PROTECTING THE BEST INTEREST OF YOU AND YOUR CLIENTS

4 OBLIGATIONS FOR PRODUCERS

At DMI, we put consumers first by supporting the growth of partner agents and advisors through customer-friendly products and superior service. The best interest standard of care is a model regulation that closely aligns to the DMI's mission.

The National Association of Insurance Commissioners (NAIC) in 2020 set forth model regulation which creates a best interest standard of care for annuities which is a higher standard of care than a suitability standard of care but is lower than a fiduciary standard of care. Several states have enacted similar regulation in 2020.

A producer, when making a recommendation of an annuity, shall act in the best interest of the consumer under the circumstances known at the time the recommendation is made, without placing the producer's or the insurance carrier's financial interest ahead of the consumer's interest.

A PRODUCER HAS ACTED IN THE BEST INTEREST OF THE CONSUMER IF THEY HAVE SATISFIED THE OBLIGATIONS OF

1. **CARE**
2. **DISCLOSURE**
3. **CONFLICT OF INTEREST**
4. **DOCUMENTATION**

These four obligations must be met if a producer is acting in the best interest of a client.

1. CARE

The producer, when making a recommendation, must exercise reasonable diligence, care, and skill to know the consumer's financial situation, insurance needs, and financial objectives. The producer must not put his/her financial interests or the insurance carrier's financial interests ahead of the consumer's interests.

The producer must make reasonable efforts to gather Consumer Profile Information from the consumer. Consumer Profile Information is considered the minimum amount of information a producer should gather before making a recommendation. There are 14 items listed under the definition of Consumer Profile Information.

It is also required that the producer understand the annuities that the producer can offer, and the producer must have a reasonable basis to believe the recommended annuity effectively addresses the consumer's financial situation, insurance needs, and financial objectives over the life of the product.

The producer does not have to examine every possible annuity in the marketplace and is able to recommend one that the producer is currently able to offer, if the recommended annuity is in the best interest of the consumer. There is no requirement to obtain additional licenses or to recommend the lowest commission product, but the recommendation must be in the best interest of the consumer. The Model Regulation does not create a fiduciary obligation or fiduciary standard of care.

If a replacement is involved, the Model Regulation indicates that a producer shall consider the whole transaction, which includes taking into consideration the following:

- The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits, such as death, living or other contractual benefits, or be subject to increased fees, investment advisory fees or charges for riders and similar product enhancements.
- The replacing product would substantially benefit the consumer in comparison to the replaced product over the life of the product; and
- The consumer has had another annuity exchange or replacement and especially within the preceding 60 months.

2. DISCLOSURE

The producer must prominently disclose certain things to the consumer. Some of the items that need to be disclosed include the scope of the relationship with the consumer and the role of the producer, a statement of whether the producer is licensed and authorized to offer certain products, a range of how many insurers the producer sells products for, a description of the sources and types of cash and non-cash compensation to be received by the producer, and a notice of the consumer's rights to request additional information about cash compensation. The consumer can also request additional information about the cash compensation to be received by the producer.

The Model Regulation provides a sample form that can be utilized. In addition, the producer must have a belief that the consumer has been adequately informed of the various features of the annuity.

3. CONFLICT OF INTEREST

The producer must identify and avoid, or reasonable manage and disclose, any material conflicts of interest. Simply put, it is important for a producer to self-identify potential conflicts of interest and eliminate them or mitigate and disclose them to consumers.

Material conflict of interest is defined in the Model Regulation as a financial interest of the producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation. Material conflict of interest does not include cash compensation or non-cash compensation under the Model Regulation.

Some examples of potential conflicts of interest include, but are not limited to:

- Having an ownership interest or serving as a board member or officer of an insurance carrier
- Giving or receiving loans involving the consumer
- Acting as an investment adviser with the consumer
- Acting as an attorney, CPA, or other professional with the consumer
- Being listed on the annuity contract as an owner, beneficiary, etc.
- Other types of business dealing with the consumer (gold, real estate, business partnership, etc.)
- Having a spouse or close family member employed by an insurance carrier
- Having an outstanding loan from an insurance carrier

4. DOCUMENTATION

The producer must document any recommendation that is made and the basis for the recommendation. This requires the producer to document the Consumer Profile Information, the producer's analysis of the consumer's financial situation, insurance needs, and financial objectives, the analysis to determine what product to recommend, how the recommended product meets the financial situation, insurance needs, and financial objectives of the consumer, why it is in the best interest of the consumer, and how the recommendation and the basis of the recommendation was communicated to the consumer.

Documentation is one of the most important aspects of the Model Regulation for producers. It is required but it also provides the evidence that a producer complied with the requirements. Many producers are already going through these steps but have not documented their thought process and the analysis that they performed to arrive at their recommendation. Regulators are essentially wanting producers to "show their work" in writing rather than just taking the producer's word for it. Remember, one of the foundational tenets of compliance is, "If it isn't documented, it didn't happen."

A signed statement from the consumer must be obtained if the consumer refuses to provide Consumer Profile Information. The NAIC provided a sample form that can be utilized.

A signed statement from the consumer must be obtained if the consumer wants to enter into an annuity transaction that is not recommended.
The NAIC provided a sample form that can be utilized.

Difference Between Suitability Standard of Care and Best Interest Standard of Care

Under a suitability standard of care, a producer can recommend any annuity that is suitable. For example, a producer determines that Annuity A is the best choice for a consumer based on the consumer's financial situation, insurance needs, and financial objectives. Annuity B is not as good of a choice as Annuity A for the consumer but is still suitable and pays a higher commission. The producer is free to recommend Annuity B under a suitability standard of care.

Under a best interest standard of care, that likely is not the case as the producer is required to make recommendations that put the consumer's interests ahead of the producer's interests and the interests of the insurance carrier. In addition, the producer is obligated to make recommendations that are in the best interest of the consumer. The producer first needs to determine if an annuity is in the best interest of the consumer. If so, the producer must consider all of the annuities available to him/her and determine which annuity is in the best interest of the consumer and recommend that annuity. The analysis of determining the annuity that is in the best interest of the consumer should be completed holistically and not based on any single factor.

Disclaimer

DMI and Summit Compliance Group, LLC ("Summit") is providing this summary as an overview of the requirements under the National Association of Insurance Commissioners (NAIC) amended Suitability in Annuity Transactions Model Regulation, sometimes referred to by its number which is 275. Throughout this document, we will refer to it simply as the Model Regulation. Please note that the information in this summary is not meant to address all aspects of the Model Regulation and should not be considered legal advice. Neither DMI, Summit, nor its members, owners, employees, or contractors provide legal advice. You should seek legal advice from your attorney.