THE SUITABILITY STANDARD: The Gold Standard of Care for Fixed Annuities

In January 2011, the Securities and Exchange Commission (SEC) released a study mandated under the Dodd-Frank Act[1] in which it recommended the adoption of uniform fiduciary standards for broker-dealers and investment advisers. The SEC has not exercised its discretionary rule-writing authority on this subject, but at a 2015 industry conference, SEC Chairman Mary Jo White indicated her support for a uniform standard and noted that she would begin discussing the matter with fellow commissioners and industry groups. This came on the heels of the re-proposal issued April 14, 2015, by the U.S. Department of Labor (DOL) of its rule to amend the definition of fiduciary under the Employee Retirement Income Security Act (ERISA), which would expand the current application of the fiduciary standard to, among other things, the purchase of an annuity product when part of a pension plan or individual retirement account.[2]

NAFA strongly believes that federal efforts to update or harmonize fiduciary standards for investment advice and asset management transactions in the securities arena must not be expanded to needs-based transactions in the insurance marketplace, which has a strong history of robust and effective state regulation.

State-Based Regulation of Insurance Products

First and foremost, it is necessary to clarify that fixed annuities are NOT investments. Fixed annuities are insurance products and have the insurance guarantees of (1) predictable income the owner cannot outlive, (2) protection from investment and market risk, and (3) minimum interest earnings in every economic climate. Further, as insurance, they are regulated by an effective and time-tested state-based regulatory and compliance framework. State laws govern the organization and licensing of insurance companies, and state insurance departments oversee insurance company operations. Generally, annuity contracts and amendments must be filed with, and approved by, each state in which contracts are sold. Insurance agents (often referred to as "producers") need to be licensed in each state in which they operate. Only licensed insurance agents may sell annuity contracts.

States apply the suitability standard of care to sales of fixed annuities and other insurance products. The product "suitability" test clearly provides consumers with comprehensive, proven protection that is the most appropriate way to regulate such insurance transactions. State product suitability requirements that apply to fixed annuities generally are based on the uniform suitability standards contained in the National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions Model Regulation (the "Suitability Model"). NAIC is a voluntary organization of the chief insurance regulatory officials of the 50 states, the District of Columbia, and five U.S. territories that promotes best practices and uniformity in state insurance laws. It has developed numerous "model regulations" that are designed to protect consumers and maintain the financial stability of the insurance marketplace, including the Suitability Model.

This NAIC regulation was first adopted in 2003, and revised and enhanced in 2006 and 2010. With each Model revision, the standards, procedures, and responsibilities imposed on both insurers and insurance producers have been heightened to better ensure that the annuity product is wholly suitable to the consumer prior to purchase. In fact, there are requirements imposed by the 2010 Suitability Standard that do not exist in the sale of any other financial product. Congress has recognized the importance and appropriateness of applying the NAIC's product

[1] Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 989J, 124 Stat. 1376 (2010).
[2] 80 FR 21928-21960, available online at http://www.federalregister.com/Browse/Document/usa/na/fr/2015/4/20/2015-08831

suitability standard to fixed annuity sales, instead of securities/investment regulations such as fiduciary requirements. Sponsored by former United States Senator Tom Harkin, an amendment to the Dodd-Frank Act was adopted in July 2010 that confirmed that fixed annuities are insurance products, exempt from securities registration and regulation, provided that the 2010 NAIC Model Regulation (or comparable product suitability standards that meet or exceed the 2010 Model) be adopted and followed by June 16, 2013.[1] An overview of the regulation is shown below.

SUITABILITY STANDARD OF CARE FOR SALES OF ANNUITIES[3] OVERVIEW

Duties	The advice given and the product recommended must be suitable for the consumer as to his or her financial situation and needs, including the consumer's suitability information.*
Supervision of Sale	The insurance company reviews each sale prior to issuing the annuity contract.
Supervision of the Seller	Insurance Company/State Insurance Department
Compensation	The insurance company pays and, with some riders, the consumer may pay an additional fee.
Product Training and Continuing Education	Yes; Producers are required to complete general suitability training and product-specific training prior to soliciting the sale of an annuity.
Compliance Handling	The State Insurance Department has the authority to review compliance of both the producer and the insurer and take action, including but not limited to refund of premium paid.
Party Responsible for Non-Compliance or Law Violation	Insurance company, insurance agency and/or agent/producer
Consumer Guarantee	The Return of Premium Guarantee provides consumers with a free look period and full refund (including penalty or fine, if any) if the state regulator determines a sale to not be suitable or if the contact owner is dissatisfied for any reason.
***Suitability Information**	1. Age 2. Annual income 3. Financial situation and needs, including the financial resources used for the funding of the annuity 4. Financial experience 5. Financial objectives 6. Intended use of the annuity 7. Financial time horizon 8. Existing assets, including investment and life insurance holdings 9. Liquidity needs 10. Liquid net worth 11. Risk tolerance 12. Tax status

As of June 2015, 35 states, plus the District of Columbia, have enacted regulations based on the NAIC 2010 Model Regulation, and three additional states have proposed its adoption. We can anticipate that the remaining states will adopt the updated Model Regulation, but, even so, most are currently operating under a prior version of the Model.

[3] References to NAIC Model Regulation #275 (as revised April 2010), Suitability in Annuity Transactions

More importantly, under the terms of Dodd-Frank, as of June 16, 2013, only fixed indexed annuities sold under the suitability standard are exempt from federal security regulation.

The fixed annuity industry has striven to remain ahead of the curve, adopting sales policies and practices that ***ensure that every annuity product sold is suitable for the specific needs of the purchasing consumer***. In fact, the industry's practices met or exceeded the 2010 Suitability Model standards and procedures for suitable annuity recommendations for many years prior to its adoption. Among other things, this regulation requires insurers to establish a system to supervise each and every recommendation of an annuity to make certain that the insurance needs and financial objectives of consumers are appropriately addressed — and that includes the individuals' need for immediate access to cash.[4] This determination by the insurer (which is also held liable for the suitability of the sale) must be done prior to the annuity being issued and delivered for its free-look period. The Model also mandates that individual producers receive general annuity training as well as product-specific training (including its benefits and limitations) regarding any annuity that they are recommending. This training is required to be given directly from the issuing insurance company.

A Successful History of Suitable Sales

Due to the processes, oversight, supervision and regulatory protections currently in place, consumers are able to successfully implement annuities in their accumulation, income and legacy plans, thereby strengthening their confidence in retirement readiness. In fact, the suitability standard has proven effective, as evidenced by low complaints and extremely high levels of consumer satisfaction.

Each year, NAIC tracks and reports complaint activity by state and product type. The NAIC website shows that the number of closed complaints in the "annuities" category has fallen substantially since 2010. Complaints have also dropped in the "group annuity" category, as well as the "indexed" and "fixed" categories specifically. The strengthened suitability regulations that states started adopting after NAIC published them in 2010 may have contributed to the improvements.

Because FINRA may receive complaints related to indexed annuities, despite the fact that these are insurance products and not securities, it is important to note that FINRA data also supports this trend. The number of arbitration cases FINRA has received related to "annuities" has declined dramatically in the past three years, as shown in the chart below.

Annuities Involved in FINRA Arbitration Cases[5]

2011	2012	2013	2014
172	147	120	113

[4] Available online at http://www.naic.org/documents/committees_a_suitability_reg_guidance.pdf

[5] FINRA Dispute Resolution Statistics as of February 2015, available online at http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics. Note that this data does not include arbitration cases coded by "Variable Annuity" type, though data in this category has also declined.

1155 F Street NW, Suite 1050 | Washington, D.C. 20004 | 414.332.9306 | www.nafa.com

Consumers continue to report satisfaction with annuity products via survey response. In fact, a LIMRA Secure Retirement Institute study from 2014 found that nearly 9 out of 10 annuity owners are confident about their lifestyle in retirement.[6] Furthermore, statistics show that annuity sales continue to climb. Total U.S. annuity sales in 2014 rose 3 percent to $235.8 billion, in large part due to record annual sales in indexed and income annuities.[7] Indexed annuity sales reached $48.2 billion in 2014, a 23 percent increase from 2013, and indexed annuities held more than 50 percent market share of all fixed annuity sales in 2014 for the first time. Immediate income annuity sales jumped 17 percent in 2014, totaling $9.7 billion. As consumers look for protection from outliving their assets, demand for fixed annuity products is likely to remain strong.

In summary, the fixed annuity industry is already subject to comprehensive and effective state regulation, which ensures that each customer is sold an annuity product that is, in fact, wholly suitable for meeting his or her personal financial needs. NAFA submits that the suitability standard of care that applies to the sale of annuities and other insurance products is the proper and "most suitable" standard of care for such sales. It is unnecessary and would be both disruptive and unworkable to attempt to replace or overlay this proven suitability standard of care with the fiduciary rules that apply to securities sales.

ABOUT NAFA

NAFA, the National Association for Fixed Annuities, is the premier trade association exclusively dedicated to fixed annuities. Our mission is to promote the awareness and understanding of fixed annuities. We educate annuity salespeople, regulators, legislators, journalists, and industry personnel about the value of fixed annuities and their benefits to consumers. NAFA's membership represents every aspect of the fixed annuity marketplace covering 85% of fixed annuities sold by independent agents, advisors and brokers. NAFA was founded in 1998. For more information, visit www.nafa.com.

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[6] LIMRA Secure Retirement Institute "Annuity Owners in Key Income Segments More Confident About Retirement," published November 6, 2014.

[7] LIMRA Secure Retirement Institute "Total U.S. Annuity Sales Improve Three Percent in 2014," updated March 12, 2015.