VIEWPOINT

Bad Apples, Annuities And The NAIC

BY DANNY FISHER

AS THE SAYING GOES, A FEW BAD apples can spoil the whole barrel.

Texas is one of 14 states that have adopted the National Association of Insurance Commissioners' Replacement Model Regulation. Most other states are expected to adopt it soon. Briefly stated, the regulation defines the responsibilities of insurers and agents regarding replacement of existing life insurance and annuities.

One of the new hair-raising requirements is for an insurer, upon request, to make records available to the insurance department concerning each agent's annuity contract replacements as a percentage of the agent's total annual annuity contract sales.

That is scary! There are millions of existing multiyear rate guarantee annuities that pay a set rate for a set number of years, after which the penalties expire and the rate is subject to change. In many cases, the rate drops to the contractual minimum guaranteed rate, which under the NAIC Model Index may be as low as 1.5%.

For years, professional agents have sold thousands of these MYGAs, with NAIC Index minimum guarantees now renewing at 2%. When these owners are offered the opportunity to transfer to a new contract earning a much higher guaranteed rate for a new period, virtually all make the transfer—as would any reasonably sane person. However, the NAIC has now clearly defined that transfer of assets as a replacement.

Let's get this straight: the NAIC has approved a method to pay policy owners rates as low as 1.5%, but will monitor agents who, in its opinion, may replace too many of those contracts with higher rate annuities. So, an agent's insurance license may now be in jeopardy when the agent does what's best for the client instead of what's best for the insurance company.

BAD AGENTS can spoil the business, but so can bad products.

I don't really believe the NAIC is trying to nail honest, professional agents to the wall. I do believe the NAIC is trying to make it harder for "bad apple" agents to do business—the agents who replace contracts still within penalty periods with new trash annuity contracts. But there is a better way.

Professional agents always present all relevant facts to their clients, regardless of how many forms are required. On the other hand, insurers and state insurance departments cannot create enough forms to protect the public from crooks.

People who sell illegal drugs are arrested every day all across America. The nation can't build enough prisons to hold all the drug pushers. The only way to stop drug trafficking is to cut off the supply of drugs. If there are no drugs, there are no drug pushers. The bad annuity problem seems similar. If the insurance commissioners would stop allowing bad annuities to be issued, the problem would dry up overnight.

As long as insurers are allowed to produce bad annuities, they can always find a pusher on the streets to deliver the trash. Alas, therein lies the rub; one person's trash is another person's treasure.

Annuities with exorbitantly high commissions, penalty periods exceeding 10 years and no penalty waiver at death are considered trash to a whole host of professional agents who refuse to sell them. But bad apple agents and insurers look at the same annuity and consider it treasure because it pays a high commission to the agent and lucrative profits to the insurer.

What's wrong with making more money? There's nothing wrong with making money, but the insurance business is based on the three-legged stool concept. The product has to be fair for the client, agent and insurer. Many annuities on the street today have a short, bad leg for the client.

In that vein, when insurance commissioners approve products for sale in their states, they apparently have a problem telling the difference between a three-legged stool and a stool specimen.

The NAIC has recognized that unscrupulous agents are selling inappropriate contracts to the public, but instead of removing bad products from the market, the NAIC just requires more forms for owners to sign in an effort to protect the agents and insurers from lawsuits. But if "trash" annuities were not produced, they couldn't be sold. If bad products weren't sold, the vast majority of lawsuits would never be filed, which would reduce the need for so many "cover-your-tail" forms.

At this stage, the number of forms required to make a simple annuity sale is ridiculous—more forms than are required to purchase certificates of deposit or mutual funds, for instance. What's more,

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when CDs mature in banks, the banks aren't required to complete replacement and suitability forms in to renew the CDs.

The NAIC has a moral and fiduciary responsibility to protect the public, not only from bad agents, but also from bad contracts. If the commissioners want to know how to tell the difference between a good annuity and a bad one, here is a simple test: "Would I let my mother put her money in this contract?" The answer will determine the quality of the annuity. NU

Danny Fisher, CLU, ChFC, is founde cipal of The Fisher Agency, Dallas, and Fisher Annuity Index. His e-mail address MrAnnuity.com.