



**Comments of the Center for Economic Justice**

**To the NAIC Market Conduct Examination Guidelines Working Group**

**Regarding Revisions to the Market Regulation Handbook for Updates to the NAIC Annuity Suitability Model Regulation**

**September 6, 2023**

The Center for Economic Justice (CEJ) submits the following comments on the 6/6/2023 draft revisions to Chapter 23 of the Market Regulation Handbook – Conducting the Life and Annuity Examination.

The only change in the 6/6/2023 draft from the prior 8/22/2022 draft revisions is a note indicating the Annuity Suitability Working Group continues to discuss the application of the safe harbor provision, yet the chapter continues to include highly problematic guidance. It is unclear why the group seeks to adopt these changes in the absence of clarification about the scope and application of the safe harbor. As currently constructed, the guidance will simply lead to insurers and producers claiming safe harbor and contesting efforts by examiners as well as inconsistent treatment across the states because of the lack of substantive guidance. There is no need to say the guidelines may be amended in the future – that is always the case. Stating that safe harbor interpretation is in flux compromises any guidance provided. We suggest deletion of the 6/6/2023 note.

I refer to the 8/22/22 changes, shown in yellow as the revised language. The revised language still provides no guidance for examiners on the comparable standards or how to verify that an insurer or financial professional is complying with the comparable standards. For example, the guidance in standard 10 states, “Review the insurers’ system of monitoring sales made in compliance with comparable standards.” Putting aside the lack of guidance for how to perform such review, the instruction itself is flawed because there is no safe harbor for insurers’ system of supervision. Rather, the regulation explicitly states the insurer remains responsible for ensuring the annuity is in the best interest of the consumer.

There should be a table showing all the requirements of the NAIC model and the comparable standards so the examiner can actually see the standards that need to be satisfied and identify any portions of the NAIC model which continue in force even if a comparable standard is used.

The revised language fails to identify guidance for situations in which the comparable standard has greater requirements than the NAIC model, including, for example, identifying and addressing material conflicts of interest. If an examiner must determine that the financial professional is complying with the comparable standard, the examiner must have knowledge of that comparable standard. While the NAIC model excuses nearly all material conflicts of interest, the comparable standards do not.

The revised language continues to fail to address guidance for examiners for situations in which there is no comparable standard for the financial professional, but the financial professional claims they are adhering to a comparable standards. What is the guidance for a financial professional selling a fixed indexed annuity who claims they are adhering to one of the safe harbors? Unlike insurance products that are securities for which loss of investment is disclosed, a fixed indexed annuity escapes oversight as a security – and the standards of care associated with the sale of a security – because the product purports to be only insurance with no potential loss of investment. Stated differently, what is the guidance for an examiner when the comparable standard fails to address a particular issue by virtue of the product not being covered by the comparable standard?

The revised language fails to identify any limitations of the safe harbor. For example, the safe harbor does not relieve an insurer of establishing and maintaining a supervision system or any of the provisions of that section. For another example, does the safe harbor supersede the producer training requirements in the NAIC model? What is the guidance for an examiner determining whether the financial professional has met the producer training requirements if the financial professional claims a safe harbor? Standard 12 adds guidance on producer training requirements, but says nothing about whether a claim to adherence to a safe harbor excuses the training requirements of the model.

The same language regarding the safe harbor provision is found in Standards 9 and 10. It is unclear why the language is repeated in two standards since Standard 9 refers to producers and standard 10 refers to insurers. The safe harbor language in the 2020 version of the Annuity Suitability Model Regulation specifically refers to and limits the safe harbor to “financial professionals,” which are defined as

For purposes of this subsection, “financial professional” means a producer that is regulated and acting as:

- (a) A broker-dealer registered under federal [or state] securities laws or a registered representative of a broker-dealer;
- (b) An investment adviser registered under federal [or state] securities laws or an investment adviser representative associated with the federal [or state] registered investment adviser; or

(c) A plan fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974 (ERISA) or fiduciary under Section 4975(e)(3) of the Internal Revenue Code (IRC) or any amendments or successor statutes thereto.

Consequently the safe harbor is not available to insurance producers who are not financial professionals as defined in the regulation and the exam guidance should state that.

Further, insurers are also not financial professionals as defined in the model regulation, so the safe harbor is not available to insurers acting in the absence of a producer.

Further, the safe harbor section specifically states that nothing in the safe harbor paragraph 6(E)(1) limits the insurers' obligation to comply with Supervision System Section 6(C)(1), which requires

Supervision system.

(1) Except as permitted under Subsection B, an insurer may not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity would effectively address the particular consumer's financial situation, insurance needs and financial objectives based on the consumer's consumer profile information

Since an insurer cannot meet this requirement in the absence of a supervision system that is reasonably designed to achieve the insurer's and its producer's compliance with the regulation, it is clear that there is no safe harbor available to insurers for recommendations and sales in the absence of a producer and no safe harbor excusing the insurer from its obligations in the model.

Consequently, Standard 10 should include the guidance:

*The safe harbor permitting financial professionals to avail themselves of compliance with a comparable standard is not available to insurers either in their capacity as sellers in the absence of a producer or as supervisors of producers.*

The safe harbor language in Standard 9 should be revised as follows:

*A safe harbor permits a financial professional to assert compliance with the annuity suitability law or regulation by complying with a comparable standard. Financial professionals are specifically defined as:*

*a producer that is regulated and acting as:*

*(a) A broker-dealer registered under federal [or state] securities laws or a registered representative of a broker-dealer;*

*(b) An investment adviser registered under federal [or state] securities laws or an investment adviser representative associated with the federal [or state] registered investment adviser; or*

*(c) A plan fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974 (ERISA) or fiduciary under Section 4975(e)(3) of the Internal Revenue Code (IRC) or any amendments or successor statutes thereto.*

*The regulator or law also identifies comparable standards:*

- *The Securities and Exchange Commission (SEC) 's Regulation Best Interest;*
- *The Financial Industry Regulatory Authority (FINRA) requirements pertaining to suitability and supervision of annuity transactions;*
- *SEC standards of conduct (including fiduciary duties) imposed upon federally registered investment advisors or investment advisor representatives; and for plan fiduciaries;*
- *The Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC); and*
- *Any additional comparable standard, covering state registered investment advisors subject to the state's securities laws. Whether this fifth option exists in any state would depend how each jurisdiction adopted the regulation.*

*In evaluating a financial professional's use of and compliance with a comparable standards, the examiner should*

- *Recognize that nothing in the safe harbor limits the commissioner's ability to enforce (including investigate) the provisions of this regulation.*
- *Become familiar with requirements of the comparable standards, the documentation associated with those standards and the means to obtain and review that documentation. In some instances, the comparable standards include stricter requirements for insurance professionals, including, for example, identify and addressing material conflicts of interest ;*
- *Ensure that entities other than financial professionals are not attempting to claim compliance with a safe harbor comparable standard. Such entities include insurers acting in the absence of a producer and insurance producers who are not investment advisers, broker dealers or plan fiduciaries.*
- *Verify that, when a financial professional is permitted to avail themselves of safe harbor compliance with a comparable standard, that the financial professional is, in fact, complying with that comparable standard.*
- *Verify that the financial professional's compliance with the comparable standard extends to products not covered by the comparable standard. For example, a fixed indexed annuity is not treated as a security and, consequently, is not specifically covered by any of the comparable standards. The examiner should verify that a financial professional's compliance with the comparable standards extends to insurance products not covered by the comparable standard and is not limited to products covered by the comparable standard.*

- *Claiming compliance with a comparable standard and failing to achieve such compliance is a violation of the regulation. Claiming compliance with a comparable standard when such standard is not applicable is a violation of the regulation.*

New Standard 16 states only one of the requirements for one of obligations for an insurer and producer in the NAIC model. The model specifies four obligations – care, disclosure, conflict of interest and documentation. The care obligation, in turn, has four components – the reasonable basis cited in the standard heading is just one of the four.

In addition, the checklist for new standard 16 does not address the actual performance of the insurer or producer in meeting the requirements of the model or standards, rather, it simply requires the examiner to “ensure the insurer’s and applicable producer’s system of annuity suitability supervision include – followed by a list of items from the NAIC model. There is a huge difference between verifying a supervision system includes certain items and verifying that the intended outcomes of the supervision system are occurring. As currently stated, there is no guidance directing the examiner to ensure the system of supervision is accomplishing the intent of model’s requirements.

In the introductory section at page 6, the proposed revisions state that licenses are required to maintain or make available record of the information required in Model #275 that are collected from the consumer, disclosures made to the consumer, including summaries of oral disclosures and other information used in making the recommendations.

The regulation creates potential consumer harm by not requiring the producer to provide in writing to the consumer the basis for the recommendation – only requiring such documentation be available to the commissioner – thereby creating the potential for a producer to document the basis for the recommendation differently from what was provided orally to the consumer. The examination guidance should include contacting a sample of consumers who purchased the annuity to learn what the consumers were told and understood to be the basis for the recommended annuity – and then compare the consumers’ understanding with the written documentation provided by the producer or insurer.

Another potential consumer harm requiring more inquiry than simply the presence of disclosures signed by the consumer relates to sales of annuities in the absence of needed consumer profile information and sales of annuities not recommended by the producer. The examiner should obtain a complete list of all transactions involving either or both of these disclosures including consumer characteristics (age, marital status, etc.) and type of product. Situations raising a red flag include a producer with a high percentage of sales associated with one or both of these disclosures or associated consumer of advanced age or complex products. For example, a producer selling a large number of multi-year guaranteed annuities with such disclosures would

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not raise the same concern as a producer selling fixed indexed, variable or buffered annuities with such disclosures.

In closing, the proposed language safe harbor and some other provisions shown in yellow are significantly inadequate and will lead to needless examination disputes and should not be adopted until better safe harbor guidance has been developed.