



*American Council  
of Life Insurers*

# Creating Connections

## Seizing Opportunities

ACLI Annual Conference 2018

# Suitability, Best Interest and the Regulation of Investment Advice

# New York Insurance Regulation 187

- Reg. 187 Current State:

- Suitability in Annuity Transactions
- New York-style Safe-harbor
  - “Substantially Similar” to NAIC and FINRA requirements; “intends to bring these national standards for annuity contract sales to New York”

- Reg. 187 Future State:

- Suitability and Best Interests in Life Insurance and Annuity Transactions
- Removal of safe-harbor language
- Effective August 1, 2019 for annuities and February 1, 2020 for life insurance

# Headline Changes:

- Best Interest Standard of Care for sales and in-force transactions
- Inclusion of Life Insurance Policies, not only Annuities
  - Exclusions:
    - “Generalized Offer” (direct response or worksite)
    - ERISA Plans
    - 401(a), 401(k), 403(b), government or church plans, non-qual. deferred comp.
    - Personal injury settlements
    - COLI/BOLI
    - Credit life insurance
    - Life settlement contracts

# “Best Interest” Standard of Care

- Duties of insurers and producers for sales transactions
  - “In recommending a sales transaction to a consumer the producer, or the insurer where no producer is involved, shall act in the best interest of the consumer.”
  - Disclosure in “reasonable summary format” of suitability considerations and product information (favorable and unfavorable) providing basis for recommendation
  - Document facts and analysis underlying recommendation

# What does “best interest” mean?

- Producer or insurer acts in the best interest of the consumer when:
  - Recommendation based on evaluation of collected suitability information and reflects the care, skill, prudence and diligence a prudent person acting in like capacity and familiar with such matters would use.
  - Only the interests of the consumer may be considered in making recommendation. Producer compensation and incentives are permitted, provided the amount of compensation or receipt of an incentive does not influence the recommendation.
  - Sales transaction is suitable (“in furtherance of consumer’s needs and objectives” based on information provided).
  - Reasonable basis to believe that consumer has been informed about features and consequences of transaction, including costs; consumer would benefit from features of policy; and, if a replacement, costs and benefits have been considered.

# What does recommendation mean?

- One or more statements that:
  - “reasonably may be interpreted by a consumer to be advice” and results in a consumer entering into or refraining from a transaction  
OR
  - Is intended by the producer or insurer to result in a consumer entering into or refraining from a transaction.
- Safe harbor for general factual information such as advertisements, marketing materials and interactive tools.

# New Bells and Whistles

- Recommendations with respect to in-force transactions also subject to best interest standard.
  - Same definition of what constitutes best interest as for sales transactions.
- Duties apply to all producers who “materially participated” in recommendation.
- Prohibition of use of title or designation of “financial planner, financial advisor or similar title” unless properly licensed or certified.
- Special disclosures if producer is limiting range of products offered to the consumer from among those available to the producer for sale.

# Insurer Responsibility and Supervision

- Insurer may not effectuate sales transaction without reasonable basis to believe it is suitable.
- Insurer must maintain and audit a system of supervision reasonably designed to ensure compliance.

# NAIC Model 275: Suitability in Annuity Transactions Model Regulation

- Sets standards and procedures for oversight of recommendations that result in the sale of an annuity:
  - Requires the recommendation be suitable based on the facts and information from the consumer.
  - Must consider the consumer's financial condition and needs.
  - Assigns various related duties for insurers and producers.
- State adoption of the 2010 model as of January 2018
  - 39 states (incl. DC) have adopted the model by law or regulation
  - 2 states have partially adopted the model
- Annuity Suitability (A) Working Group and ultimately the Life Insurance and Annuities (A) Committee control the work/direction on this Model.

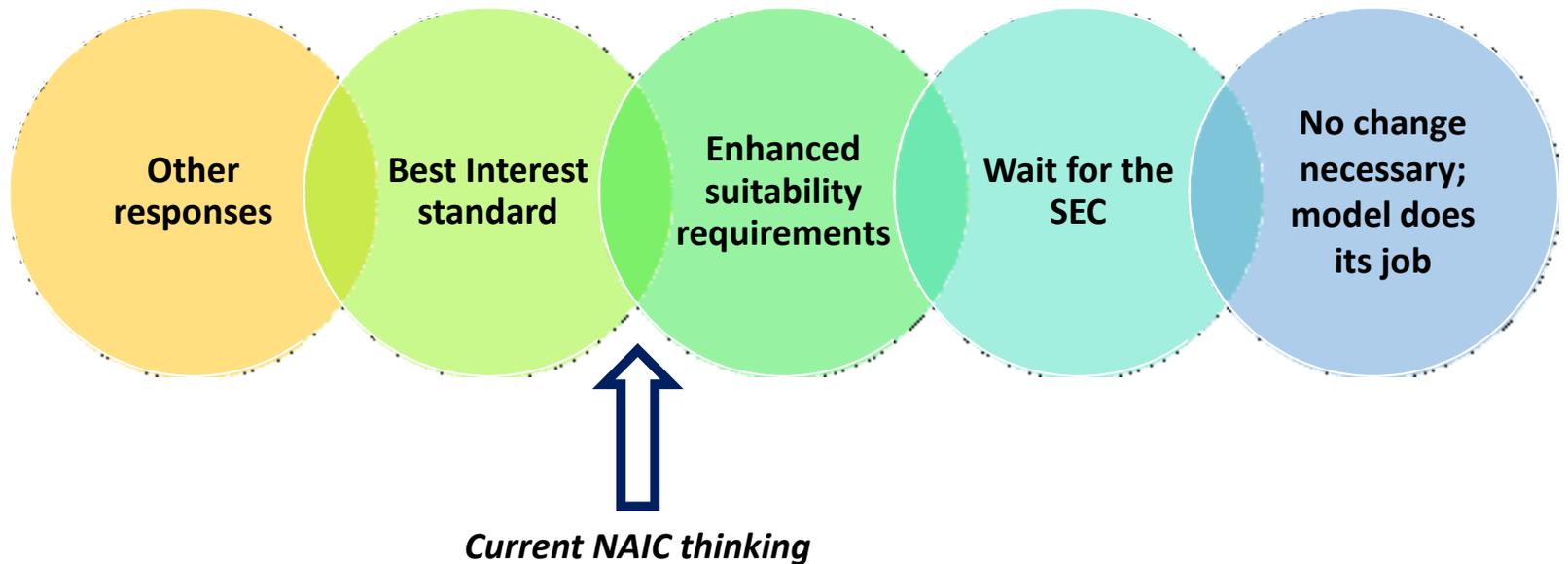
# Model Currently Under Review

- The DOL Fiduciary Rule pushed the NAIC to open the model for review, with a particular focus on adding a best interest standard
- 5<sup>th</sup> Circuit vacatur of the Fiduciary Rule disrupted NAIC momentum
- NAIC leadership re-opened the comment period on the Model in light of the court's decision, resulting in:
  - Additional working group meetings
  - 2 rounds of comments
  - Potential change in direction

# Influential Factors

- SEC Regulation Best Interest
  - Regulatory package released by SEC in April 2018; comments were due August 2018
  - Key questions around intersection of process with NAIC
  - Chairman Clayton may push for a vote in early 2019
- Individual states, including ...
  - New York: Regulation 187 effective August 2019; February 2020 for life insurance
  - California: Strong support for New York's regulation; watching for introduction of similar legislation in 2019

# Industry Response Runs the Gamut





# Biggest Issues Under Consideration

- Best Interest or not?
  - The Working Group agrees that enhanced suitability standards are necessary; refraining from calling it a “best interest” standard until the SEC process is further developed
  - SEC uses “best interest” explicitly
    - Contention around whether the absence of the term would disrupt harmonization efforts and cause confusion
    - Concerns that the term is too vague; concerns about enforceability
- Compensation Disclosure Requirements
  - Cash vs. Non-cash compensation
  - How much to disclose
  - Method of disclosure

# Next Steps

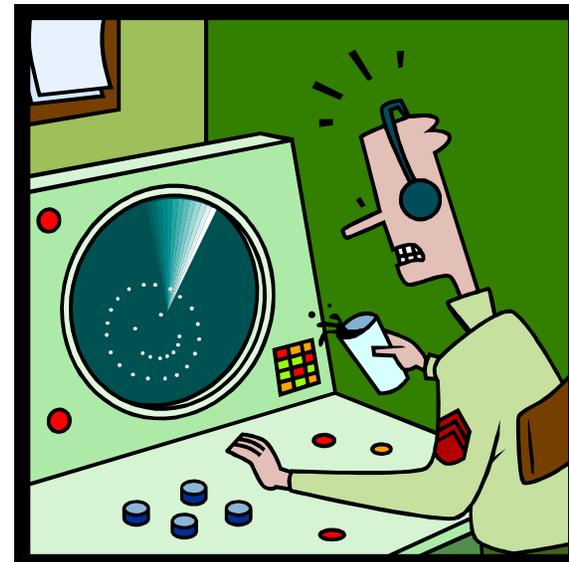
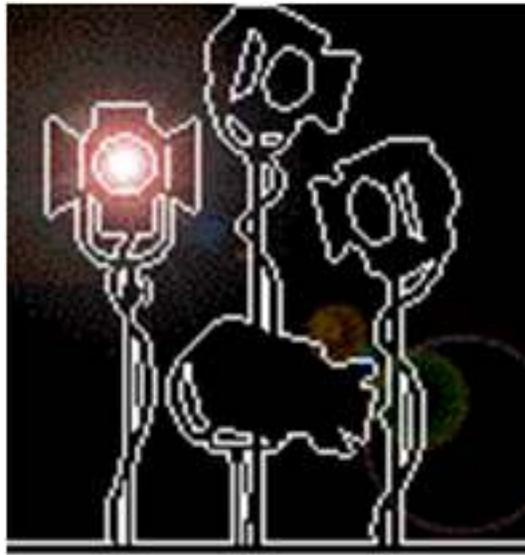
- Annuity Suitability Working Group in-person interim meeting
  - October 22-23, 2018; Chicago, IL
  - Continue detailed review of comments received; active, working drafting session expected
  - (Ambitious) working group leadership goal: Have a final draft ready for the A Committee to review at the Fall National Meeting
- NAIC Fall National Meeting
  - November 14-18, 2018; San Francisco, CA
  - Possible review of a final draft by the A Committee
    - If so, potential for a discussion regarding ways to extend to life insurance (requested by NY, supported by CA, DC)



# Focus on the SEC's Best Interest Standard of Care Initiatives for Broker-Dealers and Investment Advisers

Carl Wilkerson, Vice President & Chief Counsel American Council of Life Insurers

# Best Interest Standards: In the Regulatory Spotlight and on the Radar Screen



# SEC Engagement

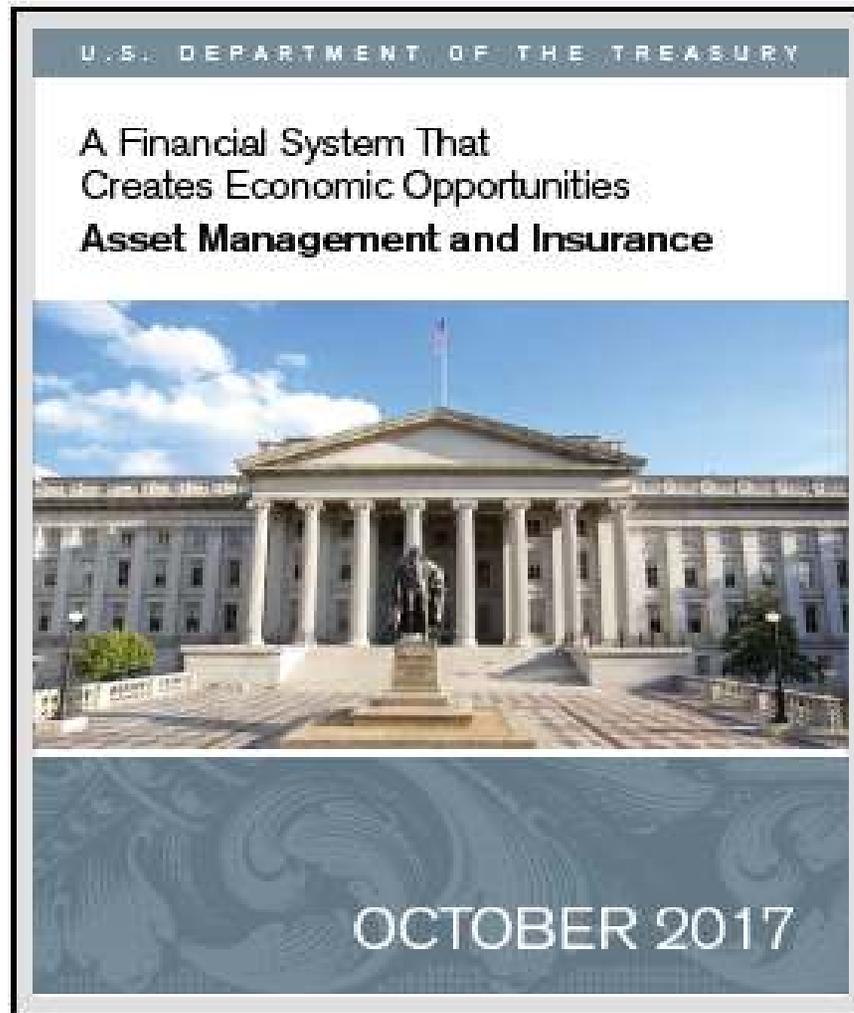
- Where it is, how it got there, and where might it end up
- Coordination with State Insurance Regulators

## Moving the Dialog Forward

- An Approach to a Reasonable Best Interest Standard of Care Across All Regulatory Platforms

# The Regulatory Continuum Contributing to Best Interest Standards

- SEC Elimination of Fixed Commissions (May 1, 1975)
- Tully Report (1995)
- Rule 202(a)(11)-1 (2005)
- RAND Report (2009)
- DOL First Proposed Fiduciary Rule (2010)
- SEC Dodd-Frank Act Section 913 Study Report (2011)
- DOL Conflict of Interest Rule Adopted (2016)
- Trump Administration Executive Order (2017)
- DOL Postponement of Fiduciary Rule (June 2017)
- SEC Chairman's Request for Information on Standards of Care (June 2017)
- NAIC Visit with SEC and DOL Leadership (October 2017)
- Treasury Report on Asset Management & Insurance (October 2017)
- U.S. Court of Appeals Vacates DOL Fiduciary Rule (June 2018)
- SEC Best Interest Initiatives (April 2018)
- New York Regulation 187-Suitability & Best Interest (July 2018)
- NAIC Amendments to Suitability in Annuity Transactions Reg. (October 2018)



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# Treasury Report On Fiduciary Rule (Page 64-70)

- Supports the current efforts at the DOL to re-examine the implications of the Fiduciary Rule.
- Believes it is appropriate to delay full implementation of the Fiduciary Rule until the relevant issues, including costs of the rule and exemptions, are evaluated.
- Believes that conflicts of interest should be addressed in a manner that preserves, to the extent possible, access to a wide range of asset classes.
- Believes that conflicts of interest should be addressed in a manner that does not disrupt the free functioning of the markets and access to financial services.”
- Encourages the SEC, the DOL, and the states to work together to implement a regulatory framework appropriately tailored to both preserve investor choice and protect retirement investors in an efficient and effective manner.”



**Villas, Castles, and Vacations:**  
*How Perks and Giveaways Create  
Conflicts of Interest in the Annuity Industry*

October 2015

Prepared by the Office of Senator Elizabeth Warren

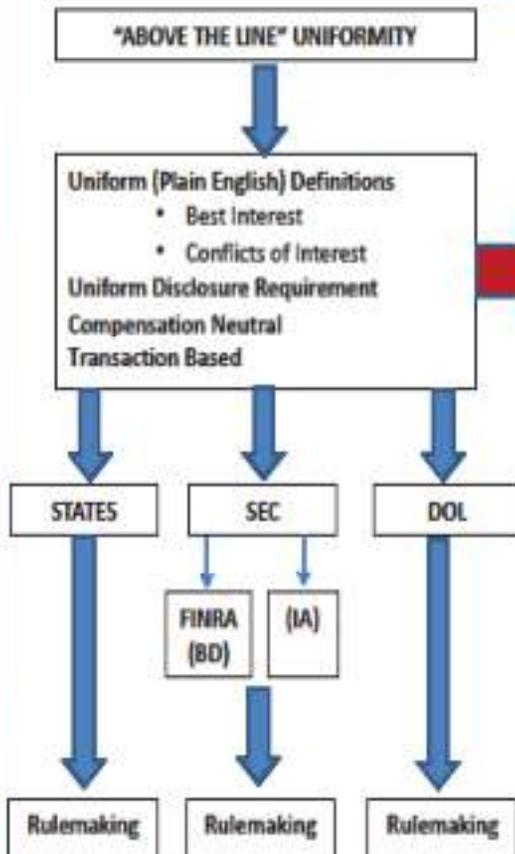
The image is the cover of a report. At the top is a photograph of a large, multi-story stone building with a central tower, surrounded by lush green trees and a well-manicured lawn. Below the photo is the title 'Villas, Castles, and Vacations:' in a bold, white, sans-serif font, followed by the subtitle 'How Perks and Giveaways Create Conflicts of Interest in the Annuity Industry' in a smaller, italicized, white font. In the center is the official seal of the United States Senate, which is a circular emblem featuring an eagle with wings spread, holding an olive branch and arrows, with a shield on its chest. The words 'UNITED STATES' and 'SENATE' are inscribed around the perimeter of the seal. Below the seal is a horizontal line, followed by the date 'October 2015' in a white, sans-serif font. At the bottom, the text 'Prepared by the Office of Senator Elizabeth Warren' is written in a small, white, sans-serif font.

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# UNIFORM STANDARD OF CARE

Goal: Approved by Industry, Regulators, and Consumer



## Common Uniform Definitions:

A recommendation is in the "Best Interest" of the consumer when the [advisor/rep/broker/insurance producer]:

- puts the consumer's interest first;
- acts with reasonable care, skill, prudence and diligence in gathering and evaluating the Consumer's Profile Information used to make the recommendation;
- makes no misleading statements;
- provides full disclosure of the recommended [investment/insurance product]'s features, fees, and charges;
- fairly discloses how and by who the [advisor/rep/broker/insurance producer] will be compensated; and
- avoids, discloses or reasonably manages Material Conflicts of Interest.

"Material Conflict of Interest" means a financial interest of an [advisor/rep/broker/insurance producer] that makes a recommendation that a reasonable person would expect to affect the impartiality of such recommendation.

## Common Disclosure Requirement:

Material Conflicts of Interest must be disclosed at or prior to the point of sale or at the time the recommendation is made (no requirement for more frequent or annual disclosures). This disclosure must include:

- the types and scope of services provided; and
- the types of compensation received by the person making the recommendation [or related party] or that the customer may pay as a result of the recommendation.

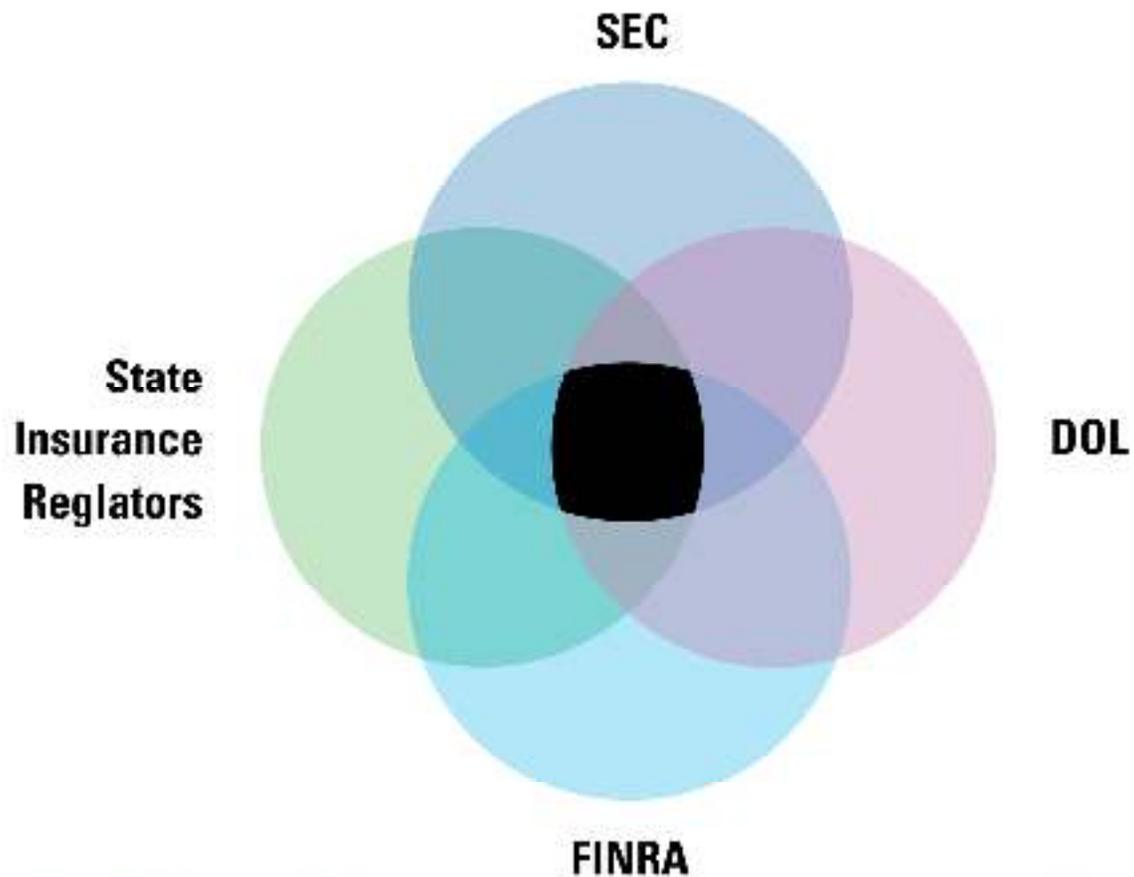
## Common Guiding Elements:

Neutrality – The uniform standard of care is neutral to business model, product type, and compensation approach such as commissions, fees, hourly rates, or sales charges, or other fees or variable compensation.

- The fact that an advisor or firm only offers or recommends proprietary or a limited range of products or product types or receives commissions or other variable compensation shall not be inconsistent with this uniform standard of care.
- The uniform standard of care does not require a recommendation of the least expensive or "best" product available.

Transaction Based – Unless otherwise agreed to in writing by the advisor and consumer, the uniform standard of care is a transaction based standard that is applied when a recommendation is made, and there is no further or ongoing obligation under the standard.

## Interrelated Regulatory Orbits



## NEWSROOM

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### **NAIC Meets with Sec. Acosta and Chairman Clayton**

Ted Nickel, NAIC President and Wisconsin Insurance Commissioner, and Julie Mix McPeak, NAIC President-Elect and Tennessee Insurance Commissioner, met with the heads of federal agencies today. In separate meetings with U.S. Secretary of Labor Alexander Acosta and SEC Chairman Jay Clayton, they discussed coordination with insurance regulators. The NAIC remains committed to working with federal agencies to ensure consumer protection and market stability.

# Summary of ACLI's Position on Best Interest Standards

- To meet their financial and retirement security needs, retirement savers deserve standards ensuring continued access to a wide variety of retirement products, retirement savings information and related financial guidance from financial professionals acting in their best interest.
- ACLI supports appropriately tailored uniform standards requiring all financial sales professionals to act in the best interest of their customers.
- The SEC's depth and decades of experience concerning the regulation of investment advisers and broker-dealers provides an excellent foundation for developing a constructive best interest standard that can be uniformly applied across all regulatory platforms, including state insurance regulations. In this way consumers will enjoy a consistent level of protection and will be able to obtain access to a wide range of retirement products and advice.
- Joint collaborative efforts between the SEC, FINRA, DOL and state insurance regulators will generate a uniform best interest standard across all regulatory platforms that properly protects consumers while advancing financial and retirement security.
- It is constructive to review existing regulatory systems, identify areas in need of improvement, and examine the economic impact of potential modifications. Conscientious evaluation of the many different business models operating in this space will contribute to efficient, effective regulation.

# SEC Best Interest Initiatives

**Proposed Regulation Best Interest** “requires a broker-dealer to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer.”

- Disclosure Obligation
- Care Obligation
- Conflict of Interest Obligation

**Proposed Form CRS** “would provide retail investors with simple, easy-to-understand information about the nature of their relationship with their investment professional, and would supplement other more detailed disclosures.”

**Proposed interpretations** “reaffirm SEC positions about the fiduciary duty investment advisers owe to their clients.” Through the reconfirmed interpretations, “investment advisers and their clients would have greater clarity about advisers’ legal obligations.”

# Constructive SEC Statements on Initiatives

- “Proposed Regulation Best Interest would not create any new private right of action or right of rescission,” nor did the SEC “intend such a result.”
- “Certain conflicts of interest are inherent in any principal-agent relationship. We do not intend for our standard to prohibit a broker-dealer from having conflicts when making a recommendation.”
- “The best interest obligation would not extend beyond a particular recommendation or generally require a broker-dealer to have a continuing duty to a retail customer.”
- “To satisfy proposed Regulation Best Interest, a broker-dealer would not be required to analyze all possible securities, other products or investment strategies to find the single ‘best’ security or investment strategy for the retail customer, broker-dealers generally should consider reasonably available alternatives offered by the broker-dealer as part of having a reasonable basis for making the recommendation, as required under the Care Obligation.”
- “Regulation Best Interest also would not necessarily obligate a broker-dealer to recommend the ‘least expensive’ or the ‘least remunerative’ security or investment strategy, provided the broker-dealer complies with the Disclosure, Care, and the Conflict of Interest Obligations.”

# Summary of ACLI's Position on Regulation Best Interest ("Reg. BI")

Reg. BI is a largely sensible, principles-based rule governing broker-dealer conduct.

Reg. BI is vastly superior to the prescriptive DOL Fiduciary Rule and its BIC exemption.

Reg. BI should retain its neutral approach to business models, operations, compensation and products.

A constructive best interest standard would require financial professionals to put a consumer's interest first by (i) acting with reasonable care, skill, prudence, and diligence in gathering and evaluating information regarding the consumer that is used to make the recommendation; (ii) making no misleading statements; (iii) providing full and fair disclosure of the recommended product's features, fees, and charges; (iv) fairly disclosing how and by whom the financial professional is compensated; and (v) avoiding, disclosing, or otherwise reasonably managing material conflicts of interest.

Reg. BI fulfills these objectives.

# (Continued) Summary of ACLI's Position on Regulation Best Interest

The SEC “should lead—but not dictate—federal and state regulatory efforts in this area” to “minimize the effects of regulatory complexity, and potentially inconsistent legal standards applied to financial advice, due to the number of regulators in this space.”

Clarity, consistency and coordination across all regulatory platforms will best serve investors, and thwart regulatory arbitrage.

Retirement savers deserve standards ensuring continued access to a wide variety of retirement products, retirement savings information and related financial guidance from financial professionals acting in their best interest.

Conscientious evaluation of the many different business models operating in this space and the economic impact of potential modifications will contribute to efficient, effective regulation.

Disclosure will need careful coordination to properly mesh with amendments to Form CRS. A single disclosure fulfilling Reg. BI and Form CRS would reduce disclosure burdens.

# Summary of ACLI Position on Form CRS

The disclosure under Reg. BI and Form CRS **should fulfill parallel philosophies** and avoid conflicting or confusing consumer information.

Form is built on the template of a full-service broker-dealer and **fits broker-dealers or investment advisers affiliated with life insurers poorly.**

Stipulates a **length that may be too short for** broker-dealer or investment adviser information in **the insurance world;**

Establishes **unnecessarily restrictive formatting standards for dual** (broker-dealer/investment adviser) **registrants.**

Is **not flexible enough to fully or accurately describe investment advisory services provided by insurance affiliates that are not registered investment advisers, such as banks or thrifts.**

Requires **inapplicable, inaccurate or misleading statements.**

Establishes **conflict of interest disclosure unsynchronized with Reg. BI.**

# Summary of ACLI Position on Proposed Investment Adviser Interpretations

SEC must consider the impact of proposals on the unique business models of life insurance companies.

SEC should continue to provide interpretative guidance and rely upon the voluminous existing guidance and case law regarding the duties of investment advisers, rather than attempting to codify this body of existing law.

Life insurers with associated investment advisers and broker-dealers are subject to multiple layers of regulation from state insurance commissioners, state securities regulators, the SEC, and FINRA.

# Statistics and Timetables

SEC Initiatives Totaled Over 1000 pages  
with 1500 Questions

6,435 Comment Letters Filed

Over 70 Meetings Between SEC and  
Industry Representatives

Adoption by 12.31.18?- SEC Chairman's  
Speech

Multiple Moving Parts and Alignment of  
Regulatory Planets-First or Second Quarter  
'19?





# Coextensive State Regulatory Developments

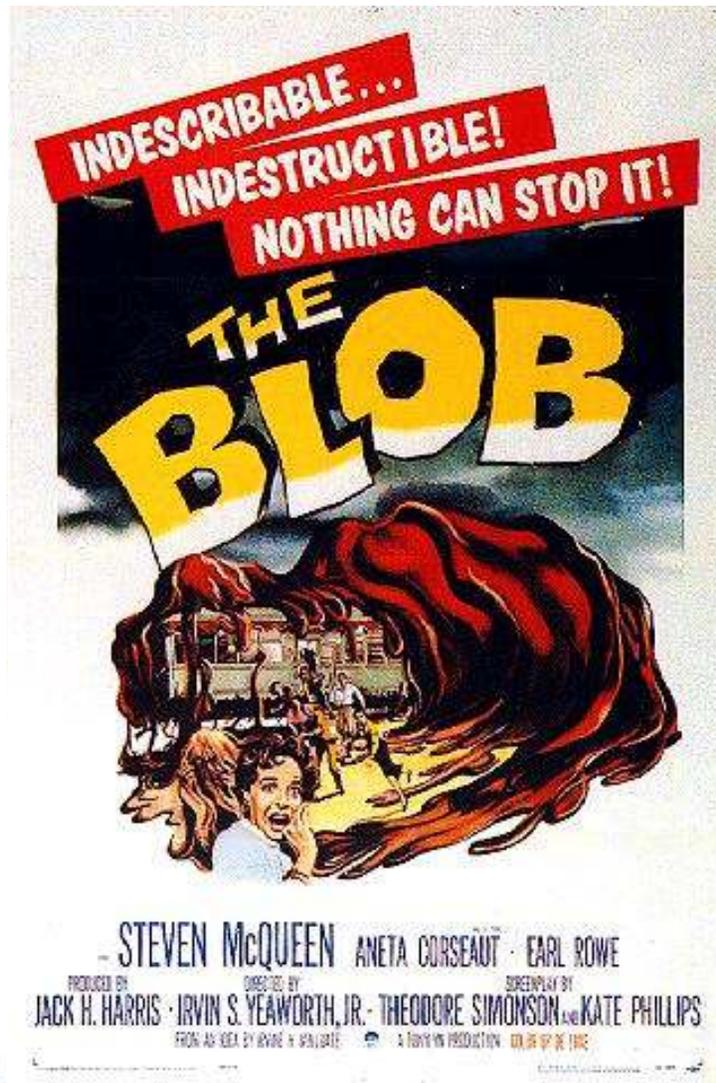
Amendments to NAIC Suitability in Annuity Model Regulation to Incorporate Best Interest Concepts

Specific State Actions with “Fiduciary Rule” Flavor

- New York Regulation 187
- Replication in Other States?

# Possible Predictors for SEC Action on Regulation Best Interest

- SEC Chairman's Request for Information: **Assumptions** about a Possible Uniform Fiduciary Standard from *SEC Request for Data & Information about Standards of Conduct for Investment Advisers & Broker-Dealers* (June 2017)
  - **"Personalized investment advice about securities"** would include a **"recommendation"** as interpreted under existing broker-dealer regulation and any actions or communications that would be considered investment advice about securities under the Advisers Act (generally not "impersonal investment advice" or general educational tools);
  - The term **"retail customer"** would have the same meaning as in the Dodd-Frank Act;
  - **Any action would apply to all SEC-registered broker-dealers and SEC-registered investment advisers;**
  - **The uniform standard would accommodate different business models and fee structures** (brokers could receive commissions, no asset-based fee requirement, principal trades allowed with disclosure);
  - **The uniform standard would generally not require either broker-dealers or investment advisers to (i) have a continuing duty of care or loyalty after providing advice about securities or (ii) provide services beyond those contractually agreed upon with the retail customer;**
  - **Offering or recommending only proprietary products** or a limited range of products would **not by itself** constitute a violation of the fiduciary standard;
  - **Advisers Act Sections 206(3) and 206(4) and related rules would continue to apply to investment advisers but not to broker-dealers; and**
  - **Existing law and guidance would continue to apply to broker-dealers.**



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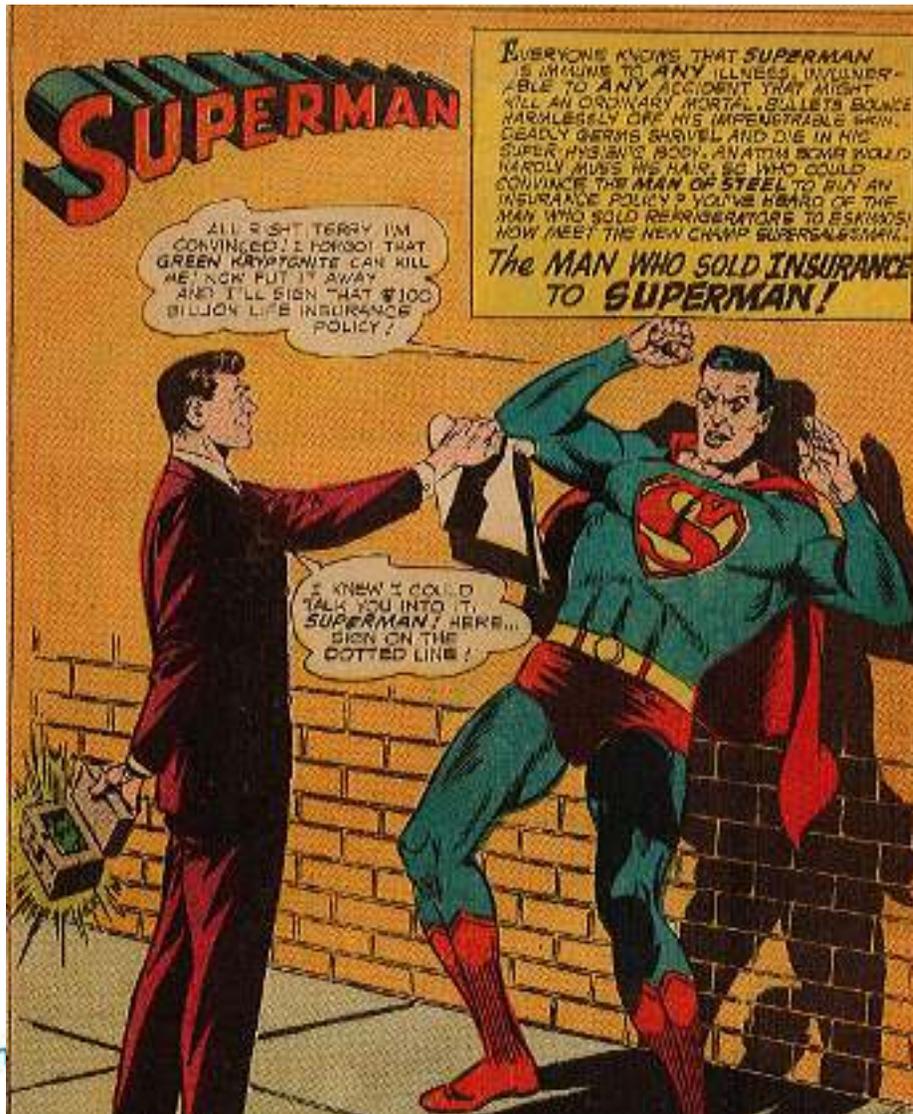
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# The Influence of Perception Measured Against Regulatory Statistics





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