LICAC

CONSUMER FEDERATION OF CALIFORNIA

United Policyholders

Life Insurance Consumer Advocacy Center

April 11, 2023

The Honorable Susan Rubio, Chair
Senate Insurance Committee
1021 O Street, Room 3310
Sacramento, CA 95814

RE: SB 263 (Dodd) - CONCERNS IF AMENDED

Dear Chair Rubio:

On behalf of the Life Insurance Consumer Advocacy Center ("LICAC") and a coalition of consumer groups including the Consumer Federation of California and United Policyholders, I write today to express our concerns about potential amendments to Senate Bill 263 that would change the bill from one that protects consumers to one that is largely hostile to consumer interests. SB 263 was introduced by Senator Dodd and sponsored by Insurance Commissioner Lara. Senator Dodd and Commissioner Lara deserve great commendation for the March 7, 2023 version of the bill, which is the strongest consumer protection measure introduced in the life insurance area in decades, and maybe ever. For the reasons discussed below and in the accompanying fact sheet, industry efforts to weaken the measure will defeat its value and should be rejected, and the bill should be enacted as originally drafted in the March 7, 2023 version of the bill.

SB 263, as amended on March 7, 2023, would rectify serious problems in the marketplace for life insurance products, especially policies that are marketed as life insurance investment plans. Such policies (often but not exclusively universal life) are touted and sold as investments that can provide tax-free payments for retirement or for medical, dependent care, or other expenses. Unfortunately, most of these policies will fail because policy fees will ultimately exceed policy credits and the policies will lapse. No tax benefits can be obtained unless the policy remains in force until the death of the insured, but approximately 80%-90% of the policies will fail to remain in force until the death of the insured. Incredibly, 29% of the policies ***fail in the first three years***, strongly suggesting that these policies should never have been sold in the first place.[1] Consumers continue to invest billions of dollars in the policies, but they are often little more than a scam, especially for middle and lower-income consumers, whose policies are most prone to failure. The policies are extremely complex, and consumers have no real chance of assessing for themselves whether the policy is a good investment. Consumers must as a practical matter trust the recommendations of the agents selling the policies.

Too often that trust is misplaced because the agent's financial interests conflict with the consumer's. The agent works for the insurance company and has no obligation under current law to consider the interests of the consumer; agents often stand to make large commissions if they persuade the consumer to purchase the policy, and sales abuses are common occurrences.

For example, Irma Bajar and Christina Schauf of Oakland bought indexed universal life insurance policies from Transamerica, after being tricked into thinking they were just helping a friend practice a presentation in front of her boss, while in fact the session was a sales pitch. The agents convinced them that the policies were a great tax-free retirement investment. They were concerned about the expense but were assured by the agents that they could reduce premiums at any time. After finding the monthly premiums hard to manage, they asked the agents about lowering the premiums but were told the policies would lapse and be worth nothing if the premiums were reduced. They had to abandon the policies rather than keep putting money into them, resulting in the loss of their entire investment of over $13,000, much of which had been transferred from a 401K account at the agents' urging.

Kim Howlett of San Diego also bought an indexed universal life insurance policy. He was impressed by the agent's sales pitch that he could invest money in the policy and then obtain tax-free income to fund his retirement. Based on the agent's recommendation, he planned to invest $105,750 per year into the policy for the first four years (totaling $423,000) and then put in no more money after that. Per the illustration, that should have allowed him to draw income of $122,797 every year beginning in year 17 and continuing to year 36 and still have money left in the policy. Mr. Howlett bought the policy but had to abandon it when he found that fees were

[1] Data supporting these estimates can be found at https://www.lifeinsuranceconsumeradvocacycenter.org/the-lapse-problem/

consuming the policy value, culminating in the loss of his entire $105,750 investment. The agent received an undisclosed first-year commission of $67,592. Mr. Howlett believes he would have been a lot more skeptical of the agent's recommendation had he known about the commission.

SB 263's 3/7/23 Version Will Help Protect Consumers of Life Insurance and Annuities

SB 263 provides many protections for life insurance and annuity consumers, including:

- SB 263 requires that agents selling life insurance policies or annuities act in the best interest of their consumer customers, ***without consideration of their own financial interests.*** SB 263's best interest standard has been adopted in New York and has withstood the insurance industry's legal challenge; the industry already knows how to implement the new standard and is doing so in New York,
- SB 263 requires that agents attempt to eliminate conflicts of interest and, if that cannot be done, to disclose them to the consumer.
- SB 263 requires that agents selling life insurance policies or annuities disclose that they are agents for the life insurance company, not for the consumer. Agents must also disclose a reasonable estimate of the amount of compensation the agent would receive if the consumer accepts the agent's recommendation.
- SB 263 prevents agents and insurers from selling products that they are not willing to recommend or for which they have not collected sufficient information about the consumer's situation to assess whether the product is suitable for the consumer.

SB 263 Should Not Be Weakened In Response To Industry Pressure

We have received indications that insurance industry lobbyists are bringing pressure to bear on the bill's sponsor and its author to weaken SB 263 to the point where it merely implements the "Suitability in Annuity Transactions" Model Regulation No. 275-1, which was adopted by the National Association of Insurance Commissioners (NAIC) in 2020. This would be a grave mistake for California. The NAIC Model was adopted with strong industry backing over the objections of consumer groups ***and*** the California Department of Insurance, where Commissioner Lara spoke out against it. It fails to protect consumers and may mislead consumers into thinking they are protected when they are not.

- The NAIC Model labels its standard a "best interest" standard, but this is not accurate. Agents ***are not required to consider only the interests of the consumer in making a***

recommendation. Agents are free to weigh their own financial interests against the consumer's interests.

- The NAIC Model purports to regulate agent conflicts of interest, but it fails to do so because it ***excludes*** from its scope all conflicts arising from "cash and noncash compensation." It thus excludes, and fails to regulate, almost all agent conflicts.
- The NAIC Model covers only annuities and ***excludes life insurance.*** This makes no sense. Not only are life insurance policies sold by the same agents using the same methods as annuities, but they are subject to the same kinds of sales abuses. Indeed, sales abuses are worse in life insurance than annuities, as indicated by the fact that ***the California Department of Insurance receives more than six times as many complaints involving life insurance as annuities (almost 5,000 over the past 5 years).*** And while annuities are currently subject to some minimal level of regulation under Insurance Code Section 10509.910, et seq. (governing suitability in annuity transactions), ***life insurance sales are not subject to any suitability regulation***, resulting in a "wild West" environment where consumers are frequently victimized by predatory agents and unfair sales practices.

The many shortcomings of the NAIC Model are discussed in more detail in the fact sheet accompanying this letter. The facts are clear that California should follow New York's lead in creating a true best interest standard by passing SB 263 and not knuckle under to industry by adopting the NAIC Model in place of SB 263.

California Should Not Rush Into Adoption Of The NAIC Model, And Consumer Groups Should Not Be Excluded From Discussions Around Amending SB 263

Some have claimed that California must act this year with respect to the NAIC Model because Section 989J of the Dodd-Frank Wall Street Reform and Consumer Protection Act sets a time limit for states to adopt legislation that meets or exceeds the minimum requirements of the NAIC Model, or else federal authorities may preempt some state regulatory authority. However, the Dodd-Frank deadline requires only that a state adopt legislation that meets or exceeds the NAIC Model, as SB 263 does, ***within five years*** of the NAIC's adoption of the Model law in the Spring of 2020. Thus, ***California has until the Spring of 2025 to adopt legislation in this area***. Until now, consumer groups have been excluded from all discussions between the author or sponsor and industry. That should not continue. There is ample time for all stakeholders, including industry groups and consumer groups, to be heard and to help fashion rules that make sense for California and actually protect consumer interests. California should not allow the insurance industry to push it to hastily adopt legislation that misleads consumers into thinking they are protected by a best interest standard when they are not, and that does nothing at all to protect life insurance consumers.

Sincerely,

/s/ Brian Brosnahan

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Brian P. Brosnahan
Executive Director
Life Insurance Consumer Advocacy Center

/s/ Robert Herrell

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Robert Herrell
Executive Director
Consumer Federation of California

/s/ Amy Bach

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Amy Bach
Executive Director
United Policyholders

CC: The Honorable Bill Dodd
Honorable Members, Senate Insurance Committee
Michael Martinez, Chief Deputy Commissioner and Legislative Director, California Department of Insurance
Josephine Figueroa, Chief Deputy Legislative Director, California Department of Insurance

FACT SHEET: COMPARISON OF SB 263 AND NAIC MODEL REGULATION 275-1

The Problem	How SB 263 Fixes the Problem	How the NAIC Model Fails to Fix the Problem
Agents recommending life insurance products that are ***not suitable for the consumer but are very profitable for the agent***.	Agents are required to make only recommendations that are in the best interest of the consumer; ***only the consumer's interest may be considered*** in making a recommendation.	Agents are free to consider their own financial interests and to weigh them against the consumer's interests, yet agents can claim that they are bound by a consumer's best interest standard.
Agents have ***undisclosed conflicts of interes***t with their customers, typically resulting from large commissions they earn only if they convince the consumer to buy the product.	Agents are required to ***identify and eliminate conflicts of interest if possible***; if not possible, the agent must disclose the conflict to the consumer	Almost all agent conflicts of interest are completely unregulated because the definition of "material conflict of interest" ***excludes those arising from "cash and noncash compensation."***
Rampant sales abuses in the life insurance market, resulting in ***over six times as many complaints*** to the Department of Insurance than in the annuities market.	SB 263, like New York's Regulation 187, ***applies to life insurance*** and annuities.	The NAIC Model ***does not apply*** to life insurance policies.
Consumers do not understand ***the agent's role and personal stake*** in a life insurance transaction.	An agent must disclose that they are an agent ***for the insurance company***, not the consumer; the agent must disclose ***a reasonable estimate of the compensation they will receive*** if the consumer accepts the agent's recommendation. Disclosure must be made at the time the recommendation is made.	Agents are ***not required to disclose*** that they work for the insurance company. Agents need disclose compensation ***only upon the consumer's request***; few consumers know how important it is to request that information, which may be grounds for the consumer to think more critically about the agent's recommendation. Those disclosures the NAIC Model does require may be made, at the agent's option, at the time the policy is delivered and accepted, which is far too late in the process for the disclosures to be helpful to the consumer.

Consumers receive only ***oral recommendation***s for important financial transactions that often involve a significant part of the consumer's retirement savings.	Agents must provide their recommendations, and the basis for the recommendation, ***to the consumer in writing***. This helps the consumer understand and recall the basis for the recommendation and helps prevent misunderstandings and disputes with the agent.	Agents need only ***make a note in their files*** concerning a recommendation they make and its basis. This promotes misunderstandings with consumers and allows agents to tell consumers one thing, while documenting something different for review by regulators.
Agents and insurers selling life insurance products ***without adequate information*** about the consumer's situation to assess whether the product is suitable for the consumer; agents selling life insurance products ***they are not willing to recommend***.	Agents and insurers are ***prohibited*** from selling life insurance and annuities if they do not have sufficient information about the consumer's situation to assess whether the product is suitable for the consumer. Agents are ***prohibited*** from selling life insurance and annuities they are not willing to recommend.	Agents and insurers can sell products even if they lack sufficient information about the consumer's situation to assess whether the product is suitable for the consumer. Agents can sell products they are not willing to recommend. In both cases, agents receive ***a liability shield*** if they get the consumer to sign a disclosure form.
Insurance companies offer agents sales contests, sales quotas, bonuses, and other compensation systems that ***increase the agent's incentives to sell unsuitable products, particularly if the agent is near the sales threshold needed to qualify for the benefit***; these kinds of programs aggravate the conflict of interest already present in a commission-based compensation system.	Insurers may pay agents traditional commissions, but they ***may not use compensation systems that favor particular products offered by the agent or offer agents sales contests, sales quotas, or bonuses.*** Insurers must compensate agents only by commissions or fees; they may not use trips and prizes or other non-commission compensation that is difficult to disclose to consumers.	Insurers ***are not restricted*** in how they design compensation systems for agents except for a prohibition on a narrow class of bonus and quota programs.