

California Legislature OKs Annuity Sales Rule Update

Think Advisor

The California Senate voted 37-0 earlier this week to give final legislative approval to Senate Bill 263, California's version of the National Association of Insurance Commissioners annuity sales standards model.

The bill would update California's existing annuity suitability rules and require annuity sellers to act in the best interest of the consumer.

The bill now goes to Gov. Gavin Newsom, a Democrat, for his signature.

California Insurance Commissioner Ricardo Lara, an elected official who's a Democrat, has joined with annuity issuer and annuity seller groups to support the bill.

The Life Insurance Consumer Advocacy Center has formed a coalition that's asking Newsom to veto the bill. The coalition includes AARP California, the Consumer Federation of America and United Policyholders.

What it means: Whether Newsom signs SB 263, and what happens in the California Legislature if Newsom vetoes the bill, could hint at how Democrats at the national level will end up handling the U.S. Department of Labor's efforts to impose new standards on sales of annuities and other products to consumers who are rolling assets out of 401(k) plans and individual retirement arrangements.

The history: The federal Employee Retirement Income Security Act of 1974 includes a provision requiring benefit plan advisors to meet a fiduciary standard of care, meaning that they should put the plan participants' interests first and disclose any unavoidable conflicts of interest.

Financial services groups, investor groups, regulators and others have clashed for decades over how to

apply the ERISA requirements.

During the administration of former President Barack Obama, the Labor Department adopted a definition of fiduciary that could have imposed many new rules on annuity sellers, strongly discouraged use of commission-based compensation arrangements and exposed the sellers to the threat of lawsuits years later if clients were unhappy with the performance of their annuities, even if the issuer met its benefits obligations.

During the administration of former President Donald Trump, the department let the federal courts kill the Obama-era fiduciary definition.

The U.S. Securities and Exchange Commission developed an alternative set of investment sales standards, Regulation Best Interest, which requires annuity sellers to act in a consumer's best interest. Reg BI appears to allow the use of sales commissions and does not appear to expose sellers to the same kind of liability risk that a fiduciary rule might create, Reg BI supporters say.

The NAIC designed its annuity sales standards update to wrap around Reg BI.

The Labor Department is now trying to bring back a broad definition of fiduciary that would impose tough new compensation disclosure and product comparison requirements on annuity sellers.

Financial planner groups support the new DOL proposals. Groups for annuity issuers and sellers contend that the DOL drafts are too vague and too broad, could slash middle-income consumers' access to annuities and could keep financial professionals from giving consumers even general information about how to save for retirement.

The NAIC update adoption incentive: Some state regulators and others believe that all states need to adopt the NAIC sales standards update to keep the SEC from regulating non-variable indexed annuities as securities.

Those regulators contend that the SEC can use section 989J of the Dodd-Frank Wall Street Reform and Consumer Protection Act to impose securities rules on the annuities if states fail to adopt strong, uniform sales standards.

Indiana and New Hampshire have adopted the NAIC update recently, bringing the total number of adopters to 44, according to the Insured Retirement Institute.

SB 263: California state Sen. Bill Dodd, D-Napa, introduced SB 263 in January 2023 with backing from Lara.

The bill has passed in the state Assembly and the state Senate without receiving any opposing votes at either the committee level or on the Assembly or Senate floor.

Views: Representatives for Newsom could not immediately be reached for comment on SB 263.

Dodd maintains that SB 263 will strengthen protections for retirement savers.

The bill “requires insurance agents to put the best interests of their clients first — ahead of any sales incentives they might make,” Dodd said in a comment about final Senate passage. “If they know an annuity is a bad fit, they will not be able to sell it.”

Lara also says that the bill will protect consumers.

The Life Insurance Consumer Advocacy Center coalition contends that the bill is misleading. It wants California to adopt annuity sales standards similar to the standards in effect in New York state.

“SB 263 uses definitional sleight of hand to authorize agents to lie to consumers by telling consumers that they have no conflicts of interest even when they stand to earn many thousands of dollars in commissions if the consumer accepts the agent’s recommendation,” the coalition writes in a public letter to Newsom.

“Although SB 263 on its face requires agents to disclose material conflicts of interest, ‘material conflict of interest’ is defined to exclude ‘cash or non-cash compensation,’” the coalition adds. “This definition exempts from the disclosure requirement nearly all conflicts of interest because nearly all conflicts of interest between agents and their customers arise from cash or non-cash compensation.”