

On October 22 and 23, 2018, the Annuity Suitability (A) Working Group (Working Group) of the National Association of Insurance Commissioners (NAIC) met in Chicago to revise the Suitability in Annuities Transactions Model Regulation (#275) (Model Regulation).

## Background

The current Model Regulation, as adopted in a majority of the states, requires insurance agents to collect personal and financial information from consumers and document that annuity sales are suitable to the consumer's needs and financial objectives. Over the past several years, the Model Regulation has received mounting criticism as being inadequate to protect consumers from questionable annuity sales. In this regard, consumer advocates and others, including state and federal governments, have proposed to require that agents disclose conflicts of interest and act solely in the consumer's best interest.

The NAIC's review of the Model Regulation is consistent with actions taken by the US Department of Labor (DOL) and Securities and Exchange Commission (SEC) to heighten the standards that apply to annuities and securities sales. In 2017, the DOL issued a final rule (which was later vacated by a court) that required agents, in making recommendations for the sale of securities of annuities to Employee Retirement Income Security Act plans and individual retirement arrangements, to act in the customer's best interest, to charge only reasonable commissions, and to not make misleading statements.<sup>1</sup> Also, earlier this year, the SEC proposed a rule to require agents making securities recommendations to retail customers "to act in the best interest of the retail customer at the time a recommendation is made, without placing the financial or other interest of the broker-dealer or natural person who is an associated person making the recommendation ahead of the interest of the retail customer."<sup>2</sup> Consistent with these federal actions, the NAIC is working to amend the Model Regulation to establish a best interest standard applicable to all annuity sales, not just sales of variable annuities and securities subject to federal law.

<sup>1</sup> Final Rule, "Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice," Department of Labor, 82 Fed. Reg. 16902, et seq. (April 7, 2017), vacated by *Chamber of Commerce of the United States v. United States DOL*, 885 F.3d 360 (5th Cir., Mar. 15, 2018). The DOL is expected to engage in further rulemaking to implement a best interest standard related to the sale of securities subject to DOL jurisdiction.

<sup>2</sup> Proposed Rule, "Regulation Best Interest," Securities and Exchange Commission, 83 Fed. Reg. 21574 et seq. (May 9, 2018)

## Results of Chicago Revision Meeting

At its October meeting, the Working Group came to consensus on the changes to the Model Regulation as described below. The NAIC website has a [copy of the revised version](#), for discussion at the NAIC Winter Meeting in San Francisco.

**(1) The Best Interest Standard.** The Working Group adopted the following best interest standard to apply to annuity sales:

A producer, when making a recommendation of an annuity, shall act in the interests of the consumer at the time the recommendation is made, without placing the producer's financial interest ahead of the consumer's interests. A producer complies with this requirement by: (1) acting with reasonable diligence, care, skill and prudence; (2) only making suitable recommendations; and (3) disclosing all producer compensation and conflicts of interest to the consumer.<sup>3</sup>

This best interest standard does not require the agent to sell the lowest-priced product to the consumer, but the recommendation must focus on whether the costs, features and benefits of the product meet the consumer's objectives and needs.

**(2) Suitability Requirements.** The Working Group's revisions to the Model Regulation continue to require the agent to recommend suitable products for sale to consumers. In this regard, the revised Model Regulation requires the agent to collect profile information from the consumer; only make recommendations taking into account the consumer's financial situation, objectives and needs; and have reasonable grounds to believe the recommendation of a product is suitable for the particular consumer.

**(3) Disclosure Requirements.** The Working Group amended the Model Regulation to require agents to disclose to consumers the following information:

- (a) A description of the scope and terms of the relationship with the consumer and the role of the producer in the transaction
- (b) The type of products that the producer is authorized and licensed to sell
- (c) A description of the sources, types and an estimate of cash and non-cash compensation that the producer might receive related to the sale
- (d) Any and all material conflicts of interest

The agent must also have a reasonable basis to believe the consumer has a reasonable understanding of the benefits and features of the annuity product being sold.

<sup>3</sup> Notably, the requirements of the Model Regulation also apply to insurers when making direct annuity sales.

**(4) Definitions.** The Working Group also revised the definition of certain terms used in the Model Regulation including the following:

- **Cash compensation:** any monetary remuneration the agent might receive from anyone related to the sale of an annuity
- **Consumer profile:** the specific information the agent must collect from the consumer to determine if a transaction is suitable for the customer
- **Material conflict of interest:** a financial interest of the producer that a reasonable person would expect to influence the impartiality of a recommendation
- **Non-cash compensation:** includes merchandise, gifts, tickets to paid events, prizes, travel expenses or meals and lodging
- **Suitable:** a recommendation that is consistent with the consumer's insurance needs and financial objectives, based upon the facts disclosed by the consumer or known at the time of the recommendation

## Next Steps

The suggested revisions to the Model Regulation are expected to be presented to the NAIC Life Insurance and Annuities (A) Committee at the NAIC's meeting in mid-November in San Francisco. Although it is not anticipated that the NAIC will adopt the revised Model Regulation at its that meeting, it is expected that the NAIC will gain further consensus around the revisions, which the NAIC can then use to enter into discussions with the SEC, FINRA and possibly the DOL to develop a unified and/or consistent approach applicable to annuities, variable annuities, and securities. These discussions are expected to result in the NAIC, SEC, FINRA and possibly the DOL establishing best interest standards that apply across all annuity and securities sales.

## Contacts

Please let us know if you have any questions. Both of the contacts below will be attending the NAIC Fall 2018 meeting in San Francisco on November 15-18.

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