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**January 22, 2018**

**Via E-Mail**

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

*Via email to*: jmatthews@naic.org

**Re: Proposed Revisions to Suitability in Annuity Transactions Model Regulation**

Dear Director Cameron and Commissioner Ommen:

On behalf of the Committee of Annuity Insurers (the "Committee") and its 32 member insurance companies that represent over 80% of the annuity business in the United States, we are writing in response to the Annuity Suitability (A) Working Group's ("Working Group") request for comment on the proposed revisions ("Proposed Revisions") to the Suitability in Annuity Transactions Model Regulation (#275) ("Model Regulation"). The Committee appreciates the opportunity to provide comments on the Proposed Revisions to assist with this important initiative to revise the Model Regulation. Set forth below, we discuss the following:

- An overview of the Committee;
- General principles we urge the Working Group to follow in moving forward with the Proposed Revisions;
- Provisions of the Proposed Revisions that Committee members believe are fundamentally unworkable and require revision;
- Recommendations for rationalizing the Proposed Revisions' disclosure requirements; and
- Comments on other specific provisions of the Proposed Revisions that the Working Group should address.

## OVERVIEW OF THE COMMITTEE

The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of federal and state policy with respect to regulatory and tax issues affecting the annuity industry. The Committee's members offer annuities through affiliated and unaffiliated distribution channels, including broker/dealers. A list of the Committee's member companies is attached as Appendix A. For over 35 years, the Committee has been involved in shaping and commenting upon many elements of the regulatory framework applicable to annuity products. In particular, as relevant to the Proposed Revisions, the Committee over many years has been actively involved in standard of conduct and suitability-related initiatives of the Department of Labor ("DOL"), the Financial Industry Regulatory Authority, Inc. ("FINRA") and the Securities and Exchange Commission ("SEC").

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## GENERAL PRINCIPLES GOVERNING THE PROPOSED REVISIONS

The Committee has carefully reviewed the Proposed Revisions and has a number of comments, questions, and requests for clarification.[1] As a general matter, the Committee supports the efforts of the Working Group to modify the Model Regulation to, among other things, provide that insurance producers (or insurers if no producer is involved) act in the "best interest" of their customers. The Committee urges the Working Group to move forward consistent with the following general principles that will be extremely important to the annuity industry, annuity purchasers and therefore the ultimate success of the Proposed Revisions:

- The Proposed Revisions should operate in full harmony to the greatest extent possible with other regulatory regimes applicable to annuity transactions, including regulatory requirements imposed by (i) the DOL under its fiduciary rule set ("DOL Fiduciary Rule") with respect to fiduciaries providing investment advice about annuities to retirement plans and investors, (ii) FINRA with respect to broker-dealers recommending variable annuity transactions to customers, and (iii) the SEC with respect to insurance products regulated as securities and the standards applicable to registered broker-dealers and investment advisers;

- The Proposed Revisions should articulate a clear and workable best interest standard that clarifies the obligations of all annuity market participants, including insurers, producers, annuity customers and regulators; and

- The Proposed Revisions should be crafted in a manner that makes maximum possible use of existing operational, compliance and transaction review structures for annuity transactions so as to minimize the operational disruption and resources required to respond to the regulatory changes.

Adopting the Proposed Revisions in a manner that fails to fully take into account the general principles above and the other comments below will have harmful effects on insurers, American investors and the economy as a whole. For example, a lack of harmonization with other regulatory regimes could significantly disadvantage annuity products compared to other investment products, and therefore result in annuity products being less available than other investment products and on fewer distribution platforms.

The importance of easy accessibility to annuity products for the investing public cannot be over-emphasized. Other than Social Security and defined benefit plans, annuities are the only investment products that can offer Americans lifetime income benefits that guarantee they will not outlive their retirement income. Annuity products can also protect against other significant risks to which individuals' retirement assets are exposed, including inflation risk, investment risk, interest rate risk, and liquidity risk, thereby allowing retail investors to acquire, in a single product, insurance against a number of different risks to their financial and retirement well-being.

## CERTAIN PROPOSED REVISIONS ARE UNWORKABLE AND REQUIRE REVISION

The Committee believes that certain of the Proposed Revisions as currently drafted are unworkable for a variety of reasons, including that they are impractical or diverge from other regulatory regimes. Set forth below is a discussion of the following unworkable provisions:

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[1] The Committee generally recommends that, as the Working Group moves forward and modified revisions to the Model Regulation are exposed for further public comment, it also consider liberal use of "Drafting Notes" that can be commented upon. Such Drafting Notes can be a vehicle in appropriate circumstances for providing clarity about the meaning and intent of new provisions. This will both help ensure that the new provisions are harmonious with other regulatory regimes and that, when individual states adopt the revised provisions, they are interpreted and applied uniformly in the various jurisdictions.

- The definition of "reasonable cash compensation";
- The producer's duties under Section 6(B)(2) to "evaluate the types of products" that correspond to the customer's financial objectives;
- The standard articulated with respect to replacements under Section 6(D)(4)(b); and
- The best interest overlay on the insurer's supervisory obligations as it relates to the producer's ability to offer another insurer's products (e.g., Section 6(H)(1)).

**The Definition of "Reasonable Cash Compensation."** Section 5(M) proposes to define "reasonable cash compensation" to mean "cash compensation that reflects the time and complexity of the product and the transaction involved and is not connected to volume of production." There are a number of flaws in this definition that must be corrected. As currently drafted, the clause "not connected to volume of production" could be read to prohibit any form of transaction-based commissions given that commissions ordinarily are paid by reference to the volume (i.e., the premium amount) of annuity products. The Committee recommends that the definition be revised to make clear that it is not intended to exclude conventional commission payments from the definition of "reasonable cash compensation."

Insofar as the clause could also be read to prohibit graded compensation structures under which a producer's compensation percentage increases as the producer sells a larger volume (or premium amount) of an insurer's products, the Committee again is concerned about potential disruption of common and widely-used compensation practices in the insurance industry. The Committee acknowledges that graded compensation structures may present potential conflicts of interest for producers. However, other regulatory regimes, such as FINRA's and the SEC's, have addressed these conflicts by requiring the use of certain conflict mitigation practices, not through outright prohibition.[2] In the interest of harmonization, the Committee believes that the apparent limitation on payments of cash compensation "connected to volume" should be revised in a manner that permits graded compensation structures, consistent with other regulatory regimes.

Finally, by utilizing the "time and complexity of the product and transaction" as the sole standard for determining whether a producer's compensation meets the "reasonable cash compensation" definition, the Proposed Revisions fail to take into account the market and economic forces that historically have driven the setting of producer compensation.[3] Further, the standard suggests that a producer's compensation should differ from one transaction with a consumer to the next, even if the same product is involved, simply because the producer devoted more time to one transaction than the other. But this implication ignores the reality that insurers, not consumers, typically set the compensation for producers, and that they do so on a per product basis, without any adjustment when compensation is paid because more "effort" may have been required for one annuity sale versus another sale. A requirement that producer compensation must be based solely on the time and complexity of the product may

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[2] *See* FINRA Conflict of Interest Report (October 2013) (p. 26-31) (noting that effective practices related to graded compensation structures include "[m]onitoring activity of representatives approaching compensation thresholds.").

[3] We note that the definition of "reasonable cash compensation" seems to be borrowed in part from some concepts that are articulated under the DOL Fiduciary Rule. However, the DOL Fiduciary Rule's focus on the "time and complexity" of a product addresses a different point related to the DOL Fiduciary Rule's reasonable compensation requirements. Under the DOL Fiduciary Rule, the time and complexity of the product was used to determine whether "differential compensation" should be viewed as permissible, and did not impact the long-standing market-driven analysis that the DOL used to determine reasonable compensation generally. The concept of "differential compensation" under the DOL Fiduciary Rule was used to determine whether different levels of compensation paid on different products could be justified.

very well require insurers to undertake what would undoubtedly be an extremely burdensome task of re-examining their existing actuarial pricing models for their annuity products to determine that compensation they pay to producers meets the new "time and complexity" standard for reasonable cash compensation. The proposed standard might also have the perverse effect of creating incentives for insurers and producers to offer unnecessarily complex products. Lastly, without clear guidance on what compensation structures would be considered reasonable under this new standard, there is a risk that each state that eventually adopts the Proposed Revisions could apply inconsistent interpretations of reasonable cash compensation. Given these considerations, the Committee urges the Working Group to reconsider the "time and complexity" standard as the sole standard for determining "reasonable cash compensation."

**Section 6(B)(2) – Duty to Evaluate the Type of Financial Products that Correspond to the Customer's Financial Objectives.** Section 6(B)(2) would require an insurance producer (or insurer where no producer is involved) to "[e]valuate the types of financial products which correspond to the consumer's disclosed suitability information and address the consumer's financial objectives." This requirement is overly broad and in certain cases would require the producer to engage in unlawful conduct. Any insurance producer will necessarily be limited in the number of products they can offer, even if the producer is also a registered representative of a broker/dealer and an investment adviser representative of a registered investment adviser. For example, an insurance producer will always be limited to the annuity products of those insurers that have appointed the producer, and limited to the types of other financial products the insurance producer is qualified to offer (e.g., many producers will not be able to offer, for example, investment advisory services or securities products). Given these considerations, the obligation imposed by Section 6(B)(2) is far too broad, and in some cases would call for insurance producers to attempt to evaluate products or services that they are not legally qualified to discuss and offer. The Committee believes that this section should either be deleted or revised to limit the duty to evaluate to the universe of products and services that the producer is authorized to offer.

**Standards for Replacements.** Section 6(D)(4)(b) would require an insurance producer (or insurer where no producer is involved) to have a reasonable basis for believing that, in the case of an exchange or replacement, "[t]he consumer would benefit from product enhancements and improvements and the replacing product would provide a *substantial financial benefit* to the consumer over the life of the product" (emphasis added). This requirement is too demanding, and it is overly focused on the financial benefit from the exchange or replacement, to the exclusion of other benefits that may be important to the consumer. Requiring the financial benefit of the replacement to be "substantial" is both too high and too vague a threshold, and creates more complexity in assessing the standard as to the appropriateness of the recommendation than simply relying on the best interest definition. Moreover, focusing solely on the "financial" benefit misses the point that, in many cases, annuities provide "peace of mind" to consumers through living benefits, or the availability to invest in different investment options, that cannot be measured quantitatively as a "financial benefit." Finally, and probably most importantly, the Committee notes that the Proposed Revisions have already built in a "best interest" standard for exchange and replacement recommendations in Section 6(D)(4). Given these considerations, the Committee strongly recommends that the Proposed Revisions simply maintain the original language in the Model Regulation related to consumers benefitting from the product enhancements and improvements.

**Insurer's Obligations for Insurance Producer's Recommendations.** Section 6(H) of the Model Regulation currently imposes requirements on an insurer to "establish a supervision system that is reasonably designed to achieve the insurer's and its insurance producers' compliance with this regulation." Under the Proposed Revisions, Section 6(H)(1)(d) would impose obligations on the insurer to "maintain procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to

determine that a recommendation is suitable and in the best interest of a consumer." Similarly, Section 6(H)(1)(e) would require that "[t]he insurer shall maintain reasonable procedures to detect recommendations that are not suitable and are not in the best interest of the consumer." The Committee believes strongly that insurers should be responsible for these supervisory obligations only with respect to assessing annuity transactions in their *own* annuity products through their appointed producers, and not with respect to any consideration of any other financial products the producers might be permitted or authorized to offer. Insurers are in no position to judge or review the activities of producers related to annuity products issued by other insurers, or any other financial products that a producer may be permitted or authorized to offer to consumers. It is simply unworkable to suggest that an insurer be responsible for any best interest review to the extent that review would require the consideration of products that the insurer does not issue. Given this, it is imperative that Section 6(H)(1)(d) and 6(H)(1)(e) make clear that the insurer's procedures and duties relate solely to the producer's offer of such insurer's annuities that the producer is authorized to sell.

With respect to this point, the Committee notes that Section 10(A) of the Proposed Revisions indicates that:

> An insurer is responsible for compliance with this regulation. If a violation occurs, either because of the action or inaction of the insurer *or its insurance producer*, the commissioner may order . . . [a]ppropriate penalties or sanctions. (Emphasis Added.)

Section 10 also should be revised to make clear that in no event should an insurer be held responsible for the actions of one of its insurance producers under Section 10 when that producer's conduct resulted in a compliance violation related to the activities of such producer offering another insurer's annuity products.

**THE PROPOSED DISCLOSURE REQUIREMENTS SHOULD BE RESTRUCTURED**

The Committee believes that the provisions of the Proposed Revisions that impact disclosure should be restructured by:

- Grouping disclosure obligations in the Model Regulation in one section or sub-section rather than their being dispersed throughout the Model Regulation as is currently the case;

- Clarifying the current text in the Proposed Revisions calling for disclosure to ensure a common understanding among insurers and producers of the disclosure obligations; and

- Providing for a layered disclosure approach that (1) provides general information to all consumers and allows producers and insurers to create broad-based, rather than individually tailored, disclosures, and (2) allows those consumers who have an interest in receiving more detailed disclosure to be able to request such additional information.

More specific comments on the disclosure requirements of the Proposed Revisions are set forth below.

**Consolidate the Disclosure Requirements.** The Proposed Revisions would impose disclosure obligations in several sections, notably, Sections 6(B)(3), 6(C) and Section 7. The Committee recommends that the Working Group restructure the Proposed Revisions to locate all the disclosure obligations in one place (e.g., a new Section 6(C), or in Section 7).

**Disclosure of Cash Compensation – Section 6(C)(2).** Section 6(C)(2) in the Proposed Revisions would require that cash compensation be disclosed as follows:

> The percentage or amount of cash 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 a recommended annuity.

*Disclosure Required Above Three (3) Percent*. The Committee believes that utilizing a three percent threshold for disclosing amounts of cash compensation would be unhelpful to consumers without context, and could result in consumers drawing inaccurate inferences, such as that no compensation is paid if the compensation paid is less than three percent and thus not disclosed at all. Of course, the cash compensation paid by insurers to producers can vary based on product type (e.g., fixed rate annuity contracts, fixed index annuity contracts, and variable annuity contracts), on the structure of the annuity contracts (e.g., the length of the surrender charge period), and on the features and guarantees provided under the annuity contract. Therefore, identifying a particular level of compensation above which disclosure is required could be inherently deceptive and viewed incorrectly as (1) "blessing" any producer compensation paid below that rate, and (2) creating an inference that any producer compensation paid above that rate is suspect. A better approach would be to require qualitative disclosures that also provide a prompt to the consumer to request additional information if so interested. An example of such disclosure (for a commission-based annuity) might be:

> You should be aware that I am paid a commission by the insurance company related to the sale of an annuity to you. The rate of my commission varies by company and by the type of annuity that you purchase. If you would like additional information on the commissions I receive, please feel free to ask additional questions to better understand my financial incentives.

*The Proposed Revisions Must Provide for Clarity to Insurers, Producers, Regulators and Consumers*. To the extent the Working Group retains a cash compensation disclosure requirement, even under a layered approach, the Committee urges the Working Group to provide clear direction to insurers, producers, regulators and consumers about what information is required about cash compensation and how cash compensation is defined. For example, any compensation disclosure requirements must provide clarity by addressing the following questions:

- How should an insurer or producer describe, differentiate and account for cash compensation made for initial purchase payments and subsequent payments?
- How should an insurer or producer describe and address "up-front" compensation versus "trail" compensation? If the Proposed Revisions include a threshold above which cash compensation disclosure is required, how should they factor trail compensation into that calculation?
- How should an insurer or producer address the optional payment structures sometimes made available to producers allowing them to choose whether in certain cases to take payment options that pay more, or less, of their compensation up-front versus a trail payment?
- How should an insurer or producer differentiate and provide for the disclosure of fee-based compensation structures where the producer's compensation is being paid by the consumer?

- How should an insurer or producer disclose and distinguish between cash compensation that is paid to the individual producer and cash compensation paid to the legal entity firm associated with the annuity sales?

- To what extent is the compensation paid to wholesalers or other interested intermediaries not involved in the recommendation required to be disclosed?

*Does the Three Percent Disclosure Limit Serve as a "Safe-Harbor" for Meeting the Definition of Reasonable Cash Compensation?* We understand that there was some discussion at the Working Group's meeting in December 2017 that the three percent threshold for cash compensation disclosure should be viewed additionally as a "safe-harbor" for meeting the definition of "reasonable cash compensation." The Committee believes that if any reasonable cash compensation safe-harbor is intended (and putting aside the appropriateness of three percent), it should be explicitly stated in the Proposed Revisions. But more importantly, if any safe-harbor is ultimately included in the Proposed Revisions, significant additional analysis of the threshold should be conducted, and the precise manner of treating different types of compensation (e.g., fee-based compensation, trail commissions) should be developed to provide for clarity to producers who attempt to rely on the safe-harbor.

**Disclosure of the Basis or Bases of the Recommendation.** Section 6(C)(3) calls for disclosure to the consumer of the "basis or bases of the recommendation." The Committee urges the Working Group to eliminate this element of the required consumer disclosure for several reasons. First, requiring this disclosure would not be in harmony with FINRA rules and DOL Fiduciary Rule disclosure requirements, as they do not require such a disclosure to investors. Second, from an operational and systems perspective, insurers and producers would be required to "build out" the infrastructure to document and deliver that disclosure and maintain evidence of such documentation and delivery. The Committee believes that disclosure forms developed to document the bases for the recommendation would either be far too simplistic (e.g., a "check the box" form on which a producer indicates the basis was "guaranteed income" or something similar), or too detailed and descriptive to be practical (e.g., a multi-page, individually tailored summary of the review process that highlights the myriad factors that go into making an annuity recommendation for a particular consumer). In short, this requirement would impose burdens on insurers and producers to generate the disclosure and would negatively impact harmonization efforts, without offering any meaningful benefit to consumers.

**Disclosure of Non-Cash Compensation – Section 7.** Section 7 of the Proposed Revisions, would require an insurance producer (or insurer where no insurance producer is involved[4]) to disclose to the consumer "information regarding the non-cash compensation that exceeds $100 per producer per year the producer receives from an insurer or intermediary that is tied to the sale of annuities including, but not limited to, gifts, meals, trips, entertainment, prizes, marketing, and advertising."

The Committee believes that Section 7 needs to be further refined. For example, as currently drafted, it appears that a producer who could receive non-cash compensation from "Insurer A" but recommends to the consumer that he or she purchase an annuity contract from "Insurer B," would nonetheless be required to disclose to the consumer the non-cash compensation that the producer could receive from Insurer A. Such disclosure would be irrelevant and likely confusing to the consumer. Given this, the Committee recommends that the disclosure obligation be triggered only when the producer's receipt of the non-cash compensation is related to the producer's recommendation of the particular annuity, and thus could be viewed as potentially creating a conflict associated with the producer's recommendation.

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[4] The Committee notes that the concept of non-cash compensation practices being applicable to insurers when no producer is involved is likely a null set; non-cash compensation is paid by an insurance company or "intermediary' to a producer, and it is not received by an insurer.

The Committee also requests that additional clarification be provided on the granularity of the disclosure that would be required by Section 7. For example, it is unclear under the Proposed Revisions whether the *amounts* of the non-cash compensation must be disclosed, or whether the *source* of the non-cash compensation amounts must be provided. In either case, insurance producers may struggle to develop a standardized disclosure document for what amounts to a "point-in-time" value – the amount and/or source of non-cash compensation. As indicated elsewhere in this comment letter, the Committee believes that the best approach for disclosure is a layered approach, where the consumer is given information on the types of non-cash compensation generally received, and informed that additional and detailed information can be received upon request.[5]

**OTHER SPECIFIC PROVISIONS OF THE PROPOSED REVISIONS SHOULD BE MODIFIED**

The following comments focus on the textual language of certain provisions of the Proposed Revisions, explaining the basis for Committee concern with the text and, where appropriate, offering alternative text. The Committee believes the comments below merit serious attention in order to move the Proposed Revisions forward, consistent with the guiding principles identified at the outset.

**The Scope of the Model Regulation.** Section 2 would be revised to provide that the scope of the regulation is to apply to "any solicitation, negotiation, recommendation or sale of an annuity." It currently applies only to a "recommendation to purchase, exchange or replace an annuity." The Committee believes the current "Scope" description is more logical and in harmony with other regulatory frameworks. While the Committee recognizes that this proposed change tracks the text in the NAIC's Producer Licensing Model Act describing a producer, and an attempt at consistency with the Producer Licensing Model Act may be the rationale behind the proposed change, there are a number of important reasons to refrain from making this change. First, the regulatory purpose of the Producer Licensing Model Act (ensuring that individuals engaging with the public on insurance sales are qualified and accountable) and the Model Regulation (establishing a standard of conduct for annuity recommendations) are very different. The scope of producer licensing statutes should be broader than the Model Regulation, as the licensing statutes have long been construed to cover a wider swath of persons than those making insurance purchase recommendations to consumers. Second, the DOL Fiduciary Rule and FINRA rules related to standards of conduct are triggered by the provision of individually tailored investment advice and recommendations, respectively. Indeed, the Model Regulation has long been in harmony with FINRA suitability-related rules in using "recommendations" as the action triggering the rule. Therefore, to continue the harmonization effort, the Proposed Revisions should maintain the current "Scope" provision under the Model Regulation. Third, as drafted, Section 2 would be applicable at a variety of different times (e.g., at solicitation and at sale) which could lead to a lack of clarity and also the possibility of the need for multiple reviews related to the same consumer transaction. Finally, the expansion of the Scope provision to cover solicitation, negotiation, and sales, could have unintended consequences. For example, it is possible that certain advertisements might be viewed as triggering all the requirements of the Model Regulation due to the inclusion of the term "solicitation."

**The Best Interest Standard.** Section 5(B)(1) would define the term "best interest" to mean "at the time the annuity is issued, acting with reasonable diligence, care, skill and prudence in a manner that puts the interest of the consumer first and foremost."

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[5] The Committee notes that the Working Group may want to review the distribution disclosure sections of the prospectuses for certain variable annuity contracts as those prospectuses typically provide a high-level overview of the types of non-cash compensation provided, and the manner in which it is provided, to broker-dealer selling firms.

*The Timing Requirement Under the Best Interest Standard.* As proposed, the standard would apply "at the time the annuity is issued." The Committee believes that the "timing" trigger of the definition should be changed from "at the time the annuity is issued," to "at the time the recommendation is made." This change would make the standard more consistent with other regulatory standards (e.g., FINRA Rule 2330), and is also a fairer approach. Given that there can be a not insubstantial time period between when a recommendation is made by a producer and when the contract is issued by the insurer, it would be unfair to make the producer a "guarantor" against any adverse changes that might occur between the time of the producer's annuity recommendation and the insurer's issuance of the annuity contract.

*Putting the Interest of the Consumer First "and Foremost."* The definition of "best interest" should be revised to eliminate the phrase "and foremost." The Committee believes that including that phrase provides no additional value to the consumer, and is confusing. The general articulations of the meaning of best interest in other regulatory regimes typically provide that best interest requires putting the customer first. Adding the phrase "and foremost" is not only superfluous: the phrase will undoubtedly create confusion for all the participants in the annuity marketplace as to whether it means something beyond or different from "first" and ultimately may work against the goal of achieving harmonization with other regulatory regimes that do not employ that phrase.

*Section 5(B)(2) of the Definition of Best Interest*. Section 5(B)(2) would clarify that "best interest" does not mean the "least expensive" annuity contract or the "single 'best' annuity contract" available. The Committee strongly supports the inclusion of these concepts in connection with the definition of "best interest," and believes that this clarifying text helps harmonize the definition with other regulatory regimes. The Committee further recommends that the best interest definition make clear that the producers, or insurers where no producer is involved, have no affirmative ongoing duty to monitor the annuity post-sale and provide advice to the purchaser. An insurance producer has not historically been charged with any ongoing duty to monitor annuity contracts post-sale. The Committee notes that this clarification would be consistent with the DOL Fiduciary Rule. Finally, the Committee recommends that, either in Section 5(b)(2), or potentially in a Drafting Note, the Proposed Revisions should also address the fact that the recommendation of proprietary products is not inconsistent with a best interest standard. This would harmonize the Proposed Revisions with, among other things, the statutory guidance impacting any potential SEC adoption of a new standard of care for broker-dealers under Section 913 of the Dodd-Frank Act of 2010.

**Definition of "Cash Compensation."** Section 5(C) would define "cash compensation" to mean "any discount, concession, fee, service fee, commission, sales charge, loan, override or cash benefit received in connection with the solicitation, negotiation, recommendation or sale of an annuity." The Committee believes that the definition should be revised to link the cash compensation only to the sale of the annuity contract. It seems highly unlikely that a producer will be paid for anything other than the sale of an annuity. In addition, making this change would better harmonize the Proposed Revisions with the FINRA definition of cash compensation.[6] Also, eliminating the references to solicitation, negotiation and recommendation of the annuity will make the definition of "cash compensation" easier to understand. Finally, the Committee requests that the Working Group specifically clarify whether it views certain employee benefit programs that can be offered by insurers to certain of their producers as being deemed to fall within the definition of cash compensation. Examples of these types of benefits might include: deferred compensation programs; access to errors and omissions insurance coverage; access to health insurance; and other typical employee benefit offerings.

**Definition of "Material Conflict of Interest."** Section 5(J)(2) would define "material conflict of interest" as including "financial incentives or rewards offered to or received by an

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[6] FINRA Rule 2320(b)(3)(C) ("in connection with the sale and distribution").

insurance producer, or a direct interest or ownership in an insurer by an insurance producer or an immediate family member of an insurance producer." The Committee recommends that this reference to financial incentives or rewards be expressly linked to the recommendation of an annuity to target the appropriate and relevant information that is required to be disclosed under the Proposed Revisions. The Committee further notes that Section 5(J)(1), which also defines "material conflict of interest," includes a reference to a recommendation.

**Definition of "Recommendation."** While there are no proposed revisions to the definition of the term "recommendation" under Section 5(N) of the Model Regulation, the Committee recommends that the Proposed Revisions adopt a "carve-out" for the provision of educational information about annuities clarifying that such information does not constitute a recommendation. In recent years, there has been a proliferation of educational tools, calculators and information about financial products and planning that are very valuable in assisting investors in understanding their financial needs. Creating a carve-out for such educational materials would be in harmony with the DOL Fiduciary Rule, which recognizes that providing certain types of educational information does not constitute providing "investment advice."[7]

**Definition of "Suitability Information."** Section 5(P)(11) would define "suitability information" to include information relating to a customer's "[r]isk tolerance, including changes in nonguaranteed elements in an annuity contract." The Committee believes strongly that the specific references to potential changes in nonguaranteed elements in an annuity should be deleted. Calling out specifically a requirement to focus on risk tolerance related to potential changes in guaranteed elements dilutes the requirement to focus on the overall risk tolerance of the consumer. For example, risk tolerance requires an assessment of, among other things, the consumer's tolerance for investment risk and interest rate risk. Arguably, these types of risks are more important than tolerance for changes to the nonguaranteed elements of the annuity contract. The general reference to risk tolerance without further elaboration as a component of suitability information makes more sense.

The Committee also notes that if this new element is added to the definition of "suitability information," producers and insurers would be required to "build out" the infrastructure used to request and collect suitability information in order to request and process information specific to nonguaranteed elements. This could require the allocation of significant and time intensive resources, particularly if it entails information technology changes to existing electronic systems used to capture suitability information and perform screening reviews. The Committee believes that whatever marginal (if any) gains to the recommendation review process are achieved by focusing on the tolerance for changes in nonguaranteed elements in an annuity contract would not be outweighed by the burdens to build out the new systems.

Finally, the Committee believes that attention to the impact of nonguaranteed elements of a contract is better attended to as a matter of disclosure to the consumer of the features of the annuity, rather than expressly factored into the suitability information collection process.

**Determination the "Annuity is Reasonable" – Section 6(F).** Section 6(F) of the Proposed Revisions would impose certain requirements on an insurer where an annuity is issued under a variety of special circumstances (such as, without a recommendation). Understanding that the analogous section of the current Model Regulation requires that the issuance of an annuity be "reasonable under all the circumstances actually known to the insurer at the time the annuity is issued," the Proposed Revisions would change the structure and language of that section to require an insurer "to determine" the reasonableness of an annuity. It is unclear whether those changes are intended to substantively change the current requirements so as to impose a different or more affirmative obligation on insurers where a recommendation is not made (or in other special circumstances identified in proposed Sections 6(F)(1)-(4)). In light of the fact that

[7] *See* 29 CFR § 2510.3-21(b)(2)(iv).

the Proposed Revisions could now include three separate standards of review (i.e., reasonableness, suitability, and best interest) in connection with annuity transactions, which is likely to lead to confusion about how those standards differ, the Committee believes additional clarity is needed as to how a determination should be made that an "annuity is reasonable" given the potentially limited information about the consumer that an insurer may have.

**The "FINRA Safe-Harbor" – Section 6(J).** The Proposed Revisions would modify the text of the Model Regulation's so-called FINRA safe-harbor (in Section 6(J)) so that it is applicable to sales that are made in compliance with FINRA's "requirements pertaining to best interest standards." Given that the FINRA rulebook does not contain any particular rule imposing a best interest standard *per se*, the Committee believes that some clarification would be helpful to indicate the Working Group's view of what currently constitutes FINRA's best interest standards. The Committee believes that preserving a workable FINRA safe-harbor is critical to ensure widespread access for American investors to annuities through a variety of distribution channels, including broker/dealers. The Working Group may want to consider revising the safe-harbor in a manner that indicates that, if firms are complying with the then-applicable FINRA standards of conduct for recommendations and supervision of annuity sales, they can rely on the safe-harbor for purposes of the Model Regulation.

**Prohibited Practices – Section 8.** Section 8 of the Proposed Revisions would identify certain prohibited practices, indicating that an insurance producer, or insurer where no insurance producer is involved:

> (1) Shall receive no more than reasonable cash compensation in making a recommendation;
>
> (2) Shall not make any materially misleading statements regarding the annuity transaction; and
>
> (3) Shall not base a recommendation on the producer's or insurer's own financial interest.

The Committee notes that Section 8(3) appears to articulate a different "best interest" standard than what appears in the Section 5(B)(1) definition of "best interest." To avoid confusion, and for purposes of simplifying the requirements of the Proposed Revisions, the Committee recommends that Section 8(3) be revised to link directly to the Section 5(B)(1) definition of best interest or, alternatively, include the text of that definition in this Section.

*  *  *

The Committee appreciates the opportunity to comment on the Proposed Revisions. Please do not hesitate to contact Cliff Kirsch (212.389.5052 or cliffordkirsch@eversheds-sutherland.com); Susan Krawczyk (202.383.0197 or susankrawczyk@eversheds-sutherland.com); Eric Arnold (202.383.0741 or ericarnold@eversheds-sutherland.com); or Maureen Adolf, Senior Policy Adviser/Insurance (212.389.5028 or maureenadolf@eversheds-sutherland.com) with any questions or to discuss this comment letter. We note that the Committee would be happy to provide any additional information to, or discuss any of the issues or concerns identified in this letter with, the Working Group if and when that would be helpful.

Respectfully submitted,

Eversheds Sutherland (US) LLP

Eversheds Sutherland (US) LLP

**FOR THE COMMITTEE OF ANNUITY INSURERS**

# Appendix A

## THE COMMITTEE OF ANNUITY INSURERS
## MEMBER LIST

AIG
Allianz Life
Allstate Financial
Ameriprise Financial
Athene USA
AXA Equitable Life Insurance Company
Brighthouse Financial, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Global Atlantic Life and Annuity Companies
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Lincoln Financial Group
Massachusetts Mutual Life Insurance Company
Metropolitan Life Insurance Company
National Life Group
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
Sammons Financial Group
Symetra Financial Corporation
The Hartford Life Insurance Companies
The Transamerica companies
TIAA
USAA Life Insurance Company
Voya Financial, Inc.