RICARDO LARA
CALIFORNIA INSURANCE COMMISSIONER

July 15, 2019

VIA E-MAIL ONLY

Jolie H. Matthews
Senior Health & Life Policy Counsel
Government Relations
National Association of Insurance Commissioners

SUBJECT: Request for Comments on Conflict of Interest and Care Obligation

Dear Ms. Matthews:

I am providing the following comments in accordance with Director Froment's request.

Topic: Conflict of Interest

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

In the context of the annuity sales, all incentives available to agents, managing general agents, general agents, and intermediaries, including independent marketing organizations, to motivate sales of annuities constitute material conflicts of interest. These incentives include offering agents commissions (including increased commission levels based on amount of sales) for selling annuities.

Material conflicts of interest also arise when production based incentives are offered. These might include bonuses based on high sales amounts as well as contests and prizes, including vacations, whether or not they include an educational component, where winning and/or being given the vacation depends on the amount sold. All other non-cash compensation, including gifts, which is based on amounts of annuities sold also constitute material conflicts of interest.

Insurers also have a material conflict of interest with regard to consumers because they need to have producers sell annuity products in order to make profit.

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

If commission structures were changed so that insurers no longer offered high first-year commissions, and instead, commissions were paid in equal amounts over the life of the annuity, problems resulting from unsuitable annuity sales would likely be minimal. However, the high first-year commission structure incents both sales of new annuities and replacement sales. Changing the commission structure as suggested would instead incentivize selling policies that would persist. That would be better for consumers.

The higher the commission, the greater the incentive to sell an annuity that may not be in the consumer's best interest. Bonuses and higher commission rates for top sellers and prizes and contests for selling large dollar amounts of annuities or specified annuities increase the likelihood that consumers will not be sold the best annuities for their situations. If these incentives did not motivate producers, insurers and intermediaries would not offer them.

The compensation provided to all in the chain who receive a commission should be disclosed. This would require disclosing commission levels provided to agents, managing general agents, general agents, intermediaries and independent marketing organizations.

Contests, prizes, bonuses and increased compensation levels based on amounts sold should stop. In 2015, Elizabeth Warren asked 15 annuity producers whether they offered non-cash incentives to agents to promote their products and whether these perks were disclosed to consumers. She found that the most frequently used incentive involved paid trips to resorts and vacation destinations. Attached for the Working Group's and Interested Parties' review is Senator Warren's discussion of her inquiry and findings, which is entitled Villas, Castles, and Vacations: *How Perks and Giveaways Create Conflicts of Interest in the Annuity Industry.*

Topic: Care Obligation

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

California's position is that there should be a fiduciary standard of care. Too many consumers have lost too much of their retirement savings through being led to purchase unsuitable annuities by producers who provided conflicted advice. Nevertheless, it is clear that this Working Group will not recommend a fiduciary standard of care.

A lower standard of care obligation of a producer should include "prudence". Too many consumers have been led to put too much of their money in long-term annuities, which has left them with insufficient available funds to use to pay for both emergencies and expenses that arise in everyday life. When the consumers have had to take more than the free withdrawal amount, they have had to pay large surrender penalties.

Producers should act prudently both in determining whether the consumer should purchase an annuity and suggesting how much of the consumer's money should be placed in the annuity. Further, to act prudently is simply to act in a non-negligent manner.

The Miriam-Webster dictionary online defines the word "prudent" as "'characterized by, arising from, or showing prudence: such as… Marked by wisdom or judiciousness // prudent advice…" In the synonym section, it states "prudent suggests the exercise of restraint guided by sound practical wisdom and discretion."

Additionally, a "reasonably prudent person" is one who does not act negligently. California Jury Instructions (BAJI) at 3.10 contains definitions of the terms "Negligence" and "Ordinary Care". Negligence is defined as:

> … [T]he doing of something which a reasonably prudent person would not do, or the failure to do something which a reasonably prudent person would do, under circumstances similar to those shown by the evidence.
>
> "It is the failure to use ordinary or reasonable care."

Further, California Jury Instructions (BAJI) at 3.11 sets forth "A Test for Determining the Question of Negligence". It states:

> One test that is helpful in determining whether a person was negligent is to ask and answer the question whether or not, if a person of ordinary prudence had been in the same situation and possessed of the same knowledge, [he] [or] [she] would have foreseen or anticipated that someone might have been injured by or as a result of [his] [or] [her] action or inaction. If the answer to that question is "yes," and if the action or an action reasonably could have been avoided, the not to avoid it would be negligence.

California Jury Instructions (BAJI) at 3.10 contains definitions of the terms "Negligence" and "Ordinary Care". "Negligence is defined as:

> …[T]he doing of something which a reasonably prudent person would not do, or the failure to do something which a reasonably prudent person would do, under circumstances similar to those shown by the evidence.
> It is the failure to use ordinary or reasonable care.
>
> Ordinary or reasonable care is that care which persons of ordinary prudence would use in order to avoid injury to themselves or others under circumstances similar to those shown by the evidence.

Clearly, given the forgoing, producers should be required to act in a prudent manner.

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?

The word "ordinary" does not necessarily imply that the producer is either reasonable or prudent. The "ordinary producer" standard merely enshrines the existing standard, which is too low. California would like to have a higher standard that is as close to a fiduciary standard as possible. Requiring that the producer's care obligation include prudence would be beneficial. Producers should act prudently and not negligently when selling consumers annuities. Adding a required duty of honesty, good faith, and fair dealing would also help to raise the standard.

California Insurance Code section 785 (a) states:

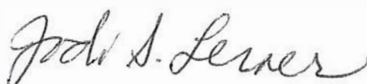
> All insurers, brokers, agents, and others engaged in the transaction of insurance owe a prospective insured who is 65 years of age or older, a duty of honesty, good faith, and fair dealing. This duty is in addition to any other duty, whether express or implied, that may exist.

I propose that the Working Group consider whether a duty of good faith and fair dealing should be set forth in the Model Regulation and be applicable to annuity transactions with all consumers who are working with a producer and/or insurer on purchasing an annuity.

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?

There should be a written record of the recommendation that explains the grounds for the recommendation and the advantages and disadvantages of purchasing the product. Commissions, fees and surrender charges should be disclosed in this document. Further, the document should be in plain English with adequate spacing between paragraphs so that it is readily readable. The consumer should be provided a copy of the document at the time of application. The insurer should also be provided with a copy of the document as part of the application process. The producer should also explain this information orally.

Cordially,



Jodi S. Lerner
Attorney III

Villas, Castles, and Vacations:

How Perks and Giveaways Create Conflicts of Interest in the Annuity Industry

October 2015

Prepared by the Office of Senator Elizabeth Warren

I. EXECUTIVE SUMMARY

Many Americans rely on retirement investment advisers for guidance on how to save towards retirement, and most advisers have their customers' best interests at heart. But because of loopholes in the law, it is perfectly legal for some advisers to steer customers into complex financial products that will earn the highest rewards, perks and prizes for the advisers – even if they are bad options for their customers. Research suggests that this loophole costs Americans an estimated $17 billion every year.[1] That's $17 billion taken out of the pockets of retirees by unscrupulous advisers who are more interested in collecting fees and prizes for themselves than helping families build real security. In order to protect consumers from these types of abuses, the Department of Labor has proposed a draft rule to put an end to these conflicts of interest by closing these loopholes.[2]

Kickbacks pose an especially dangerous problem. When companies can offer kickbacks to agents for recommending high-cost financial products, and when those kickbacks are hidden from the customers, the likelihood that consumers will be duped into buying bad products increases sharply. To explore the prevalence of this type of conflict of interest, in April 2015 Sen. Elizabeth Warren (D-MA) opened an investigation, asking fifteen leading annuity providers for information on whether they offered non-cash incentives such as lavish cruises, luxury car leases, and other perks to annuity sales agents to promote their products and whether their customers were aware of the agents' compensation arrangements [3]

While none of the companies questioned by Sen. Warren provided complete answers to the questions in her April 2015 letter, the responses nonetheless reveal a widespread practice of offering agents kickbacks in exchange for promoting certain annuities and other insurance industry products and that such kickbacks are effectively concealed from customers. Kickbacks may benefit the agent and the company, but they do so at the expense of their customers. And loopholes in the law make these kickbacks perfectly legal.

Overall, thirteen of the fifteen companies – 87% - admitted to offering kickbacks directly to agents, indirectly through third party gift payments, or both.

Other key findings of the investigation include:

- **The majority of companies admitted to providing rewards and inducements, such as expensive vacations and other prizes, to annuity agents in exchange for sales.** While financial industry rules to restrict non-cash compensation have been in place for over a decade, significant loopholes in those rules still allow companies to provide perfectly legal, non-cash compensation to sales agents.[4] Nine of the fifteen companies that responded to Sen. Warren's request letter indicated that they provide non-cash compensation to annuity agents. One company described these kickbacks as "common in the industry." The most frequently offered incentives involve all-expense-paid trips to expensive vacation destinations such as Aruba, the Bahamas, and other resorts. The companies also admitted to providing items such as golf outings, dinners at restaurants, tickets to sporting events, sports memorabilia, theatre tickets, gift cards, and other rewards—to agents who sold their products.

- **Companies also create conflicts of interest by offering perks and inducements to annuity sales agents through third party marketing organizations.** Even companies that do not provide non-cash compensation awards directly to agents frequently provide incentives to the third-party marketing organizations that then pass these awards on to the agents. Ten of the fifteen companies indicated that they provide such indirect payments. These payments are then used to provide kickbacks to agents, including expensive vacations, golf outings, iPads, jewelry, and other items. One expert described these third party marketing organizations as "the primary culprits of this type of agency perks."[5]

- **Current disclosure rules are inadequate to ensure that customers are informed about the incentives agents receive for selling them specific financial products.** Companies are required to provide certain information about non-cash compensation in their prospectuses, but the information provided to Sen. Warren and other publicly available information indicates that no company that offers payments or kickbacks to agents or third parties provides

annuity purchasers with a clear, accessible, specific, and easy to understand explanation of their agent reward system, their third-party payments to marketing organizations, or the way these payments may be structured to encourage agents to sell the company's annuities and other products without regard to whether they benefit the customer.

- **Existing rules and regulations to deter conflicts of interest are completely inadequate.** Companies that responded to Sen. Warren's request for information pointed out that they were regulated under federal, state, and industry rules and guidelines and emphasized that they followed these rules quite carefully. However, this investigation reveals that those rules still left these companies with ample room to build a business model in which annuity providers could offer a wide range of perks and kickbacks to annuity agents irrespective of the quality of the financial products sold. As a result, many consumers continue to receive investment advice from sales agents who have incentives to put their own interests ahead of their customers, which may help explain how consumers lose an estimated $17 billion every year relying on the advice of conflicted advisers.

Federal and state regulations are designed to curb kickbacks illegal for certain advisers and certain products, but loopholes in the law permits many companies to continue to offer these rewards and many agents to continue to take them. Thirteen of the companies investigated (87%) admitted providing kickbacks to sales agents – either directly or indirectly - for selling their financial products. Giveaways such as expensive vacations, sports tickets, golf outings, and electronics present a conflict of interest for many agents and create incentives to sell products that are not in the consumers' best interest. Conflicts of interest like these are not restricted to the annuity industry; throughout the financial industry they cost families an estimated $17 billion every year.

The Department of Labor has proposed a new Conflict of Interest rule that would eliminate some of the worst sales practices in the retirement investment advice industry. This rule, if finalized, would provide important and necessary protections for people who entrust their life savings to a retirement adviser.

II. INTRODUCTION

More than $235 billion worth of annuities were sold to customers in the United States in 2014.[6] Annuities can be a valuable product for some consumers in some circumstances, offering guaranteed payouts over time. But annuities are complex instruments that involve difficult calculations, non-standard terms, hefty surrender fees, and abundant legalese that often obscure their full costs and risks. These features make it difficult for customers to comparison shop, often placing them at the mercy of a sales agent.

Many stories have surfaced about seniors being sold high-cost annuities, losing tens of thousands of dollars of their nest eggs on management costs, commissions and other fees.[7] Other stories have emerged about inappropriate products, such as the sale of long-term annuities to wholly inappropriate individuals, such as people who have already surpassed their life expectancies or to individuals with terminal illnesses, Alzheimer's or dementia.[8] The problem of high cost or unsuitable products is particularly acute with annuities because many customers are at or near retirement age, a time when they will have almost no chance to recover their investment if they are deceived by a sales agent.

Annuities are generally marketed through a network of individual agents and advisers who sell directly to customers. Unlike doctors, lawyers, certified public accountants, some fee-based financial advisers, and certain retirement advisers, many of the agents and advisers selling annuities and some other financial products can put their own financial interests ahead of the interests of the person they are advising. As a result, an agent can legally sell a retiree a high-cost annuity that is less appropriate for the customer than a similar product—and agents can be incentivized to sell these products by the fact that they will earn a bigger fee or a fancy vacation that they would not earn on a competing product.

In April 2015, Sen. Warren released information raising questions about annuity industry sales practices. In a letter to fifteen annuity providers,[9] Sen. Warren asked the companies to provide information on their use of non-cash compensation, the types of non-cash compensation awarded, the circumstances under which they would award such non-cash compensation, and the extent and type of disclosure given to consumers about this non-cash compensation. The fifteen companies who

were asked for this information collectively sold $168 billion worth of annuities in 2014, representing 71% of total industry sales.[10]

While none provided complete answers to every question asked by Sen. Warren, all fifteen companies responded at least in part to this request for information. As a result, Sen. Warren was able to assemble significant new information on the extent, type, and practices of non-cash compensation used by companies to reward agents who sell their annuities. This report contains the findings of that investigation.

III. FINDINGS

1. The Majority of Companies Provide Non-Cash Compensation Directly to Agents Selling Annuities

Of the fifteen companies that responded to Sen. Warren's request letter, nine indicated that they provide non-cash compensation and perks directly to annuity agents.

In their responses, annuity providers were surprisingly forthright about how and why they provided this compensation. One respondent noted that it "is common in the [annuity] industry" for agents to "receive non-cash compensation."[11] Another clarified that "incentives…are separate and apart from commissions, and … are based on the amount of business a particular agent … produces."[12] A third "offers additional benefits for our top individual producers."[13] A fourth noted that "non-cash awards serve as a secondary source of sales compensation."[14]

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Requirements – Limited to the **Top 80 Qualifiers**.

Minimum Qualifications – Conference Credit of $100,000 and 12 New Cases (General Agent and Agent levels). Cases can be Fixed Life and/or Fixed Annuities. Variable products are not eligible for conference credit.

Qualification Period – January 1, 2014 through December 31, 2014. Applications must be issued and paid (all issue requirements satisfied) by the final cutoff date of December 31, 2014.

Production Requirement – A minimum of $100,000 of conference credit is needed to qualify (General Agent and Agent levels). Conference credit is based upon the following formula:

- 100% on paid life business up to commissionable target first-year premium and (*except as noted below) last survivor policies.*
- 5% for fixed annuities with a 2014 application date.
- 5% for first-year Single Premium UL.
- Standings are reported on in-force business, and conference credits are not assignable.
- 10% for Universal Life excess.

Case Requirement – A minimum number of 12 new cases (General Agent and Agent levels). These cases may be any combination of fixed life and/or fixed annuity plans.

Persistency Requirement – A minimum life persistency of 80% is required on all business.

Eligibility – The top 80 licensed representatives of the Company who qualify in accordance with the official requirements are eligible for an invitation to attend. The licensed representative must be contracted and in good standing with the Company at the time the conference is held.

Invitation – Conference attendance is available only to those who qualify and are invited by the Company to attend. A guest must be accompanied by the qualifier in order to attend the conference and must be 18 years of age or older.

An individual who qualifies and receives an invitation and who, for any reason, is unable to attend the conference is not entitled to any other compensation, nor may the qualifier substitute in his/her stead any other person.

Expenses – Federal/state income tax incurred as a result of attending the conference is the responsibility of the qualifier. A 1099 in the amount of the "fair market value" of the trip will be issued. It is suggested that participants consult their tax advisor in regard to tax treatment.

American National Insurance Company will provide:

- Air transportation and transfers from the nearest major airport to and from the conference destination
- Taxes and tips necessary to complete the included portions of the conference
- Hotel accommodations
- Specified meals
- Expenses for Tour/Activity sponsored by the Company

Any deviation from the conference program is at the qualifier's expense and subject to availability. All additional travel expenses must be paid in full by the participant prior to the conference. The Home Office may, if necessary, amend the rules governing qualification requirements for the 2015 Conference during the qualification period.

Conference qualification may not be available to all representatives.
Contact your Marketing Organization for verification.
1-888-501-4043, Option 1 www.img.anicoweb.com

Companies also indicated that they provide a large variety of valuable prizes. The responses to Sen. Warren's inquiries referred to numerous types of giveaways and incentives provided to financial advisers and other annuity sales agents. The most frequently cited inducements involve paid trips to resorts and vacation destinations – often touted as annual sales meetings or conventions "with an educational component." One company noted the ubiquity and importance of these trips, describing them as a "long standing practice" and "an important tool … to incent sales."[15]

Nine of the fifteen companies reported offering these kinds of vacations and trips to conventions or sales conferences, or other forms of non-cash compensation.

In general, and in order to stay within existing legal guidelines, qualification requirements for these trips appear to be based on sales incentives that include all types of a company's products sold by the agent – including annuities, life insurance, and other insurance products.

For example, American Equity offered a trip to San Francisco in October 2015 for "top performing" sales agents ("and their guests") with sales of over $3 million in annuities and life insurance. The company brochure for this trip notes that the "event [is] in one of the country's most picturesque and storied cities… at one of the world's most luxurious hotels."[16] For an even more select group of agents, the fifteen top sellers referred to as the "Chairman's Club," American Equity offers "a perennial opportunity to celebrate our uppermost producers with our most exclusive retreat…four days in the heart of California's wine country at the prestigious Calistoga Ranch and Spa."[17] The company offered a similar trip for top-selling producers to Walt Disney World in 2014, with the added bonus of paying for children of sales agents who had an extra $600,000 worth of sales of American Equity products.[18]

Athene offers its "Leaders of Olympus" trips to agents with at least $3.5 million worth of sales. In 2016, this conference will "stay at The Ritz-Carlton Aruba — an unforgettable luxury beach resort overlooking the Caribbean Sea….[that] offers elegant style and unmatched amenities. Enjoy a sunset from your private balcony, relax in the superbly appointed spa, or walk barefoot along the coast at dawn. For more excitement, explore the nearby nightclubs, try your luck in the 24-hour casino, shop 'til you drop. Start qualifying today — an island full of culture, stunning landscapes, exotic cuisine and more awaits you in Aruba."[19]

For its ten agents with the highest sales levels, Athene offers an additional perk: "an extended ultra-luxe experience … an extra two days at The Ritz-Carlton Aruba, in addition to business class airfare, executive suites, and a private charter catamaran cruise."[20] Last year, Athene offered its' highest-selling agents and their guest "an incredible trip to the Shelbourne in Dublin, Ireland...[and] a three day trip extension to Dromoland Castle, a luxurious hotel located near the beautiful scenery of the Cliffs of Moher."[21]

Lincoln Financial offered agents a trip to South Africa in 2015, followed by an offer in 2016 for "an extraordinary getaway to the newest resort destination in the Bahamas, Baha Mar. … [Y]ou'll escape to this colossal luxury retreat on the northern shores of New Providence Island. Spread over 1,000 acres, Baha Mar features four extravagant hotels, world-class hospitality and a wealth of amenities that combine to create a sanctuary of adventure and relaxation. Lincoln qualifiers and guests will enjoy the stylish accommodations and modern comforts of the Grand Hyatt at Baha Mar. Days will be spent unwinding on the sun-drenched sands of Cable Beach, exploring the sparkling turquoise waters of the Atlantic, immersing yourself in the Bahamian culture at a bustling market or enjoying cool ocean breezes from the fairways of the Jack Nicklaus-designed TPC at Baha Mar."[22]

Other trips to conventions and sales conferences are not as lavish, and some appear to focus on education rather than on providing perks or vacations. For example, one company noted that on its education and training trips, agents are required to spend at least five hours per day on such activities; others do not pay for spouses or children, or do not cover all costs (such as airfare, hotels, or meals) associated with the trip.

There are numerous other annuity providers that offer similar trips: for example, Fidelity Guarantee and Life

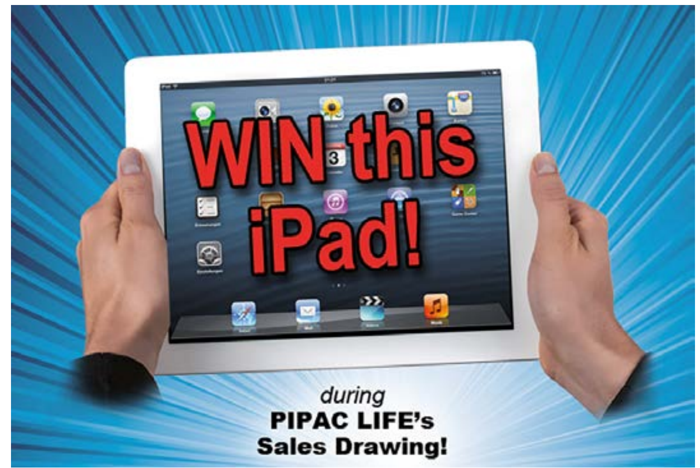
offered agents the opportunity to attend the company's 2015 Power Producer Conference at the Four Seasons Resort in Punta Mita, Mexico;[23] Mutual Trust invited sales agents to its annual Vanguard Conference in Laguna Beach, California, offering "star treatment" to its top agents;[24] American National offered a five-day, four-night stay at the Cove Atlantis on Paradise Island in the Bahamas for top-selling agents and their guests.[25] One annuity provider – Reliance – notes "We do not offer company-sponsored conventions." Instead, the company says, "We believe that since you do the work selling annuities, you should choose where and when you want to travel. Imagine the possibilities... redeem your RSL Rewards travel credits for a weekend getaway, a trip across country to see your team's championship win, or that overseas vacation that's been on your "someday" list … With RSL Rewards, there are no limits on how you use your travel credits. Redeem your credits for hotel stays, meals, rental cars, cruises, first-class airfare, or just about any other travel-related luxury … Combine your travel credits for the trip of a lifetime."[26]

Resort vacations are not the only compensation offered by companies to agents. The majority of companies indicate that they offer free business support to agents, such as administrative and marketing support and training. But the list of giveaways goes beyond assistance directly related to annuity sales. Companies reported that they provide items such as golf outings, dinners at expensive restaurants, tickets to sporting events and sports memorabilia, theatre tickets, and gift cards.[27]

Other companies offer additional perks. The Great American Insurance Group rewards agents who sell the company annuities with "Partner Points" that can be redeemed for "You have the ability to select how you would like to be rewarded, with thousands of items in many different categories. From luxury vacations to today's hottest electronics, the possibilities are truly endless-and the choice is all yours."[28]

2. Companies Offer Payments to Agents through Third Party Marketing Organizations Representatives.

Sen. Warren's investigation reveals that the vast majority of annuity providers also provide substantial incentive payments to third-party "Sales and Marketing Organizations" (SMOs) and "Field Marketing Organizations" (FMOs) – and that these payments are



then used to provide perks and rewards to agents.

Financial advisers and annuity sales agents work either directly for annuity companies or they work independently and are affiliated with one or more marketing organizations. These organizations provide support for the agents, and in exchange collect a fee or commission on sales.

The investigation reveals that even in cases where companies do not choose to provide or are barred by FINRA rules from providing non-cash compensation awards directly to agents, they frequently provide cash or non-cash incentives to the third-party marketing organizations that then pass these awards on to the agents. Ten of the fifteen companies – 67% - reported making such payments.

Companies described these payments and perks given to the third parties in a number of different ways. One stated that "Independent marketing organizations … may receive enhanced payments based on attainment of established sales levels"[29]; another noted that "FMOs and agents also may receive non-cash compensation… Examples include … golf events, annual FMO meetings and FMO events and symposium sponsorships." [30] This company stated that it "typically pays the cost of transportation, lodging, and meals" at these events.[31] A third clarified that while it does not offer non-cash incentives directly to independent agents, it "may also pay additional compensation … to certain broker-dealer firms. This additional compensation can be used by these independent firms for conferences, education seminars, training, sales promotions, etc."[32]

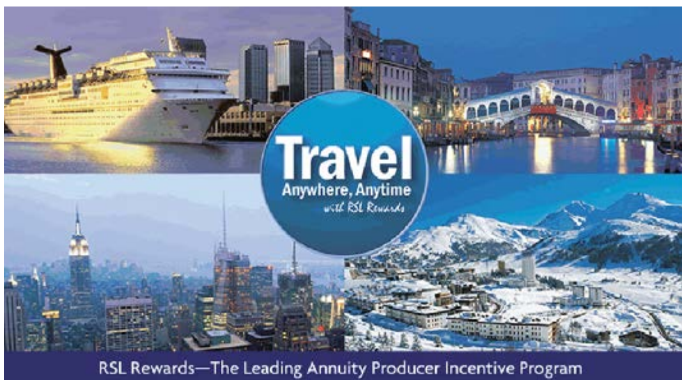
These marketing organizations in turn, use these payments to reward their agents with a large variety of

non-cash compensation. There are numerous examples of these perks, and experts consulted by Sen. Warren's staff indicated that the perks flowing from these third parties to agents were more numerous and more valuable than the perks flowing directly from companies selling annuities to agents. One expert has claimed that the FMOs have become "glorified travel agencies."[33] and noted that they are "the primary culprits of this type of agency perks."[34]

Examples are numerous. The marketing organization DressanderBHC offers its top producing agents an "exclusive, invitation-only" trip to the Ocean Reef Club in Key Largo, Florida.[35] Financial Brokerage, Inc. offers top-selling agents entry into its "Elite Producer Group … designed to provide our top producers additional incentives … as a member of the Elite Producer Group, you'll receive the recognition and awards you deserve."[36] Perks offered to agents that qualify for the Elite Producer Group include up to $1,500 cash, trips to the Turks and Caicos, Tuscany, and Costa Rica,[37] and a $1,500 Tag Heuer or Movado Watch.[38] Marketing organizations give away iPads,[39] golf outings,[40] and jewelry – including an "NFL-style Super Bowl Ring."[41]

One consulting group put together in 2011 a list of "Top Ranked FMO Reward Trips" that included a thirty day around the world trip for two, a week in Bora Bora, Tahiti, the Ritz on Grand Cayman Island, a trip to Monte Carlo, and a week in Rome, Italy.[42]

Overall, thirteen of the fifteen companies surveyed by Sen. Warren reported that they provided kickbacks either directly to agents or indirectly through third-party marketing organizations. These kickback schemes are problematic because they appear designed to focus the attention of agents on the rewards associated with a sale, rather than the costs imposed on the customers—and they are perfectly legal. This is particularly troubling with products such as annuities in which complex calculations, hefty surrender fees, legal jargon and non-standard terms make it difficult for lay customers to assess the true costs of the product. Also, prize giveaways based on a sales threshold (e.g., sales of $3.5 million qualify for a luxury vacation) rather than a flat commission or a fee-per-consultation encourage agents to concentrate sales with one company and, as they near a designated goal, to press harder to sell an annuity or other company product regardless of the appropriateness of that investment or its costs to the customer.



It is important to note that not all companies engage in these practices. Two of the fifteen companies that responded to Sen. Warren's letter reported that they refuse to pay non-cash direct or indirect kickbacks, which suggests that it is possible to build a viable business model without offering these inducements to agents. But this inquiry also demonstrates that companies that don't offer such incentives are forced to compete for billions of dollars worth of business with those that offer plush vacations and other perks to selling agents, suggesting that those companies that do not use such compensation schemes might attract even more business if such kickbacks were banned.

3. Disclosure is Inadequate

As part of her investigation, Sen. Warren asked the companies for information on the disclosures given to customers of the perks, giveaways, and rewards awarded to agents in exchange for annuity sales. This analysis of the information provided reveals that the companies typically provide disclosures through annuity prospectuses, and that these prospectuses describe the rewards only in the broadest and most vague terms. Among the companies that provide perks such as free travel, no company clearly described the nature and type of rewards, or the locations of annual trips provided to agents, in its annuity prospectuses. None of the disclosures clearly reveal that these perks may create incentives for the agent to put his or her own interests ahead of those of the customer. The limited disclosures that are provided to consumers are buried deep within the prospectuses in complex legalese, rather than being provided in an easily available and understandable fashion.

For example, one prospectus notes – on page 70 – that "Financial professionals and their managers are also eligible for various benefits, such as … non-cash compensation items … includ[ing] conferences,

seminars, and trips (including travel, lodging, and meals in connection therewith), entertainment, awards, merchandise, and other similar items." The third party payments to marketing organizations are described – also on page 70 – by noting that the company "may make bonus payments to certain selling firms based on aggregate sales of our variable insurance contracts."[43]

Another provided a similarly broad description on page 135 of their prospectus, noting that the company "may also offer "non-cash compensation," as defined under FINRA's rules, which includes among other things, merchandise, gifts, marketing support, sponsorships, seminars, entertainment and travel expenses."[44] Rather than providing full details, the prospectus notes that "You may ask your registered representative how he/she will personally be compensated, in whole or in part, for the sale of the contract to you or for any alternative proposal that may have been presented to you." [45]

Prudential provides one of the most detailed disclosures, listing the specific broker-dealers that have received payments from the company.[46] But this disclosure is buried on page 55 of the prospectus. In addition, the disclosure provides no specific information on the amount of payments, noting only that "During 2014, the least amount paid, and greatest amount paid, were $25.00 and $9,079,316.06, respectively."

Insurance companies are required to provide certain information about non-cash compensation in their prospectuses. But the information provided to Sen. Warren and other publicly available information indicate that companies do not provide annuities purchasers with clear, accessible, specific, and easy to understand information about their non-cash compensation practices or their third-party payments to marketing organizations that incentivize agents to sell the company's annuities and other products.

4. Current Regulations and Consumer Protections are Inadequate

The responses provided by these companies to Sen. Warren emphasizes that they take great care to follow existing laws and FINRA regulations regarding non-cash compensation for annuity sales. One company noted that there is "a comprehensive regulatory framework relating to cash and non-cash compensation, including disclosure and supervisory obligations, limitations on gifts and entertainment and a structure for sales incentives, all designed for investor protection."[47] Another noted that "regulatory requirement[s] consist of a robust framework of consumer protection regulations established by the SEC, FINRA, state security regulators, and state insurance departments."[48]

The American Council of Life Insurers described six different sets of laws and regulations -- the National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions Model Regulation, FINRA Rule 2230, the NAIC Annuity Disclosure Model Regulation, the NAIC Model Replacements Regulation, the NAIC Unfair Trade Practices Act, and state insurance laws – designed to thwart non-cash compensation that creates conflicts of interests.[49]

This investigation reveals, however, that existing rules do not adequately protect consumers from conflicts of interest or ensure that they are adequately notified of these conflicts. These rules contain numerous loopholes. Current rules:

- Do not bar non-cash compensation for fixed income annuities;
- Permit companies to provide expensive vacations under the guise of sales meetings and conventions;
- Permit companies to provide compensation via payments to third-party marketing organizations that provide an end-run around restrictions on non-cash compensation; and
- Permit companies to provide non-cash compensation for sales of a broad array of a company's products.

As a result of these loopholes, the majority of companies queried currently offer annuity sales agents non-cash compensation that creates significant conflicts of interests and harms consumers.

IV. POLICY OPTIONS TO ADDRESS ANNUITY SALES CONFLICTS OF INTEREST

Despite existing state and federal regulations and a decade of industry self-regulation, companies have been able to take advantage of legal loopholes and lax disclosure requirements to provide perks, rewards, and

other forms of non-cash kickbacks to agents who sell annuities. Giveaways such as expensive vacations, sports tickets, golf outings, and electronics present a conflict of interest for many agents and can incentivize them to sell products that are not in the consumers' best interest.

The Department of Labor has proposed a new Conflict of Interest rule that would eliminate the worst sales practices of the annuity industry and the retirement investment advice industry more broadly. The rule would close the loopholes in existing law by requiring that all advisers who give retirement advice specifically directed to an individual investor must act in the best interest of their clients. This means that a retirement investment adviser cannot steer a customer to an inferior product simply because it boosts the adviser's own income or comes with an enticing giveaway. It would also require that advisers clearly and prominently disclose any conflicts of interest, such as luxury vacations or NFL Super Bowl-style rings instead of burying these disclosures in the fine print.

The results of this investigation suggest that strong Conflict of Interest rules are necessary to prevent consumers from losing billions of dollars of their hard-earned savings.

V. CONCLUSION

This investigation reveals that companies representing tens of billions of dollars in annuity sales are allowed to offer and do offer a variety of kickbacks, from lavish vacations to golf outings to gift cards to iPads, either directly to annuity sales agents or indirectly to these agents via third-party marketing organizations, in exchange for selling a specific company's products. Disclosure of these perks and payments to consumers is inadequate, and even with regulations designed to curb these kinds of payments, some companies have identified and taken advantage of numerous loopholes in those rules so they continue to offer these kickbacks.

The perks offered by companies to agents create a conflict of interest that result in consumers – many of whom are at or near retirement age – receiving advice about investments in annuities that may not match their needs. The annuity industry is not the only industry affected by these conflicts. Across the financial industry, conflicts cost American investors an estimated $17 billion in retirement savings every year. New regulations are needed to protect consumers and end this financial conflict of interest.

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