

## Theory without Facts: The Case for State Regulation

SEC Chairman Cox tells the anecdotal story about his father's unsatisfactory purchase of a fixed indexed annuity. Coincidentally, the father of the head of the securities division in Alabama, Joe Borg, bought an index annuity five years ago and Mr. Borg told us recently that his father did not understand what he was sold. Susan Nash from the SEC stated at the proposed rule hearing when asked what the states were doing to address unsuitable sales that "the states are just concerned with company solvency." A lawyer and her client read aloud a letter from a family at a California legislature committee hearing for index annuities suitability sales to demonstrate how the client's father was sold an unsuitable annuity and had no money when he went into a nursing home. Attendees find out at the end of the reading that the annuity in question was a **variable** annuity. At a Wisconsin committee meeting for index annuity supervision, a member of the committee who represents the security distribution channel expressed the need for more product training because the complaints against indexed annuity sales are "huge compared to traditional annuities." At that same meeting a representative from NASAA said that the need for supervision is "not because of the product but because how the product is sold."

While companies in all industries hope for 100% customer satisfaction it is unlikely to be possible in the imperfect world in which we live. Thus when evaluating effective oversight regulations, it is best that we stick with the facts, and not be unduly influenced by the experience of any singular consumer.

NAFA's position has been clear and strident that inappropriate, unsuitable, fraudulent or misleading sales are bad for the consumer and bad for the insurance industry. The association also opposes the Rule because it proposes egregious and duplicative regulation that adversely impacts consumers who need and desire index annuities. Most of the discourse about indexed annuities and the rationale for the proposal is based on anecdotal theory and not facts. Milton Friedman's famous insistence on the empirical testing of theoretical generalizations and rejection of "facts without theory and theory without facts" can equally be applied to public policy as it was to economic policy. NAFA believes that when the facts are equally applied centralized oversight by a self-appointed federal authority is not necessary, prudent or good public policy.

Theory #1– The states are "just" concerned with solvency.

FACT: The NAIC as well as individual states have taken the lead on initiatives involving education, training, suitability, licensing and supervision.

**Education & Training** -The NAIC Insurance Regulator Professional Designation Program was created in response to requests by regulators for a structured professional development path based on the NAIC curriculum. To comply with new, more rigorous instructional standards associated with the Designation Program, NAIC's curriculum has been re-developed and enhanced to include targeted learning outcomes, interactive teaching strategies, and the latest and most practical information participants need to support critical regulatory initiatives. See [http://www.naic.org/education\\_designation.htm](http://www.naic.org/education_designation.htm).

**Suitability of Annuity Sales** - 31 states adopted the model regulation. AK, NY, OH, & TN have not adopted the model. Alaska is a month or two away from adoption. The NAIC

Annuities A Committee has developed a model CONSUMER ALERT. The Suitability of Annuity Sales (A) Working Group has been charged to provide insurers uniform guidance in developing agent training, supervision and monitoring standards in order to better protect annuity consumers from unsuitable sales and abusive sales and marketing practices.

*Annuity Disclosure* - The ACLI has also taken on the initiative of improving Annuity Disclosure by creating the CEO Task Force on Annuities to bridge the Annuity information gap, driven by concern over consumer misunderstanding. The CEOs priorities are: Uniform adoption of NAIC Disclosure Model Regulation and Consumer Empowerment through improved simplified disclosure. The CEOs want to enhance current disclosure requirements under state insurance and federal securities law by using Templates for fixed and indexed annuities based on the NAIC disclosure model and Templates for variable annuities that follows federal securities laws.

*Producers Licensing* – Uniformity and reciprocity for producers licensing has been a goal of the NAIC for years. The concept of uniformity relates to resident licensing. The NAIC has adopted 37 Uniform Resident Licensing Standards that focus on eight broad areas, including: 1) licensing qualifications; 2) pre-licensing education; 3) licensing testing; 4) integrity/background check standards; 5) license application process; 6) appointment process; 7) continuing education requirements; and 8) limited lines. Reciprocity addresses non-resident licensing. The NAIC has identified four conditions that a state must satisfy in order for the state to be considered “reciprocal.” In 2007, the NAIC identified producer licensing reform as one of its key strategic issues. As a result, the NAIC conducted a national, comprehensive, producer licensing assessment and issued the NAIC Producer Licensing Assessment Aggregate Report of Findings.

*Interstate Insurance Compact* – The Compact has been adopted by 31 States and Puerto Rico to date, representing one-half of the premium volume nationwide. The Compact established a multi-state public entity, the Interstate Insurance Product Regulation Commission (“IIPRC”) which serves as an instrumentality of the Member States.

*NAIC Unfair Trade Practices Act* – A draft dated March 27, 2008 was proposed by Commissioner McCarty to direct the Committee members’ attention to the current proposed travel underwriting revisions. The proposed travel underwriting revisions to the UTPA was adopted at the Life Insurance and Annuity (A) Committee Meeting, March 30, 2008 in Orlando, Florida.

In addition the states of Iowa, California, Florida and Wisconsin – accounting for a large percentage of fixed annuity buyers have developed or are developing disclosure templates, supervision requirements, illustration limitations, designation restrictions and state-specific suitability rules. In Mr. Borg’s own state of Alabama a Task Force was developed to investigate annuity sales, particularly as they apply to the suitability of the products sold to Alabama consumers.

Theory #2 – The complaints about index annuities are driving the need for change.

FACT: The following information is taken from the March 2008 NAIC Customer Information Source report.

NAIC Filed Complaints	2007	2006	2005
Total (ALL Lines)	204,801	208,138	210,001
Total Annuities/% of Total	2,284/1.12%	2,157/1.04%	1,621/.77%
FIA Specific/% of Total	248/0.12%	231/0.11%	105/0.05%
FIA Sales (in 000s)	\$25,100,000	\$25,300,000	\$27,260,000
% of all annuities (in 000s)	9.7%	10.7%	12.6%

It is clear by this data that a product representing only 10% of all annuities sold (Source: LIMRA) with only 1/10<sup>th</sup> of a percent of closed complaints has many satisfied customers.

Theory #3: It is not what is sold it is how it is sold

FACT: According to the same NAIC report based on the REASON for the complaint, a complaint regarding the marketing & sales of an insurance product make up only about 3% of the total complaints. Bear in mind that the complaint reason is not broken down by product. Therefore, complaints regarding marketing and sales include all insurance products marketed (e.g, health, long term care, life and annuities). The most common reasons (almost 70% for each year) for complaints were claim handling and underwriting.

It is impossible to make a fair comparison of this data to similar statistics in the security industry as there is no such consolidated reporting and analysis of consumer complaints made public by the overseer of security sales or by the security industry. Without accurate and relative data, it is inappropriate, and perhaps untruthful, to make this type of comparison.

The proposed rule makes it clear that the SEC ignores the unique aspects of index annuities that make them insurance products and they do not appear to be aware or informed about the existing and newly enacted state laws that protect consumers from unsuitable sales, prohibit fraudulent and misleading sales practices, require full disclosure and free return of unsuitable policies, provide non-forfeiture protection and minimum interest guarantees. Nor do they seem to be interested in the “theoretical testing of generalizations” with empirical analysis.

Based on the actions that the insurance companies, state insurance regulators and industry associations have taken and will continue to take to eradicate abusive, misleading and/or fraudulent marketing practices, to ensure suitability supervision and review, and to oversee agent training, education and licensing, NAFA believes the consumers today enjoy a safe and secure environment to consider the purchase of index annuities and a local state insurance commissioner’s office to seek redress if they believe they have been misled or pressured into buying an unsuitable product.

If a discussion about the effectiveness of these actions is deemed appropriate, it is in the best interest of the consumer that the discussion be based on factual, empirical data.