

California Annuity Sales Rule Bill Faces Consumer Group Opposition

Think Advisor

SB 263, California's annuity sales standards update bill, sailed through the state Senate in May, with no opposing votes at the committee level or on the state Senate floor.

But the ultimate fate of the bill is still uncertain because of ongoing strong opposition from California consumer groups.

One open question is whether a California move to use its own annuity sales standards after 2025 could give the Securities and Exchange Commission a chance to regulate fixed annuity sales in all states.

What It Means

How U.S. individual fixed annuity sales rules will work after 2025 is still unclear.

The Annuity Sales Rule Fight

Life insurers that offer annuities can promise customers to provide a guaranteed stream of benefits payments for a specified period of time, or the lifetime of an annuity holder.

Regulators, consumer groups and financial organizations that offer investment products without guarantees have often objected to the efforts insurers and their agents use to sell annuities.

The SEC already shares regulation of variable annuities with state insurance regulators.

Under former President Barack Obama, federal regulators tried to require sellers of all types of annuities, including fixed annuities, to meet a fiduciary standard, or a requirement to put the consumer's interest first. Many sales standards specialists contend the use of a fiduciary standard would prohibit the use of annuity sales commissions.

Today, in spite of the rise of annuity products and annuity distribution programs aimed at the fee-based annuity market, about 98% of U.S. individual annuity sales involve commission-based compensation arrangements, according to Sheryl J. Moore, the CEO of Wink, a life and annuity tracking firm.

While Donald Trump was president, federal regulators ended the effort to impose a fiduciary standard, and the SEC adopt Regulation Best Interest, or Reg BI, which requires annuity sellers to act in the best interest of a consumer considering annuities and to show that they have considered a wide range of options for a retirement saver and why they have recommended the options they have.

Now, under President Joe Biden, the U.S. Department of Labor appears to be inclined to renew the fight for a fiduciary standard.

The NAIC Model Update

The National Association of Insurance Commissioners, a Kansas City, Missouri-based group for insurance regulators, developed an annuity sales rules model based on a “suitability” strategy, or effort to ensure that the annuities offered to a consumer suit the consumer’s needs, in 2003.

The NAIC then adopted a suitability update in 2012.

States can choose whether to implement NAIC models. Many have based their annuity sales rule laws and regulations on the NAIC model update.

In 2020, the NAIC approved a new suitability model update designed to complement the SEC’s Reg BI approach. It requires annuity sellers to act in the best interest of the consumer, to consider a wide range of annuity options, and to document the thinking behind product recommendations, but it appears to allow continued use of sales commissions.

Since the NAIC approved the suitability update, at least 38 states, including Florida, Pennsylvania and Texas, have implemented it, according to the American Council of Life Insurers. Oregon became the 38th state adopter on June 1, when Gov. Tina Kotek, a Democrat, signed SB 536, a suitability update bill, according to the ACLI.

New York state has taken a different approach and has implemented its own standards for life insurance and fixed annuity sales.

The Section 989J Problem

California legislative analysts have highlighted one of the concerns driving swift state adoption of the NAIC suitability update: a belief that Section 989J of the Dodd-Frank Wall Street Reform and Consumer Protection Act may give the SEC authority to share oversight of fixed annuity sales with state insurance regulators if states fail to adopt the NAIC's update by 2025.

California SB 263

The California Department of Insurance developed California's suitability update bill, SB 263, with support from the California Department of Aging.

Sen. Bill Dodd, D-Napa, California, introduced the bill in March.

When Dodd introduced the bill, many life and annuity groups — including the American Council of Life Insurers, the Association of California Life and Health Insurance Companies, the Federation of Americans for Consumer Choice, Finseca, the Independent Insurance Agents & Brokers of California, the National Association for Fixed Annuities and the National Association of Insurance Financial Advisors – California — strongly opposed the bill, based on the argument that it was too different from the NAIC model.

Groups that say they represent consumers, including the Center for Economic Justice, the Consumer Federation of America, the Consumer Federation of California, the Life Insurance Consumer Advocacy Center and United Policyholders, also opposed the bill, based on arguments that the bill was too close to the NAIC model update and too closely based on Reg BI.

Lawmakers have made several sets of revisions to the original draft of SB 263.

In April, when the California Senate Insurance Committee reviewed the bill at a hearing, speakers such as Matthew Powers, a vice president with the Association of California Life and Health Insurance Companies, and Shari McHugh, a lobbyist for NAIFA-California, said they liked the version of the bill under consideration at that point and wanted to see the bill move forward.

Consumer group speakers, such as Brian Brosnahan of the Life Insurance Consumer Advocacy Center, a lawyer who represents policyholders in disputes involving life insurers, blasted the bill.

Brosnahan criticized the bill for exempting cash-value life insurance from the scope of the Reg BI rules.

He also blasted the bill for requiring annuity sellers to disclose “material conflicts of interest,” but using what he contended is a misleading definition of “material conflict of interest.”

The NAIC definition “would exclude cash and non-cash compensation,” he said. “This would exempt 99% of the conflicts of interest from the scope of the bill.”

Annuity sellers would have to disclose whether they owned part of a life insurer issuing an annuity, but they would not have to disclose whether they would receive a \$40,000 commission for selling the annuity, Brosnahan said.