



Comments of the Center for Economic Justice
To the NAIC Market Conduct Examination Guidelines Working Group
Life and Annuity Exam Standards Revisions Related to
2020 Revisions of NAIC Suitability in Annuity Transactions Model Regulation
September 16, 2022

In addition to the joint comments submitted today with the IIABA, the Center for Economic Justice offers the following additional comments. These comments are CEJ's alone.

Standard 1 – Page 5 of 88 of the September 8, 2022 Meeting Materials

The first new paragraph contains a number of incorrect statements. We suggest the following corrections.

The NAIC first adopted a model regulation establishing a suitability standard of care for the sale of annuities to seniors in 2003. In 2006, the NAIC revised the model regulation to expand consumer protections to all consumers as the Suitability in Annuity Transactions Model Regulation (#275). The NAIC revised the model law again in 2010 including three core changes: (1) clarified that the insurer is responsible for compliance with the model's requirements even if the insurer contracts with a third party; (2) required a review of all recommended annuity transactions; and (3) established producer general training and specific-product training requirements.

The Section 989J of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") specifically refers to the 2010 model regulation and any successor regulation that exceeds the requirements of the model regulation as the "Suitability in Annuity Transactions Model Regulation." Section 989J of the Dodd-Frank Act confirmed this exemption of certain annuities from the Securities Act of 1933 and confirmed state regulatory authority. This model also specifically identifies annuities that are exempt.

The NAIC again revised the Suitability in Annuity Transactions Model Regulation in 2020. This NAIC intends for the revised Model 275 to be a successor regulation that exceeds the requirements of the 2010 model regulation and, consequently, meets the requirements of a successor regulation set out in the Dodd Frank Act.

As of September 2022, over half of the jurisdictions have adopted a version of the 2020 model with little variance from the NAIC model. Examiners should reference their own jurisdiction's version and adjust review standards accordingly.

New Standard – Producer Shall Not Place the Producer's or Insurer's Financial Interest Ahead of the Consumer's Interest.

Model 275 (2020) establishes best interest obligations in Section 6A:

“Best Interest Obligations. A producer, when making a recommendation of an annuity, shall act in the best interest of the consumer under the circumstances known at the time the recommendation is made, without placing the producer's or the insurer's financial interest ahead of the consumer's interest. A producer has acted in the best interest of the consumer if they have satisfied the following obligations regarding care, disclosure, conflict of interest and documentation:”

First, the Model 275 (2020) defines producer to include an insurer where no producer is involved. So the above requirement should be understood to mean a producer or an insurer where no producer is involved shall not place the producer's or insurer's financial interest ahead of the consumer's interest.

Second, this financial interest obligation is in addition to the other four requirements of care, disclosure, conflict of interest and obligation.

Consequently, the exam guidelines should include this requirement as a standard and should provide guidance to examiners.

Standard 5 (Page 23 of 88 of 9/8/22 Meeting Materials)

Standard 5 is *“The insurer has suitability standards for its products, when required by applicable statutes, rules and regulations.”*

The Review Procedures include:

For annuity products, ensure the regulated entity maintains a written statement specifying the standards of suitability used by the insurer. The standards should specify that an insurer's issuance of an annuity shall be reasonable under all the circumstances actually known to the insurer at the time the annuity is issued.

And

Note: Sales made in compliance with Financial Industry Regulatory Authority (FINRA) requirements pertaining to suitability and supervision of annuity transactions shall satisfy the requirements under this regulation. Examiners should be mindful of the fact that both variable annuity sales and variable life sales are typically sold using FINRA requirements.

These paragraphs should be revised or removed for several reasons.

First, despite reference to compliance with FINRA suitability and supervision of annuity transaction requirements, there is no reference to a specific FINRA document to be reviewed.

Second, there is no guidance regarding what constitutes compliance with FINRA requirements.

Third, as discussed in more detail in the CEJ IIABA comments submitted separately, there is no FINRA guidance regarding the sales of annuities that are not securities. Consequently, it is unclear how an examiner, a producer, or an insurer can rely upon a suitability standard that does not apply to the sale of certain types of annuities.

Fourth, FINRA guidance attempts to ensure compliance with the SEC's Regulation Best Interest. In August 2022, the SEC issued a staff bulletin regarding conflicts of interest under Reg BI. (<https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest>) The bulletin states:

Reg BI's obligation to act in the retail customer's best interest is satisfied by complying with the rule's four component obligations: Disclosure, Care, Conflict of Interest, and Compliance. The Conflict of Interest Obligation requires broker-dealers that make recommendations to retail customers to establish, maintain, and enforce written policies and procedures reasonably designed to:

- *identify and at a minimum disclose, or eliminate, all conflicts of interest associated with a recommendation;*
- *identify and mitigate (i.e., modify practices to reduce) conflicts of interest at the associated person level;*
- *identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer (e.g., only make recommendations of proprietary or other limited range of products) and any conflicts of interest associated with such limitations, and prevent such limitations and associated conflicts of interest from causing the broker-dealer, or a natural person who is an associated person of the broker-dealer, to make recommendations that place the interest of the broker-dealer or such natural person ahead of the interest of the retail customer; and*

- *identify and eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.* [\[5\]](#)

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1. ***Do all broker-dealers and investment advisers have conflicts of interest?***

Yes. All broker-dealers, investment advisers, and financial professionals have at least some conflicts of interest with their retail investors. Specifically, they have an economic incentive to recommend products, services, or account types that provide more revenue or other benefits for the firm or its financial professionals, even if such recommendations or advice are not in the best interest of the retail investor. [\[14\]](#) *This can create substantial conflicts of interest for both firms and financial professionals. The nature and extent of conflicts will depend on various factors, including a firm's business model. Consistent with their obligation to act in a retail investor's best interest, firms must address conflicts in a way that will prevent the firm or its financial professionals from providing recommendations or advice that places their interests ahead of the interests of the retail investor.*

2. ***What are some examples of conflicts of interest for broker-dealers, investment advisers, or financial professionals?***

Under both standards, a conflict of interest is an interest that might incline a broker-dealer, investment adviser, or financial professional—consciously or unconsciously—to make a recommendation or render advice that is not disinterested. Examples of common sources of conflicts of interest can include, but are not limited to:

- *compensation, revenue or other benefits (financial or otherwise) to the firm or its affiliates, including fees and other charges for the services provided to retail investors (for example, compensation based on assets gathered and/or products sold, including but not limited to receipt of assets under management (“AUM”) or engagement fees, commissions, markups, payment for order flow, cash sweep programs, or other sales charges) or payments from third parties whether or not related to sales or distribution (for example, sub-accounting or administrative services fees paid by a fund or revenue sharing);*
- *compensation, revenue or other benefits (financial or otherwise) to financial professionals from their firm or its affiliates (for example, compensation or other rewards associated with quotas, bonuses, sales contests, special awards; differential or variable compensation based on the product sold, accounts recommended, AUM, or services provided; incentives tied to appraisals or performance reviews; forgivable loans based upon the achievement of specified performance goals related to asset accumulation, revenue benchmarks, client transfer, or client retention);*

- *compensation, revenue or other benefits (financial or otherwise) (including, but not limited to, gifts, entertainment, meals, travel, and related benefits, including in connection with the financial professional's attendance at third-party sponsored trainings and conferences) to the financial professionals resulting from other business or personal relationships the financial professional may have, relationships with third parties that may relate to the financial professional's association or affiliation with the firm or with another firm (whether affiliated or unaffiliated), or other relationships within the firm; and*
- *compensation, revenue or other benefits (financial or otherwise) to the firm or its affiliates resulting from the firm's or its financial professionals' sales or offer of proprietary products or services, or products or services of affiliates.*

While the examples above represent some common sources of conflicts of interest, the staff notes that there are other sources of conflicts that firms and their financial professionals may need to consider in light of their specific business models.

In contrast, Model 275(2020) declares cash and non-cash compensation is not a conflict of interest. Consequently, a producer or insurer relying compliance with FINRA or SEC requirements would face a higher standard concerning conflicts of interest.