

The Center For Economic Justice

1506 South First St.

Austin, TX 78704

(512) 912-1327

(fax) 912-1375

April 30, 2001

Roseanne Mead
Chair, NAIC Suitability Working Group

By Electronic Mail

Re: Suitability Model Regulation: Safe Harbors

Dear Ms. Mead:

The Center for Economic Justice offers the following comments on the issue of “safe harbors” within the draft suitability regulation.

First, while we believe that regulators should encourage insurer participation in IMSA and similar organizations, the issue of formal “recognition” by insurance regulators is much broader than safe harbors for suitability. This broader issue is being addressed by the NAIC in the market conduct working group. Consequently, the safe harbor section should be eliminated from the suitability regulation at this time and should be revisited at some point in the future after the broader issues of “recognizing” a private organization for market conduct compliance has been addressed by the NAIC.

Second, it is clearly premature to identify membership in a private organization as complying with suitability requirements because the suitability requirements have not yet been established. It is therefore impossible to determine if compliance with IMSA or NASD standards will comply with the requirements of the suitability regulation.

Third, it is clearly premature to consider membership in IMSA as a safe harbor because no evidence has been presented that such membership is effective generally at addressing insurer market conduct problems and effective specifically at addressing suitability market conduct problems. We have seen no evidence or analysis of the effectiveness of IMSA membership in reducing or eliminating market conduct problems. Until an independent analysis verifies the effectiveness of IMSA, it is unreasonable to consider membership in IMSA a safe harbor.

Interestingly, in its April 20, 2001 letter, IMSA offers no such evidence. Rather, Mr. Walters writes:

IMSA member companies have been awaiting recognition on behalf of the NAIC that would signal a willingness to formally acknowledge the significant benefits IMSA has brought to the life insurance marketplace. Over the past seven years, IMSA member companies, on their own initiative, have spent hundreds of thousands of dollars and devoted hundreds of thousands of hours to establish IMSA as a full-fledged organization

whose marketplace standards have become the benchmark of excellence within the life insurance industry. These efforts warrant formal acknowledgement in the Model Regulation's "safe harbor" provision.

Mr. Walters argues that recognition is warranted solely because insurers have spent money and time participating in IMSA. With due respect to Mr. Walters, recognition is warranted if results are demonstrated, not simply because effort has been expended. Yet, nowhere in Mr. Walters' letter do we find any objective or analytic description of the effectiveness of IMSA membership.

Fourth, according to Mr. Walters' letter, designating IMSA membership as a safe harbor would simply delegate the creation of market conduct standards from the legislature and the insurance regulator to a private industry organization. In attempting to explain why an IMSA safe harbor would not "deem" compliance, Mr. Walters writes:

Second, the "safe harbor" provision does not simply "deem" compliance based upon a company's IMSA membership but rather requires the state insurance commissioner to make a case-by-case determination regarding whether a company has complied with IMSA standards on a continuous basis.

Thus, according to Mr. Walters, the IMSA safe harbor means that the job of insurance regulators is to determine whether insurers have complied with standards established by insurers. This is inappropriate.

Fifth, we find the IMSA standards regarding suitability to be significantly inadequate. Mr. Walters' letter states the proposed safe harbor of IMSA membership "acknowledges the rigors associated with compliance with IMSA standards generally and IMSA's "need-based selling" standard specifically." We find no "needs-based selling" standard in the IMSA handbook. In fact, the IMSA handbook states the following:

Code A: The insurable needs or financial objectives of its customers are determined based upon relevant information obtained from the customer and the company enters into transactions which assist the customer in meeting his or her insurable needs or financial objectives.

Comment: The market and sale of covered products may often encompass practices other than "needs-based selling." Customers may have legitimate financial objectives that go beyond what may be fairly characterized as "insurable needs." It must also be recognized that in some instances, it may not be practical or appropriate to consult individually with each customer.

Further, the IMSA handbook provides no approach indicators or deployment indicators to determine if the company is making suitable sales. Rather, the IMSA compliance activities focus on gathering information and complying with applicable state laws and regulations.

Question 1.1: Does the company have policies and procedures designed to reasonably assure determination of the customers' insurance needs or financial objectives which encourage the use of fact-finding tools, in the marketing and sales of covered products?

Code B: It maintains compliance with applicable laws and regulations

Question 1.2: Does the company have in place policies and procedures designed to reasonable assure compliance with laws and regulations applicable to the marketing and sale of covered products.

Code B creates a circular logic to the safe harbor proposal. The regulation establishes membership in IMSA as compliance with the regulation, presumably because IMSA has specific standards in place that assure compliance with the regulation. But the IMSA standards refer to compliance with state laws and regulation.

Finally, the IMSA handbook provides the following monitoring indicators regarding suitability:

1.1.c.1 The company monitors, on an individual or trend basis, that independent and captive distributors make determinations of customers' insurable needs or financial objectives, and takes corrective action, where appropriate. Examples of such monitoring techniques include: customer surveys, distributor surveys, internal audits, tracking complaints, etc.

1.1.c.2 The use of fact-finding tools is a factor in the company's reward and recognition systems for independent and captive distributors and appropriate company employees.

1.1.c.3 The company obtains feedback from appropriate company employees, customers or independent and captive distributors to determine if these policies and procedures are used, and takes corrective action, where appropriate. Such feedback might be obtained from surveys, focus groups, etc.

1.1.c.4 The company obtains feedback through complaints, and takes corrective action where appropriate.

1.1.c.5 If the company has applications or supporting materials that include the questions listed in 1.1.b.4 or 1.1.b.5 above, it monitors the answers provided to the questions, and takes corrective action, where appropriate.

1.1.c.6 The company monitors lapse trends as an indicator of whether customers' insurable needs may not have been addressed and takes corrective action, where appropriate.

1.1.c.7 The company monitors exceptions to its general underwriting guidelines and practices pertaining to customers' insurable needs and financial objectives, and takes

corrective action, where appropriate. Such monitoring could include: review of an exception log or vesting limited authority to grant exceptions in certain personnel, etc.

1.1.c.8 The company has defined customer profiles for its products and has conducted analyses to determine if the sales patterns of its products are consistent with those policies, and takes corrective action, where appropriate.

1.1.c.9 The company monitors access to fact-finding tools by captive and independent distributors and appropriate company employees, and takes corrective action, where appropriate. For example, through monitoring inventory stock, or tracking requests for forms through an Intranet site.

1.1.c.10 The company routinely monitors, through a sampling of policy files, that needs assessment tools were used, and takes corrective action, where appropriate.

1.1.c.11 The company gathers customer satisfaction survey data that address insurable needs and financial objectives.

These monitoring indicators highlight several important issues. First, if insurance companies are actively complying with IMSA standards, there should be substantial information to review to determine if insurers are employing these activities and if the activities are effective. Second, it is clear that the insurance company has, or should have, considerable control over suitability of sales and responsibility for suitability should be assigned to both insurers and producers. Third, there is no safeguard against products designed for unsuitable sales. One monitoring activity is to determine if sales are made to the target audience (1.1.c.8), but there is no guaranty that the products are designed to be suitable for the target audience.

Thank you for your consideration.

Sincerely,



Birny Birnbaum
Executive Director