The Center For Economic Justice
1506 South First St.
Austin, TX 78704
(512) 912-1327
(fax) 912-1375

June 6, 2001

Roseanne Mead
Chair, NAIC Suitability Working Group

By Electronic Mail

Re: Suitability Model Regulation: May 11, 2001 Draft

Dear Ms. Mead:

The CEJ offers the following comments on May 11 draft suitability regulation.

Recommendations versus Recommendations That Result in a Sale

We support the working group's decision to apply the suitability requirements to all recommendations. We believe the elimination of unsuitable recommendations – whether or not they result in a sale – are the goal of the suitability model.

The ACLI offers two arguments against application to all recommendations. First, it is not necessary because a prohibition against not suitable recommendations that result in a sale will cause the elimination of not suitable recommendations. Second, the record keeping requirements will be onerous.

In response to the first point, it is not appropriate to wait for consumers to actually be harmed to stop insurer practices that will clearly harm consumers. Some on the working group have argued that regulators already have tools to identify and stop harmful recommendations that do not result in a sale. We do not believe this is the case, since regulators were not the first to identify and attack major problems of not suitable product sales. Moreover, if these other tools exist to identify and stop not suitable recommendations that do not result in a sale, these same tools exist to stop not suitable recommendations that do result in a sale. In essence, the argument against applying the regulation to all recommendations is an argument against a suitability model at all.

Finally, the complaints about record keeping are premature. The record keeping requirements must first be established before the issues of cost and capability can reasonably be evaluated.

Definitions: Suitable Recommendation

The definition of suitable recommendation is too broad to allow the regulation to be a meaningful regulatory tool. Even if a product was harmful to the consumer, an insurer or producer could argue that the product, at least in part, "assisted" the consumer in "meeting the consumer's insurable needs or financial objectives." Under this definition, the abuses

associated with vanishing premiums and churning would not run afoul of the suitability standard because the products provided life insurance and thus, assisted in meeting the consumer's insurance needs. The use of "or" instead of "and" between insurance needs and financial objectives eviscerates the standard.

The proposed definition of suitable recommendation again reveals the problem with making suitable recommendation the regulatory standard. We agree with the comments of State Farm that the standard set by this regulation should be a not unsuitable standard:

> The distinction between suitable and not unsuitable may be subtle but it is important. Determining suitability is not an objective process. It should be clear that recommendation does not have to be the perfect recommendation, but rather it must not be a wrong recommendation. We believe a "not unsuitable" standard is the clearest way to convey this standard.

By making "not unsuitable" the standard, the thrust of the regulation is to stop abusive practices that harm consumers as opposed to second-guessing insurers and insurance producers about the most appropriate products for a particular consumer. Making "not unsuitable" the regulatory standard will also provide for more efficient and fair enforcement of the regulation.

Definition: Recommendation

We recommend the inclusion of the phrase "if any" in this definition to address the issue of an insurer or insurance producer who has only one product to offer.

> "Recommendation" means specific advice directed by an insurer or an insurance producer to an individual consumer regarding which, if any, specific product amount or benefit option should be applied for and which is intended to lead the consumer to engage in an insurance transaction in accordance with that advice.

Further, we disagree with the ACLI comments on this definition. We believe their suggestion to add the term "personalized" is redundant with the term "specific" in the current draft. We also oppose limiting the definition to recommendations that involve "information collected directly from the consumer" because the insurer has access to all sorts of information about the consumer that may cause the insurer to target a particular group of consumers without ever collecting any information directly from the consumers. This is particularly true because of the ability of financial institutions to share information among affiliates with ease and without the consumer's permission or knowledge.

Credit Insurance Exemption

We appreciate the intent in the May 11, 2001 model regulation draft to subject certain credit insurance products, which have been the subject of unsuitable sales, to the suitability regulation.

We suggest, however, that the exemption be limited to *monthly outstanding balance credit insurance*. While single premium credit insurance is typically written in connection with closed-end loans and monthly outstanding balance credit insurance is typically written in connection with open-end, or revolving, loans, this is not always the case. Consequently, to ensure that single premium (SP) credit insurance *is* subject to the regulation, the exemption should be for monthly outstanding balance (MOB) credit insurance.

CUNA Mutual and CCIA argue against subjecting single premium credit insurance to the suitability regulation, arguing that "the mode of payment is a not an appropriate issue to be addressed in a suitability regulation." We disagree with this argument for two reasons. First, the difference between MOB and SP credit insurance is much more than the mode of payment. They are different products. As pointed out in previous comments, SP credit insurance often provides far more coverage than necessary to pay off the loan, while MOB coverage typically provides exactly the amount of coverage necessary to pay off the loan. Second, the mode of payment is clearly a suitability issue. Suitability involves more than whether a consumer requires some form of life insurance. Suitability also involves the timing of the purchase, the amount of coverage, the cost of the coverage and the nature of payments. There is a profound difference in whether credit insurance helps or harms a consumer based upon the differences in MOB and SP products. It is, for example, the difference between a consumer making monthly payments that start at $31 per month and decline to $27 over the five-year term of MOB credit insurance coverage and a consumer paying $4,700 for insurance and loan points on insurance up front and $7,000 in finance charges for SP credit insurance for five years of coverage.

We disagree with the suggestion in the drafting note that, if a NAIC working group is charged with looking at single premium credit insurance issues, then credit insurance should get a complete exemption from the model regulation. The proponents of subjecting SP credit insurance to suitability requirements have substantially documented the consumer harms associated with unsuitable sales of SP credit insurance. The fact that the NAIC is on the verge of acknowledging what many other agencies and organizations have already accepted – consumer harm associated with the sale of some SP credit insurance – should cement the decision the subject SP credit insurance to suitability requirements.

CCIA repeats its arguments that credit insurance should be exempt from suitability requirements because credit insurance is only sold in connection with loans and because there is regulatory oversight of credit insurance. As we have countered in the past, the fact that a product is suitable for a particular purpose does not mean the product is suitable for all consumers. And the fact that there is regulatory oversight of rates and forms does not mean that the product is suitable for all consumers.

Finally, ACLI argues for a credit insurance exemption, but offers only the generic statement that, "The necessary consumer protections in existing law and regulation have been documented and respond to concerns by working group members." In fact, we and other commenters have documented that existing law and regulations have not protected consumers from unsuitable sales of SP credit insurance. We have cited a study by the Departments of Treasury and Housing and Urban Development as well as statements by Fannie Mae and Freddie Mac regarding the abuses associated with SP credit insurance. In contrast, ACLI and others seeking an exemption for credit insurance cite federal disclosure requirements and assert that such disclosures, *by definition*, protect consumers. We have cited studies by the credit industry itself showing that disclosures alone have not protected consumers.

Duties of Insurers

As stated above, we believe the duty of insurers and insurance producers, in Section A, should be to not make unsuitable recommendations.

We recommend that Section C clarify the responsibility of insurers:

> An insurer shall adopt and effectuate guidelines and procedures reasonably designed to assure that the insurer and its insurance producers do not make unsuitable recommendations. An insurer's guidelines and procedures shall be appropriate to the methods of distribution and the insurer's product offerings.

In Section D(3), we recommend that compliance activities include statistical analysis of sales to types of sales, insurance producers and customer characteristics.

Duties of Insurance Producers

As stated above, we believe the duty of insurers and insurance producers, in Section A, should be to not make unsuitable recommendations.

Compliance

We have two comments on Section A. First, this section provides that an insurer complies with the regulation if it adopts and maintains guidelines reasonable designed to assure compliance. There is no provision, however, that the guidelines and procedures actually result in compliance. Thus, the draft provides for the possibility of the situation where an insurer is making unsuitable recommendations but is deemed in compliance with the regulation because certain procedures and guidelines are in place. While we support efforts to encourage insurers to establish such guidelines and procedures, the bottom line for compliance must be the absence of unsuitable recommendations.

Second, in comparison with the procedures specified in the IMSA handbook, the provisions of Section A are quite brief and limited. We suggest using the Code A section of the IMSA Handbook (pages 57 to 60) as the starting point for discussion of compliance procedures.

Regarding Section B, we request some demonstration of evidence that membership in NASD results in the absence of unsuitable recommendations and enforcement against people that make unsuitable recommendations. It seems reasonable to ask for evidence of the effectiveness of self-enforcement before such an approach is adopted by the NAIC.

Section C provides for a rebuttable presumption that the recommendation was suitable if relevant information was collected and considered and if the insurer or producer conformed with insurer's guidelines and procedures. We suggest that a third item must be present – that the insurer's guidelines and procedures can reasonably be expected to prevent unsuitable recommendations. Conformance with empty or meaningless guidelines should not be a defense against unsuitable recommendations.

Recordkeeping

Given the industry concerns about recordkeeping burdens, we recommend that this section be expanded to more explicitly describe the types of records that should be maintained and the mechanisms for keeping such records.

Penalties

We oppose the ACLI recommendation. Limiting aggregate penalties to $25,000 removes an important deterrence incentive from the model. Moreover, the ACLI proposal does not provide for the Commissioner to offer any restitution to consumers. We support Option 1 with the addition of a $10,000 maximum per violation, no aggregate maximum and added language to require the Commissioner to order restitution to harmed consumers.

Thank you for your consideration.

Sincerely,

Birny Birnbaum

Birny Birnbaum
Executive Director