suitability  
in Annuity Transactions Model Regulation (#275)

Dear Director Cameron and Commissioner Ommen:

The California Department of Insurance ("CDI") appreciates the opportunity to comment on the draft revisions to the Suitability in Annuity Transactions Model Regulation.

CDI urges the Working Group to consider extending this Model Regulation to the sales of life insurance products which have an investment component. If the Working Group declines to include these types of life insurance products from this Model Regulation, we ask that permission be requested of "A" Committee to draft a model regulation that covers suitability in the sales of these products. The comments below do not include proposed language that would be necessary if these types of life insurance products were to be covered by this Model Regulation.

**Section 1 Purpose**

Section A. should be amended to make clear that the recommendations to consumers must be in the consumers' best interest. As currently written, it is unclear whether the word "their" refers to insurers or consumers.

I propose the following language:

- A. The purpose of this regulation is to require insurers to establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers that are suitable, in ~~their~~ the consumers' best

interest and result in transactions involving annuity products so that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed.

#### Section 4 Exemptions

I suggest that the Working Group review the exceptions listed at Subsection B. (1) through (4) to make sure that these exemptions not inadvertently exclude from this Model Regulation situations where producers solicit individual employees to purchase annuities which are offered as part of one or more of the enumerated retirement saving plans. Excluding these plans would only make sense when there is an employer with a fiduciary obligation actually looking out for employees. Articles published in the New York Times raise concerns about sales by individual agents of 403(b) annuities to teachers. Although it is not clear whether any of those 403(b) plans are covered by ERISA, similar issues may arise regarding the exempted plans in situations where individual producers meet with employees to recommend purchasing annuities as a means to save for retirement.

#### Section 5 Definitions

1. Proposed subsection B., which defines “**Best interest**”, is too narrow for these reasons:
  - a. Subsection (1) applies only when the annuity is issued. The term “Best interest” should apply not only when the annuity is issued, but also when the producer sells the annuity and delivers it to the consumer. Further, the standard set forth in subsection (1) is insufficient; and
  - b. Proposed Subsection (2) appears to provide an overbroad exemption. Sales of proprietary products that are in the consumers’ best interest should be permitted. In situations where the producer determines that the sale of an annuity is suitable and in the client’s best interest, the producer should recommend the annuity that he or she sells that is best suited to the consumer’s needs.

I propose the following language:

- B (1) “Best interest” means, at the time the annuity is *offered; sold; issued; and delivered*, acting with *the* reasonable diligence, care, skill and prudence, *that a reasonably prudent person acting in a like capacity and familiar with such matters would act, and* in a manner that puts the interest of the consumer first and foremost.
- (2) “Best interest” does not *require that* ~~mean~~ a resulting recommendation is the least expensive annuity product, or the annuity product with the highest stated interest rate or income payout rate, available in the marketplace at the time of the annuity transaction. “Best interest” also does not *require that* ~~mean~~ the recommendation is the single “best” annuity product available in the marketplace at the time of the annuity transaction, ~~but based on the insurance producer’s judgment acting with reasonable diligence, care, skill and prudence, the producer believes the~~

recommendation is in the best interest of the consumer ***However, as part of acting in the consumer's best interest in compliance with subparagraph B. (1) above, if the producer and/or insurer recommend the purchase of an annuity, the annuity recommended and issued must be the best annuity for the consumer's circumstances sold by the insurance producer and insurer where no producer is involved, taking into consideration the consumers' suitability information; the price; and annuity contract terms, including but not limited to the fees, interest rate, surrender charge period, riders, and other information that is known or should be known by the producer or insurer if no producer is involved.***

2. At proposed Section 5. C., the term "concession" should be defined. The definition should also be broadened to read:

"Cash compensation" means any discount, concession, service fee, commission, sales charge, loan, override, or cash benefit ***or other remuneration*** received in connection with the solicitation, negotiation, recommendation or sale of an annuity."

3. At proposed Section 5. I., the term "Intermediary" should be amended to make clear that the intermediary does not sell annuities. I propose that this definition be amended to read:

"Intermediary" means an entity contracted with the insurance company to facilitate ***a producer's and/or insurer's*** sale of an annuity.

4. The definition of the term "Material conflict of interest" should be amended. Instead of the recommendation being "impartial", it should be in the best interest of the consumer. The insurer's duty should not be limited to situations in which no producer is involved. Additionally, this definition should be broadened so that the term "Material conflicts of interest" applies not only to financial incentives or rewards offered to or received, but also to financial incentives or rewards which are made available as a result of meeting sales targets. The possibility of receiving incentives based on sales targets constitutes a conflict of interest.

I suggest that the term "Material conflict of interest" be amended as follows.

- (1) "Material conflict of interest" means a financial interest of an insurance producer ***and/or the insurer where no producer is involved***, that a reasonable person would expect to ***could*** affect the ***ability of the producer and/or insurer to: (1) exercise his/hers/its best judgment and (2) put the consumer's interests before the producer's and/or insurer's own interest.*** ~~impartiality of the recommendation.~~
- (2) "Material conflict of interest" includes financial incentives or rewards ***available to; or offered to; or received by an insurance producer; or a direct interest or ownership in an insurer by an insurance producer or an immediate family member of an insurance producer. It also includes non-cash compensation available to, offered to, or received as a result of meeting target sales levels.***

5. At proposed Section 5. K., the term “Negotiate” should be broadened to include guidance.
6. At proposed Section 5. N., the term “Recommendation” should be broadened to include information and guidance. This definition should also apply to insurers, regardless of whether a producer is involved. I suggest that the term “Recommendation” be amended to read:

N. “Recommendation” means advice, guidance, or information provided by an insurance producer or an insurer ~~where no producer is involved~~, to an individual consumer that results in a purchase, exchange or replacement of an annuity in accordance with that advice, guidance or information.

7. At proposed Section 5. O., the term “Replacement” should be amended to apply to insurers, regardless of whether a producer is involved. It should read:

O. “Replacement” means a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer or to the proposing insurer ~~if there is no~~ ***whether or not a producer is involved***, that by reason of the transaction, an existing policy or contract has been or is about to be:...

8. At proposed Section 5. P., I suggest the following:

- a. The term “Suitability information” should be amended and broadened to read as follows:

P. “Suitability information” means information that is reasonably appropriate to determine ***whether*** ~~the suitability of a recommendation is suitable and in the best interest of the consumer~~, including the following...”

- b. Amend subparagraph (8) to require that both the consumers’ assets and financial products be considered. It should read:

(8) Existing assets ***and*** ~~or~~ financial products, including investment and life insurance holdings...

- c. Two additional suitability criteria should be added to the list:

***(14) Whether or not the consumer has a reverse mortgage;***

***(15) Whether or not the consumer intends to apply for means tested government benefits, including, but not limited to, Medicaid or the veterans’ aid and attendance benefit.***

Proposed subsections (14) and (15) are important because people who had to obtain a reverse mortgage on a home and people who need to apply for Medicaid or the Veterans' aid and attendance benefit generally need access to their funds and should not be tying their monies up in annuities. California requires that these two additional suitability factors be considered.

### **Section 6 Duties of Insurers and of Insurance Producers**

1. Subsection A. should be amended: (a) for clarity; (b) to be applicable to insurers regardless of whether a producer is involved; and (c) to require that the producer and insurer, in recommending an annuity, take into account other pertinent information regarding the consumer about which the producer and/or insurer becomes aware, for example, health concerns. I suggest this paragraph be amended to read as follows:
  - A. In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the insurance producer, or the insurer ~~where no producer is involved,~~ shall ~~have reasonable grounds for believing that the recommendation is suitable for~~ only make **only** a recommendation that is suitable and in the best interest of the consumer at the time it is made based on the basis of the facts disclosed to the consumer as to his or her investments and other insurance products and as to his or her financial situation and needs, including the consumer's suitability information, **and other relevant information about the consumer about which the insurance producer or insurer may become aware** and that there is a reasonable basis to believe all of the following:
2. Regarding Subsection B. subparagraph (1), there should be an explanation as to what constitutes "reasonable efforts" to obtain the consumer's suitability information.
3. Subsection B. subparagraph (2) may be construed as permitting a life agent who is not also an investment advisor or registered broker-dealer to evaluate a client's investment portfolio and advise the client as to whether the client's securities should be sold in order to purchase an annuity. This conduct could be construed as acting as an investment advisor without being properly licensed to do so. I suggest that the Working Group discuss this matter and address it either in this section or in Section 8. Prohibited Practices.
4. Subsection C. should be amended to requires written disclosure of: (1.) The amount of compensation the producer receives; and (2.) The basis or bases of the recommendation.

Subparagraph C. (2) is unclear. What does the 3% relate to? Is it the face value of the annuity? Further, since subparagraph (1) requires that all material conflicts of interest be disclosed, subparagraph (2) seems to conflict with subsection (1) because subparagraph (2) could be read as requiring that compensation be disclosed only if the commission or fee is above three percent of some amount. I suggest that Subsection C. be amended as follows:

- C. In making a recommendation, the insurance producer, or insurer where no producer is involved shall disclose to the consumer:
- (1) Any and all material conflicts of interest, **including that the producer will receive a commission or fee for the sale of the annuity; the amount of the commission or fee and, if applicable, all other compensation the insurance producer will receive as a result of a contract for services for advice or for the sale of the annuity to the consumer. This disclosure shall be made verbally and in a separate standalone document that is no more than two pages in length and is written in plain language in 14 point font that is left with the consumer when the application is signed;**
  - (2) ~~the percentage or amount of each 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 the recommended annuity; and~~
  - (3) The basis or bases of the recommendation. **This disclosure shall be made verbally and in a separate standalone document that is no more than two pages in length and is written in plain language in 14 point font that is left with the consumer when the application is signed.**
5. Subsection D. (2) is problematic. There will almost always be certain features of an annuity, like tax-deferred growth, that would benefit a consumer. Just because an annuity has a few features that a consumer would benefit from doesn't mean that purchasing that annuity would be in the consumer's best interest. The standard set forth in this subsection is simply too low. California Insurance Code section 10509.914(a) (2) requires that the consumer receive a tangible net benefit from the transaction. California's standard is more appropriate to a best interest standard. Accordingly, I recommend the following language:

- (2) The consumer would ~~benefit from certain features of the annuity, such as tax-deferred growth, annuitization or death or living benefit~~ **receive a tangible net benefit from the transaction;**

Further, Subsection D. (4) should require that the producer or insurer if no producer is involved compare the annuity that is to be replaced or exchanged with the replacing annuity to determine whether going ahead with the transaction is in the consumer's best interest. This comparison should be documented. Additionally, D. (4) (b) should be amended to require that the replacing annuity provide a substantial benefit to the consumer over the life of the annuity; under a Best interest standard, it is not enough for this requirement to be just a factor to be considered. California requires the standard apply regarding replacement sales to seniors. Under a best interest standard, this requirement should extend to all purchasers.

6. The proposed language in subsection F. is weaker than the language in the current version of the Model Regulation. CDI has had enforcement cases in which the agent falsely claimed to have made no recommendation and/or the consumer refused to provide his/her suitability

information. The amended version of Subsection F. provides unscrupulous agents an easy way to avoid suitability requirements without the insurer's knowledge. A "best interest" standard requires a higher standard than that set forth in the current or proposed language of the Model Regulation. Instead of weakening this provision, the Working Group should strengthen it. California Insurance Code section 10509.914 provides stronger consumer protections than the Model Regulation by requiring that the insurer's issuance of an annuity subject to paragraph (1) "be reasonable under all circumstances actually known, **or which, after reasonable inquiry should be known, to the insurer or the insurance producer at the time the annuity is issued.**" [emphasis added]

If the Working Group decides to adopt the proposed language, an additional provision should be added requiring that prior to issuing the annuity, the insurer follow up with the consumer by sending the consumer a suitability questionnaire and the consumer must either complete the suitability questionnaire or write on the questionnaire a short sentence confirming that this purchase fits within the applicable scenario listed in F. (1); (2); (3) or (4).

I propose the following addition to Subsection F.

F. (1) ~~Except as provided under paragraph (2) of this subsection, neither an insurance producer, nor an insurer, shall have any obligation to the consumer under subsection A or C related to any annuity transaction if~~ An insurer is not obligated to determine an annuity is suitable, but instead, shall determine the annuity is reasonable prior to issuance based on the circumstances actually known to the insurer at the time the annuity is issued if any of the following situations occur:

- ~~(a) (1) No~~ The producer makes no recommendation is made;
- ~~(b) (2)~~ A recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer;
- ~~(c) (3)~~ A consumer refuses to provide relevant suitability information and the annuity transaction is not recommended; or
- ~~(d) (4)~~ A consumer decides to enter into an annuity transaction that is not based on a recommendation of the consumer or the insurance producer.

~~(2) An insurer's issuance of an annuity subject to paragraph (1) shall be reasonable under all the circumstances actually known to the insurer at the time the annuity is issued.~~

**(2) If any of the situations set forth in paragraphs (1)(a); (c); or (d) occur, prior to issuing the annuity, the insurer shall send the consumer a product suitability form with a cover letter that states that in order to ensure that the consumer is purchasing an annuity which is in the consumer's best interest, the insurer is requesting the consumer's suitability information. If the consumer refuses to complete the suitability form, the consumer must write on the form: "I refuse to complete this questionnaire and want to purchase the annuity which was not recommended by the insurance agent."**

**(a) The insurer is prohibited from issuing the annuity until it receives a response to its mailing from the consumer.**

7. Subsection G. (2) and (3) raise the same concerns I raised above regarding Subsection F. CDI has had enforcement cases in which the agent falsely claimed to have made no recommendation and/or the consumer refused to provide his/her suitability information. The amended version of Subsection F. provides unscrupulous agents an easy way to avoid suitability requirements without the insurer's knowledge. A best interest standard requires a higher standard than that set forth in the proposed language or the current Model Regulation. I suggest an additional paragraph that will immediately follow paragraph (3) which states:

**If any of the situations set forth in paragraphs (2) or (3) occur, prior to issuing the annuity, the insurer shall send the consumer a product suitability form with a cover letter that states that in order to ensure that the consumer is purchasing an annuity which is in the consumer's best interest, the insurer is requesting the consumer's suitability information. If the consumer refuses to complete the suitability form, the consumer must write on the form:**

**"I refuse to complete this questionnaire and want to purchase the annuity which was not recommended by the insurance agent."**

**The insurer is prohibited from issuing the annuity until it receives a response to its mailing from the consumer.**

8. Section H. (2) should be amended to include the additional consumer protections afforded by California law.

- (a) Subparagraph (a) should be amended per California Insurance Code section 10509.914 (f)(2)(A) to add the following as the last sentence:

An insurer is responsible for the compliance of its insurance producer with the provisions of this article regardless of whether the insurer contracts for performance of a function required under this subdivision and regardless of the insurer's compliance with subparagraph of this paragraph.

- (b) Subparagraph (b) should be amended per Insurance Code section 10509.914 (f)(2)(B) to include the word "reasonable" before the word "supervision" to make clear that a reasonableness standard applies.

- (c) Subparagraph (b)(i) should be amended include the word "reasonable" before the word monitoring.

9. Subsection I. should be amended so that this provision is also applicable to both producers and insurers, in keeping with California Insurance Code section 10509.914 (g).

10. Subsection J. should be further discussed by the Working Group since there is no FINRA Rule that requires that a best interest standard apply to annuity transactions. Additionally, a subparagraph should be added that states: “Except as provided in this paragraph, all other provisions of this Model Regulation remain applicable to these broker-dealer sales.”

### **Section 7 Non-Cash Compensation Disclosure Requirement**

It is insufficient to merely permit disclosure of non-cash compensation that exceeds \$100 per producer per year other than health benefits and other ERISA type benefits which are received as a result of being a producer selling proprietary products. Bonuses, contests, special awards, differential compensation and other incentives that are won or received as a result of having sold a threshold dollar amount of annuities would reasonably be expected to affect a producer’s ability to act impartially and in the consumer’s best interest. Therefore, these types of incentives should be prohibited. Accordingly, I recommend that Section 7 be amended as follows:

In addition to the disclosures required under Section 6 of this regulation, an insurance producer or an insurer, where no producer is involved, shall disclose to the consumer information regarding the non-cash compensation that exceeds \$100 per producer per year the producer receives from an insurer *and/or* intermediary that is tied to the sale of *proprietary* annuities including, but not limited to, *health insurance and other ERISA type benefits. gifts, meals, trips, entertainment, prizes, marketing, and advertising. Differential compensation and other incentives whether offered by or received from an insurer and or intermediary, including but not limited to gifts, meals, trips, entertainment, prizes, marketing, and advertising, that are intended or would reasonably be expected to cause, producers to make recommendations that are not in the best interest of the consumer are prohibited.*

### **Section 8 Prohibited Practices**

Subsection (2) of Section 8 should be amended to also prohibit material the misleading omissions. Accordingly, I recommend the following amendment.

- (2) Shall not make any materially misleading statements *or omissions* regarding the annuity transaction; and

### **Section 9 Insurance Producer Training**

1. California requires that all producers who want to sell annuities take a one-time eight credit-hour training course and satisfactorily complete four continuing education credits prior to license renewal every two years. I suggest that a drafting note be added that permits States to require additional course hours as their laws require.

2. I suggest that the Working Group consider the following amendments to the training topics.
  - a. At Subsection B. (3)(c), the Model Regulation requires training on “How product specific annuity contract features affect consumers”. California Insurance Code section 10509.915(b)(3)(C) requires that producers receive training on: “How fixed, variable, and indexed annuity contract provisions affect consumers”. I propose that this subparagraph of the Model Regulation be amended to use the more specific language set forth in California law.
  - b. The training topics should be amended to include that set forth in California Insurance Code section 10509.915(b)(3)(F), which requires that producers receive training on:

Prohibited sales practices, the recognition of indicators that a proposed insured may lack the short-term memory or judgment to knowingly purchase an insurance product, and fraudulent and unfair practices...for sales of annuities...
3. Regarding subparagraph (4)(b), compliance with FINRA Rule 1250 is insufficient reason for producers to avoid be required to take the additional training required by the Model Regulation. FINRA Rule 1250 is general; it does not mention annuities, nor does it list any issues that must be discussed within the broad topic of “suitability and sales practice considerations”. Further, currently, FINRA Rules do not require a “best interest” standard for annuities sales. California’s and the NAIC Model’s requirements regarding training topics appear to be better aimed at providing consumer protection in the context of annuity sales than does FINRA Rule 1250. Therefore, it seems that it would be a mistake to include this carve out in the Model Regulation.
4. California law does not include a “deemer” provision applicable to training taken in another state. California requests that subparagraph B. (8) be deleted.

### **Section 10. Compliance Mitigation; Penalties**

1. Subsection A. limits the actions the Commissioner may take to those set forth therein. California law provides broader authority to the commissioner. It allows him to take the actions listed in this portion of the Model Regulation, “in addition to any other available penalties, remedies, or administrative actions”. I propose that this provision be amended to make clear that the Commissioner retains the authority to obtain all penalties and remedies available, even though they may be additional to those set forth in the Model Regulation.
2. Subparagraph A. (2) contains the terms “general agency” and “independent agency”. These terms are not defined in the Model Regulation. The California Insurance Code does not reference the term “independent agencies”. It does refer to “managing general agents”. The

Working Group should consider amending this subparagraph to delete the term “independent agency” and use the term “managing general agents” if appropriate.

3. An additional provision should be added to this Section that provides: “Nothing in this Model Regulation shall affect the obligation of an insurer for acts of its agents, or any consumer remedy or cause of action that is otherwise provided for.” This provision accords with California law and a “Best interest” standard.

**Proposed Additional Section**

There be added an additional section which authorizes the Commissioner to adopt reasonable rules and regulations, and amendments and additions, as are necessary to administer this Regulation.

Sincerely,



Jodi S. Lerner  
Attorney