



December 19, 2008

Sean Dilweg, Commissioner and Chair, NAIC Suitability of Annuity Sales (A) Working Group
State of Wisconsin, Office of the Commissioner of Insurance
125 South Webster Street
GEF III – 2nd Floor
Madison, Wisconsin 53702

Dear Commissioner Dilweg:

NAVA, Inc.,¹ the Association for Insured Retirement Solutions, respectfully submits these additional comments on the Discussion Draft proposing modifications to the NAIC Suitability in Annuity Transactions Model Regulation (the “Suitability Model Regulation”). We submitted some preliminary comments by letter dated December 3.

General Comments

As we stated in our earlier comments, the Discussion Draft, if fully adopted, would result in a dramatic restructuring of the current regulatory framework that governs annuity sales and necessitate large scale changes in existing systems and procedures for both insurers and distributors. The Draft is overly detailed and prescriptive, would require costly and unnecessary duplication of systems and processes, result in a decrease in efficiency and effectiveness in ensuring suitable annuity recommendations, and likely undo the uniformity that has been achieved by widespread adoption of the current Suitability Model Regulation.

To the extent that modifications to the current Suitability Model Regulation may be needed, we strongly suggest that the best way to achieve meaningful and effective changes is for the Working

¹ NAVA is a not-for-profit organization dedicated to the growth and understanding of annuity and variable life insurance products. NAVA represents all segments of the annuity and variable life industry with over 300 member organizations, including insurance companies, distribution firms, banks, investment management firms, and industry service providers.

Group, the annuity industry and other interested parties to work together at a full or half day interim meeting, as proposed in the joint letter filed by ACLI, IMSA, NAIFA and NAVA on December 4. This type of collaboration has worked well in the past. The industry supported the development of the original Senior Protection in Annuity Transactions Model Regulation and its subsequent expansion to provide protections to all annuity purchasers, and continues to support the uniform adoption of the expanded Model in all fifty states and the District of Columbia. The industry would welcome the opportunity to work with the Working Group on potential revisions.

We have major concerns regarding two aspects of the Discussion Draft – the new suitability standard, and the elimination of the ability of insurers to delegate suitability and supervision to third party distributors. We will address each of these concerns in detail, and also provide brief comments on several other proposed provisions.

I. Suitability Standard

Proposed Section 6A would modify the suitability standard in the current Suitability Model Regulation by adding the term “objective” so that it would now require an insurance producer, or insurer where no producer is involved, to have an objective reasonable basis for believing that a recommendation is suitable for the consumer. The term “objective” is not required by FINRA suitability Rule 2310 on which the Model’s standard was based and is confusing and problematic.

Reasonableness is used in drafting to provide an objective standard for action that involves a measure of judgment. In other words, for an action to be reasonable requires something more than just the actor’s good faith or subjective belief. Adding the term objective will cause confusion as parties will not know what more is intended in addition to reasonable conduct. In addition, we note that determining the suitability of an investment depends on the particular circumstances of the customer as they exist at the time of the recommendation. The use of the term objective would suggest that a transaction could be reviewed with hindsight years later and a recommendation that was suitable at the time it was made might be determined to not be suitable in light of subsequent changes in circumstances.

Section 6B places an absolute obligation on the part of the insurance producer or insurer to obtain all of the suitability information listed in Section 5M prior to execution of an annuity transaction. Further, Section 7B(4)(c)(iv) would require an insurer to disapprove any annuity sale if any suitability information is not submitted with the application. The current Suitability Model Regulation requires the producer or insurer to make reasonable efforts to obtain certain specified customer information, which is consistent with the requirements of FINRA suitability Rules 2310 and 2821. For privacy reasons or otherwise, a customer may not wish to divulge all of the enumerated information. For example, a customer may reasonably not want to disclose each and every asset and investment he or she owns or all current living expenses. The proposed language would absolutely prevent a customer

from purchasing an entirely suitable annuity if the customer wanted to protect the privacy of his/her personal financial information. The current language requiring a reasonable effort to obtain the information should be retained.

If the Working Group determines that the suitability standard needs to be changed, we suggest that an appropriate model could be NASD Rule 2821. Although Rule 2821 was designed for recommendations of deferred variable annuities, modifications could be made so that sales of other annuity contracts that are not subject to the rule would nevertheless comply with its principles in order to achieve uniform standards for all types of annuities. This would have to be phased in over a period of time.

As we have previously advised, the NAVA Straight-through Processing (STP) Standards initiative incorporate the requirements of NASD Rule 2821 in its suitability standards. The STP suitability standards are based on the premise that the insurer would delegate to the distributor the day-to-day oversight of the suitability of annuity transactions, which is permitted under the current Suitability Model Regulation. However, the insurer could so delegate only if the distributor adopted and implemented written policies and procedures in accordance with the standards which would include, among other things, conformance with the principles of NASD Rule 2821 for all annuity transactions. The industry is in the process of a phased implementation of the standards and our intent is for the standards to be utilized by all distribution channels.

II. Elimination of Delegation

We are particularly concerned that the Discussion Draft would eliminate the ability of insurers to delegate suitability and supervision to third party distributors which is permitted by Section 6D of the current Suitability Model Regulation. This would be a dramatic departure from current requirements.

The current Suitability Model Regulation imposes appropriate responsibilities on both distributors and insurers. Section 6D(2) requires general agents and independent agencies to either adopt a system established by an insurer to supervise recommendations of its insurance producers that is reasonably designed to achieve compliance with the regulation, or establish and maintain such a system, including written procedures and conducting periodic reviews of records that are reasonably designed to assist in detecting and preventing violations of the regulation.

On the federal level, distributors of variable annuities are also required to comply with rules promulgated by FINRA which impose a suitability obligation on producers recommending the purchase or exchange of a variable annuity and require broker-dealers to establish and maintain a system to supervise the activities of their registered representatives, registered principals and other associated persons that is reasonably designed to achieve compliance with applicable securities laws

and regulations, and with other FINRA rules. The supervision system must include written procedures and provide for the review and endorsement by a registered principal, in writing, of all transactions.

Section 6D(1) of the current Suitability Model Regulation specifies that an insurer either must assure that a system to supervise recommendations that is reasonably designed to achieve compliance with the regulation is established and maintained, or establish and maintain such as system itself. Section 6D(3) and (4) permit insurers to satisfy this obligation by contracting with a third party to establish and maintain a system of supervision with respect to producers under contract or employed by the third party. In so doing, the insurer must, among other things, “make reasonable inquiry to assure that the third party is performing the functions required”, including “based on reasonable selection criteria, periodically select third parties ...for a review to determine whether the third parties are performing the required functions.”

As required by the Suitability Model Regulation, many insurers have developed supervision systems and procedures to monitor the effectiveness of their distributors’ procedures and systems. If the Working Group believes that the monitoring systems being utilized today have not been effective in identifying and correcting improper sales activities by insurance producers and insurance agencies, we believe the proper course of action is to strengthen the requirements for insurer monitoring, rather than completely eliminate delegation as the Discussion Draft would do.

We suggest that one way to improve the usefulness of insurer monitoring practices would be to follow the approach NAVA has developed as part of our (STP) Standards initiative. As we have previously explained, NAVA has developed comprehensive insurer compliance reports that help insurers monitor the effectiveness of their distributors’ supervision systems and help both the insurers and distributors identify unsuitable sales patterns.

The reports utilize trend analysis and provide detailed information of each distributor’s business with that insurer regarding a number of factors such as the age of the purchaser, share class, benefit election, subaccount allocation, replacements and surrenders. When insurers provide the reports to distributors, they will highlight any activities that are outside of their anticipated normal ranges for that particular item. In turn, the distributors are expected to investigate the variance and either provide an acceptable explanation or undertake remedial steps. Distributors will also use such reports to monitor the sales practices of their producers in conformance with both state and federal laws.

While these reports were created as a component of STP, the data that is collected and analyzed includes all third party distributor sales, whether completed electronically or in paper. In addition, the NAVA insurer compliance reports were shared with the ACLI which has prepared comparable suitability monitoring guidelines for use by member insurers.

Sample insurer compliance reports and the NAVA STP Insurer Compliance Reports Specifications, Principles and Guidelines explaining the purposes, goals and uses of the reports are attached to this comment letter. We continue to be available to provide a demonstration of the reports to the Working Group.

Section 6C(2)(a) of the Discussion Draft states that that Section 7 does not require an insurer to review, or provide for review of, all insurance producer solicited transactions. However, Section 7 would impose obligations on insurers that would almost certainly require them to review all transactions.

For example, Section B(4)(c)(i)(I) requires insurers to mail to each customer a statement clearly describing the customer's Suitability Information as collected by the producer and a request that the customer respond and identify any information that is incorrect. This requirement is inconsistent with the statement in Section 6C(2)(a) that Section 7 does not require an insurer to review all insurance producer solicited transactions. How can the insurer be expected to summarize the customer Suitability Information for each transaction without reviewing each transaction?

Section B(4)(c)(iii) would require insurers to attempt to call, prior to acceptance of an application, all customers age 70 or older, to interview them to verify their liquidity related to suitability information and their understanding of the liquidity related to features of the annuity. A transactional review would be required to determine the age of each applicant.

Section B(4)(c)(iv) would require the insurer to disapprove any annuity sale if any suitability information or transaction monitoring elements is not submitted with the application. This too appears to be inconsistent with Section 6C(2)(a) since, again, the insurer would have to review each transaction in order to know if all required information is included.

Other Specific Comments

I. Section 5. Definitions – the Discussion Draft introduces many new terms which are poorly defined, vague, or raise other questions as to their meaning.

D. *High risk factor* – requires insurers to speculate as to what may be likely to create materially higher risk of unsuitable sales. Further, we do not understand how the features of a product, which were filed with and approved by state insurance departments, should be deemed to create a higher risk of a violation.

I. *NAIC Life Insurance Committee* – this future committee would have significant authority to promulgate guidelines that would be binding on insurers, insurance agencies and insurance producers, and would appear to infringe on the authority of state insurance departments to determine what should be required in their jurisdiction.

M. *Suitability information* – the list of required customer information includes several items that are not required by NASD Rule 2821 and are of questionable value, such as monthly income and expenses, or duplicative, such as liquid assets and liquid net worth. Subsection (17) would require collection of information regarding costs and benefits of any replaced financial product. In many instances, the producer may have very limited access to or ability to obtain this type of detailed information about other products owned by the customer. Subsection (19) raises many questions. What is the time horizon over which a “reasonably” anticipated change in living circumstances should be considered? Are health questionnaires or medical underwriting going to be required to determine such anticipated changes?

II. Section 6. Duties of Insurers and of Insurance Producers to Recommend Suitable Products -

Section 6D states that compliance with FINRA Conduct Rules pertaining to suitability shall satisfy the requirements under this section for the recommendations of variable annuities. We agree completely with this “safe harbor” since, as noted earlier, sales of variable annuities by registered broker-dealers are subject to comprehensive suitability, principal review and supervision rules under Rules 2310 and 2821. However, the Drafting Note would seem to limit the safe harbor to only specific transactions that have been reviewed by FINRA. While FINRA examinations do include review of transactions, they primarily focus on the firm’s written supervisory procedures, licensing and registration status of its sales persons, exception reports and customer complaints, and its internal process for approving customer transactions and ensuring the suitability of recommendations made to customers. We request clarification that the intended safe harbor applies where the broker-dealer’s procedures and processes have been found by FINRA to comply with applicable rules.

Section 6E states that “no insurer or insurance producer may represent that an insurer’s suitability review standards is a standard to determine suitability.” We request clarification as to what this means.

III. Section 7. Insurer Supervision System – Section 7 would impose a number of new obligations on insurers, including establishment and maintenance of a supervision system, creation of a supervision organization consisting of a senior executive, supervision officer, qualified supervision personnel and audit and special investigation units, training programs for insurance producers, and supervision standards and procedures. In many instances, these insurer obligations would duplicate systems, procedures, programs and personnel that already exist within annuity distributors.

The supervision organization requirements of Section 7B(2) would impose significant new structural and functional overhead expenses for insurers. At a time when insurance companies are decreasing staffing due to economic conditions this would be extremely burdensome.

Section 7B(3) would require all insurers to provide a training program for their insurance producers. Most annuity contracts today are sold through independent producers who may sell products for 15 to 25 different insurers. In such a circumstance, this provision would appear to require all 15 to 25 insurers to provide a training program to the same producer which would clearly be duplicative and overly time consuming.

As noted above, Section B(4)(c)(i)(I) requires insurers to mail to each customer a statement clearly describing the customer's Suitability Information as collected by the producer and a request that the customer respond and identify any information that is incorrect. The statement is to be mailed not later than 14 days after the effective date of the annuity sale. The provision is completely silent as to what, if anything, the insurer is expected to do with the customer's response, and the summary does not even have to be sent until after the contract has been issued. The statement in (c)(IV) that an insurer shall not use the statement and the customer's response as evidence of the accuracy of the suitability information makes no sense, particularly where the customer's response affirms that the information was accurate.

Section 7B(4)(k) requires insurers to have standards that prohibit the sale of an annuity if the source of the funding of the annuity, directly or indirectly, is a reverse mortgage. This blanket prohibition is inappropriate and would prevent customers from using part of the proceeds from a reverse mortgage to create a lifetime income stream through the use, for example, of an immediate or payout annuity, or a deferred annuity with a Guaranteed Lifetime Withdrawal Benefit (GLWB).

A vital and growing need of many older consumers is the use of reverse mortgages as a retirement income planning and security tool and consideration of particular types of annuities for legitimate purposes should not be precluded.

Thank you for the opportunity to offer these comments. If we can answer any questions or be of further assistance, please contact me, or Michael DeGeorge, General Counsel, at (703) 707-8830, extension 20

Sincerely,



Catherine J. Weatherford
President & CEO

cc: Kim Shaul, Deputy Commissioner, Wisconsin
All members of the Suitability of Annuity Sales Working Group
Other Interested Parties