



**American Council of Life Insurers**

**David Leifer**

Vice President & Associate General Counsel

August 3, 2018

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 200549-1090

Re: Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles, File No. S07-08-18. *id.* at 21416

By Electronic Delivery

Dear Mr. Fields:

The American Council of Life Insurers (ACLI) advocates on behalf of approximately 290 member companies dedicated to providing products and services that contribute to consumers' financial and retirement security. ACLI members represent 95 percent of industry assets, 93 percent of life insurance premiums, and 98 percent of annuity considerations in the United States. 75 million families depend on our members' life insurance, annuities, retirement plans, long-term care insurance, disability income insurance and reinsurance products. Taking into account additional products including dental, vision and other supplemental benefits, ACLI members provide financial protection to 90 million American families.

ACLI has fully participated in the long-evolving SEC and Congressional dialog about the regulation of broker-dealers and investment advisers.<sup>1</sup> We appreciate the opportunity to share our views on proposed

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<sup>1</sup> Since 2007, ACLI submitted input on four SEC actions concerning broker-dealers and investment adviser standards of conduct, including:

- ACLI's [response](#) to the SEC Chairman's Request for Information about Standards of Conduct for Broker-Dealers and Investment Advisers (Oct. 3, 2017) found at <https://www.sec.gov/comments/ia-bd-conduct-standards/cil4-2640466-161282.pdf>.
- ACLI's July 5, 2013 [Submission](#) in response to the SEC's [Request for Data and Information on Brokers, Dealers and Investment Advisers](#);
- ACLI's August 30, 2010 [Submission](#) in response to the SEC's request for information on its [Study on the Responsibilities of Brokers, Dealers, and Investment Advisers](#) in fulfillment of Section 913 of the Dodd-Frank Act; and,
- ACLI's December 13, 2007 [Submission](#) in response to the RAND [Study on Broker-Dealer and Investment Advisory Issues](#).

**American Council of Life Insurers**

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Form CRS, which would create a requirement for a uniform relationship disclosure document to be used by broker-dealers and investment advisers. Our submission focuses on this initiative from the perspective of life insurers, their products and their distributors to ensure the regulation provides an inclusive, business model neutral framework that helps Americans achieve financial and retirement security. We will also offer comments separately on Proposed Best Interest (BI) and the SEC's Proposed [Interpretation for Investment Adviser Standards of Conduct](#)<sup>2</sup> and its request for input on related questions.

We appreciate the opportunity to provide input into this important rulemaking process. Our comments that follow begin with general comments that provide background on the life insurance industry and the business and regulation of life insurance affiliated broker-dealers. We then identify several overarching issues of concern to life insurance companies regarding disclosure. Following this are specific comments that track the Instructions to Form CRS.

## I. The Role of Life Insurers in U.S. Capital Formation and the Economy

The SEC's standard of conduct proposals "were designed to advance the agency's tripartite mission—to protect investors, to maintain fair, orderly and efficient markets, and to facilitate capital formation."<sup>3</sup> The SEC website emphasizes that "the SEC's regulation of the securities markets facilitates capital formation, which helps entrepreneurs start businesses and companies grow. Last year nearly \$4.27 trillion was raised in public and private securities offerings, promoting economic growth and job creation."<sup>4</sup> These are important considerations in finalizing a best interest standard for broker-dealers.

Life insurers are significant institutional investors that have a major role in U.S. capital formation and the U.S. economy. Life insurers' assets supporting fixed insurance products (\$4.25 trillion) and variable insurance products (\$2.52 trillion) reflect a substantial percentage of the U.S. equities and bond market. Life insurers' assets are invested in corporate bonds (33%), stocks (31%), government bonds (8%), commercial mortgages (6%), and other assets (22%). Life insurers are the largest institutional investor in U.S. corporate bond financing. Approximately 49% of life insurers' \$6.7 trillion total assets in 2016 were held in long-term bonds, and over 38% of corporate bonds purchased by life insurers have maturities exceeding 20 years (at the time of purchase).<sup>5</sup> Life insurers, therefore, are significant participants in the U.S. equities market and are one of the principal sources of U.S. long-term corporate financing. In these roles, life insurers have an important impact on the U.S. economy.<sup>6</sup>

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[ACLI's RAND Study Submission](#) (and those of other commentators) does not appear to be available on the SEC's website or through RAND. The RAND report included scant, if any, reference to the role life insurance salespersons play in the distribution of IA and BD services. It will be important to include the insurance industry in the analysis on Proposed Regulation BI, Proposed Form CRS, and the SEC's Investment Adviser interpretive analysis and policy questions.

<sup>2</sup> <https://www.gpo.gov/fdsys/pkg/FR-2018-05-09/pdf/2018-08679.pdf>; (last visited on July 5, 2018).

<sup>3</sup> See SEC Chairman Clayton's [Testimony on Oversight of the U.S. Securities and Exchange Commission](#) (June 21, 2018) [<https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission>] before the House Financial Services Committee.

<sup>4</sup> This [statement](#) appears on the SEC website highlighting job creation due to capital formation; [<http://www.secvip.org/#>] (last visited July 3, 2018).

<sup>5</sup> These calculations are based on data from the 2017 NAIC Annual Statement Data and ACLI calculations based on and the U.S. Federal Reserve Board, Flow of Funds Accounts of the U.S.

<sup>6</sup> We greatly appreciate the Chairman Clayton's recognition of life insurers contributions to U.S. capital formation and the economy. See SEC Chairman Clayton's [Testimony on Oversight of the U.S. Securities and Exchange Commission](#) (June 21, 2018) [<https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission>] before the House Financial Services Committee. The Chairman's testimony noted that at least 51% of U.S. households are invested directly or indirectly in our capital markets with 44% of all households owning

Poorly designed rules can have a significant negative impact on life insurers' capital formation. Before it judicial vacatur, DOL's Fiduciary Rule caused a significant reduction in the sale of new insurance products. Variable annuity sales declined 21 percent in 2016 (from \$133 billion in 2015 to \$104.7 billion). Further, in the first quarter of 2017, variable annuity sales declined 8 percent, year-over-year, to \$24.4 billion, and indexed annuity sales were off 13 percent, to \$13.6 billion.<sup>7</sup> Consequently, life insurers had fewer new assets to invest in U.S. capital formation and the economy. The rule also burdened the economic and retirement security of less affluent and middle-income markets distinctively served by life insurers.

The now vacated DOL Fiduciary Rule's profound negative bearing on insurance product sales directly implicated the U.S. economy, capital markets, and capital formation. Valuable lessons spring from these recent experiences. A carefully constructed best interest standard that includes all broker-dealer business models fairly and equitable both protects consumers and enables the continuation of life insurers' contributions to capital formation and the economy.

Several aspects of the SEC's initiatives appear to have been built on the template of full-service broker-dealers that do not fit limited-purpose broker dealers affiliated with life insurers equitably. We urge the Commission to bear this in mind when considering the purpose and scope of Form CRS.

In his remarks at the Annual Government-Business Forum on Small Business Capital Formation, SEC Chairman Clayton aptly observed that "a key to restoring vibrancy in our public markets is recognition that a one size regulatory structure does not fit all."<sup>8</sup> We agree.

## **II. The Operation and Scope of Business Conducted by Broker-Dealers Affiliated with Life Insurers**

A brief background on the nature of operations, services and securities products associated with life insurers may help frame our concern with several aspects of Form CRS and may help transform the regulation into a more equitable framework. Broker-dealers affiliated with life insurance companies are significantly different from full service or "wire-house" broker-dealers in their operations, products and services. One type of broker-dealer affiliated with life insurers engages in retail securities activities primarily, or only, in the context of a larger insurance business. Many registered representatives associated with these broker-dealers operate principally as life insurance and annuity salespersons. Securities sales can frequently constitute an incidental amount of business (or none) relative to insurance product sales by an office or registered representative. Some of these broker-dealers sell only the products of their affiliated life insurance company.

In some cases, the insurance-affiliated retail broker-dealer may sell a broader array of securities products, including mutual funds, 529 plans, 401(k), 403(b) plans and individual securities. Certain of these broker-

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at least one U.S. mutual fund. It is also important to note that like mutual funds, many U.S. households also participate indirectly in our capital markets through variable annuities and variable life insurance contracts funded an array of underlying mutual funds: 29,172,000 individual variable annuity contracts and 4,959,000 individual variable life insurance contracts were in force in the U.S. as of 2016. Many Americans indirectly participate in the U.S. stock market through these SEC regulated contracts.

<sup>7</sup> The damage inflicted on annuity sales also caused an adverse ripple effect on the contributions of agents and distributors to the economy, tax revenue and small business employment.

<sup>8</sup> See [Remarks to the Annual Government-Business Forum on Small Business Capital Formation](#) (Nov. 30, 2017); [<https://www.sec.gov/news/public-statement/annual-government-business-forum-small-business-capital-formation>] (last visited on July 3, 2018).

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dealers and a segment of their registered representatives are dually registered as investment advisers and investment advisory representatives (“IAR” or “IARs”), respectively, and can also offer various investment advisory services such as financial planning for a fee and managed accounts. As a by-product of this type of broker-dealer affiliated with life insurers, supervision and compliance is often conducted within the overall insurance distribution system, and fulfills FINRA, SEC and state insurance standards.

Another type of life insurer-affiliated broker-dealer is strictly a “wholesaler” distributing the insurance company’s variable products through affiliated and unaffiliated selling broker-dealers. This type of broker-dealer generally does not engage in retail activities and does not maintain possession or control of customer funds or securities. Those insurance company employees who perform wholesaling duties or certain related activity are generally registered with the insurer’s wholesaling broker-dealer. Care should be taken in Form CRS to distinguish these types of wholesaling broker-dealer activity from widespread retail sales broker-dealer activity. In some instances, an insurance-affiliated broker-dealer may conduct both wholesaling and retail activity.

### **III. Life Insurers’ Current Regulatory Framework**

An updated assessment of the current regulatory framework is important to the SEC’s ability to evaluate the range of potential regulatory actions. To that end, life insurance companies and their associated persons currently fulfill a broad array of regulation administered by state insurance departments, the Securities and Exchange Commission (SEC), the DOL, the Financial Industry Regulatory Authority (FINRA), and various state securities departments.

Existing comprehensive regulations govern important aspects of the customer relationship, including suitability standards, disclosure, advertising, supervision, maintenance of customer account assets, data collection, training, compensation, and supervision of associated persons. In general, the federal securities laws and FINRA rules govern individual variable insurance contracts, and state insurance laws and regulations apply to fixed insurance products. In some cases, insurance products invoke both federal and state laws. Collectively, this body of regulatory provisions and oversight provide important consumer protection and strong enforcement tools.

We have attached an Appendix to highlight the extensive network of laws and regulations governing insurance product sales activities. Laws and regulations most relevant to Form CRS include:

- The National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions Model Regulation;
- FINRA Rule 2330 governing suitability and supervision in the sale of variable annuities;
- FINRA Rule 2320 governing non-cash compensation for variable products and mutual funds;
- The NAIC Annuity Disclosure Model Regulation;
- The NAIC Model Replacements Regulation, and state insurance regulations such as New York Regulation 60 which governs replacements;
- The NAIC Unfair Trade Practices Act and the prohibition on “unfair financial planning practices;” and,
- State insurance consulting laws governing the simultaneous receipt of product commissions and fees for insurance consulting services.

Life Insurers provide significant written disclosures at the point of sale to satisfy multiple regulators’ requirements and to help customers understand the nature of their various products and relationships. These disclosures include many product related materials (insurance sales illustrations, policy contracts, required “buyers’ guides,” prospectuses), marketing materials describing the firm’s offerings, documents

that provide the terms for a brokerage or advisory relationship (brokerage account agreements, advisory account agreements, Form ADV, investment policy statements), and other required disclosures.

Life insurers fulfill a considerable amount of post-sale disclosure depending on the nature of products and services provided, such as in-force insurance ledgers, transaction confirmations, periodic performance reporting for investment accounts, and updated Form ADV brochures. Several state and Federal laws are designed to ensure appropriate sales practices and suitable recommendations consistent with customers' financial objectives and best interests.

Insurance products are the only products in today's financial marketplace with free-look provisions extending for 10 or more days. These features give consumers a meaningful opportunity to carefully evaluate purchases after the sale and to change their mind for any reason, including cost factors, to receive a refund.

The NAIC discussed state insurance regulatory standards<sup>9</sup> in a 2017 submission to the SEC that explained:

*All annuity contracts, including fee-based annuity contracts, must comply with applicable state laws including those addressing, for example, required policy provisions, prohibited policy provisions, permitted exclusions and prohibited exclusions, policy format requirements, readability requirements and supporting documentation requirements, such as actuarial memorandum requirements.*

*Generally, the policy, application, riders and endorsements are required to be submitted in the filing along with the actuarial documentation to demonstrate compliance with nonforfeiture requirements. Some states will perform prior review and approve the product for sale in advance ("prior approval") while other states permit insurers to file the product and sell it unless the product filing is disapproved by the regulator ("file and use.") In addition, 44 states and Puerto Rico, representing more than 75% of premium volume, are part of an Interstate Insurance Compact (Compact).*

*The Compact established a multi-state public entity, the Interstate Insurance Product Regulation Commission (IIPRC), which serves as an instrumentality of the Member States. The IIPRC stands in the shoes of the compacting states and serves as a central point of electronic filing for certain insurance products, including life insurance, annuities, disability income, and long-term care insurance to develop uniform product standards, while at the same time affording a high level of protection to purchasers of asset protection insurance products.*

In summary, an updated assessment of the current state insurance regulatory framework is important for the SEC's equitable consideration of Form CRS. Partnership between state insurance regulators, the SEC, and FINRA will fulfill this commendable goal constructively.

#### **IV. General Comments on Proposed Form CRS**

*The Proposed Form CRS is based on a full-service broker-dealer model and does not provide for workable disclosure of information relevant to customers of insurance-affiliated broker-dealers. Firms should have the flexibility in the Form CRS to accurately describe their business model and what their clients can expect from the relationship. This would make the document more user friendly and hopefully make it more likely that a customer would read the document.*

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<sup>9</sup> See NAIC [Comment](https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00452.pdf) on RIN 1210-AB82 Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions (Aug. 7, 2017) <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00452.pdf> [last visited on October 1, 2017].

Life insurance companies that have affiliated broker-dealers typically have a business model that is much different from the full-service broker-dealer model that the Proposed Form appears to be drafted to describe. For example, the sale of variable annuity and variable life insurance products typically would not involve the creation of a “brokerage account” within which a customer could buy and sell investments for a transaction fee. Rather, such a broker-dealer takes an application, which is sent to the life insurer, who then issues a contract or policy directly to the customer. As a result, many of the statements mandated in the Proposed Rule are inaccurate from the perspective of a life insurer-affiliated broker-dealer. If unchanged, the result would be the conveyance of information to consumers that is misleading and/or simply not true. We are confident that this is not what the Commission desires.

Life insurance companies often (but not always) have “introducing affiliated broker-dealers”. In these instances, the life insurance affiliated broker-dealer is not charging the fees described in the Proposed Form. Other life insurance companies employ still different models, which can involve other affiliated entities. For example, beginning in the 1990s many life insurance companies either acquired or formed federal thrift institutions (e.g., federal savings banks) to meet particular financial services needs of their customers across the 50 states. These thrifts, which are now regulated by the OCC, are often limited purpose entities, providing fiduciary services such as trusts and investment management programs to their clients (the latter can be comparable to the advisory services available through Registered Investment Advisers). Even insurance firms with dual registrants may choose to run the brokerage business through the dual registrant but provide their retail investment management programs primarily through the thrift. Companies should be allowed and encouraged to accurately describe their particular business model, products and services. The Proposed Rule with its reliance on prescribed, mandated disclosures is insufficiently flexible in its current form to allow for this tailored disclosure.

We believe that the intent of the Commission in creating the Proposed Form would best be met by allowing for greater flexibility in the required disclosures. We appreciate the desire of the Commission to standardize disclosure to some extent so that consumers have less confusion regarding the differences between broker-dealers and investment advisers, but this laudable goal can only be met if allowance is made for each business model to be presented accurately for the consumer. Specifically, taking a more principles-based approach to the required disclosures and allowing companies to provide a narrative description of the products and services offered would result in more effective communication regarding the nature of the relationships offered by the broker-dealer to its customers.

The goal of any disclosure should be to provide meaningful and accurate information in an accessible manner. The Background information accompanying the Proposed Rule recognizes “the benefits of retail investors having access to diverse business models and of preserving investor choice among brokerage services, advisory services, or both.” Yet the prescriptive nature of the required disclosures does not in our view sufficiently allow for these diverse business models to be explained. We presume the Commission’s goal is to set forth some clear markers for consumers to facilitate an understanding of the differences between broker-dealers and investment advisers. This is a laudable goal, but again we believe must be done in a manner that promotes accuracy. We believe less reliance on prescriptive language while mandating that certain topics be covered is the preferable approach.

*The Form CRS disclosure should be comprehensive and incorporate all of the disclosure required by proposed Regulation BI, including conflict disclosure.*

The disclosure obligation under Reg. BI provides an important means for consumers to understand the material facts relating to the scope and terms of the relationship, and all material conflicts of interest associated with the recommendation. The SEC’s approach here properly advances informed consumer

decision making, and equitably allows broker-dealers to create disclosure tailored to their specific business model, product line, and operation. This framework wisely avoids a “one-size-fits-all” approach to regulation recently noted by SEC Chairman Clayton.<sup>10</sup> Unfortunately, the Form CRS Proposed Rule is highly prescriptive and does not allow for the same flexibility.

The disclosure standards in Form CRS do not mesh well with the disclosure proposed in Reg. BI. Further, the creation of two new disclosure events may frustrate the worthwhile goals of consumer understanding by enlarging the already significant number of disclosure documents a consumer would face.<sup>11</sup> The volume of disclosure currently delivered can, unfortunately, dilute the value of meaningful disclosure essential to understanding and informed decision making. Increased disclosure documents also thwart the SEC’s commendable emphasis on streamlined, simplified, user-friendly, plain-English information.<sup>12</sup> A single disclosure fulfilling Reg. BI and Form CRS would reduce disclosure burdens and increase the likelihood consumers will read the required information. We encourage the merging of required disclosure under Reg. BI and Form CRS in a single document.

The disclosure under Reg. BI and Form CRS should fulfill parallel philosophies and avoid conflicting or confusing consumer information. Suggested conforming changes are discussed in greater detail in our comment letter on Form CRS, which notes that, among other things, that the proposed form:

- Is built on the template of a full-service broker-dealer and fits limited purpose 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;
- Is overly prescriptive, in contrast with the appropriate custom tailoring for disclosure under Reg. BI;
- Is not flexible enough to fully describe in a meaningful and accurate way investment advisory services provided by insurance affiliates that are not registered investment advisers, such as banks or thrifts;
- Imposes an inappropriate competitive imbalance and inaccurate picture concerning the relative number of disciplinary actions in sales organizations with large numbers of financial professionals;
- Establishes unnecessarily restrictive formatting standards for dual (broker-dealer/investment adviser) registrants;
- Requires statements that are inapplicable, inaccurate or misleading; and,
- Establishes conflict of interest disclosure unsynchronized with that in Reg. BI.

The disclosure standards and objectives should be consistent and parallel in Form CRS and Reg. BI to avoid confusion and to promote clear understanding. A more flexible approach to required disclosure is preferable and would serve consumers better. In addition, greater flexibility in content and length of Form CRS will allow life insurers to more fully describe products which are often more complex than those offered by full service broker-dealers.

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<sup>10</sup> Chairman Clayton observed that “a key to restoring vibrancy in our public markets is recognition that a one size regulatory structure does not fit all.” See *Remarks to the Annual Government-Business Forum on Small Business Capital Formation* (Nov. 30, 2017); [<https://www.sec.gov/news/public-statement/annual-government-business-forum-small-business-capital-formation>] (last visited on July 3, 2018).

<sup>11</sup> For the variable life and variable annuities under the SEC’s jurisdiction this can be especially profound. Consumers will already receive a prospectus, a contract under state insurance law, sales literature, confirmation statements, periodic reporting documents and other related disclosures.

<sup>12</sup> The disclosure burdens on variable annuity consumers could be further reduced if the SEC implemented long evolving simplified variable product prospectus disclosure and FINRA point-of-sale disclosure.

Another practical approach to communicating useful information without dilution through over-disclosure would allow elective access to more detailed disclosure through imbedded links to broker-dealer or product manufacturer websites, where consumers can find more comprehensive information.<sup>13</sup> The SEC has referenced and supported this constructive approach in Reg. BI and other initiatives.

This position is consistent with current SEC statements, in particular those made at the time of the recent amendments to the Form ADV Part 2.<sup>14</sup> The SEC stated in the adopting release that it “will continue to consider different approaches to delivering financial information to investors.”<sup>15</sup> The SEC should consider approaches that enable BDs and IAs provide concise and helpful written disclosures to retail customers, by allowing BDs and IAs to reference links to their websites for certain types of additional, detailed information. It should be reconfirmed in the final Reg BI adoption.

*The SEC’s model form CRS does not anticipate the distribution of variable annuity or variable life products, which are the primary products offered by insurance-affiliated broker-dealers, and are also offered by many non-insurance affiliated broker dealers.*

- The required disclosures for brokerage accounts and advisory accounts do not apply in large part to variable annuities and variable life products sold on a commission basis.
- For broker dealers that sell these products as well as offering brokerage accounts, a separate disclosure or separate section for the distribution of these products is needed, while for broker-dealers that sell only these products, there needs to be much greater flexibility in describing the customer relationship.
- The focus on cost in the disclosure does not take into account that cost may not be the most important factor in ensuring customer’s best interest, where product features, particularly in the insurance context, may provide unique benefits not available with other securities products. The disclosure document should require a balancing of costs and benefits, without an undue focus on costs alone.
- The comparisons to be provided by standalone investment advisers and standalone broker-dealers is not a relationship disclosure, but could be more accurately described as a hypothetical description of products the consumer might purchase somewhere else. Broker-dealers should not be required to describe products and services that they do not offer and about which they may have limited expertise. We appreciate the desire of the Commission to inform consumers about the differences between broker-dealers and investment advisers. But this is not the ideal way to

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<sup>13</sup> We would urge that consideration of any additional disclosure requirements would include a thorough analysis of the disclosures that retail customers currently receive. For example, when purchasing a deferred variable annuity, a retail (and other) customer must be informed of the general terms of various features of deferred variable annuities, such as surrender period and surrender charges; potential tax penalties; mortality and expense charges; investment advisory fees; potential charges for and features of riders; the insurance and investment components; and market risk. Additionally, such retail (and other) customers must be provided with a product prospectus, which provides a comprehensive and detailed description of the variable annuity. Finally, such retail (and other) customers are provided prospectuses for the mutual funds underlying the product subaccounts in which they invest. Simply piling more disclosure on top of the above-noted disclosure information is more likely to result in “information overload” than an enhanced understanding of the product or transaction by retail customers.

<sup>14</sup> Amendments to Form ADV, Investment Advisers Act Release No. IA-3060 (July 28, 2010), *available at* <http://www.sec.gov/rules/final/2010/ia-3060.pdf> .

<sup>15</sup> *Id.*

go about it. An alternative would be for the Commission to develop general educational materials that could be delivered (or provided via linking) to retail investors. The National Association of Insurance Commissioners has developed a number of Buyer's Guides, including one for variable annuities. These provide general information and outline questions/issues for retail investors to consider and ask. Registered representatives are required to provide these Buyer's Guides to customers, but only the Buyer's Guide(s) that are relevant to the product(s) being offered to a particular retail investor. This could be a worthwhile avenue for the Commission to pursue.

- It is critically important that firms should only be required to describe and make disclosures about products and services which they offer. Encouraging consumers to ask questions about products, services and to request cost comparisons is neither fair nor useful. A broker-dealer may have little experience with or knowledge about advisory services and would be in no position to provide accurate answers to questions about advisory costs, or whether an investor would save money with one account versus another. It would be similar to requiring a Chevrolet salesman to provide detailed comparison information between Chevrolet and Honda models—it would be of no benefit to the consumer.

*The contrast between the services offered by broker-dealers and investment advisers fails to recognize valuable services available through certain products offered by some life insurance companies that provide the equivalent of ongoing monitoring for their clients.*

- Many life insurers offer model portfolios in variable annuity and variable life products that essentially act similarly to advisory accounts.
- This again points out the binary approach that the SEC has taken, which is not entirely accurate for the distribution of variable annuity and variable life products.

*Form CRS is unfairly prejudicial against larger firms that almost always have a disclosure event for one or more of their current or former registered representatives.*

- All firms should be required to encourage prospects and clients to conduct due diligence on them, without a requirement to state that they have a regulatory history. This requirement would result in virtually all large organizations being required to so state, disclosure that is not relevant with respect to most of the organization's representatives.
- Small firms that could pose the most danger to clients often do not have a regulatory history.
- We suggest a reference to FINRA Brokercheck would provide more useful insight for clients.

*The SEC should consider the development of educational materials that can be made available to all investors.*

- ACLI believes the best approach to providing information to investors and potential investors is for the SEC to create general information that can be given in written form to consumers and/or linked on the SEC website. This will better serve the objective of conveying correct and meaningful information to consumers than having broker-dealers and investment advisers attempt their own creation of educational materials.

## **V. Specific Comments to the Instructions to Form CRS**

### General Instructions

#### 1. Introduction

- There should be a single disclosure document delivered to the customer.
- As noted above, Form CRS should allow for inclusion of the disclosures required by Proposed Rule BI and the disclosures should be consistent. The four (4) page limitation for Form CRS is artificially short and additional space should be allowed for introducing material.
- Section 1(E) regarding dual registrants particularly stands out as overly restrictive in terms of format. The side-by-side format mandated will be difficult to accomplish within the four (4) page limitation. A simplified format on separate pages would be more appropriate. In addition, the side-by-side format may be confusing to consumers by providing too much unnecessary information. This is an area where linking would likely be effective. A shorter, simplified description could be provided, and the consumer can click through to see additional information if it is of interest/relevance to the consumer.
- There should be greater clarity that a company can omit required disclosures that are not applicable/accurate to the business model of that company. This concern arises in a number of areas, and perhaps a clear statement that covers all required disclosures early on in the document and which makes this point would be the best outcome.
- Initial Delivery—the Proposed Rule should make clear that delivery of the Form CRS should occur “at or prior to the time of the first transaction.”
- Section 7 regarding additional delivery requirement—this is one instance, and there are others within the Proposed Rule, where the broker-dealer disclosure presumes the existence of a brokerage account. This may not be true with respect to the sale of variable insurance policies and annuities. This is another example of where the Proposed Rule may require the disclosure of something that is not true in a particular instance. Companies should only be required to disclose that which is true and correct about their firm, products and relationship with retail customers.
- Another example of the Proposed Rule being inflexible is that (at least in the insurance world) not all services are provided to all customers. There may be instances where certain services are provided only to retail customers with account balances above a certain level, for example.

## 2. Relationships and Services

- Item 2, B(1) the Proposed Rule mandates “If you open a brokerage account, you will pay us a transaction fee, generally referred to as a commission, every time you buy or sell an investment.” Again, this is not always an accurate statement for an insurance affiliated broker-dealer. The Instructions make a reference to the exclusion of items that are not applicable, but the thrust of the mandated disclosures leaves the reader with the impression that little flexibility is envisioned by the Commission. We would propose language early on along the lines of: “The Commission does not intend for any disclosures to be made that would have the likelihood of confusing or misleading the retail investor. Certain disclosures set forth below may be inapplicable to you, and if that is the case these disclosures should be excluded. You should only disclose information that accurately describes the products and services offered by you to retail investors.”

- Item 2, B(4) requires that if you limit the choices available to the consumer you must state “Other firms could offer a wider range of choices, some of which might have lower costs.” This is an example of a mandated disclosure that is inappropriate and could disadvantage insurance affiliated broker-dealers. Certain products may cost more, but they may offer greater value to the customer. Other products may cost comparatively less, but offer lesser value. It would be no more fair to require a firm that offered only ETFs to say “these products may cost less, but they do not come with benefits like guaranteed lifetime income, which could be important to the financial security of you and your family”. The Proposed Rule should not make value judgements between and among products. In particular, cost is one factor that a retail investor should rightly consider when evaluating investment options, but it is far from the only factor. The cheapest product, or the second cheapest product, may not be the best investment for a particular retail investor given their individual circumstances and investment goals.
- It is important that the SEC does not adopt a “one size fits all” mandated disclosure. Instead, the SEC should pursue disclosure that is tailored and meaningful for the consumer. Even among life insurer affiliated broker-dealers there exist different business models. There are differences with respect to services offered to retail investors, the ways in which investors pay for those services and the ways in which registered representatives are compensated. The disclosure of meaningful and accurate information should be the touchstone of any required disclosure.

### 3. Standard of Conduct

- As noted above we believe it is critical that the Best Interest disclosures and the Form CRS disclosures be aligned. Unfortunately, we do not believe that is currently the case. One approach may be to have the disclosures contained in a single Proposed Rule, either the BI or the Form CRS, but not both. Having inconsistent disclosure requirements will only invite confusion for all concerned, may foster litigation and will be of no benefit to retail investors.

### 4. Summary of Fees and Costs

- Item 4, Summary of Fees and Costs is replete with required statements that may be unnecessary/misleading. For example, the required statement regarding surrender charges when an annuity is sold. This is another example in our view of singling out a particular product for a special disclosure. Many products and services have fees and costs associated with them, and firms should be required to be transparent with retail investors about those fees and costs. But the Commission should require in neutral language that fees and costs be disclosed without doing so in a way that could imply that certain products are less expensive (and therefore better) than other products.

### 5. Comparisons to be provided by standalone investment advisers and standalone broker-dealers

- As noted above, broker-dealers and investment advisers should only be compelled to describe the actual products and services which they offer. Requiring explanations of products and services not offered will only lead to confusion and the dissemination of misinformation.

6. Conflicts of Interest

- Section 6, Conflicts of Interest should be carefully synced-up with the BI Proposed Rule to ensure consistency. This is the same concern identified under the Standard of Conduct Section. It is essential that the BI and Form CRS treat the disclosure of conflicts of interest in an identical fashion to avoid unintended confusion and compliance challenges that could spawn litigation. We also believe it is critical that all Regulation BI disclosures be provided in the Form CRS.

7. Additional Information

- Section 7, Additional Information. As was noted previously, requiring disclosure of disciplinary events will likely disadvantage larger firms as opposed to small/single person broker-dealers. A reference to BrokerCheck would be a fairer and more useful disclosure for consumers. The lack of disclosure by a small broker-dealer could give a retail investor a false sense of security. Conversely, disclosure of regulatory events by larger firms would tend to mislead customers regarding potential areas of concern. This is another area where the Commission may wish to develop general information that could be provided through a brochure or via deep linking.

8. Key Questions to Ask

- As explained above, we encourage the Commission to consider the development of educational materials that could be provided in paper or through electronic access that would provide consumers with general information about investment options.

Thank you for consideration of our comments, and please let us know if we can provide additional information.

Sincerely,

*David Leifer*

David Leifer

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Federal and State Regulations Governing the Sale of Fixed and Variable Annuities:  
Comprehensive Protections for Financial and Retirement Product Consumers

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**Table of Contents**

FINRA Rule 2330: Suitability and Supervision in the Sale of Variable Annuity Contracts.....2

FINRA Rule 2320: FINRA Rules Governing Non-Cash Compensation in the Sale of Variable  
Contracts and Mutual Funds.....9

NAIC Suitability in Annuity Transactions Model Regulation: A Coordinated Approach to  
Suitability and Supervision in the Sale of Individual Annuity Contracts.....12

The NAIC Annuity Disclosure Model Regulation: Disclosure Standards in Annuity Distribution.19

NAIC Insurance and Annuities Replacement Model Regulation: A Systemic Approach to  
Appropriate Sales Practices.....24

NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional  
Designations in the Sale of Life Insurance and Annuities.....38

The Impact of State Insurance Consulting Laws and Related Provisions on Insurance Producers  
Performing Financial Planning Services.....41

A Comprehensive System of State Regulation Governs the Distribution of Insurance and  
Annuity Contracts.....44

NAIC Annuity Buyer’s Guide for Annuities.....51

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## **FINRA Rule 2330: Suitability and Supervision in the Sale of Variable Annuity Contracts**

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation  
American Council of Life Insurers © 2017 All Rights Reserved  
March 28, 2017

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### **I. Scope of This Outline Segment**

A. FINRA [Rule 2330](#) [Formerly NASD Rule 2821], which governs suitability and supervision in the sale of variable annuity contracts, was approved by the SEC in 2008, and was under development since 2004. The rule evolved through six different stages, five at the SEC, and one at FINRA.

B. This outline segment will summarize the elements of Rule 2330, and discuss its administrative history to illuminate FINRA's purpose and intent.

### **II. Substantive Overview: Rule 2330 has four primary provisions**

A. Requirements governing recommendations, including a suitability obligation, specifically tailored to deferred variable annuity transactions;

B. Principal review and approval obligations;

C. A specific requirement for broker-dealers to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the rule's standards; and,

D. A targeted training requirement for broker-dealers' associated persons, including registered principals.

### **III. The Rule's Requirements in Greater Detail**

A. Revised Rule 2330 established the following specific requirements:

1. *Recommendation Requirements.* When recommending a deferred variable annuity transaction, Rule 2330 requires broker-dealers and salespersons to have a reasonable basis to believe that the: customer *has been informed of, in a general fashion,* the various features of the deferred variable annuity,

- a) customer *would benefit from* certain features of a deferred variable annuity (e.g., tax-deferred growth, annuitization or a death benefit); and
- b) the deferred variable annuity as a *whole* and the underlying sub-accounts or riders are suitable for the particular customer.
- c) the particular deferred variable annuity that the registered representative is recommending, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and the riders and similar product enhancements are suitable (and in the case of an exchange, the transaction as a whole also is suitable) for the customer based on the information the registered representative is required to make a reasonable effort to obtain.

2. Revised Rule 2330 requires these determinations to be *documented and signed* by the salesperson recommending the transaction.

- a) Rule 2330 would also require salespersons to make *reasonable efforts* to obtain information concerning customers' age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the variable annuity, investment time horizon, existing investment and insurance holdings, liquidity needs, liquid net worth, risk tolerance, tax status and other information used by the salesperson in making recommendations.

3. *Supervisory Review.* Rule 2330(c) requires that a principal review each variable annuity purchase or exchange within seven business days after the signed application arrives at the broker-dealer's office of supervisory jurisdiction in good order. A registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity.

- a) In reviewing the transaction, the registered principal would need to take into account the extent to which:
  - the customer would benefit from certain features of a deferred variable annuity;
  - the customer's age or liquidity needs make the investment inappropriate; and,
  - the customer involved an exchange of a deferred variable annuity: will incur surrender charges, face a new surrender period, lose death or existing benefits,
  - have increased mortality and expense fees, appears to have a need for any potential product enhancements and improvements,

or had another deferred variable annuity exchange within the preceding 36 months.

- Under Rule 2330, the supervisory review standards must be signed and documented by the registered principal that reviewed and approved the transaction.

4. *Supervisory Procedures.* Rule 2330 requires broker-dealers to establish and maintain specific written supervisory procedures reasonably designed to achieve and evidence compliance with the standards in Rule 2330. The broker-dealer must have procedures to screen and have principal review of the recommendations requirements in Rule 2330, and determine whether the salesperson has a particularly high rate of effecting deferred variable annuity exchanges.

5. *Training.* Under the proposal, broker-dealers would need to develop and document specific training policies or programs designed to ensure that salespersons recommending transactions, and registered principals who review transactions, in deferred variable annuities comply with the requirements of Rule 2330 and that they understand the material features of deferred variable annuities, including liquidity issues, sales charges, fees, tax treatment, and market risks.

6. *Automated Supervisory Review.* FINRA's submission on the rule indicated that the rule would not preclude firms from using automated supervisory systems, or a mix of automated and manual supervisory systems, to facilitate compliance with the rule.

a) In addition, FINRA delineated what, at a minimum, a principal would need to do if his or her firm intends to rely on automated supervisory systems to comply with the proposed rule.

b) Specifically, a principal would need to (1) approve the criteria that the automated supervisory system uses, (2) audit and update the system as necessary to ensure compliance with the proposed rule, (3) review exception reports that the system creates, and (4) remain responsible for each transaction's compliance with the proposed rule.

c) Finally, FINRA noted that a principal would be responsible for any deficiency in the system's criteria that would result in the system not being reasonably designed to comply with the rule.

7. *Tax Qualified Plans.* Rule 2330 does not apply to variable annuity transactions made in connection with tax-qualified, employer-sponsored retirement or benefit plans that either are defined as a "qualified plan" under Section 3(a)(12)(C) of the Exchange Act or meet the requirements of Internal Revenue Code Sections 403(b) or 457(b), unless, in the case of any plan, the

broker-dealer makes recommendations to individual plan participants regarding the variable annuity.

#### IV. Review and Explanation of (Revised) Rule 2330

##### A. Supervisory review standards changed

1. FINRA enlarged the time period for supervisory review to seven days after the signed application arrives at the broker-dealer's OSJ in good order.

a) Compare to *prior* draft: "Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but *no later than seven business days after the customer signs the application*, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity."

b) Compare to earlier draft: the third amendment required the principal must review and approve the transaction "[n]o later than *two business days following* the date when a member or person associated with a member *transmits a customer's application* for a deferred variable annuity to the issuing insurance company for processing or *five business days from the transmittal date* if additional contact with the customer or person associated with the member is necessary in the course of the review."

2. FINRA rationale: ensuring that all broker-dealers have adequate time to perform a thorough principal review of these transactions.

a) In view of the variety of features and provisions in connection with the issuance of deferred variable annuity contracts, FINRA became persuaded that principal review of variable annuity sales requires greater time than reviews of many other securities transactions.

b) The provision of a reasonable amount of time for pre-transmittal review, however, posed potential problems related to other rules concerning the prompt handling of customer funds.

(1) For instance, FINRA Rule 2330 states generally that member firms shall not make improper use of customer funds, and FINRA Rule 2820 specifically requires member firms to "transmit promptly" the application and the purchase payment for a variable contract to the issuing insurance company.

(2) Similarly, Rules 15c3-1 and 15c3-3 under the 1934 Act require certain member firms to promptly transmit and forward funds.

(3) Rules 15c3-1(c)(9) and (10) under the 1934 Act define the terms "promptly transmit and deliver" and "promptly forward" funds as meaning "no later than noon of the next business day after receipt of such funds."

3. FINRA solution to regulatory conflicts with prompt pricing standards:

a) FINRA asked for, and obtained from the SEC, regulatory relief regarding Rules 15c3-1 and 15c3-3 when the same circumstances exist. As a companion to the rule approval, the SEC provided an exemptive order from the prompt pricing provisions.

b) FINRA made clear that a broker-dealer that is holding an application for a deferred variable annuity and a non-negotiated check from a customer written to an insurance company for a period of seven business days or less would not be in violation of FINRA Rules 2330 if the reason that the application and check are being held is to allow a principal to complete his or her review of the transaction pursuant to proposed Rule 2330.

B. Recommendation requirements revised

1. FINRA revised proposed Rule 2821 to state that “[n]o member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member *has a reasonable basis to believe* that the transaction is suitable in accordance with Rule 2310.”

2. FINRA is substituting the phrase “has a reasonable basis to believe” for “has determined,” which appeared in the prior draft of the rule.

3. FINRA rationale: FINRA softened the review requirement in response to comments that the reasonable basis standard was more strict than with other similar financial products.

C. Non-recommended transactions conditionally excluded. FINRA revised the rule conditionally so that it does not apply to non-recommended transactions, such as situations where the member is acting solely as an order taker. FINRA believed Rule 2821 should not prevent a fully informed customer from making his or her own investment decision.

1. Conditional exclusion from rule, however.

a) A registered principal “may authorize the processing of the transaction if the registered principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the registered principal has not approved the transaction, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity.”

2. FINRA rationale:

a) Change allows a customer to decide to continue with the non-recommended purchase or exchange of a deferred variable annuity

notwithstanding the broker-dealer's belief that the transaction would be viewed as unsuitable if it had been recommended.

b) The new requirement that the principal independently determine that the transaction was not recommended adds another layer of protection. Requirement "should discourage salespersons from attempting to bypass compliance requirements for recommended sales by simply checking the 'not recommended' box on a form."

c) Customers must indicate an explicit intent to continue with the non-recommended transaction notwithstanding the unsuitability determination, which will help ensure that the customer's decision is an informed one.

D. "*Undue concentration*" standard eliminated. FINRA eliminated prior requirements that registered principals consider "the extent to which the amount of money invested would result in an undue concentration in a deferred variable annuity."

E. The annuity or deferred variable annuities should be evaluated in "the context of the customer's overall investment portfolio."

1. FINRA Rationale:

a) Requirement was unclear and could cause confusion. Because other provisions in Rule 2330 already capture the important aspects of this "undue concentration" determination, FINRA has eliminated it as superfluous.

F. Generic disclosure allowed

1. Under recommendation requirements, FINRA clarified that required disclosure may be generic and not specific to the product. Clarification now requires that "the customer has been informed, *in general terms*, of various features of deferred variable annuities. . . ."

2. FINRA rationale:

a) Simply a clearer statement of original rule's intent.

G. "Unique features" requirement relaxed and expanded

1. Provision now states that salesperson must have "a reasonable basis to believe that . . . the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit."

2. FINRA Rationale:

a) FINRA accepted commenters' position that there are other financial products that have features similar to those of a deferred variable annuity,

so a requirement that the customer would benefit from the *unique* features was relaxed to benefiting from *certain* features.

b) Living benefits added to the list of certain features that may be beneficial for customer in addition to death benefit.

#### H. Required surveillance practices for replacement activities clarified

1. FINRA indicated that principal need not examine every transaction when salesperson has a potentially higher rate of replacement sales. FINRA emphasized instead review on a periodic basis via exception reporting rather than as part of the principal review of each exchange transaction

2. FINRA revised the supervisory procedures guarding against inappropriate replacement practices so that, “the member also must (1) implement surveillance procedures to determine if the member’s associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable FINRA rules, or the federal securities laws (“inappropriate exchanges”) and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.”

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## **FINRA Rule 2320: FINRA Rules Governing Non-Cash Compensation in the Sale of Variable Contracts and Mutual Funds**

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American Council of Life Insurers © 2017 All Rights Reserved  
March 28, 2017

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### **I. Scope of This Outline Segment**

A. This Outline Segment addresses the permitted uses of non-cash compensation in the sale of variable contracts and mutual funds. FINRA significantly modified this rule to reduce the range of permitted non-cash compensation arrangements.

B. FINRA's non-cash compensation rule does not apply to fixed annuities because they are excluded from the definition of security under the Federal securities laws.

1. Fixed index annuities are excluded from categorization as securities under the Harkin Amendment to the Dodd-Frank Act, the Harkin Amendment conditions its protections to compliance with the NAIC's Suitability in Annuity Transactions Model Regulation or substantially similar features of that amendment.

2. Absent compliance with the NAIC's Suitability in Annuity Transactions Model Regulation or similar provisions, fixed index annuities could lose their immunity from the Federal securities laws and distributors of this product could, therefore, be subject to FINRA requirements, including the non-cash compensation rule.

### **II. FINRA Rules Governing Non-Cash Compensation.**

A. In 1998, FINRA adopted Rule [2320](#) which governs non-cash compensation. A parallel non-cash compensation rule exists for mutual funds in FINRA Rule [2341\(L\)\(5\)](#). A supplemental [FINRA Q & A](#) addresses a number of questions on the rules' applicability to specific situations, and contains a good thumbnail summary about the rules.

B. FINRA Rule 2320 prevents abuses and strictly limits non-cash compensation in the sale of variable insurance products to:

1. Gifts of up to \$100 per associated person annually;

2. An occasional meal, ticket to a sporting event or theater, or comparable entertainment;

3. Payment or reimbursement for training and education meetings held by broker-dealers or issuers/sponsors for the purpose of educating associated persons of broker-dealers, so long as certain conditions are met;

4. In-house sales incentive programs of broker-dealers for their own associated persons; and,

5. Contributions by any company or other FINRA member to a broker-dealer's permissible in-house sales incentive program, subject to explicit conditions.

C. Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, are conditioned on:

1. The member's or nonmember's non-cash compensation arrangement, if it includes variable contract securities, is based on the total production of associated persons with respect to all variable contract securities distributed by the member;

2. The non-cash compensation arrangement requires that the credit received for each variable contract security is equally weighted;

3. No unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or nonmember's organization of a permissible non-cash compensation arrangement; and

4. The record keeping requirement in the rule is satisfied. Rule 2320 requires broker-dealers to maintain records of all non-cash compensation received by the broker-dealer or its associated persons in permitted non-cash compensation.

D. FINRA Pending Proposal to Revise Non-Cash Compensation Rules.

1. In August 2016, FINRA [proposed](#) several amendments to the non-cash compensation rules that are pending closure and SEC approval. The proposed FINRA amendments would:

a) Consolidate the rules under a single rule series in the FINRA rulebook;

b) Increase the gift limit from \$100 to \$175 per person per year and include a *de minimis* threshold below which firms would not have to keep records of gifts given or received;

c) Amend the non-cash compensation rules to cover all securities products, rather than only direct participation programs (DPPs), variable insurance contracts, investment company securities and public offerings of securities; and,

d) Incorporate existing guidance and interpretive letters into the rules.

2. Additionally, FINRA proposed a revised approach to internal sales contests for non-cash compensation such that if payment or reimbursement of expenses associated with the non-cash compensation arrangement is preconditioned on achievement of a sales target, the non-cash compensation arrangement must:

a) Be based on the total production with respect to all securities products; and,

b) Not be based on conditions that would encourage an associated person to recommend particular securities or categories of securities.

3. Finally, FINRA proposed to incorporate into the amended rules a principles-based standard for business entertainment that would require firms to adopt written policies and supervisory procedures for business entertainment arrangements.

a) The records must include: the names of the offerors, companies or other broker-dealers making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the broker-dealer and its associated persons with the rule.

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**NAIC Suitability in Annuity Transactions Model Regulation: A Coordinated Approach to Suitability and Supervision in the Sale of Individual Annuity Contracts**

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation  
American Council of Life Insurers © 2017 All Rights Reserved.

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**I. NAIC Suitability and Supervision Responsibilities in NAIC Model Regulation Governing Individual Annuity Sales**

A. The National Association of Insurance Commissioners (NAIC) adopted several evolving sets of revisions to its model regulation governing suitability and supervision in the sale of individual annuity contracts.

1. The NAIC's initial regulation was entitled the Senior Protection in Annuity Transactions Regulation, and governed suitability and supervision in annuity transactions with "senior consumers" age 65 or older.

2. The NAIC's 2006 revision to this regulation applied it to all individual annuity sales. To reflect the broader application of the regulation, it was re-titled the Suitability in Annuity Transactions Model Regulation. This regulation incorporated suitability and supervision practices parallel to those under the federal securities laws and FINRA rules.

3. In 2010, the NAIC added further amendments to the Suitability in Annuity Transactions Model Regulation. Among other things, the 2010 NAIC revisions to the regulation established new restrictions on supervisory delegation to third-party and reliance on producer suitability recommendations, established a new producer training requirement (which must be completed by producers prior to their being able to solicit the sale of annuities), and expanded powers of Commissioners to levy sanctions and penalties.

B. The evolving iterations of the NAIC model regulation can be found at NAIC Model Regulation Service II-275-1 (2010). Over 30 states have implemented the 2010 version of the model regulation and two have proposed the regulation for adoption. 14 states have adopted the 2006 version of the regulation. Over time, these states are expected to incorporate the 2010 revisions as they update their regulations.

C. Because the 2010 amendments to the model regulation are built upon the original 2006 model, the 2006 model is discussed first. The 2010 modifications to the model are summarized separately below, following the 2006 regulation's summary.

D. ACLI supports strong suitability standards to ensure annuity sales recommendations are suitable and will promote consumer confidence in making informed annuity purchase decisions.

## II. Approach of the 2006 Revised NAIC Regulation

- A. The regulation establishes standards and procedures governing recommendations in annuity transactions, to ensure “that insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed.”
- B. The regulation imposes suitability and supervision duties for insurers and insurance producers, including requirements for maintaining written procedures and conducting periodic reviews of records to detect and prevent unsuitable sales practices.

## III. Scope and Governing Framework of the 2006 Revised NAIC Regulation

- A. The regulation applies to any recommendation to purchase or exchange an annuity made to a consumer by an insurance producer, or an insurer where no producer is involved, that results in the purchase or exchange recommended.
  - 1. “Annuity” means a *fixed annuity or variable annuity* that is *individually solicited*, whether the product is classified as an individual or group annuity [Section 5 (A)].
  - 2. “Recommendation” means advice provided by an insurance producer, or an insurer where no producer is involved, to an individual consumer that results in a purchase or exchange of an annuity in accordance with that advice [Section 5(D)].
- B. The regulation does not apply to annuity transactions involving:
  - 1. Direct response solicitations where there is no recommendation based on information collected from the consumer under the regulation;
  - 2. Contracts funding specified retirement plans:
    - a) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);
    - b) A plan described by Sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer;
    - c) A government or church plan defined in Section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the IRC;
    - d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;
  - 3. Settlements of, or assumptions of, liabilities associated with personal injury litigation or any dispute or claim resolution process; or

4. Formal prepaid funeral contracts.

#### IV. Duties Imposed Under the Regulation [Section 6]

A. **Suitability Standard:** In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the insurance producer, or the insurer where no producer is involved, shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to his or her investments and other insurance products and as to his or her financial situation and needs.

1. “Insurer” means a company required to be licensed under the laws of this state to provide insurance products, including annuities.
2. “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.
3. Note: this suitability standard directly parallels the general standard of FINRA Suitability Rule 2310(a), set forth at [http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element\\_id=1159000466](http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466) .

B. **Suitability Ingredients** [Section 6(A)]: Prior to the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain information concerning:

1. The consumer’s financial status;
2. The consumer’s tax status;
3. The consumer’s investment objectives; and
4. Such other information used or considered to be reasonable by the insurance producer, or the insurer where no producer is involved, in making recommendations to the consumer.
5. Note: the suitability ingredients above precisely track those in FINRA Suitability Rule 2320(b) set forth at [http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element\\_id=1159000466](http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466) .
6. An insurer or insurance producer’s recommendation under the suitability standard and ingredients must be reasonable under all the circumstances actually known to the insurer or insurance producer at the time of the recommendation [Section 6(c)(2)].
  - a) Neither an insurance producer, nor an insurer where no producer is involved, has any obligation to a consumer under the

suitability standard [Section 6(a)] related to any recommendation if a consumer:

(1) Refuses to provide relevant information requested by the insurer or insurance producer;

(2) Decides to enter into an insurance transaction that is not based on a recommendation of the insurer or insurance producer; or

(3) Fails to provide complete or accurate information.

(4) Note: these narrow exclusions directly parallel FINRA approaches to suitability in Rule 2310.

### C. Supervision Standard

#### 1. For insurers:

a) An insurer either (i) shall assure that a system to supervise recommendations that is reasonably designed to achieve compliance with the suitability standards in the regulation is established and maintained, or (ii) shall establish and maintain such a system, including, but not limited to:

(1) Maintaining written procedures; and

(2) Conducting periodic reviews of its records that are reasonably designed to assist in detecting and preventing violations of this regulation.

b) To fulfill the supervision standard, an insurer may contract with a third party, including a general agent or independent agency, to establish and maintain a system of supervision as required by Section 6(D)(1) regarding insurance producers under contract with, or employed by, the third party.

(1) To utilize a third party for supervision, an insurer must make reasonable inquiry to assure that the third party is performing the functions required under the regulation, and must take reasonable action under the circumstances to enforce the contractual obligation of the third party to perform the functions.

(2) An insurer may comply with its obligation to make reasonable inquiry by doing all of the following:

(a) Annually *obtain a certification* from a third party senior manager who has responsibility for the delegated functions that the manager has a reasonable basis to represent, and does represent,

that the third party is performing the required functions; and

(b) Based on reasonable selection criteria, periodically select third parties for review to determine whether the third parties are performing the required functions. The insurer must perform those procedures to conduct the review that are reasonable under the circumstances.

c) Insurers that contract with a third party to perform supervision and that comply with the certification and periodic review procedures will fulfill their supervisory responsibilities under the regulation.

d) Note: the supervisory approaches implemented in the regulation parallel those in FINRA Rule 3010(a).

e) No one may provide a certification under the regulations supervisory delegation unless:

(1) The person is a senior manager with responsibility for the delegated functions; and

(2) The person has a reasonable basis for making the certification

2. For insurance producers:

a) A general agent and independent agency either must (i) adopt a system established by an insurer to supervise recommendations of its insurance producers that is reasonably designed to achieve compliance with the regulation, or (ii) establish and maintain such a system, including, but not limited to:

(1) Maintaining written procedures; and

(2) Conducting periodic reviews of records that are reasonably designed to assist in detecting and preventing violations of this regulation.

3. Scope of required system of supervision for insurers and producers:

a) An insurer, general agent or independent agency is not required to review, or provide for review of, all insurance producer solicited transactions; or

b) An insurer, general agent or independent agency is not required to include in its system of supervision an insurance producer's recommendations to consumers of products other than

the annuities offered by the insurer, general agent or independent agency.

c) Note: these clarifications to the scope of the supervisory requirements parallel those applied under FINRA Rule 3010.

4. Deference to FINRA Suitability rule for variable annuity sales:

a) Compliance with FINRA's suitability rule will satisfy the regulation's suitability requirements for variable annuity recommendations.

b) Deference to FINRA suitability standards and practices in variable annuity sales does not, however, limit the insurance commissioner's ability to enforce the regulation.

**D. Recordkeeping**

1. Insurers, general agents, independent agencies and insurance producers must maintain or be able to make available to the commissioner records of the information collected from the consumer and other information used in making the recommendations that were the basis for insurance transactions for [a specified number of] years after the insurance transaction is completed by the insurer.

2. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

3. Records required to be maintained by this regulation may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

**E. Enforcement Powers and Mitigation Provisions**

1. To implement the regulation, the state insurance commissioner may order:

a) An insurer to take reasonably appropriate corrective action for any consumer harmed by the insurer's, or by its insurance producer's, violation of this regulation;

b) An insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this regulation; and

2. Any applicable penalty under the state code may be reduced or eliminated if corrective action for the consumer was taken promptly after a violation was discovered.

## **V. Overview of the Modifications in the 2010 Revised NAIC Suitability in Annuity Transactions Model Regulation**

- A. Insurance producers are required to obtain information about the customer's needs and financial objectives when formulating a recommendation for an annuity purchase and must have reasonable belief that the recommendation is suitable. (NAIC Model Sec. 6(A)&(B)).
- B. Insurers must assure that a system is in place to supervise compliance with the Model, including review of producers' recommendations. (NAIC Model Sec. 6(F)(1)(d)).
- C. An insurer must conduct reviews of its records to assist in detecting and preventing violations of the regulation. (NAIC Model Sec. 6(F)(1)(e)).
- D. When an insurer contracts with a third party to establish a system of supervision, the insurer must monitor and audit, as appropriate, to assure that the third party is performing the required functions. (NAIC Model Sec. 6(F)(2)(b)(i)).
- E. When an insurer relies on a third party to perform required suitability functions, the third party, when requested by the insurer, must give a certification that it is performing the functions in compliance with the regulation. (NAIC Model Sec. 6(F)(2)(b)(ii)).
- F. Sales of annuities made in compliance with stringent federal securities rules pertaining to suitability and supervision (FINRA Rule 2330) satisfy the requirements under the Model. (NAIC Model Sec. 6(H)).
- G. An insurance producer shall not solicit the sale of an annuity unless the producer has adequate knowledge of the product and shall be in compliance with the insurer's product training standards. (NAIC Model Sec. 7(A)).
- H. Insurance producers who engage in the sale of annuities must complete an annuity training course approved by the appropriate State. (NAIC Model Sec. 7(B)).
- I. The Commissioner may order that an insurer or producer take appropriate corrective action for any consumer harmed by the insurer's, or producer's, violation of the regulation. (NAIC Model Sec. 8(A)(1)&(2)).

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## **The NAIC Annuity Disclosure Model Regulation: Disclosure Standards in Annuity Distribution**

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### **I. Scope of Outline**

- A. This outline summarizes the elements of the NAIC Annuity Disclosure Model Regulation, the required Disclosure Statement and the required NAIC Buyer's Guide to Fixed, Indexed and Variable Annuities.
- B. The NAIC Annuity Disclosure Model Regulation can be found at NAIC Model Reporting Service 245-I (April 2016).

### **II. Objective of the Annuity Disclosure Model Regulation**

- A. To provide standards for the disclosure of certain minimum information about annuity contracts to protect consumers and foster consumer education.
  - 1. The regulation specifies the minimum information which must be disclosed and the method and timing of delivering it.
  - 2. The regulation seeks to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts.

### **III. Annuities Covered by the Regulation**

- A. All group and individual annuity contracts, except:
  - 1. Registered or non-registered variable annuities.
  - 2. Immediate and deferred annuities having only non-guaranteed elements.

3. Annuities used to fund:
  - a) An employee pension plan which is covered by the Employee Retirement Income Security Act (ERISA);
  - b) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer,
  - c) A governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or a tax exempt organization under Section 457 of the Internal Revenue Code; or
  - d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.
4. Structured Settlement Annuities.
5. Note: Under the model regulation, states may optionally elect to exclude charitable gift annuities and structured settlement annuities also.

#### **IV. Information Mandated in Required NAIC Disclosure Statement**

- A. The generic name of the contract, the company product name, if different, form number, and the fact that it is an annuity;
- B. The insurer's name and address;
- C. A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate:
  1. The guaranteed, non-guaranteed and determinable elements of the contract, and their limitations, if any, and an explanation of how they operate;
  2. An explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;
  3. Periodic income options both on a guaranteed and non-guaranteed basis;
  4. Any value reductions caused by withdrawals from or surrender of the contract;
  5. How values in the contract can be accessed;
  6. The death benefit, if available, and how it will be calculated;

7. A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and

8. Impact of any rider, such as a long-term care rider.

D. Specific dollar amount or percentage charges and fees, which must be listed with an explanation of how they apply.

E. Information about the current guaranteed rate for new contracts that contains a clear notice that the rate is subject to change.

F. Insurers must define terms used in the disclosure statement in language understandable by a typical person in the target market.

**V. Required NAIC Buyer's Guide to Fixed Deferred Annuities (appears at the end of the outline).**

A. A Buyer's Guide prepared by the NAIC provides information about different aspects of annuities, such as

1. What an annuity is.
2. Descriptions of the different kinds of annuities.
  - a) Single premium or multiple premium.
  - b) Immediate or deferred.
  - c) Fixed or variable.
3. How interest rates are set for the deferred variable annuity.
  - a) Explanation of current interest rate.
  - b) Explanation of minimum guaranteed rate.
  - c) Explanation of multiple interest rates.
4. Description of charges in the contract.
  - a) Surrender or withdrawal charges.
  - b) Free withdrawal features.
  - c) Contract fee.
  - d) Transaction fee.
  - e) Percentage of premium charge.
  - f) Premium tax charge.

5. Fixed Annuity Benefits
  - a) Annuity income payments.
  - b) Annuity payment options.
    - (1) Life only.
    - (2) Life annuity with period certain.
    - (3) Joint and survivor.

## **VI. Timetable for Delivery of Required Disclosure Statement and Buyers' Guide:**

A. At or before the time of application if annuity application is taken in a *face-to-face meeting*.

B. No later than five (5) business days after the completed application is received by the insurer, if annuity application is taken by means *other than in a face-to-face meeting*.

1. With applications received from a *direct solicitation through the mail*:
  - a) Inclusion of a Buyer's Guide and Disclosure Statement in the direct mail solicitation satisfies the requirement for delivery no later than five (5) business days after receipt of the application.
2. *For applications received via the Internet*:
  - a) Taking reasonable steps to make the Buyer's Guide and Disclosure Statement available for viewing and printing on the insurer's website satisfies the requirement for delivery no later than five (5) business day of receipt of the application.
3. Annuity solicitations in other than face-to-face meetings must include a statement that the proposed applicant may contact the insurance department of the state for a free annuity Buyer's Guide. Alternatively, the insurer may include a statement that the prospective applicant may contact the insurer for a free annuity Buyer's Guide.
4. *Extended Free-Look Period*: where the Buyer's Guide and disclosure document are not provided at or before the time of application, a free look period of no less than fifteen (15) days shall be provided for the applicant to return the annuity contract without penalty. The free look runs concurrently with any other free look provided under state law or regulation.

## **VII. Required Report to Contract Owners**

A. For annuities in the payout period with changes in non-guaranteed elements and for the accumulation period of a deferred annuity, the insurer

must provide each contract owner with a report, *at least annually*, on the status of the contract that contains at least the following information:

1. The beginning and end date of the current report period;
2. The accumulation and cash surrender value, if any, at the end of the previous report period and at the end of the current report period;
3. The total amounts, if any, that have been credited, charged to the contract value or paid during the current report period; and
4. The amount of outstanding loans, if any, as of the end of the current report period.

**VIII. The NAIC Annuity Buyers' Guide is accessible through an embedded link on page 51.**

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**NAIC Insurance and Annuities Replacement Model Regulation:  
A Systemic Approach to Appropriate Sales Practices**

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**I. NAIC Insurance and Annuities Replacement Model Regulation**

A. In June 2000, the NAIC adopted substantial amendments to the 1998 Insurance and Annuities Replacement Model Regulation. This regulation establishes substantial protections for consumers through required systems of supervision, control, monitoring, and recordkeeping for insurers and producers. Additionally, the regulation requires plain-English notices, and signed disclosure about the replacement transaction.

1. The NAIC's Model Regulation and amendments promote uniformity among state insurance regulations.
2. Citation: Insurance and Annuities Replacement Model Regulation, NAIC Model Regulation Service-July 2006 at III-621-1.

**B. Approach of the amended regulation**

1. The amended regulation establishes duties for insurance producers, replacing insurers, and existing insurers designed to protect consumers.
  - a. For example, insurers using insurance producers must, among other things:
    - (1) Maintain a *system of supervision and control*;
    - (2) Have the *capacity to monitor* each producer's life and annuity replacements for that insurer;
    - (3) Ascertain that required *sales material and illustrations are complete and accurate*; and
    - (4) *Maintain records* of required notification forms and illustrations that can be produced.
  - b. A required notice of replacement must be presented, read to consumers, and signed by the producer and consumer.
2. The regulation lists illustrative violations, and establishes penalties that may include the revocation or suspension of a producer's or company's license, monetary fines, and forfeiture of commissions or compensation. Commissioners may require insurers to make

restitution, and restore policy values with interest when violation are material to the sale. [See, Section 8 of the regulation].

#### C. Overview of Issue

1. A replacement occurs when an individual uses existing life insurance policy or annuity contract values to purchase a new policy or contract.
2. A replacement may involve the use of the entire value of an existing policy or contract, as in the case of a surrender, or it may involve the use of only a portion of the existing values.
3. Under the NAIC Model as amended in 2000, the use of *any* portion of the values of an existing policy or contract to purchase a new policy or contract constitutes replacement, including borrowing, assigning dividends, lapsing, or forfeiting.
  - a. External replacement occurs when a company replaces the life or annuity product of another company.
  - b. Internal replacement occurs when a company replaces a life or annuity contract that it has already issued.

#### D. *Purpose* of the Amended NAIC Replacement Regulation

1. To regulate the activities of insurers and producers with respect to the replacement of existing life insurance and annuities.
2. To protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions, and to:
  - a. Assure that purchasers receive information with which a decision can be made in his or her own best interest;
  - b. Reduce the opportunity for misrepresentation and incomplete disclosure; and
  - c. Establish penalties for failure to comply with the regulation.

#### E. Regulation *Applies to Variable Life Insurance and Variable Annuity Replacements*

1. The term *replacement* is defined in the regulation to mean a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be:
  - a. Lapsed, forfeited, surrendered or partially surrendered,

assigned to the replacing insurer or otherwise terminated;

- b. Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;
  - c. Amended so as to effect either a reduction in force of for which benefits would be paid;
  - d. Reissued with any reduction in cash value; or
  - e. Used in a financed purchase.
2. The regulation excuses variable life and variable annuity contracts from requirements in Sections 5(A)(2) and 6(B) to provide illustrations or policy summaries.
- a. In place of the policy summaries and illustrations requirement, the regulation mandates “premium or contract distribution amounts and identification of the appropriate prospectus or offering circular” instead.
  - b. In all other respects, the regulation fully applies to individual variable contract replacements.

F. *Exceptions* from regulation for group contracts

1. The regulation does not apply to transactions involving:
- a. Policies or contracts used to fund:
    - (1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);
    - (2) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer;
    - (3) A governmental or church plan defined in Section 414, a governmental or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the Internal Revenue Code; or
    - (4) A non-qualified deferred compensation arrangement established or maintained by an employer or plan sponsor.
  - b. Group life insurance or group annuities where there is no

direct solicitation of individuals by an insurance producer.

c. Credit life insurance.

## G. Duties of Producers and Insurers in Replacement Transactions

### 1. Duties of insurers that use producers [Section 4.]

a. Under the regulation, each insurer must:

(1) *Maintain a system of supervision and control* to insure compliance with the requirements of this regulation that shall *include at least* the following:

(a) *Inform its producers of the requirements of the regulation* and incorporate the requirements of the regulation into all relevant *producer training manuals* prepared by the insurer;

(b) *Provide to each producer a written statement of the company's position with respect to the acceptability of replacements* providing guidance to its producer as to the appropriateness of these transactions;

(c) *A system to review the appropriateness of each replacement transaction that the producer does not indicate is in accord with the regulation's standards;*

(d) Procedures to *confirm* that the *requirements* of this regulation have been *met*; and

(e) Procedures to *detect transactions that are replacements of existing policies or contracts* by the existing insurer, but that have not been identified as such by the applicant or producer.

(2) *Have the capacity to produce*, upon request, and make available to the Insurance Department, *records of each producer's*:

(a) *Replacements*, including financed purchases, as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(b) *Number of lapses* of policies and contracts

by the producer as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

- (c) Number of transactions that are *unidentified replacements of existing policies* or contracts by the existing insurer detected by the company's monitoring system as required by Section (4)(A)(5) of the regulation; and
  - (d) *Replacements, indexed by replacing producer and existing insurer.*
- (3) Require with or as a part of each application for life insurance or an annuity a signed statement by both the applicant and the producer as to whether the applicant has existing policies or contracts;
  - (4) Require with each application for life insurance or an annuity that indicates an existing policy or contract a completed notice regarding replacements as contained in Attachment 1 to the regulation;
  - (5) When the applicant has existing policies or contracts, retain completed and signed copies of the notice regarding replacements in its home or regional office for at least five years after the termination or expiration of the proposed policy or contract;
  - (6) When the applicant has existing policies or contracts, obtain and retain copies of any sales material as required by Section 3(E) of the regulation, the basic illustration and any supplemental illustrations used in the sale and the producer's and applicant's signed statements with respect to financing and replacement in its home or regional office for at least five years after the termination or expiration of the proposed policy or contract
  - (7) Records required to be retained by the regulation may be maintained in paper, photograph, microprocess, magnetic, mechanical or electronic media or by any process which accurately reproduces the actual document.

## 2. Duties of Replacing Insurers that Use Producers [Section 6].

- a. Where a replacement is involved in the transaction, the replacing insurer shall:
- (1) Verify that the required forms are received and are in compliance with the regulation;
  - (2) Notify any other existing insurer that may be affected by the proposed replacement within five business days of receipt of a completed application indicating replacement or when the replacement is identified if not indicated on the application, and mail a copy of the available *illustration or policy summary* for the proposed policy or available disclosure document for the proposed contract within five business days of a request from an existing insurer; [*note: this illustration and policy summary requirement does not apply to variable contracts.*]
  - (3) Be able to produce copies of the notification regarding replacement required in Section 4(B), *indexed by producer, in its home or regional office* for at least five years or until the next regular examination by the insurance department of a company's state of domicile, whichever is later; and
  - (4) Provide to the policy or contract owner notice of the right to return the policy or contract within thirty (30) days of the delivery of the contract and receive an unconditional full refund of all premiums or considerations paid on it, including any policy fees or charges or, in the case of a *variable or market value adjustment policy or contract*, a payment of the cash surrender value provided under the policy or contract plus the fees and other charges deducted from the gross premiums or considerations or imposed under such policy or contract.
- b. In transactions where the replacing insurer and the existing insurer are the same or subsidiaries or affiliates under common ownership or control [*internal replacements*] allow credit for the period of time that has elapsed under the replaced policy's or contract's incontestability and suicide period up to the face amount of the existing policy or contract. With regard to *financed purchases* the credit may be limited to the amount the face amount of the existing policy is reduced by the use of existing policy values to fund the new policy or contract.

c. If an insurer *prohibits the use of sales material other than that approved by the company*, as an alternative to the requirements of Section 3(E) the insurer may:

(1) Require with each application a statement *signed by the producer* that:

- Represents that the producer used only company approved sales material;
  - *Lists*, by identifying number or other descriptive language, the *sales material that was used*; and
  - States that copies of all sales material were left with the applicant in accordance with Section 3(D); and
- Within ten days of the issuance of the policy or contract:
- (a) Notify the applicant by sending a letter or by verbal communication with the applicant *by a person whose duties are **separate from the marketing area** of the insurer*, that the producer has represented that copies of all sales material have been left with the applicant in accordance with Section 3(D);
  - (b) Provide the applicant with a *toll free number* to contact *company personnel involved in the compliance function* if such is not the case; and
  - (c) Stress the importance of retaining copies of the sales material for future reference; and
- Keep a copy of the letter or other verification in the policy file at the home or regional office for at least five years after the termination or expiration of the policy or contract.

### 3. Duties of the Existing Insurer [Section 6].

a. Where a replacement is involved in the transaction, the existing insurer shall:

(1) Upon notice that its existing policy or contract may be replaced or a policy may be part of a financed purchase, *retain copies* of the notification in its home or regional office, *indexed by replacing insurer*, notifying it of the

replacement for at least five years or until the conclusion of the next regular examination conducted by the Insurance Department of its state of domicile, whichever is later.

(2) Send a letter to the policy or contract owner of the right to receive information regarding the existing policy or contract values including, if available, an in force illustration or policy summary if an in force illustration cannot be produced within five business days of receipt of a notice that an existing policy or contract is being replaced. The information shall be provided within five business days of receipt of the request from the policy or contract owner.

(3) Upon receipt of a request to borrow, surrender or withdraw any policy or contract values, send to the applicant a notice, advising the policy or contract owner of the effect release of policy or contract values will have on the non-guaranteed elements, face amount or surrender value of the policy or contract from which the values are released. The notice shall be sent separate from the check if the check is sent to anyone other than the policy or contract owner. In the case of *consecutive automatic premium loans or systematic withdrawals* from a contract, the insurer is only required to send the notice at the time of the first loan or withdrawal.

#### 4. Duties of Producers [Section 4].

- a. A producer who initiates an application must submit to the insurer, with or as part of the application, a statement signed by both the applicant and the producer as to whether the applicant has existing policies or contracts. If the answer is "no," the producer's duties with respect to replacement are complete.
- b. If the applicant answered "yes" to the question regarding existing coverage referred to in Subsection (A), the producer shall present and read to the applicant, not later than at the time of taking the application, a notice regarding replacements in the form as described in Attachment 1 to the regulation or other substantially similar form approved by the commissioner. *The notice shall be signed by both the applicant and the producer* attesting that the notice has been read aloud by the producer or that the applicant did not wish the notice to be read aloud (in which case the producer need not have read the notice aloud) and left with the applicant.
- c. The notice shall list all life insurance policies or annuities

proposed to be replaced, properly identified by name of insurer, the insured or annuitant, and policy or contract number if available; and shall include a statement as to whether each policy or contract will be replaced or whether a policy will be used as a source of financing for the new policy or contract. If a policy or contract number has not been issued by the existing insurer, alternative identification, such as an application or receipt number, shall be listed.

- d. In connection with a replacement transaction *the producer shall leave with the applicant* at the time an application for a new policy or contract is completed *the original or a copy of all sales material*. With respect to electronically presented sales material, it shall be provided to the policyholder in printed form no later than at the time of policy or contract delivery.
- e. Except as provided in Section 5(C) of the regulation, in connection with a replacement transaction the producer shall submit to the insurer to which an application for a policy or contract is presented, a copy of each document required by this section, *a statement identifying any preprinted or electronically presented company approved sales materials used, and copies of any individualized sales materials, including any illustrations used in the transaction*

#### H. Selected Definitions

- 1. Section 2(D) defines the term *financed purchase* as “the purchase of a new policy involving the actual or intended use of funds obtained by the withdrawal or surrender of, or by borrowing from values of an existing policy to pay all or part of any premium due on the new policy.”
  - a. If a withdrawal, surrender, or borrowing involving the policy values of an existing policy are used to pay premiums on a new policy owned by the same policyholder *within thirteen months before or after the effective date of the new policy* and is known by the replacing insurer, or if the withdrawal, surrender, or borrowing is shown on any illustration of the existing and new policies made available to the prospective policyowner by the insurer or its producers, it will be *deemed prima facie evidence of a financed purchase*.
- 2. Section 2(I) defines the term registered contract as “a variable annuity contract or variable life insurance policy subject to the prospectus delivery requirements of the Securities Act of 1933.”

I. Several aspects of the amended NAIC model regulation parallel SEC and FINRA positions concerning Section 1035 exchanges and bonus annuity sales.

1. Selected list of parallel regulatory concepts

- a. FINRA Guideline on Variable Life Insurance Distribution: NTM 00-44 (June 2000).
- b. FINRA Guidelines on Supervisory Responsibilities: NTM 99-45 (June 1999).
- c. FINRA Statement on Variable Annuity Distribution: NTM 99-35 (May 1999).
- d. SEC Office of Compliance Inspections and Examinations: Indicators of “Good” Internal Controls in Variable Contract Distribution.

(1) A compilation of the SEC’s indicators drawn from speeches and seminar comments is discussed in Wilkerson, *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 20.

e. SEC Examination of Variable Annuity “Bonus” Programs

(1) Several of the items requested in the SEC’s inspection letter requested documents and information that the amended NAIC Model Replacement Regulation also addresses.

(a) Scope of documents requested in the SEC’s examinations was outlined in *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 6.

a. FINRA and SEC inspection sweeps focusing on “Section 1035 exchanges” of variable contracts and “life financing” arrangements (1998 and 1996.)

(1) These sweeps and the documentation they elicited were discussed in *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 11 and 15.

## Attachment 1 to this Outline on the Model Replacement Regulation

### IMPORTANT NOTICE: REPLACEMENT OF LIFE INSURANCE OR ANNUITIES

*This document must be signed by the applicant and the producer, if there is one, and a copy left with the applicant.*

You are contemplating the purchase of a life insurance policy or annuity contract. In some cases this purchase may involve discontinuing or changing an existing policy or contract. If so, a replacement is occurring. Financed purchases are also considered replacements.

A replacement occurs when a new policy or contract is purchased and, in connection with the sale, you discontinue making premium payments on the existing policy or contract, or an existing policy or contract is surrendered, forfeited, assigned to the replacing insurer, or otherwise terminated or used in a financed purchase.

A financed purchase occurs when the purchase of a new life insurance policy involves the use of funds obtained by the withdrawal or surrender of or by borrowing some or all of the policy values, including accumulated dividends, of an existing policy, to pay all or part of any premium or payment due on the new policy. A financed purchase is a replacement.

You should carefully consider whether a replacement is in your best interests. You will pay acquisition costs and there may be surrender costs deducted from your policy or contract. You may be able to make changes to your existing policy or contract to meet your insurance needs at less cost. A financed purchase will reduce the value of your existing policy or contract and may reduce the amount paid upon the death of the insured.

We want you to understand the effects of replacements before you make your purchase decision and ask that you answer the following questions and consider the questions on the back of this form.

1. Are you considering discontinuing making premium payments, surrendering, forfeiting, assigning to the insurer, or otherwise terminating your existing policy or contract? \_\_\_ YES \_\_\_ NO

2. Are you considering using funds from your existing policies or contracts to pay premiums due on the new policy or contract? \_\_\_ YES \_\_\_ NO

If you answered "yes" to either of the above questions, list each existing policy or contract you are contemplating replacing (include the name of the insurer, the insured, and the contract number if available) and whether each policy will be replaced or used as a source of financing:

**INSURER NAME**  
**CONTRACT OR POLICY#**  
**INSURED OR ANNUITANT: REPLACED (R) OR FINANCING (F)**

- 1.
- 2.
- 3.

Make sure you know the facts. Contact your existing company or its agent for information about the old policy or contract. [If you request one, an in force illustration, policy summary or available disclosure documents must be sent to you by the existing insurer.] Ask for and retain all sales material used by the agent in the sales presentation. Be sure that you are making an informed decision.

The existing policy or contract is being replaced because \_\_\_\_\_  
\_\_\_\_\_.

I certify that the responses herein are, to the best of my knowledge, accurate:

\_\_\_\_\_

Applicant's Signature and Printed Name

\_\_\_\_\_

Date

\_\_\_\_\_

Producer's Signature and Printed Name

\_\_\_\_\_

Date

\_\_\_\_\_

I do not want this notice read aloud to me. \_\_\_\_\_ (Applicants must initial only if they do not want the notice read aloud.)

A replacement may not be in your best interest, or your decision could be a good one. You should make a careful comparison of the costs and benefits of your existing policy or contract and the proposed policy or contract. One way to do this is to ask the company or agent that sold you your existing policy or contract to provide you with information concerning your existing policy or contract. This may include an illustration of how your existing policy or contract is working now and how it would perform in the future based on certain assumptions. Illustrations should not, however, be used as a sole basis to compare policies or contracts. You should discuss the following with your agent to determine whether replacement or financing your purchase makes sense:

PREMIUMS: Are they affordable?  
Could they change?  
You're older--are premiums higher for the proposed new policy?  
How long will you have to pay premiums on the new policy? On the old policy?

POLICY VALUES: New policies usually take longer to build cash values and to pay dividends.  
Acquisition costs for the old policy may have been paid, you will incur costs for the new one.  
What surrender charges do the policies have?  
What expense and sales charges will you pay on the new policy?  
Does the new policy provide more insurance coverage?

INSURABILITY: If your health has changed since you bought your old policy, the new one could cost you more, or you could be turned down.  
You may need a medical exam for a new policy.  
Claims on most new policies for up to the first two years can be denied based on inaccurate statements.  
Suicide limitations may begin anew on the new coverage.

IF YOU ARE KEEPING THE OLD POLICY AS WELL AS THE NEW POLICY:

How are premiums for both policies being paid?  
How will the premiums on your existing policy be affected?  
Will a loan be deducted from death benefits?  
What values from the old policy are being used to pay premiums?

IF YOU ARE SURRENDERING AN ANNUITY OR INTEREST SENSITIVE LIFE PRODUCT:

Will you pay surrender charges on your old contract?  
What are the interest rate guarantees for the new contract?  
Have you compared the contract charges or other policy expenses?

OTHER ISSUES TO CONSIDER FOR ALL TRANSACTIONS:

What are the tax consequences of buying the new policy?  
Is this a tax free exchange? (See your tax advisor.)  
Is there a benefit from favorable "grandfathered" treatment of the old policy under the federal tax code?  
Will the existing insurer be willing to modify the old policy?

How does the quality and financial stability of the new company compare with your existing company?

**(Attachment 2 to Replacement Outline)**

**NOTICE REGARDING REPLACEMENT  
REPLACING YOUR LIFE INSURANCE POLICY OR ANNUITY?**

Are you thinking about buying a new life insurance policy or annuity and discontinuing or changing an existing one? If you are, your decision could be a good one--or a mistake. You will not know for sure unless you make a careful comparison of your existing benefits and the proposed policy or contract's benefits.

Make sure you understand the facts. You should ask the company or agent that sold you your existing policy or contract to give you information about it.

Hear both sides before you decide. This way you can be sure you are making a decision that is in your best interest.

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## **NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities**

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation American Council of Life Insurers © 2017 All Rights Reserved.

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### **I. NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities.**

- A. This NAIC regulation directly parallels the North American Securities Administrators Association (NASAA) credentialing regulations and was developed in close coordination with NASAA and supported by NASAA.
- B. See [http://www.nasaa.org/content/Files/Senior\\_Model\\_Rule110807.pdf](http://www.nasaa.org/content/Files/Senior_Model_Rule110807.pdf)
- C. The NAIC regulation and an accompanying bulleting can be obtained on the NAIC website at [http://www.naic.org/Releases/2008\\_docs/senior\\_sales.htm](http://www.naic.org/Releases/2008_docs/senior_sales.htm) .

### **II. Purpose of the NAIC Regulation**

- A. The regulation establishes standards to protect consumers from misleading and fraudulent marketing practices with respect to the use of senior-specific certifications and professional designations in the solicitation, sale or purchase of, or advice made in connection with, a life insurance or annuity product.
- B. The regulation will apply to any solicitation, sale or purchase of, or advice made in connection with, a life insurance or annuity product by an “insurance producer,” that is defined as a person required to be licensed under the laws of this State to sell, solicit or negotiate insurance, including annuities.

### **III. Prohibited Uses of Senior-Specific Certifications and Professional Designations [Section 5]**

- A. Under the regulation, it will be an unfair and deceptive act or practice in the business of insurance within the meaning of the Unfair Trade Practices Act for an insurance producer to use a senior-specific certification or professional designation that indicates or implies in such a way as to mislead a purchaser or prospective purchaser that insurance producer has special certification or training in advising or servicing seniors in connection with the solicitation, sale or purchase of a life insurance or annuity product or in the provision of advice as to the value of or the advisability of purchasing or selling a life insurance or annuity product, either directly or indirectly through publications or writings, or by issuing or promulgating analyses or reports related to a life insurance or annuity product.

B. The prohibited use of senior-specific certifications or professional designations includes, but is not limited to, the following:

1. Use of a certification or professional designation by an insurance producer who has not actually earned or is otherwise ineligible to use such certification or designation;
2. Use of a nonexistent or self-conferred certification or professional designation;
3. Use of a certification or professional designation that indicates or implies a level of occupational qualifications obtained through education, training or experience that the insurance producer using the certification or designation does not have; and
4. Use of a certification or professional designation that was obtained from a certifying or designating organization that:
  - a) Is primarily engaged in the business of instruction in sales or marketing;
  - b) Does not have reasonable standards or procedures for assuring the competency of its certificants or designees;
  - c) Does not have reasonable standards or procedures for monitoring and disciplining its certificants or designees for improper or unethical conduct; or
  - d) Does not have reasonable continuing education requirements for its certificants or designees in order to maintain the certificate or designation.
5. Under the regulation, there is a rebuttable presumption that a certifying or designating organization is not disqualified solely for purposes of subsection A(2)(d) when the certification or designation issued from the organization does not primarily apply to sales or marketing and when the organization or the certification or designation in question has been accredited by:
  - a) The American National Standards Institute (ANSI);
  - b) The National Commission for Certifying Agencies; or
  - c) Any organization that is on the U.S. Department of Education's list entitled "Accrediting Agencies Recognized for Title IV Purposes."
6. In determining whether a combination of words or an acronym standing for a combination of words constitutes a certification or

professional designation indicating or implying that a person has special certification or training in advising or servicing seniors, factors to be considered shall include:

- a) Use of one or more words such as “senior,” “retirement,” “elder,” or like words combined with one or more words such as “certified,” “registered,” “chartered,” “advisor,” “specialist,” “consultant,” “planner,” or like words, in the name of the certification or professional designation; and
- b) The manner in which those words are combined.

7. For purposes of this NAIC regulation, a job title within an organization that is licensed or registered by a State or federal financial services regulatory agency is not a certification or professional designation, unless it is used in a manner that would confuse or mislead a reasonable consumer, when the job title:

- a) Indicates seniority or standing within the organization; or
- b) Specifies an individual’s area of specialization within the organization.

8. Under this subsection, financial services regulatory agency includes, but is not limited to, an agency that regulates insurers, insurance producers, broker-dealers, investment advisers, or investment companies as defined under the Investment Company Act of 1940.

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**The Impact of State Insurance Consulting Laws and Related Provisions on  
Insurance Producers Performing Financial Planning Services**

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**I. The Impact of State Insurance Consulting Laws and Related Provisions on  
Insurance Producers Performing Financial Planning Services**

A. Background

1. A degree of variability exists in state insurance statutes and regulations concerning financial planning by life insurance agents.
2. Careful review of the various state laws and regulations is valuable in confirming proper procedures and activities.

B. NAIC Unfair Trade Practices Act provisions governing financial planning:

1. §2(M) of the NAIC Unfair Trade Practices Act defines an unfair financial planning practice by an insurance producer to be:
  - a) Holding himself or herself out directly or indirectly to the public as they "financial planner," "investment advisor," "consulted," "financial counselor," or any other specialists engaged in the business of giving financial planning for advice relating to investments, insurance, real estate tax matters or trust and estate matters when such person is in fact engaged only in the sale of policies.
  - b) Engaging in the business of financial planning without disclosing to the client prior to the execution of the agreement provided for in paragraph 3 [of this regulation], or solicitation of the sale of a product or service that:
    - (1) He or she is also an insurance salesperson, and
    - (2) That a commission for the sale of the insurance products will be received in addition to a fee for financial planning, if such is the case.

c) This NAIC provision forbids fees other than commission for financial planning by insurance producers, unless such fees are based upon a written agreement, signed by the client in advance; a copy of the agreement must be given to the client at the time it is signed.

### C. Insurance Consulting Laws

1. Many states have adopted statutes or regulations generally referred to as "insurance consulting" provisions that seek to protect insurance product policyholders by preventing the receipt of insurance commissions and insurance consulting fees concerning the same sale.

2. It is unlikely that this body of law was intended to govern broad-spectrum of financial planning conducted by insurance agents in today's market. Nonetheless, financial planning and investment advisory activities could inadvertently trigger the scope and terms of the insurance consulting laws.

a) Insurance consulting laws evolved to address problems of a traditional life insurance environment, not more recent developments such as financial planning for investment advice.

b) While the application of the insurance consulting laws to financial planning is not clear, potential coverage could be triggered in two ways:

(1) Fee and commission financial planning arrangements that also involve a recommendation and ultimate purchase of insurance product;

(2) Commission only financial planning arrangements that involve the recommendation and ultimate purchase of an insurance product.

c) Insurance consulting laws generally fall into two categories:

(1) States prohibiting insurance agents from receiving both consulting fees and sales commissions in connection with the same assurance product sale.

(a) See, e.g., Connecticut Insurance Code §38 – 92h (an individual serving as a quote certified insurance consultant" is prohibited from receiving both sales commission and a consultant's commission in connection with the sale of insurance).

(2) States permitting insurance agents to obtain both consulting fees and sales commissions in connection with the same insurance product sale, providing clear

disclosure about the joint receipt of a fee and commission is communicated.

(a) See, e.g., Arkansas Insurance Department Bulletin No. 1185 (May 10, 1985): "the obvious intent of this section [§66 -- 3023 (3)] is to permit genuine utilization of the [property/casualty and life/disability] agent's expertise, for compensation, but to require proper disclosure to the client and to prevent price gouging by unscrupulous persons."

(b) See also, New Mexico Insurance Rule 80-3-6 (c) which states that "terms such as financial planner, investment advice or, financial consultant, or financial counseling shall not be used in such a way as to imply that the insurance agent is generally engaged in an advisory business in which compensation is unrelated to sales, unless such is actually the case.

(3) A compilation of state laws and regulations about insurance consulting laws and investment advisor provisions is set forth below.

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**A Comprehensive System of State Regulation Governs  
the Distribution of Insurance and Annuity Contracts**

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**A. State Insurance Regulation**

Through a network of statutes and regulations, state insurance departments heavily regulate the operations, products, and sales of life insurance companies. Life insurers and their salespersons must satisfy this regulatory structure in their state of domicile and every jurisdiction in which they distribute life insurance and annuities. Uniformity of regulation is accomplished throughout the states by means of model statutes and regulations promulgated by the National Association of Insurance Commissioners (the "NAIC"). Many of the insurance statutes and regulations promulgated and enforced by state insurance departments fulfill regulatory goals quite similar to those of the state securities administrators. The summary below highlights the broad scope and comprehensiveness of certain state insurance statutes and regulations. While only a small portion of the larger universe of state insurance regulation, this regulations are directly relevant in evaluating the market conduct structure governing insurance salespersons engaged in the delivery of financial planning and broker-dealer services. This discussion is intended to fill in other areas not covered in the preceding outline materials to this submission.

**B. Unfair Trade Practices**

Virtually every state has enacted a version of the NAIC Model Unfair Trade Fair Practices Act which was developed to regulate trade practices in the insurance business by defining and prohibiting practices that constitute unfair methods of competition or unfair deceptive acts or practices.<sup>1</sup>

A variety of the activities defined to be unfair trade practices directly parallel the purpose and scope of state securities codes. Section 4(A) involves misrepresentations and false advertising of insurance policies, and identifies unfair trade practices to include any estimate, illustration, circular or statement, sales misrepresentation, omission or comparison that misrepresents the benefits, advantages, conditions or terms of any policy, among other things.

Section 4(B) involves false information and advertising generally. This provision defines an unfair trade practice to include making, publishing or disseminating in a newspaper, magazine or other publication, on any radio/television station any assertion,

<sup>1</sup>This model statute governs items previously subject to Section 5 of The Federal Trade Commission Act. Congress observed that continued regulation of insurance by the states was in the public interest. See, legislative history of NAIC Unfair Trade Practices Act, NAIC Model Regulation Service at 880-20(1993).

representation or statement about an insurer or its business, which is untrue, deceptive or misleading.

Knowingly making any false statement of any material fact to insurance regulators, or in documents that will be publicly disseminated, is defined to be an unfair trade practice in Section 4(B) of the Model Unfair Trade Practices Act. This proscription is consistent with the truthfulness and accuracy of reports, records and representations required of Broker/Dealers by the NASD and the SEC under the federal securities laws.

Section 4(J) involves the failure to maintain marketing and performance records, and defines as an unfair trade practice the failure of an insurer to maintain its books, records, documents, and other business records in such an order that data regarding complaints, claims, reading, underwriting and marketing are accessible and retrievable for examination by the insurance commissioner. Data for at least the current calendar year in the two preceding years must be maintained under this standard. This provision directly parallels the scope and purpose of NASD Conduct Rule 3110 regarding books and records.

Section 4(K) defines the failure of any insurer to maintain a complete record of all the complaints it received since the date of its last market conduct examination to be an unfair trade practice. The records of complaints must indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint and the time it took to process each.<sup>2</sup> For purposes of this subsection, the term “complaint” means any written communication primarily expressing a grievance.

Like state securities administrators, insurance commissioners have the power to examine and investigate the affairs of every insurer operating in the insurance department’s state “in order to determine whether such insurer has been or is engaged in any unfair trade practice prohibited by [the Unfair Trade Practices Act].”<sup>3</sup> Several provisions embellish this important authority.

For example, Section 7 of the Unfair Trade Practices Act gives insurance commissioners extensive authority to initiate hearings concerning unfair trade practices, to compel witnesses, appearances, production of books, and service of process. Section 7 sets forth detailed administrative and procedural practices, in order to assure due process and quasi-judicial formality.

Section 8 of the Unfair Trade Practices statute authorizes insurance commissioners finding insurers guilty of unfair trade practices to issue written findings and enforcement orders requiring the insurer to cease and desist from engaging in the act or practice. The insurance commissioner also has the discretionary authority to suspend and revoke

<sup>2</sup>The NAIC has also promulgated a Model Regulation for Complete Records to be maintained pursuant to Section 4(K) of the NAIC Unfair Trade Practices Act. See, NAIC Model Regulation Service at 844-1(1992). This regulation sets forth a complaint record form, content requirements, maintenance requirements, and standards concerning the format of complaint records.

<sup>3</sup> See Section 6, Power of Commissioner, Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-9(1993).

the insurer's license if the insurer knew or reasonably should have known that its conduct violated the Unfair Trade Practices Act, and to order penalties of \$1,000 for each violation up to an aggregate penalty of \$100,000, unless the violation was committed flagrantly in conscious disregard of the act, in which case the penalty may be up to \$25,000 for each violation to an aggregate total penalty of \$250,000. A similar monetary violation may be imposed under Section 11 for violations of cease and desist orders. The act also provides for judicial review of insurance commissioner orders and authorizes immunity from prosecution for witnesses who attend, testify or produce books, records or other paper correspondence.<sup>4</sup>

These significant powers that may be used by insurance commissioners to enforce violations of unfair trade practice proscriptions, together with the recordkeeping, reporting and inspection powers of the Act, provide a package of regulatory tools directly analogous to state securities codes, the NASD Rules of Conduct and SEC regulations governing market conduct practices and the prosecution of violations. In a sum, the unfair trade practice laws provide meaningful proscriptions that eliminate the need for duplicative regulation of variable contracts.

### **C. NAIC Model Fraud Laws and Fraud Legislation**

Enactment of state fraud statutes represents another significant insurance regulatory development. Recent market conduct issues have resulted in some insurance departments requiring insurer management to assume increased responsibility for supervision of sales activities. Other states have taken an approach similar to that of New York and Pennsylvania by requiring insurer review of market conduct compliance, thus placing direct responsibility at the corporate officer level. This widespread action dovetails with the objectives of the Federal Crime Control Statute and the Federal Sentencing guidelines, discussed below.

While states have taken different approaches to the issue, the majority of states addressing the fraud issue enacted legislation similar to the NAIC Model Fraud Laws.<sup>5</sup>

### **D. Market Conduct Examinations**

Nearly every jurisdiction has enacted a version of the NAIC Model Law on Examinations.<sup>6</sup> This Act is designed to provide an effective and efficient system for examining the activities, operations, financial condition and affairs of all persons transacting the business of insurance in each state and concerning individuals otherwise subject to the insurance commissioner's jurisdiction. The Act is intended to enable commissioners to adopt a flexible system of examinations and allocate resources deemed appropriate and necessary for the administration of the insurance laws of each state. The Model Law on Examinations sets forth standards for the conduct of

<sup>4</sup>See Sections 8, 9, 10, 11 and 14 of the Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-10 through 13(1994).

<sup>5</sup>See NAIC Insurance Fraud Prevention Model Act, NAIC Model Reporting Service at 680-1(1995).

<sup>6</sup>See NAIC Model Regulation Service at 390-1(1991).

examinations, commissioner authority, scope, and scheduling of examinations. It also details the scope of examination reports which shall be comprised of only facts appearing on books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined.<sup>7</sup>

Significantly, this Model Act dovetails with the NAIC Market Conduct Examiner's Handbook, an extremely detailed manual for examiners to assure that examiners follow comprehensive, uniform practices and procedures. The Examiner's Handbook is divided into seven different sections and contains 58 different standards. Among other things, the Examiner's Handbook addresses complaint handling, marketing and sales, producer licensing, and company operations/management.<sup>8</sup>

<sup>7</sup>See Sections 3, 4, and 5 of the Model Law on Examinations, NAIC Model Regulation Service at 390-5 (1991). Section 5 also sets forth detailed provisions for orders and administrative procedures in the conduct of hearing and adoption of a report on examination.

<sup>8</sup>Certain standards under the complaint handling section illuminate the depth and scope of the market conduct examination. Several standards are set forth below in this note as representative examples.

#### Complaint Handling-**Standard 2**

The company has adequate complaint handling procedures in place and communicates such procedures to policyholders.

##### **Review Procedures and Criteria**

Review manuals to verify complaint procedures exist. Procedures in place should be sufficient to require satisfactory handling of complaints received as well as internal procedures for analysis in areas developing complaints. There should be a method for distribution of and obtaining and recording response to complaints. This method should be sufficient to allow response within the time frame required by state law.

Company should provide a telephone number and address for consumer inquiries.

#### Complaint Handling-**Standard 3**

The company should take adequate steps to finalize and dispose of the complaint in accordance with applicable statutes, rules and regulations and contract language.

##### **Review Procedures and Criteria**

Review complaints documentation to determine if the company response fully addresses the issues raise. If the company did not properly address/resolve the complaint, the examiner should ask company what corrective action it intends to take.

##### **Commentary:**

Reference to the examiner's general instructions on Handbook page VIII-14 (November 1995) reveals that an inquiry broader in scope than the mere resolution of a given complaint is expected. For example, the Handbook contains the following instructions: "The examiner should review the frequency of similar complaints and be aware of any pattern of specific type of complaints....Should the types of complaints generated be cause for unusual concern, specific measures should be instituted to investigate other areas of the company's operation."

#### Complaint Handling-**Standard 4**

Throughout most of 1995 and 1996, the NAIC significantly revised the Market Conduct Examiner's Handbook. The NAIC, together with industry input, sought to expand and enhance tools fostering the detection and prevention of marketplace abuse in the life insurance industry. Market conduct examinations are extremely comprehensive and serve as a means of positive reinforcement, by discouraging deficient practices that will be detected on examination, resulting in remedial action, and insurance department intervention.

### **E. Agents' Licensing and Testing**

The NAIC Agents and Brokers Licensing Model Act,<sup>9</sup> which appears virtually in every state, governs the qualifications and procedures for licensing insurance and annuity agents and brokers. This model law sets forth examination and licensing standards in great detail, and has a specific category for variable annuities and variable life insurance contracts. Licensed salespeople must be deemed by the insurance commissioner to be competent, trustworthy, financially responsible, and of good personal and business reputation. Insurance brokers must also fulfill experience requirements. Section 8 of this regulation governs license denial, non-renewal and termination, giving the insurance commissioner broad discretion to suspend, revoke or refuse to issue or renew a license upon finding any of a variety of conditions including materially untrue statements, violation or noncompliance with insurance laws, withholding, misappropriating or converting customer moneys, conviction of a felony or misdemeanor involving moral turpitude, forgery, or cheating on licensing examinations, among other things.

### **F. Agent Investigation: Character and Background Investigation Requirements**

Most jurisdictions require that insurance producer license applicants be competent, trustworthy, and of good moral character in order to obtain a license. However, some now expressly require appointing insurers to certify that they have investigated the applicant's character and background and have found the applicant to be qualified and worthy of a license. Similar to FINRA, some jurisdictions implement fingerprinting as part of the background check. Related to these requirements is the portion of the NAIC Producer Licensing Model Act that allows the commissioner to refuse to issue an insurance producer's license if the commissioner finds that the individual has committed any act that is a ground for denial, suspension or revocation of the license. A law survey on this topic appears at the end of this segment of the appendix.

### **G. Continuing Education for Agents and Brokers**

In granting insurance agents and brokers licenses, most states also impose significant continuing education standards that parallel in objective and scope the continuing

The time frame within which the company responds is in accordance with applicable statutes, rules, and regulations.

#### **Review Procedures and Criteria**

Review complaints to ensure company is maintaining adequate documentation. Determine if the company response is timely. The examiner should refer to state laws for the required time frame.

<sup>9</sup>See NAIC Model Regulation Service at 210-1 (2008).

education standards recently developed by the securities industry together with the NASD. As in other areas seeking uniformity, the NAIC has promulgated the Agents and Brokers Licensing Model Act.<sup>10</sup> Under Section 5 of this model regulation, licensed agents must annually satisfy courses or programs of instruction approved by insurance commissioners in each state according to a minimum number of classroom hours, which typically is in the range of 25 class room hours per year for life and annuity salespersons. The courses include those presented by the Life Underwriter Training Council Life Course Curriculum, the American College's Chartered Life Underwriter and Chartered Financial Planner curriculum, and the Insurance Institute of America's programs in general insurance, for example. Like FINRA's initial and ongoing educational requirements for registered representatives, state insurance regulators understand that testing, licensing and demonstration of continued competence through continuing education is critically important in the distribution of insurance and annuity products. A law survey on this topic appears at the end of this segment of the appendix.

## **H. Variable Contract Statutes**

Life insurance companies are authorized to issue separate accounts funding variable life insurance and annuity contracts upon fulfilling a variable contract statute in their domestic state, which typically follows the NAIC Model Variable Contract Law.<sup>11</sup> This NAIC model statute gives the insurance commissioner exclusive authority to regulate the issuance and sale of variable contracts and to issue rules and regulations appropriate to carry out the act's purpose. This model act and associated regulations that appear under state insurance law gives an additional, important measure of regulatory scrutiny and purchaser protection.

Collectively, the NAIC statutes and regulations provide a significant network of comprehensive regulation over many important aspects affecting the marketing and sale of variable contracts that closely reflect the purpose and scope of analogous concepts of securities regulation.

## **I. Insurance Producer Database**

From a market conduct perspective, life insurers have committed to a single, industry-accessible national producer database to facilitate their ability to track pertinent information regarding licensed producers. Access to information having a bearing on the producer's background, qualifications and competency is a valuable tool to insurers in the employment/appointment screening process. Moreover, widespread availability of such information makes it more difficult for a producer with significant disciplinary history to continue illegal or unethical practices by "company jumping."

NIPR ([National Insurance Producer Registry](#)) is a non-profit affiliate of the National Association of Insurance Commissioners (NAIC). It was created in October 1996 to develop and operate a national repository for producer license information (PDB) and to establish a network to facilitate the electronic exchange of producer information.

<sup>10</sup>See NAIC Model Regulation Service at 215-1 (2015).

<sup>11</sup>See NAIC Model Regulation Service at 260-1 (2015).

The Producer Database (PDB) is an electronic database consisting of information relating to insurance agents and brokers (producers) accessible through the NIPR Gateway on a subscription basis through the Internet. Internet PDB links participating state regulatory licensing systems into one common system establishing a repository of producer information. Internet PDB also contains or references producer information from sources such as the Regulatory Information Retrieval System (RIRS) of the NAIC. Its development is based, in part, on the belief that the widespread availability of such information will make it more difficult for a producer with significant disciplinary history to continue illegal or unethical practices.

The NIPR Gateway is an electronic communication network that links state insurance regulators with the entities they regulate to facilitate the electronic exchange of producer information; including license applications, appointments, and terminations. To date, data standards have been developed for the exchange of appointment and not-for-cause termination information. All data flowing through the NIPR Gateway will conform to these standards.

Through Internet PDB, industry is able to access all public information related to a producer provided by participating states, including licensing, demographics and final regulatory actions. The product is designed to assist insurers in exercising due diligence in the monitoring of agents and brokers to reduce the incidence of fraud. Currently, Internet PDB contains information on over 2.9 million producers. Information available includes:

- Demographics-name, date of birth, addresses
- License Summary-state of license, license number, issue date, expiration date, license type/class, residency, lines of authority, status, status reason, status/reason effective date.
- Continuing Education-CE compliance indicator, CE renewal date, CE credits needed.
- Certificates and Clearance-date issued, issuing state, receiving state, certification or clearance indicator.
- Regulatory Actions-State of action, entity role, origin of action, reason for action, enter date penalty/fine/forfeiture, effective date, file reference, time/length of dates.
- Appointment Information-Effective date, termination date, reasons for termination.

Currently all 50 states, DC and PR participate in the PDB.

In many respects, this producer data base parallels the purpose and scope of FINRA's Central Records Depository or CRD. Through the NIPR data base, problem producers can be tracked and deterred from the insurance business.

The NAIC [Buyer's Guide for Deferred Annuities](#) provides plain-English, streamlined, simplified disclosure about fixed, variable and index annuities that allows apples to apples comparisons essential to informed purchase decisions. It contains a valuable list of core questions that consumers should ask salesperson when considering an annuity. The Buyer's Guide is not attached to this Appendix because of its digital size. We recommend clicking through the above link to fully visualize the valuable content, readability, and its use of white space and color.