July 10, 2019

Submitted electronically to jmatthews@naic.org

Director Jillian Froment, Ohio Department of Insurance
Chair, Annuity Suitability Working Group

c/o Jolie H. Matthews, Senior Health and Life Policy Counsel
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Contact: Kim O'Brien, FACC Spokesperson & Americans for Annuity Protection, Vice Chair
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RE: ***Request for Comment on Conflict of Interest and Care Obligation***

Dear Director Froment:

We first wish to commend you for delving more deeply into issues surrounding the NAIC's best interest regulatory proposals – in this case tackling the definition of conflict of interest and the care obligation. We believe existing proposals are lacking in clarity in many respects and most importantly on what exactly would be expected of affected parties under these proposals, including regulators themselves who may be left with vague new standards and enforcement responsibilities. Thus we welcome a more deliberative process to dig deeper into these proposals and ensure eyes are wide open on how these proposals would affect our industry and the customers we serve.

Indeed, we believe there is lengthy list of issues needing deeper consideration, and hopeful the NAIC will be dealing with all these issues in due course in an orderly and deliberative manner. These issues include – among others - how to make requirements more objective (which we commented on previously), ensuring everyone is on a level playing field (there should be few if any exemptions), going much deeper on exactly what disclosures are expected of companies and agents (we continue to be believe a template should be developed), developing clearer rules relating to non-cash compensation (FINRA has detailed guidelines in this regard), and clarifying the standard of care itself (formulations like "best suited" and "putting client interests first" are ill-defined and ultimately litigation traps).

Given the many comment letters already submitted by the FACC Campaign and others, we appreciate you are likely already aware of the issues and intending to tackle them in a purposeful way. We only want to stress here that we think these issues are critical to address and resolve so there is far more clarity and certainty than what has been put forward so far. The insurance industry is not the securities industry and it is important regulators fully consider the implications of this kind of regulation on all parts of our industry, including the independent agent channel.

As we have stated on many occasions in writing and at meetings, the FACC Campaign remains resolute in its belief the suitability model works and applying a securities-based standard to insurance sales is incongruous and wrongheaded. Instead we have advocated for more focused intelligent disclosure that would help align agent and consumer interests without creating artificial legal liability. We will not repeat our arguments – we have made them many times – but we are hoping this current work by the NAIC delving deeper into discrete issues will help the NAIC see the inherent problems with "best interest" and help the NAIC see there are better approaches.

With all that said, we wish to offer the following reactions in response to your specific inquiries in this round of comments:

Topic: Conflict of Interest

Question 1: *What constitutes a material conflict of interest when recommending annuities?*

We believe the definition of conflict of interest put forth in the Iowa proposal is sensible[1]:

> "**Material** conflict of interest" means a **financial** interest of the producer, or the insurer where no producer is involved, in the sale of an annuity that a **reasonable** person would expect to influence the **impartiality** of a recommendation.

We put in bold the words that are important and help distinguish it from the SEC definition which we think is severely flawed. First, this definition applies to material conflicts which is important so trivial or attenuated conflicts cannot be used as pretext to reverse sales of annuities. Second, this definition applies to a financial interest which is important to avoid encompassing obscure non-financial matters. Third, this definition applies a reasonable person standard which is proper as opposed to the absurd "consciously or unconsciously" standard adopted by the SEC. Fourth, the definition looks to whether the effect is to influence impartiality of a recommendation, which seems proper.

However, while we think this definition appears sensible, we also think the NAIC must come up with guidance that is specific and operational for the industry. It is important that there be clarity on what amounts to a conflict and what must be disclosed. For example, if an agent receives extra training from a company, is that a conflict. If the agent attends a training course at the company headquarters, is that a conflict. If the agent owns a small amount of stock in the insurance company, is that a conflict? If the agent gets a wedding gift from an officer of an insurance company, is that a conflict? Are such conflicts time bound so they only apply to "incentives" received within the prior year or some other reasonable period. And to the extent there are real

[1] The nature of these questions require us to set aside our more fundamental objections. In this instance, while FACC could support the Iowa definition of "conflict of interest", that should not be mistaken with support for current proposals addressing conflicts of interest. FACC maintains that better disclosure is needed for compensation and for conflicts of interest but approaches establishing a supposedly higher standard of care (i.e., best interest) are too subjective, unworkable, and tantamount to fiduciary duty.

conflicts, such as where an agent might also be an accountant or attorney, what disclosures are required by the NAIC.

These are just a few examples to help illustrate the need for guidance. While we have our own views on each point, what is important is for regulators to address these issues and come up with specific directions on what amounts to a conflict and what must be disclosed. While we recognize it is not possible to come up with exhaustive guidance and to some extent discretion will be required of affected agents and insurers, we think the NAIC must provide reasonable guideposts so there is common understanding on what these rules would truly require. This could also be addressed in part through adoption of a disclosure template as we have suggested a number of times.

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

We believe this is potentially perilous concept absent much more clarity.

It conflates a number of issues that must be disassembled and addressed individually. That is, requiring insurers and agents to "avoid or otherwise reasonably manage" conflicts endeavors to address a wide spectrum of issues in one fell swoop with no distinction between conflicts that are avoidable and/or should be avoided, conflicts that can and should be addressed through disclosure, and conflicts that might lend themselves to being managed by a supervisory authority. Lumping all conflicts together and ordering everyone to deal with conflicts as they see fit is not reasonable or realistic.

It is self-evident this topic of conflicts is complex and has engendered lengthy treatment by FINRA and the SEC over the years relative to brokers and advisors. We welcome the NAIC attempt to address these conflict issues for the insurance industry but it must be recognized this topic does not lend itself to quick or simple solutions. We think the notion of managing conflicts is especially fraught with peril absent much more deliberation and attention to detail, but we can offer a few preliminary perspectives.

First, we think the general requirement should be to disclose conflicts, and disclosure should be deemed proper and sufficient absent an express prohibition against specified conflicts. The NAIC should consider whether there are any conflicts that are so egregious they should be prohibited; otherwise the default should be disclosure. For example, to the extent sales contests favoring a single product are conflicts that must be avoided, the regulation should state this explicitly. Second, as discussed above, we think the NAIC should define what disclosure is needed and consider adopting a template. Agents and insurers need to know exactly what is expected of them to identify and address conflicts through disclosure. Third, we believe the concept of managing conflicts beyond disclosure is elusive and creates an unattainable "touch the clouds" compliance

obligation for industry in the absence of precisely delineated expectations and responsibility. The notion of "reasonably managing" conflicts is patently subjective and can never be satisfied short of removing the conflict completely which is unrealistic in most cases. We urge the NAIC to remove any requirement to "reasonably manage" conflicts unless objective rules and parameters can be established.

With regard to managing conflicts of interest, it is worth emphasizing there are inherent problems for the insurance industry not applicable to the securities industry. Notably, in its final rule, the SEC put the responsibility to mitigate conflicts on the broker-dealer and not the registered representative, recognizing that managing conflict is a supervisory function. Of course that supervisory structure does not exist in the insurance industry and requiring individual insurance agents to "reasonably manage" their own conflicts seems like a non-sequitur. By the same token, insurers do not necessarily control agents, especially in the independent agent model, so insurers too have limited capability to manage conflicts for agents who represent multiple carriers and multiple products across many compensation arrangements. It should also be recognized that commission schedules ranging across a spectrum of annuity products is more complex than a relatively simpler compensation scheme applicable to sale of stocks, bonds, and mutual funds, and this further adds to the challenge for the insurance industry. We continue to believe the securities industry and insurance industry are apples and oranges in important respects and urge the NAIC to proceed cautiously to avoid creating major disruption.

Let us also comment on disclosure of compensation because, again, we are concerned this has not received the attention it deserves. While we believe the existing proposals are confusing in regard to disclosure of compensation, we hope there is general agreement that any "conflict" relating to compensation can be addressed through disclosure, but the question remains what exactly must be disclosed. What is left unaddressed in particular is the extent to which an agent would be expected to disclose compensation for products that were *not* recommended or sold to the consumer. The products that were not recommended or sold of course would constitute the alternative products might have resulted in less compensation to the agent and thus are the supposed basis for a conflict. We believe it should suffice for the agent to disclose in general terms that she or he may have earned more commission for sale of certain products versus others. But industry needs to know, and regulators must decide, whether the expectation is that the agent must share details on compensation across all products in order for the consumer to have been given sufficient disclosure. We think this is one of many challenging questions left unaddressed in existing proposals.

We apologize to the extent we raise more questions than provide answers but it is our view that these proposals remain vague and need considerable work. We reserve our right to provide additional comment as we continue to study and reflect on these issues.

Topic: Care Obligation

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

We believe not. The term "prudence" is redundant, nebulous, and invites elevation of these obligations to a fiduciary standard. However, we believe the terms care, skill, and diligence are problematic as well. These are all imprecise words that represent minimal standards for any professional and indeed are ordinarily expected of any licensed agent. The question is whether these terms take on new or additional meaning when used in this regulation in a manner that will invite second-guessing and litigation. In our view, instead of using such ill-defined terms, the regulation should be simply state what actions are required from agents and insurers. Or if these terms are used, then it should be made clearer what exactly constitutes "care", "skill", and "diligence" relative to these requirements.

***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?*

We believe "reasonableness" is an appropriate standard provided it is also clear the measure of reasonableness is based on comparison to insurance agents with the same or similar licenses. We believe the November 2018 proposal was not clear in this regard; we believe the Iowa proposal is an improvement in seeking to clarify that agents are to be compared to agents with the *same or similar* licensing authority for purposes of this law. We think "same or similar" may need further clarification to ensure insurance-only agents are compared only to other insurance-only agents.

We have explained the importance of this clarification in prior comment letters. Absent such clarification, we fear insurance agents would be unfairly compared to other kinds of financial professionals, which would put insurance-only agents at legal and regulatory risk, and ultimately force insurance agents to become securities licensed merely for defensive purposes. We believe this would be harmful to our industry and more importantly harmful to consumers.

***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?*

We believe this question is somewhat academic because as a practical matter most or all agents will keep written documentation. We think oral documentation would only suffice if it is recorded or captured in some way.

More importantly, we are concerned with the unqualified requirement that agents provide "the basis" for a recommendation. We believe in most cases the basis for a recommendation is complex and involves many elements, some obvious and some more subtle. We think the requirement should be to provide a "description of the primary reason or reasons for the recommendation" or words to that effect. In other words, the obligation should be to explain the

key reasons for the recommendation but leave room for the possibility that there could be multiple reasons for any recommendation and sometimes it is not practical to list out every possible consideration in the course of a transaction.

In closing, we wish to emphasize each of FACC's previously submitted comment letters identify critical issues and include suggestions for making the regulation more objective and administratively manageable. Addressing all these areas in a meaningful fashion would help convert the proposed rule into a more practical and workable regulation that producers and insurers could actually understand and implement, and regulators could reasonably interpret and enforce.

While we remain adamant that best interest is a faulty concept, we will do our best to help the NAIC craft a potentially workable proposal, in the hope that would help protect our industry and most importantly our clients.

Respectfully submitted,

Dwight Carter, Chair, FACC Campaign