LIFE INSURANCE ASSOCIATION OF MASSACHUSETTS

Office of the Secretary of the Commonwealth
Attn: Proposed Regulations – Fiduciary Conduct Standard
Massachusetts Securities Division
One Ashburton Place, Room 1701
Boston, MA 02108

January 7, 2020

Re: Proposed Massachusetts Fiduciary Standard of Conduct for Broker-Dealers, Agents and Investment Advisers.

Dear Secretary Galvin:

The American Council of Life Insurers[1] (ACLI) and the Life Insurance Association of Massachusetts (LIAM) offer joint comments on the Division of Securities' proposed fiduciary standard of conduct under the Massachusetts Securities Code published December 13, 2019.[2] The initiative would add a new provision to 950 CMR 12.200 that purports to establish "a fundamental conduct standard requiring broker-dealers, agents and investment advisers to adhere to the common-law fiduciary duties of utmost loyalty and care when dealing with their customers and clients."[3] In addition to imposing common law fiduciary status and obligations, the fiduciary standard requires recommendations and advice to be made in the best interest of customers and clients without regard to the interests of the broker-dealer or advisory firm or its personnel.

[1] The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry.90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits.

ACLI's 280 member companies represent 94 percent of industry assets in the United States. In Massachusetts, 224 ACLI members are licensed to conduct business and, as of January 1, 2020, these life insurers authorized to conduct business in Massachusetts represent $11,007,967,594 in total annuity considerations in Massachusetts (98% of the industry) and $3,610,366,500 in life insurance premiums in Massachusetts (94% of the industry). Our members' premiums on Disability Insurance and Long Term Care Insurance in Massachusetts were $770,000,000 and $281,000,000, respectively (2018). For further information about ACLI see https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/Public-About-ACLI/AboutACLI_2019.ashx?la=en

The Life Insurance Association of Massachusetts is a trade association representing 18 of the nation's leading life, long term care and disability income insurers. LIAM develops consensus on issues of importance to the industry and represents its members before the Massachusetts legislature and state government agencies.

[2] http://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Notice-of-Comment-Period-and-Public-Hearing.pdf
[3] The fiduciary standard would apply to broker-dealers, agents, investment advisers, and investment adviser representatives when providing investment advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the transferring of assets to any type of account.

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Retirement savers deserve regulatory standards that assure continued access to a wide variety of retirement products, retirement savings information, and related financial guidance from financial professionals. ACLI and LIAM support appropriately tailored uniform standards requiring all financial sales professionals to act in the best interest of their customers. But far from helping retirement savers, Massachusetts' proposed fiduciary conduct standard would harm retirement savers by constricting their access to valuable products and interfering with their access to information critical to making informed decisions. ACLI and LIAM submitted comments[4] on the precursor to the proposal that was published on June 14, 2019.

The proposed Massachusetts fiduciary regulation would violate state and federal law in several respects. Among other things, the regulation is arbitrary and capricious, unsupported by substantial evidence, and contrary to law under the Massachusetts Administrative Procedure Act. The proposal would violate the Massachusetts and U.S. Constitutions and is preempted by federal statutes and regulations.

Summary of Position

- Life insurers create and market products and services that fulfill consumers' retirement, estate, tax, and financial planning needs. ACLI and LIAM support appropriately tailored uniform standards requiring all financial sales professionals to act in the best interest of their customers while assuring that they continue to have access to a wide variety of retirement products and the information necessary to make informed decisions.
- Reasonable, uniformly implemented standards serve the best interests of consumers and financial professionals alike, avoid conflicting or duplicative regulatory standards, and preclude harmful regulatory arbitrage.
- The proposed fiduciary regulation is the opposite of an appropriately tailored uniform standard. The proposed fiduciary regulation exceeds the Securities Division's statutory authority and conflicts with other Massachusetts statutes; contradicts and is preempted by Federal securities laws; contains undefined and ambiguous terms; violates the U.S. Constitution in several respects; and constructs an aberrational regulatory patchwork that will ultimately harm, not help, retirement savers.
- Congress gave the SEC the authority to establish new conduct standards for broker-dealers and after a lengthy administrative process, the SEC has done so by promulgating Regulation Best Interest (Reg BI)[5]. Yet, the proposed fiduciary regulation (which is openly based on the State's disagreement with the SEC's policy choices) would prohibit activity expressly and deliberately permitted under the SEC's Reg BI. The proposed regulation is thus preempted under express preemption standards, including under the National Securities Markets Improvements Act, which precludes state securities administrators from adopting conflicting regulations.
- The proposed fiduciary regulation unreasonably overlooks more robust protections of consumers recently adopted by the SEC soon to be adopted by the National Association of Insurance Commissioners (NAIC) that address the same regulatory concerns and obviate the need for additional regulation. The proposed fiduciary regulation fails to identify a sufficient need for substantial new regulatory burdens, fails to consider more protective regulation, and unreasonably dismisses the costs of new regulation.

[4] https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/preliminarycomments/2019-07-26-Life-Insurance-Association-of-Massachusetts-and-American-Council-of-Life-Insurers.pdf
[5] https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf

- By creating regulatory uncertainty and new and excessive compliance burdens, the proposed regulation will cause a contraction in the delivery of financial and retirement products to the detriment of Massachusetts citizens.

I. The Proposed Regulation Improperly Usurps Legislative Functions: The Division of Securities Lacks Statutory Authority to Adopt by Regulation a Fiduciary Duty for Broker-Dealers

Neither the Massachusetts Uniform Securities Act nor the federal securities laws contain a fiduciary duty for broker-dealers or investment advisers. Rather, fiduciary duty evolved from judicial decisions that interpreted a common law fiduciary duty that applied only to investment advisers.[6] The SEC regularly affirms that no rule establishes a fiduciary duty for investment advisers.[7] Indeed, in a June 5, 2019 interpretive release[8], the SEC stated: "[t]he fiduciary duty to which advisers are subject is not specifically defined in the Advisers Act or in Commission rules."[9] Likewise, the invitations of comment on the Massachusetts fiduciary proposal and preproposal stated that "this conduct standard is based on the <u>common law</u> fiduciary duties of care and loyalty."

The creation of a fiduciary duty by regulatory fiat violates core separation-of-powers principles by exercising a legislative function outside the scope of the Division's rulemaking authority. Codification of a judicially established fiduciary standard in Massachusetts securities regulations represents a significant change in the law. Establishing a fiduciary duty by <u>regulation</u>, therefore, inappropriately usurps the role and responsibilities reserved for the Massachusetts legislature and reflects an *ultra vires* action.

The proposal is promulgated under Section 204(a)(2)(G) of the Massachusetts Uniform Securities Act, which provides that

> The Securities Division can deny, revoke, suspend, cancel or withdraw the registration of any broker-dealer or investment adviser who, among other things, "(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business."

Nothing in that statutory provision gives the Secretary or the Division of Securities authority to <u>adopt by regulation</u> a <u>fiduciary duty</u> for broker-dealers or investment advisers. Rather, Section 204 grants the Secretary defined authority to "take any other appropriate action" in the public interest concerning <u>the continued registration</u> of broker-dealers or investment advisers. It does not provide *carte blanche* authority to subject broker-dealers or investment advisers to a fiduciary duty by rulemaking. The overarching purpose and title of Section 204 is "denial, revocation, suspension, cancellation and withdrawal of registration." This very precise and circumscribed title and purpose do not grant the Secretary authority to adopt a fiduciary duty. That is a role reserved for the legislature, not the Division

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[6] In *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 194 (1963), the Supreme Court construed an investment adviser as a fiduciary owing clients "an affirmative duty of utmost good faith, and full and fair disclosure of all material facts."
[7] See SEC *Interpretation Regarding Standard of Conduct for Investment Advisers*, Release No. IA-5248; File No. S7-07-18 (June 5, 2019) https://www.sec.gov/rules/interp/2019/ia-5248.pdf
Richards, *<u>Fiduciary Duty: Return to First Principles</u>*, Eighth Annual Investment Adviser Compliance Summit (February 27, 2006) at https://www.sec.gov/news/speech/spch022706lar.htm#2.
[8] *Id.*
[9] The SEC cited the seminal case on this point: *SEC v. Capital Gains Research Bureau, Inc*., 375 U.S. 180, 194 (1963). The Massachusetts

of Securities. To be sure, the Securities Division has authority to regulate conduct by broker-dealers and advisers that is actually "unethical" or "dishonest." But the lack of stringent fiduciary obligations with respect to broker-dealers who are not fiduciaries at common law or by statute does not mean that broker-dealers are engaged in dishonest or unethical conduct. Even without this rule, the Division has brought enforcement actions against the practices it cites as grounds for the rule—evidence that the sweeping imposition of new and costly fiduciary obligations is unnecessary as well as beyond the Division's jurisdictional grant.[10]

II. The Proposed Regulation Conflicts with the Massachusetts Uniform Securities Act Exclusion for Insurance, Endowment and Annuity Contracts

The undefined terms in the proposed regulation, as discussed above, operate to contradict provisions under the Massachusetts Uniform Securities Act.

Massachusetts Uniform Securities Act Section 110A § 401 (K) provides that

> "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed or variable number of dollars either in a lump sum or periodically for life or some other specified period;

This definitional exclusion from the definition of "security" makes it clear that all insurance, endowment policies and annuity contracts are outside the scope of the Massachusetts Uniform Securities Act and the regulations thereunder. All insurance, endowment and annuity contracts, therefore, are also excluded from the scope of regulations adopted under the Massachusetts Uniform Securities Act. The proposal's imprecise and undefined terms summarized below in Section V, however, could invalidly pull these statutorily excluded insurance products, and the broker-dealers selling them, into the proposed regulation.

III. The Proposed Regulation Disregards the Broker-Dealer Exclusion from the Definition of Investment Adviser Under the Massachusetts Uniform Securities Act

Massachusetts Uniform Securities Act Section 110A § 401 (m)(1)(F) also provides that the term

> "Investment Adviser" does not include "a registered broker-dealer or registered broker-dealer agent."

This exclusion is unequivocal and unqualified. All registered broker-dealers are excluded from the definition of investment adviser in Massachusetts and the accompanying judicial application of a fiduciary duty. In distinct contrast, the broker-dealer exclusion from the investment adviser definition under the federal Investment Advisers Act of 1940 and the Uniform Securities Act promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) has a conditional exclusion for activity that is "solely incidental" to broker-dealer functions. Massachusetts' more broad and unconditional exclusion reflects a conscious determination of the legislature. The proposal would subject broker-dealers to a fiduciary duty, which contradicts the blanket exclusion for registered broker-dealers from the definition of investment adviser and the judicially applied fiduciary duty to

[10] *See* nn.8-13 in the June 14, 2019 *Preliminary Solicitation for Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives* https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/fiduciaryconductstandardidx.htm.

investment advisers. This result conflicts with the plain wording and intent of this exclusion in the statute. The application of the proposal to broker-dealers in this context usurps the unequivocal determination by the Massachusetts legislature not to treat broker-dealers as investment advisers subject to a fiduciary duty.

IV. The Proposal Conflicts with the Insurance Commissioner's Exclusive Authority to Regulate the Issuance and Sale of Insurance Products

The proposed fiduciary rule also conflicts with state law in other ways. The Massachusetts Insurance Law states that the negotiation, solicitation, sale or transaction in fixed or variable insurance or annuity contracts by any person shall not be subject to the provisions of" the Massachusetts Securities Code.[11] This statutory provision in the Massachusetts Insurance Law gives exclusive, unequivocal jurisdiction to the Insurance Commissioner over the issuance and sale of insurance products. The legislature's purpose in granting exclusive Insurance Commissioner jurisdiction over insurance product sales and distributors was to prevent the same transaction or the same activity from being subject to two state level regulators. Shared jurisdiction could produce the untenable result that one regulator approves while the other regulator denies a particular activity or standard of behavior. The uncertainty of shared or joint jurisdiction would impair the insurance business. The Massachusetts legislature, however, was clear on this. The Securities Division has no jurisdiction.

Notwithstanding the Massachusetts Insurance Commissioner's exclusive jurisdiction over all insurance and annuity contracts and their sales, the request for comment states that "given the overlap of securities-related and non-securities-related advice, the Division has a strong interest in regulating the conduct of its registrants regardless of the presence or absence of securities" and expresses that insurance product sales by broker-dealers are within the scope of the regulation. But the exclusive jurisdiction of the Insurance Commissioner absolutely precludes the Division's assertion of jurisdiction and the application of a fiduciary standard to insurance product sales and distributors. The attempt to impose a fiduciary duty regarding insurance and annuity contracts blatantly ignores the legislature's unequivocal reservation of exclusive jurisdiction to the Massachusetts Insurance Commissioner and the Massachusetts Insurance Law. The Securities Division has no authority over the sale of insurance or annuity contracts. The Securities Division's assertion of jurisdiction is *ultra vires*.

V. The Proposed Regulation Exceeds the Authority of the Division of Securities Because It Lacks A Nexus To Securities

All initiatives implementing the Massachusetts Uniform Securities Act must have a fundamental nexus to regulating securities, broker-dealers, or investment advisers. This statutory focus is derived from the Uniform Securities Act promulgated by the National Conference of Commissioners (NCCUSL) on which the Massachusetts Uniform Securities Act is framed.

[11] M.G.L. c. 175, § 3; Section 3: Unauthorized insurance, annuity or variable annuity contracts; prohibition
Section 3. No company shall make a contract of insurance or annuity, including any such insurance or annuity contract which is a contract on a variable basis, upon or relative to any property or interests or lives in the commonwealth, or with any resident thereof, and no person shall negotiate, solicit, sell or in any manner aid in the transaction of such contracts, or of their continuance or renewal, except as authorized by this chapter or chapter one hundred and seventy-six, or except as otherwise expressly authorized by law; and any such contract and the negotiation, solicitation, sale or transaction thereof by any person shall not be subject to the provisions of chapter one hundred and ten A [the MA Securities Code].. (emphasis added).
https://malegislature.gov/Laws/GeneralLaws/PartI/TitleXXII/Chapter175/Section3

Similarly, many references within the Massachusetts Uniform Securities Act underscore the statute's fundamental nexus to securities. The U.S. Court of Appeals in *A.S.Goldmen & Co. v. New Jersey Bureau of Securities*[12] stated that the purpose of the "blue sky" laws (on which the Massachusetts securities laws are based) was to regulate securities.[13] The proposed regulation, however, controverts this constraint because several imprecise and undefined terms lack any nexus to securities or securities professionals and, thus, exceed the authority of the Division of Securities.

For example, in several instances, the proposed regulation would apply to a "recommendation." The proposal does not limit this triggering event to securities activity, broker-dealers, or investment advisers. This expansive term could inappropriately apply, therefore, to recommendations having nothing to do with securities activities, broker-dealers, or investment advisers. Left unlinked to securities, the proposal's terminology is unacceptably vague and overwhelming in scope.

Under the proposed regulation a "dishonest or unethical business practice" includes providing investment advice or recommending to a customer, an <u>investment strategy, the opening of, or</u> <u>transfer of assets to, any type of account</u>. The regulation does not define the term "investment strategy." This imprecise term and its operation under the initiative lacks a fundamental nexus to securities.

By way of example, acquisitions of real estate, art or stamp collections could be considered worthwhile "investments" in a generic sense. Would a recommendation of these non-securities constitute an "investment strategy" triggering the proposed regulation's fiduciary standard? These recommendations do not involve securities and should not be drawn into the proposed regulation because they might trip the imprecise and undefined concepts implicit in the term "investment strategy." Real estate agents often remark that the purchase of a home "is the best investment you will ever make." Would the agent's recommendation to purchase a property invoke the proposed regulation because it involves an "investment strategy"? Without a securities-linked nexus, the "investment strategy" non-definition would operate in excess of the Securities Division's statutory authority. The lack of any limiting principle also conflicts with the Massachusetts legislature's express decision to exempt "the negotiation, solicitation, sale or transaction" in fixed or variable insurance or annuity contracts by any person" from regulation by the Securities Division.[14]

The provision's application to the "opening of, or transfer of assets to, any type of account" is similarly vague. In the business world many activities involve the opening of an account and the transfer of assets to complete a transaction having nothing to do with securities. For example, a customer could open an account and transfer assets to pay a premium on a term life insurance policy. This has nothing to do with the statutory purpose and scope of the Massachusetts Uniform Securities Act. Similarly, a customer could open a bank account and transfer assets to it from another financial account. Even though the transaction has nothing to do with securities, the definitional threshold is so unclear that it potentially provokes the proposal's terms.

These non-securities transactions are only a few of many examples demonstrating that undefined and imprecise terms in the proposal could operate to spark an unintended and inappropriate fiduciary duty under the proposal. This consequence would exceed the Securities Division's statutory authority.

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[12] 163 F.3d 780, 1999 U.S. App. LEXIS 147 (3d Cir. N.J. Jan. 7, 1999).
[13] *See* Loss, Seligman & Paredes, *Fundamentals of Securities Regulation* at 13 (7th ed. Rev.2018).
[14] M.G.L. c. 175, § 3.
https://malegislature.gov/Laws/GeneralLaws/PartI/TitleXXII/Chapter175/Section3

These terms are also void for vagueness and would not survive judicial challenge, particularly given the potential criminal consequences that could attach to violations of a rule issued pursuant to the Massachusetts Uniform Securities Act.[15] Financial professionals will be deterred from offering advice or providing financial and retirement solutions due to numerous ambiguities in the proposal. As a result, the proposed regulation will harm retirement savers and investors by restricting their access to the information and options they need to make sound financial decisions.

VI. Consumers Are Fully and Appropriately Protected Under Existing Law

It is a fundamental principle of sound regulation that an agency should act only when existing protections have been found insufficient. No such finding could be made here.

To begin with, effective tools already exist under the Massachusetts Uniform Securities Act through the definition of "investment adviser" in 110A § 401 (m). The investment adviser definition has a functional, three-part test with the appropriate nexus to securities required under state securities codes that governs individuals (i) in the business (ii) of providing advice about the purchase or sale of securities (iii) for compensation. The Massachusetts definition of investment adviser is the same as the definition of investment adviser under the Investment Advisers Act of 1940. Individuals triggering the definition of investment adviser are already subject to a well-established fiduciary duty under a long line of judicial precedent.[16]

Moreover, state and federal securities regulators issued seminal guidance interpreting the application of the investment adviser definition to financial planners in Investment Advisers Act Release 1092[17]. According to that release, “the views expressed in this statement were developed jointly by [SEC’s] Division [of Investment Management] staff and the North American Securities Administrators Association, Inc. ("NASAA") to update Investment Advisers Act Release No. 770 and <u>provide uniform interpretations of the application of federal and state investment adviser laws to financial planners and other persons</u>.” [18] Massachusetts is a member of the NASAA and should endeavor to implement uniform approaches to regulating the activities of investment advisers and associated fiduciary duty standards.

The proposed regulation significantly deviates from uniform approaches at the SEC and in other state regulatory forums. The aberrational approach in the proposed regulation will impose unwarranted legal and compliance burdens discouraging the delivery of retirement and financial solutions. Disparities in Massachusetts will lead to harmful regulatory arbitrage. Moreover, because the regulation imposes burdens on broker-dealers who service out-of-state as well as in-state clients that

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[15] M.G.L. c. 110A, § 409(a): Any person who willfully violates any provision of this chapter except section 404, <u>or who willfully violates any rule or order under this chapter</u>, or who willfully violates section 404 knowing the statement made to be false or misleading in any material respect, <u>shall upon conviction be fined not more than $100,000 or imprisoned not more than 10 years in the state prison</u>, or both; but no person may be imprisoned for the violation of any rule or order if he proves that he had no knowledge of the rule or order.

[16] Section 206(1) and (2) of the Advisers Act make it unlawful for an investment adviser, directly or indirectly, to “employ any device, scheme, or artifice to defraud any client or prospective client” or to “engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.” In *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 194 (1963), the Supreme Court construed an investment adviser as a fiduciary owing clients “an affirmative duty of utmost good faith, and full and fair disclosure of all material facts.” Further, the court found a “failure to disclose material facts must be deemed fraud or deceit within its intended meaning, for . . . the darkness and ignorance of commercial secrecy are the conditions under which predatory practices best thrive.” *Id*. at 200.

[17] https://www.sec.gov/rules/interp/1987/ia-1092.pdf

[18] *Id*. Emphasis added.

greatly outweigh any putative local benefit to Massachusetts' residents (indeed, substantial evidence shows that the regulation will hurt rather than help in-state retirement savers by depriving them of critical access to and information about annuities) it violates federal protections against state regulatory discrimination under the Commerce Clause.

In addition to robust and recently enhanced regulation of broker-dealers, life insurance companies and their associated persons currently fulfill a broad array of regulations administered by state insurance and securities departments, the SEC, DOL, and FINRA. 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. In some cases, insurance products are subject to both federal and state laws. In addition, several new additional consumer protections have been adopted by the SEC under the Reg. BI initiative and the parallel developments in the NAIC's Suitability in Annuity Transactions Model Regulation. These important regulatory standards collectively provide important consumer protection and strong enforcement tools that buttress the purpose of the Massachusetts Uniform Securities Act and the stated intent of the proposal.

As one example of regulatory protection, clarification on the scope of broker-dealer conflict management and mitigation under Reg. BI can be constructively drawn from the comprehensive FINRA Report on Conflicts of Interest.[19] In its conflicts report, FINRA focused on measures to identify and manage broker-dealers' conflicts in three critical:

- Enterprise-level frameworks to identify and manage conflicts of interest;
- Approaches to handling conflicts of interest in manufacturing and distributing new financial products; and,
- Approaches to compensating salespersons.

The report identified effective practices that FINRA observed or that, based on experience and analysis, FINRA believed could help broker-dealers improve their conflicts management practices. It also contained more general observations and commentary on firms' practices for enhanced conflicts management. The report encouraged the creation of a comprehensive framework to identify and manage conflicts of interest across and within broker-dealers' business lines that is scaled to the size and complexity of their business. The conduct under FINRA's conflicts position is just one of many complementary state and federal standards protecting consumers in the acquisition of financial and retirement products.

After the SEC's adoption of Regulation Best Interest, FINRA had dedicated resources to assist broker-dealers with their implementation of Reg BI and Form CRS in various ways, such as by providing guidance and training in their implementation efforts.[20] In addition, FINRA hosted in-person meetings and educational events to assist with these efforts.

As with other SEC rules, FINRA has emphasized that it will rigorously examine for and enforce compliance with Reg BI and, in doing so, FINRA will adhere to SEC guidance and interpretations.

[19] https://www.finra.org/sites/default/files/Industry/p359971.pdf

[20] *See* https://www.finra.org/rules-guidance/key-topics/regulation-best-interest Similarly, in late September 2019, the SEC issued a compliance guide on Regulation Best Interest and accompanying disclosure Form CRS for small entities. While aimed at small entities, the compliance guide is a valuable source of interpretation for all entities and highlights items of priority in the SEC's view.

FINRA staff expects to work with SEC staff to ensure consistency in examining broker-dealers and their associated persons for compliance with Reg BI. In addition, FINRA will review FINRA rules to see whether changes are needed to align FINRA rules with the SEC's rulemaking.[21] Any proposed changes to FINRA rules will be filed with the SEC for public comment and available on FINRA's website.

FINRA recently created a Reg. BI and Form CRS Checklist[22] to help broker-dealers assess and implement constructive changes to their policies, procedures and compliance programs in response to Reg. BI and Form CRS. The checklist outlines the major requirements of the rules and identifies key elements of FINRA rules, SEC's Reg. BI and Form CRS that must be followed.[23]

FINRA committed to working with SEC staff to ensure FINRA's "consistency in examining broker-dealers and their associated persons for compliance" with Reg. BI and Form CRS. FINRA is also reviewing its rules to see whether changes are needed to align them with the SEC's rules.[24]FINRA's CEO Robert Cook stated that FINRA is thoroughly evaluating changes to its rulebook that would reflect Reg. BI.[25] FINRA held a one-day Reg. BI conference[26] on Dec. 18, 2019, in Washington DC, to bring regulators, executives and industry practitioners together to learn more about the rule.

In sum, the comprehensive and expanding network of SEC, FINRA and state insurance regulation appropriately protects consumers, as further highlighted in Appendix D. The proposed Massachusetts fiduciary regulation would thwart these significant standards through conflicting approaches and regulatory excesses.

VII. Preemption by Federal Law

The proposed fiduciary regulation would be preempted by federal law, under well-established express and conflict preemption principles.

For example, the proposed regulation contradicts the National Securities Market Improvements Act of 1996 (NSMIA), which prohibits any state law from establishing requirements "which differ from, or are in addition to, the requirements of federal law."[27] The proposal establishes standards different from those currently governing broker-dealers and investment advisers under the federal securities laws[28] and contradict the SEC's Regulation Best Interest, including Form CRS and its reiterated

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[21] *See*, https://www.finra.org/media-center/finra-unscripted/regulation-best-interest
[22] *See* https://www.finra.org/sites/default/files/2019-10/reg-bi-checklist.pdf
[23] A copy of the FINRA checklist appears in Appendix C.
[24] Waddell, *FINRA Updates Reg. BI Webpage with Compliance Checklist*, ThinkAdvisor (Oct. 8, 2019) at https://www.thinkadvisor.com/2019/10/08/finra-updates-reg-bi-webpage-with-compliance-checklist/
[25] https://www.thinkadvisor.com/2019/09/11/finra-chief-explains-2-pronged-reg-bi-approach/?slreturn=20191113201940
[26] *See* https://www.finra.org/events-training/conferences-events/2019-Regulation-BI-Conference
[27] Friedman, *The Impact of NSMIA on State Regulation of Broker-Dealers and Investment Advisers*, 53, Bus. Law 511 (1998) ["Section 15(h)(1) prohibits states from establishing 'for brokers or dealers' regulations that are different from or in addition to federal regulations. By preempting all state and local laws, rules and administrative congress, Congress presumably intended to go beyond merely provisions that appear in a state's blue-sky laws." *Id*. at 513] Accord, Stevens, *Mutual Funds, Investment Advisers, and the National Securities Markets Improvements Act*, 52 Bus. Law 419 (1997); *see also* 15 U.S.C. §§ 78o(i)1), 80b-3a(b)(1).
[28] While Section 101(C)(1) of NSMIA grants states the ability "to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions," the imposition of a different fiduciary duty standard in Massachusetts is beyond the scope of this limited authority for state regulators.

investment adviser interpretations. As such, the proposal would contradict the mandates of NSMIA and settled preemption principles.

The initial proposal emphasized that a transaction-based fee (commission) would not be a breach of fiduciary duty if the fee is "reasonable" (undefined) and "is the best" (again undefined) "of the reasonably available fee options." Such language could have been interpreted to be the lowest fee, something in conflict with Section 913 of the Dodd-Frank Act.[29] Although this "best of" language has been eliminated from the revised proposal, the problem remains. By imposing a duty of loyalty, the Securities Division may enforce a "best of" standard on a case-by-case basis, without providing clear guidance as to when, in hindsight, compensation will be deemed to have breached the duty of loyalty or been excessive. The result will be to encourage broker-dealers and advisors to emphasize investment options that carry the lowest fees, even when a lower-fee option is not the best fit for a consumer's particular needs.

The proposed Massachusetts regulation establishes a fiduciary duty and a duty of loyalty. In its discussion of regulation BI, the SEC expressly declined to include a fiduciary duty and a duty of loyalty in line with Section 913 of the Dodd-Frank Act.[30] Further, the SEC explained that "we wish to underscore that proposed Regulation Best Interest focuses on specific enhancements to the broker-dealer regulatory regime, in light of the unique characteristics of the brokerage advice relationship and associated services that may be provided, and therefore would be separate and distinct from the fiduciary duty that has developed under the Advisers Act."[31] This statement reveals that the SEC chose not to create by regulation a fiduciary duty, in distinct contrast with the Massachusetts proposal. Moreover, this SEC statement reveals that the proposed Massachusetts regulation quoted immediately below misrepresents the SEC's action:

> In accordance with Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Securities and Exchange Commission (SEC) conducted a study (the 913 Study) and the SEC staff recommended that the SEC establish a uniform fiduciary duty standard for investment advisers and broker-dealers when providing investment advice about securities to retail customers that is consistent with the standard that currently applies to investment advisers.[32]

The proposed Massachusetts regulation directly conflicts with the SEC's Regulation Best Interest and Congressional determinations governing the primacy of the Federal securities laws. For these and other reasons, the Massachusetts proposal violates the wording and intent of NSMIA.

[29] The SEC's Section 913 Study Report stated that '[b]roker-dealers may offer solely proprietary products, a limited range of products, or a diverse range of products.*" See* Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("913 Study"), at 9-10, available at www.sec.gov/news/studies/2011/913studyfinal.pdf . Likewise, the SEC noted that "Broker-dealers may offer solely proprietary products, a limited range of products, or a diverse range of products. *Id.*

[30] The SEC's explanation of Reg. BI indicates that "[a]s recommended by the 913 Study, we are proposing to require, through implementation of policies and procedures, broker-dealers to, at a minimum disclose, or eliminate, all material conflicts of interest, which draws from principles of an investment adviser's duty of loyalty under the Advisers Act, which includes an investment adviser's duty to disclose." The release further noted that "We also believe that the proposed Conflict of Interest Obligations, in conjunction with our Disclosure Obligation, are consistent with the principles underlying the recommendations of the 913 Study relating to a duty of loyalty. *See*, Reg. BI Release at 187-189.

[31] Reg. BI Release at 21585.

[32] *Id.*

The proposed fiduciary conduct standard further conflicts with 15 U.S.C. § 78o(i)(1), which preempts a state's imposition of recordkeeping requirements that vary from those established by the SEC. The proposed regulation would effectively impose new recordkeeping requirements because regulated parties must develop, implement, and document new policies to ensure compliance. Reg. BI imposes conduct standards that apply only at the point of recommendation. By holding broker-dealers and agents to a fiduciary standard, the proposed rule will create ongoing obligations extending past that point. Regulated entities will have to monitor the performance of an account and develop new compliance systems. All of this will require extensive new record-keeping. Additionally, the rule imposes a duty of loyalty requiring that broker-dealers and agents make recommendations without regard to the financial interest of anyone other than the customer/client. This is a new standard that would require regulated entities to develop new supervisory systems.

The proposed Massachusetts fiduciary rule further violates NSMIA because it prohibits sales practices permitted by the SEC in Reg. BI and imposes a fiduciary duty on broker-dealers, which the SEC explicitly declined to do. In this regard, the SEC explained that

> The Commission is utilizing its authority under 913(f) [of the Dodd-Frank Act] in order to adopt an enhanced investor-protection standard for broker-dealers that maintains the availability of both the broker-dealer model and the investment adviser model. The Commission has chosen not to apply the existing fiduciary standard under the Advisers Act to broker-dealers in part because of concerns that such a shift would result in fewer broker-dealers offering transaction-based services to retail customers, which would in turn reduce choice and may raise costs for certain retail customers.
>
> Moreover, the Commission has chosen not to create a new uniform standard applicable to both broker-dealers and investment advisers which, among other things, would discard decades of regulatory and judicial precedent and experience with the fiduciary duty for investment advisers that has generally worked well for retail clients and our markets. We believe that adopting a "one-size-fits-all" approach would not appropriately reflect the fact that broker-dealers and investment advisers play distinct roles in providing recommendations or advice and services to investors, and may ultimately harm retail investors. Instead, the Commission has chosen to enhance existing obligations for broker-dealers when they make recommendations to a retail customer, while, in a separate interpretation, reaffirming and in some cases clarifying an investment adviser's fiduciary duty.[33]
>
> Although key elements are substantially similar, the Commission notes that the obligations of a broker-dealer under Regulation Best Interest and the obligations of an investment adviser pursuant to its fiduciary duty under the Advisers Act differ in certain respects, taking into account the scope of the services and relationships typically offered by broker-dealers and investment advisers.[34]
>
> [T]he recommended uniform standard would neither require the absolute elimination of any particular conflicts (in the absence of another requirement to do so) nor impose on broker-dealers a continuing duty of loyalty or care; nor would the receipt of commissions or other

[33] Adoption release at page 55
[34] Adoption release at page 59.

standard compensation, sale of proprietary products, or engaging in transactions on a principal basis, in and of themselves, violate the fiduciary standard.[35]

In addition, the proposed Massachusetts regulation is preempted by ERISA, which displaces "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."[36] The proposed regulation provides that "[n]othing in [this regulation] shall be construed to apply to" ERISA fiduciaries. The proposed regulation would continue to impose a fiduciary standard on state-licensed broker-dealers who service employee benefit plans, however, even though those broker-dealers are not acting as ERISA fiduciaries under federal law. Consequently, ERISA preempts the proposed Massachusetts fiduciary rule.

VIII. The Proposed Fiduciary Regulation Unreasonably Disregards Substantial Evidence of the Likely Economic Impacts on Insurers, Agents and Consumers

The proposed regulation not only unreasonably discounts enhanced federal and state regulatory oversight of broker-dealers but also unreasonably ignores evidence of the likely impact on life insurers, insurance agents and consumers that will result. Section 5 of Chapter 30A of Title III of the Massachusetts General Laws provides that "no rule or regulation so filed with the state secretary shall become effective until an estimate of its fiscal effect including that on the public and private sector."[37] Even apart from that express state-law statutory standard, principles of reasoned decision-making applicable to the Division would require the Division to assess the disadvantages of the rule on insurance companies, insurance agents and consumers. The Initial Small Business Impact Statement[38] does not fulfill the standards required by the statute. As such, the proposed regulation is fundamentally deficient. Two recent examples of regulatory actions establishing a fiduciary duty for broker-dealers demonstrate both public and private sector harm. These situations are directly analogous to the negative impact the proposal would have on the public and private sectors in Massachusetts.

During its operation, DOL's Fiduciary Rule caused a significant reduction in the sale of new insurance products. This was caused by increased operational costs and exposure to increased litigation risks under the Fiduciary Rule. Variable annuity sales declined 21 percent in 2016 (from $133 billion in 2015 to $104.7 billion) and a further 8.7 percent in 2017 ($95.6 billion).[39] Also, in 2017 indexed annuity sales declined by almost 10 percent to $55 billion.[40] The same elements exist in the proposed Massachusetts fiduciary rule, which can be expected to profoundly discourage the distribution of insurance products, if adopted as proposed.

Nothing in the proposal's small business impact statement addresses the negative impact of the proposal on insurance products and the state's 7,030 insurance salespersons[41]. Many insurance agencies in Massachusetts are small businesses, and they are wholly absent from the calculus of economic impact. These burdens are more than what the impact simply characterizes as "administrative costs." Rather, they will be crippling to small insurance brokerages. The proposal

[35] Proposal Release at page 65.
[36] 29 U.S.C. § 1144(a).
[37] https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIII/Chapter30A/Section5
[38] http://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Initial-Small-Business-Impact-Statement.pdf
[39] LIMRA, Secure Retirement Institute.
[40] *Id*.
[41] *See* U.S Bureau of Labor Statistics *Employment of Insurance Sales Agents by State* (May 2018) https://www.bls.gov/oes/current/oes413021.htm#(1)

inappropriately establishes winners and losers in its mechanics and illegitimately blends the unique sales function of broker-dealers with the advice functions of investment advisers. If the Massachusetts legislature had intended identical regulation, it could have chosen to do so. It did not.

In discussing the regulations' potential deterrent effect on new business formation, the impact statement concludes that any burden is outweighed by the "cost to investors of conflicted advice" and references the 2015 Council of Economic Advisor's (CEA) $17 billion estimated annual investor cost of conflicted financial advice.[42] But the underlying assumptions CEA used to reach this number have been discredited in scholarly economic analysis[43], and the $17 billion "cost" was not even used by the Department of Labor itself in its 2016 Regulatory Impact Analysis on its Fiduciary Rule.[44] There is thus no basis to support the Division's conclusion that the proposed regulations will not significantly increase compliance costs. The proposal establishes the same fiduciary duties imposed under the now vacated DOL fiduciary rule – and even DOL concluded that its rule would have resulted in significant compliance costs.[45] According to the research group LIMRA, if the Labor Department's regulation had remained in-force, 54 percent of advisors might have dropped or turned away small investors, resulting in as many as 4 million middle class households losing access to information needed to ensure a secure retirement.[46]

This scenario began to unfold during the DOL fiduciary rule's brief existence. Many financial firms moved to a fee-for-service-only model and abandoned consumers with account balances of less than $250,000.[47] The regulation eliminated choice and access, harming small and moderate-balance savers and typical buy-and-hold investors who rely on commission-based services for their retirement needs. According to the latest available data, eighty percent of annuity holders have total annual incomes below $100,000 and more than one third (35 percent) have household incomes less than

[42] *See* http://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Initial-Small-Business-Impact-Statement.pdf at 3.
[43] Several economists concluded that the underlying assumptions used by CEA were significantly flawed. *See* Robert Litan and Hal Singer, Economists Inc., Good Intentions Gone Wrong: the Yet-To-Be-Recognized Costs of the Department of Labor's Proposed Fiduciary Rule (July 2015), available at https://ei.com/wp-content/uploads/2017/02/LitanSingerFiduciary.pdf; Craig M. Lewis, Forbes, *An Inflated $17 Billion Talking Point From The DOL*, (December 16, 2015), available at www.forbes.com/sites/realspin/2015/12/16/an-inflated-17-billion-talking-point-from-the-dol/#54b1aedc2831. *See also* Megan Milloy, American Action Forum, *Warren is Wrong about the Fiduciary Rule* (February 8, 2017), available at www.americanactionforum.org/insight/warren-wrong-fiduciary-rule/;
[44] See Regulation Advice Markets, Definition of the Term "Fiduciary" Conflicts of Interest – Retirement Investment Advice, Regulatory Impact Analysis for Final Rule and Exemptions (April 2016), available at www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/ria.pdf. The reference to the $17B figure came from Obama Administration talking points, but did not appear in the DOL's cost-benefit analysis, as noted in text above.
[45] *Id.*

[47] *See* Wurston, *J.P. Morgan Moves Forward with Plan to Drop Commissions in IRAs* , Wall Street Journal (Mar. 13, 2017) ["Clients would be steered toward accounts where they manage the investments themselves or accounts that charge fees based on a percentage of assets, which could be costlier for those who trade little" due to DOL rule.]; InvestmentNews, *J.P Morgan Moves Ahead on Dropping Retirement Commissions*, Mar. 14, 2017, [J.P Morgan told some wealth management customers with individual retirement accounts that as of April 7 their "financial adviser will no longer be able to provide investment guidance," according to a letter sent to clients.] *See also* attached letters from BDs that abandoned small and moderate investors in Appendix C. The SEC also noted on June 5, 2019 that "it was widely reported that a number of firms [broker-dealers] responded to the DOL Fiduciary Rule by either requiring customers to enter into more expensive advice relationships or by passing through higher compliance costs to customers, which altered many retail customer relationships with their financial professionals." *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release No. 34-86031; File No. S7-07-18 at 22 https://www.sec.gov/rules/final/2019/34-86031.pdf. *See also* Alex Steger, *Exclusive: UBS to Cut over 800 Funds from Platform*, CITYWIRE, Mar. 13, 2018, ; Michael Thrasher, *Ameriprise Drops Hundreds of Funds Offered to Brokerage Clients*, WEALTHMANAGEMENT.COM, June 8, 2017,; Hugh Son, Bruce Kelly, *Wells Fargo Advisors Restricting Investments for Retirement Accounts*, INVESTMENTNEWS, May 24, 2017.

$50,000.[48] Appendix B to this submission contains copies of letters from firms that abandoned small and moderate retirement savers following the adoption of the DOL Fiduciary Rule.

Concerns about the impairment of investor access, choice, and cost are not theoretical. The SEC emphasized in a June 5, 2019, release that "with the adoption of the now vacated DOL Fiduciary Rule, there was a significant reduction in retail investor access to brokerage services,[49] and we believe that the available alternative services were higher priced in many circumstances."[50] The SEC further noted that "while the full effects of the DOL Fiduciary Rule were not realized as it was vacated during the transition period, a number of industry studies indicated that, as a result of the DOL Fiduciary Rule, industry participants had already or were planning to alter services and products available to retail customers."[51]

As the record presented to the SEC helped to demonstrate, the DOL rule unquestionably burdened the economic and retirement security of less affluent and middle-income markets distinctively served by life insurers. In a directly parallel fashion, the Massachusetts proposal will diminish the delivery of retirement and financial solutions due to its muddied interpretive, compliance and regulatory waters, and will inflict equivalent harm on Massachusetts citizens.[52] It is incumbent upon the Division to analyze this empirical evidence before regulating in this area. Poorly designed regulations thwart the delivery of these retirement and financial solutions by imposing unreasonable compliance burdens and uncertain legal standards.[53] Consequently, the proposal will impair life insurers' capacity to invest in Massachusetts because business will be diminished through regulatory disorder. Nothing in the proposal's statement of economic impact considers the proposal's negative bearing on consumers, life insurers, salespersons, retirement security, investments, infrastructure, jobs, taxes and the economy in Massachusetts.

Other domestic and global initiatives restricting commissioned-based advice and focused on fiduciary duty contributed to a quantifiable advice gap for less affluent and middle-income markets. For example, in 2014, Morningstar UK reported that eleven million investors fell through an 'advice gap' following industry regulation banning commissioned financial product sales. More recently, the Financial Times of London UK published an analysis on May 21, 2019, observing that:

> Investors have seen their access to financial advice slimmed as a result of the Retail Distribution Review, which banned advisers from taking commission from the investments they sold and forced them to charge customers upfront instead. The rules, which took effect in 2013, were designed to improve standards in the market but have made it harder for

[48] Gallup, 2013 Survey of Owners of Individual Annuity Contracts, 2013.
[49] *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release No. 34-86031; File No. S7-07-18 at 22 https://www.sec.gov/rules/final/2019/34-86031.pdf.
[50] *Id.*
[51] *Id.* at footnote 33.
[52] The application of the fiduciary rule to truthful, non-misleading speech violates the First Amendment of the U.S. Constitution. The Constitution protects commercial speech because of both consumers' and society's strong interests "in the free flow of commercial information." *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council Inc*., 425 U.S. 748, 763 (1976). Given these profound consumer and societal interests in the dissemination of commercial information, the Supreme Court has firmly "rejected the 'highly paternalistic' view that government has complete power to suppress or regulate commercial speech" *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557, 561(1980).
[53] In a quantifiable and parallel impact due to inoperable, burdensome DOL fiduciary regulations, a study conducted by the LIMRA-LOMA Secure Retirement Institute found that 54 percent of advisors would be forced to drop or turn away small investors. *See* DOL Viewpoints - *The Proposed Fiduciary Rule: Advisors' Pers*pective, LIMRA Secure Retirement Institute (2016).

> customers with smaller portfolios to get advice, meaning that those with assets of less than £50,000 have struggled to find an adviser.[54]
>
> In 2016 the Financial Conduct Authority said advisers were requiring customers to have assets of at least £50,000 before taking them on. New digital services, known as robo-advisers, have emerged in the UK to fill that gap, but Open Money said that such services were not providing the personalized advice that customers need and "cannot replace the service provided by fully regulated financial advisers."[55]

The impact of the proposed fiduciary regulation could likewise impair citizens and the economy in Massachusetts. 376 life insurers are authorized to conduct business in Massachusetts and 14 are domiciled in Massachusetts. Life insurers contribute significantly to the economy in Massachusetts, providing, among other things:

- 70,400 jobs,
- $591 billion in investments, financing business development, job creation, and services, and
- $916 billion in total life insurance coverage,

Efficient and effective regulatory standards in Massachusetts will broaden consumers' functional access to financial and retirement solutions through life insurance, annuities and other insurance products. In turn, premiums on insurance products are invested in capital formation and the economy. These factors provide important reasons to develop functional, effective regulation governing broker-dealers and investment advisers. Unfocused regulation burdens life insurers and would hinder their constructive contributions to Massachusetts's economy. The infographic and data chart attached in Appendix A to this document highlight other significant roles life insurers play in Massachusetts's economy.

Government studies reveal that many individuals and families are not adequately prepared for financial and retirement security.[56] Insurance products can play a significant role in American's

[54] Beioley, *Financial Advice Gap has Widened since 2015, Says Report- Millions are Priced Out of the Market and Unaware of Free Help Available*, Financial Times of London (May 21, 2019) https://www.ft.com/search?sort=relevance&q=Financial+Advice+Gap+has+Widened+since+2015%2C+Says+Report-+Millions+are+Priced+Out+of+the+Market+and+Unaware+of+Free+Help+Available .

[55] *Id.* In a similar vein, the Massachusetts Securities Division strongly questioned the validity of robo advice under investment advisory standards in a Policy Statement at http://www.sec.state.ma.us/sct/sctpdf/Policy-Statement--Robo-Advisers-and-State-Investment-Adviser-Registration.pdf. The Massachusetts proposal will create an advice gap for less affluent individuals and families identical to that which occurred during the operation of the DOL's Fiduciary Rule, leading to reliance the on robo advice the Division criticizes. Other regulators also questioned the validity of robo advice. *See*, SEC's Office of Investor Education and Advocacy and the Financial Industry Regulatory Authority, Inc., *Investor Alert: Automated Investment Tools*, May 8, 2015, https://www.sec.gov/oiea/investor-alerts-bulletins/autolistingtoolshtm.html ; Kara M. Stein, Commissioner, SEC, Remarks at Harvard Law School's Fidelity Guest Lecture Series: *Surfing the Wave: Technology, Innovation, and Competition* (Nov. 9, 2015) https://www.sec.gov/news/speech/surfing-wave-technology-innovation-and-competition-remarks-harvard-law-schools-fidelity.

[56] *See, e.g.,* GAO Report to Congress, *The Nation's Retirement System-A Comprehensive Re-evaluation Is Needed to Better Promote Future Retirement Security* (Oct 2017) [Fundamental changes have occurred over the past 40 years to the nation's current retirement system, made up of three main pillars: Social Security, employer-sponsored pensions or retirement savings plans, and individual savings. These changes have made it increasingly difficult for individuals to plan for and effectively manage retirement]; Speech, SEC Commissioner Kara Stein*, The New American Dream: Retirement Security* (Oct 16, 2018) ["Today, we as a nation face a fast-approaching crisis—an aging population without sufficient resources to fund a secure retirement. This crisis is a collective problem that, unless solved, will cause many individual

management of retirement and financial risks.[57] Functional regulation will ensure that Massachusetts consumers have better exposure to insurance products in building a firm financial foundation throughout life and in retirement.

The proposal's economic impact statement states that the Division is not aware of any other Massachusetts agency with regulations governing broker-dealers "that precludes them from adhering to such a standard." But the Massachusetts Insurance Law states that "the negotiation, solicitation, sale or transaction in fixed or variable insurance or annuity contracts by any person shall not be subject to the provisions of" the Massachusetts Uniform Securities Act.[58] The request for comment states that "given the overlap of securities-related and non-securities-related advice, the Division has a strong interest in regulating the conduct of its registrants regardless of the presence or absence of securities" and expresses that insurance product sales by are within the scope of the regulation. The exclusive jurisdiction of the Insurance Commissioner precludes the Division's assertion of jurisdiction and the application of a fiduciary standard to insurance product sales and distributors.

IX. The Proposed Regulation Will Impair Financial and Retirement Security for Massachusetts Citizens

Government studies reveal that many individuals and families are not adequately prepared for financial and retirement security.[59] Each day, 10,000 Americans turn age 65 and many can expect to

tragedies…. The retirement tsunami is approaching. Now is the time to do something about it. Let's move to higher ground."] https://www.sec.gov/news/speech/speech-stein-101618; Oakley and Kenneally, *Retirement Security 2015: Roadmap for Policy Makers Americans' Views of the Retirement Crisis,* (Mar. 2015) ["Some 86 percent agree that the nation faces a retirement crisis, and 57 percent strongly agree there is a crisis. Surprisingly, the sentiment is highest among those with annual income above $75,000] https://www.nirsonline.org/reports/retirement-security-2015-roadmap-for-policy-makers-americans-views-of-the-retirement-crisis/ .

[57] The Department of Labor observed that thirty-one percent of IRAs include investments in annuities. *See, e.g.*, DOL's Fiduciary Investment Advice, Regulatory Impact Analysis at 54 (Apr. 14, 2015) https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/ria.pdf .

[58] M.G.L. c. 175, § 3; Section 3: Unauthorized insurance, annuity or variable annuity contracts; prohibition
Section 3. No company shall make a contract of insurance or annuity, including any such insurance or annuity contract which is a contract on a variable basis, upon or relative to any property or interests or lives in the commonwealth, or with any resident thereof, and no person shall negotiate, solicit, sell or in any manner aid in the transaction of such contracts, or of their continuance or renewal, except as authorized by this chapter or chapter one hundred and seventy-six, or except as otherwise expressly authorized by law; and any such contract and the negotiation, solicitation, sale or transaction thereof by any person shall not be subject to the provisions of chapter one hundred and ten A [the MA Securities Code].. (emphasis added).
https://malegislature.gov/Laws/GeneralLaws/PartI/TitleXXII/Chapter175/Section3

[59] *See, e.g.,* GAO Report to Congress, *The Nation's Retirement System-A Comprehensive Re-evaluation Is Needed to Better Promote Future Retirement Security* (Oct 2017) [Fundamental changes have occurred over the past 40 years to the nation's current retirement system, made up of three main pillars: Social Security, employer-sponsored pensions or retirement savings plans, and individual savings. These changes have made it increasingly difficult for individuals to plan for and effectively manage retirement]; Speech, SEC Commissioner Kara Stein*, The New American Dream: Retirement Security* (Oct 16, 2018) ["Today, we as a nation face a fast-approaching crisis—an aging population without sufficient resources to fund a secure retirement. This crisis is a collective problem that, unless solved, will cause many individual tragedies…. The retirement tsunami is approaching. Now is the time to do something about it. Let's move to higher ground."] https://www.sec.gov/news/speech/speech-stein-101618; Oakley and Kenneally, *Retirement Security 2015: Roadmap for Policy Makers Americans' Views of the Retirement Crisis,* (Mar. 2015) ["Some 86 percent agree that the nation faces a retirement crisis, and 57 percent strongly agree there is a crisis. Surprisingly, the sentiment is highest among those with annual income above $75,000] https://www.nirsonline.org/reports/retirement-security-2015-roadmap-for-policy-makers-americans-views-of-the-retirement-crisis/ .

live 20 years or longer in retirement. Massachusetts has 1.8 million residents age 65 or older.[60] Every day 252 Massachusetts residents reach age 65. Research shows that one-third of Americans approaching retirement have between nothing and $25,000 in savings to supplement Social Security income.

Insurance products can play a significant role in consumer's management of retirement and financial risks.[61] Functional best interest standards will ensure that consumers have better exposure to insurance products in building a firm financial foundation throughout life and in retirement.

In 2018, the SEC Chairman emphasized that:

> Main Street investors, now more than ever before, are responsible for saving for retirement. With the shift away from traditional defined benefit pension plans, American workers are increasingly relying primarily on defined contribution plans, such as 401(k) plans and IRAs, to save for retirement. We owe it to these investors to make sure they have access to a broad mix of investment opportunities to save for retirement and to achieve other financial goals. Accordingly, we are looking at initiatives to facilitate access to capital for issuers and to make sure Main Street investors have the best possible mix of investment opportunities.[62]

On this point, the 2017 Treasury Report on Asset Management and Insurance[63] explained that "[b]ecause annuities are the only financial services product that can provide a guaranteed lifetime income stream, and because longevity risk (the risk of outliving one's assets) has become a key retirement concern, annuities are an important contributor to the Core Principle of empowering Americans to save for retirement."[64]

Defects in the proposed regulation will impair the delivery of financial and retirement security to Massachusetts residents, especially small and moderate retirement savers. This is a regrettable negative consequence of the proposal.

X. Improved Investor Understanding: 2018 RAND Study Modifies Form CRS

The Securities Division notice and request for public comment noted that investors may not be fully informed:

> *"The empirical studies supporting the 2008 RAND Report found that investors were fundamentally confused about the differences between broker-dealers and investment advisers. A key finding of the 2008 RAND Report is that most investors mistakenly believed the intermediary (whether it is a broker-dealer or*

[60] "Annual Estimates of the Resident Population for Selected Age Groups by Sex: April 1, 2010 to July 1, 2017", U.S. Census data. Retrieved June 10, 2019.

[61] The Department of Labor observed that thirty-one percent of IRAs include investments in annuities. *See, e.g.*, DOL's Fiduciary Investment Advice, Regulatory Impact Analysis at 54 (Apr. 14, 2015) https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/ria.pdf .

[62] *See* Chair Clayton's remarks in *SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks* (Dec. 6, 2018) at https://www.sec.gov/news/speech/speech-clayton-120618 (last visited December 31, 2019).

[63] https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-that-creates-economic-opportunities-asset_management-insurance.pdf

[64] *Id*. at 70.

> *an investment adviser) is acting in the investor's best interest. That report concluded that investors do not have the education and background to understand and effectively use disclosures such as the current Form ADV, Part 2."*

This observation in the proposal is stale and inaccurate. RAND also conducted a much more recent study -- in 2018 -- evaluating proposed Form CRS through extensive consumer testing to assure it addressed the concerns highlighted in its 2008 study. The SEC carefully addressed the input that was elicited through the 2018 RAND study and modified the final form significantly in response. Again, SEC Chair Clayton called out the incorrect assertion that Form CRS will not accomplish the goals of addressing investor confusion regarding the differences between brokers and adviser. He stated:

> *We have engaged in extensive and rigorous investor testing relating to the issues addressed by the relationship summary, not just for purposes of this rulemaking, but in connection with our long history in this space. The amount of feedback, investor testing and other information our staff considered in developing the final requirements for the relationship summary, leveraging their considerable experience and expertise with investor disclosures, was extensive—perhaps even unprecedented.*
>
> *It is clear that retail investors are confused about the differences between brokers and investment advisers. The new Form CRS relationship summary is a substantial improvement over existing retail disclosures, which are often lengthy, framed in legal terminology and dispersed among many documents. No existing retail disclosure provides this level of transparency and comparability across SEC-registered investment advisers, broker-dealers, and dual registrants.*[65]

It is important, therefore, to base the proposal on more current data to avoid stale and Ill-advised regulatory standards that are harmful to Massachusetts residents.

In a related development concerning enhanced consumer-focused disclosure about variable life insurance and variable annuities, the SEC invited comment on proposed rule and form amendments[66] that are intended to help investors make informed investment decisions regarding variable annuity and variable life insurance contracts. The proposal would modernize disclosures by using a layered disclosure approach designed to provide investors with key information relating to the contract's terms, benefits, and risks in a concise and more reader-friendly presentation, with access to more detailed information available online and electronically or in paper format on request. The proposed new rule would permit registrants to satisfy their prospectus delivery obligations under the Securities Act of 1933 for a variable annuity or variable life insurance contract by sending or giving a summary prospectus to investors and making the statutory prospectus available online.

The proposed rule also would consider registrants to have met their prospectus delivery obligations for any portfolio companies associated with a variable annuity or variable life insurance contract if the

[65] *See* Chair Clayton's remarks in *SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks* (Dec. 6, 2018) at https://www.sec.gov/news/speech/speech-clayton-120618 (last visited December 31, 2019).
[66] https://www.sec.gov/rules/proposed/2018/33-10569.pdf

portfolio company prospectuses are posted online. In addition, the SEC proposed amendments to the registration forms for variable annuity and variable life insurance contracts to update and enhance the disclosures to investors in these contracts, and to implement the proposed summary prospectus framework.

The SEC's disclosure initiative reflects life insurers' long-advocated approach[67] to summary disclosure: streamlined, simplified plain-English information through layered disclosure and access to more detailed information through supplemental web-based distribution. Current prospectuses of 1000 pages would reduce to 10 pages under this initiative. The initiative would enhance informed purchase decisions, reduce printing, postage, storage and environmental pollution. In November, the SEC staff announced that the initiative is expected to be adopted largely as proposed in April 2020.

Regarding variable contract disclosure, Consumer Federation of America[68] (CFA) has expressed unequivocal support for layered disclosure and a summary prospectus, and recommended the SEC extend layered summary disclosure into a wider range of retail contexts. In 2012, the CFA stated that:

> Our approach to disclosure issues is guided by three simple principles. Disclosure policy should be designed to ensure that investors get the information they need, in a form they can use, at a time when it is useful to them in making their investment decision.[69] <u>Over the years, however, we have come to accept that summary disclosures, though imperfect, may in fact be better at conveying information than the more complete disclosures we have traditionally preferred</u>. While our views had been evolving for some time, research we conducted in 2005-2006 on mutual fund purchase practices was decisive in convincing us to drop our opposition to summary disclosure documents.
>
> Two factors were particularly influential in changing our views: one was the further evidence provided by our survey that a majority of investors do not view the prospectus as an important source of information; the other was the high quality of the "fund snapshots" produced by many fund companies for display on their websites.
>
> Particularly appealing was the way some fund companies took advantage of the flexibility provided by the Internet to both highlight key data and draw the investor in to more complete and detailed discussions of important topics. In short, there are a variety of at least theoretical benefits to summary disclosure. Summary documents have the potential to be effective in allowing investors to make quick comparisons among a number of options before narrowing down their selection for more careful review.

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[67] See ACLI Feb. 15, 2019 submission commenting on the SEC's Summary Disclosure Initiative for Variable Annuities and Variable Life Insurance; ACLI submission on the SEC's Best Interest Initiative (August 3, 2018) [beginning at page 31]; ACLI's response to the SEC Chairman's ***Request** for Information about Standards of Conduct for Broker-Dealers and Investment Advisers* (Oct. 3, 2017) [beginning at page 6]. ACLI's July 5, 2013 Submission in response to the SEC's Request *for Data and Information on Brokers, Dealers and Investment Advisers* [beginning at page 15]; 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 [beginning at page 10]; and, ACLI's December 13, 2007 Submission in response to the *RAND* Study *on Broker-Dealer and Investment Advisory Issues* [beginning at page 6].

[68] According to its website, the CFA "is an association of non-profit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy, and education. Today, nearly 300 of these groups participate in the federation and govern it through their representatives on the organization's Board of Directors."

[69] Submission of Consumer Federation of America on the SEC's Study on Financial Literacy https://www.sec.gov/comments/4-645/4645-44.pdf

> In addition, some investors who might be turned off by a lengthier document may be drawn in by the summary and encouraged to explore further in certain key areas. On the other hand, some investors who never look beyond the summary might still be said to benefit if, absent a summary, they wouldn't have looked at any disclosure document. In such cases, while we might consider that the investor is making an inadequately informed investment decision, they would still arguably be better informed than they would otherwise have been without exposure to the summary document.
>
> We would encourage the Commission [SEC] to consider how wider use of summary disclosure documents could be incorporated into a layered approach to disclosures in a variety of retail contexts.

In its 2012 analysis, the CFA further stated that:

- When it comes to direct-to-investor disclosure, less is often more;
- Summary disclosures should focus on the issues most important to an informed decision; and,
- Disclosures should be designed to promote sound decision-making.

ACLI and LIAM agree with the CFA's supportive perspective on layered summary disclosure stated above and its positive impact on consumer decision making. This CFA statement indicates that the SEC summary disclosure is efficient and effective. The Massachusetts proposal fails to fully consider the wide menu of constructive disclosure developments that have recently evolved to aid consumer understanding of financial professionals and products. The summary conclusions in the proposed regulation is out of date and no longer relevant.

XI. Non-Cash Compensation Treatment Conflicts with Federal Securities Law Standard

The proposed regulation provides that "it shall be presumed to constitute a breach of the duty of loyalty for a broker-dealer" if a recommendation to purchase, sell, or exchange any security commodity or insurance product "is made in connection with any sales contest, implied or express quota requirement, or other special incentive program." This restriction against non-cash compensation directly conflicts with the SEC's new standard under Reg. BI, which allows "contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time" under the rule's conflict of interest obligation. Similarly, FINRA permits very limited non-cash compensation for variable products in Rule 2320. It is a longstanding practice of life insurers to use non-cash compensation, such as educational conferences, to train their agents and to expand the product and compliance knowledge of financial representatives. Consequently, the proposed fiduciary rule fully contradicts the SEC and FINRA treatment of non-cash compensation and violates the NSMIA prohibition on state law conflicts with Federal securities laws and is, therefore, preempted.

XII. The Proposed Rule Violates the First Amendment as Applied to the Commercial Speech of Broker-Dealers by Abridging Consumer's Rights to Receive Truthful, Non-misleading Information About Retirement Products and Services

The proposed Massachusetts fiduciary rule imposes significant content-based and discriminatory burdens on the commercial speech of ACLI and LIAM members—insurers, insurance agents, and brokers who market and sell annuities to American retirement savers—in an unconstitutional effort to influence the purchasing decisions of consumers. Under the Supreme Court's commercial speech jurisprudence—including the Court's seminal decision in *Sorrell v. IMS Health Inc*., 564 U.S. 552, 566 (2011)—the proposed regulation is subject to, but fails, the "heightened judicial scrutiny" that the First Amendment demands be applied to such regulations of commercial speech. The Court recently warned, moreover, of the dangers of policing the content of professional speech and cautioned that a State does not have "unfettered power to reduce a group's First amendment rights by simply imposing a licensing requirement." *Nat'l Institute of Family & Life Advocates v. Becerra*, 138 S. Ct. 2361, 2375 (2018).

Consumers depend on access to truthful, non-misleading information about their suitable retirement options. The Regulation's application to truthful, non-misleading speech violates the First Amendment of the U.S. Constitution. The application of the proposed regulation to ordinary sales conversations about retirement products—conversations that are not made in a "fiduciary" capacity but that, day in and day out, provide consumers with a critical source of information about retirement products and retirement savings—abridges the freedom of speech guaranteed by the First Amendment. All commercial speech proposes a commercial transaction, and thus recommends that a customer engage in that transaction. The proposed regulation directly regulates such commercial speech by imposing fiduciary obligations on all recommendations by broker-dealers and others, including recommendations regarding the purchase of insurance products, like annuities that provide critical income guarantees for retirement savers.

The proposed regulation is presumptively unconstitutional because it restricts and burdens that commercial speech based on its content, and it restricts the ability of ACLI and LIAM members and their agents to communicate truthful, commercial information to consumers based on the subject matter of those communications. The proposed regulation piles unreasonable, unworkable, and unnecessary burdens on truthful, non-misleading speech recommending selected retirement products—recommendations that are already required by law to be suitable for the customer in question.

The proposed regulation raises especially serious First Amendment concerns because it abridges consumers' right to receive truthful, non-misleading information about life insurers' financial and retirement products— information that is important to their personal life decisions. By forcing broker-dealers who sell these retirement products to provide recommendations only in a fiduciary capacity or not at all, the proposed regulation will raise the cost of, and deny many retirement savers access to, information about retirement options that is currently provided by broker-dealers and other as part of truthful, non-misleading sales conversations. The Securities Division's apparent belief that government-mandated silence is a preferable alternative to non-fiduciary sales conversations, and the position that no set of clear or simple disclosures could ever enable consumers to make informed choices about retirement products, countermand core First Amendment principles and precedent. The proposed regulation will therefore deprive American consumers of vital access to truthful retirement information.

XIII. Unacceptably Broad and Confusing Expansion Beyond the Proposed Fiduciary Rule Appears in the Narrative Accompanying the Request for Comment

A number of excessive statements appear in the narrative accompanying the proposal's request for comment[70]. A few examples demonstrate this significant concern.

[70] http://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/Request-for-Public-Comment.pdf

- Undocumented regulatory need or consumer harm. According to the request for comment, “the potentially catastrophic harm that can result from conflicted advice requires the rigorous approach embodied in the proposed regulations.” Nothing in the narrative documents or substantiates “catastrophic” harm.

- Assertion of jurisdiction over insurance products. The invitation of comment states that “while the Division does not take any position on annuities generally, the Division has seen numerous abusive practices involving the sale of annuities. This is exacerbated by the complexity of these products, the often-high costs and fees, and the high commissions for selling them.” This critical statement is unsubstantiated in the proposal or its narrative and cannot support the initiative’s extension to insurance products.

- Carte blanche to regulate. The proposal’s narrative states that “given the overlap of securities-related and non-securities-related advice, the Division has a strong interest in regulating the conduct of its registrants regardless of the presence or absence of securities.” This statement suggests that the Division views its authority to include regulating anything that is not a security. This profoundly exaggerates the Division’s scope of authority, which is limited to securities and securities professionals.

- Retroactive impact. According to the narrative, “the Proposal applies to recommendations made and advice provided to a customer or client. “Customer” and “Client” are defined to include both current and prospective customers and clients.” This excessively broad statement suggests that the proposal could have retroactive application to existing recommendations and compensation arrangement, such as trail commissions in some financial products.

- Non-cash compensation precluded. The narrative states that ‘sales contests, quotas, and other special incentives provide no benefit to the customer or client and are, therefore, repugnant to the principle of loyalty. The Division believes that Reg. BI does not go far enough to curb the myriad known abuses that have resulted from these and similar practices. Recommendations and advice that are truly best for the customer or client should not require any extra incentive.” This statement disregards different business models and blurs the distinction between sales recommendations and investment advice—two different functions. And, as noted above, this contradicts Reg. BI and therefore violates the NSMIA prohibition on conflicting state laws.

- Ban on proprietary products. The narrative explains that “the Division may deem it a breach of the duty of loyalty to effect a principal transaction when an agency transaction would have been cheaper for the customer, to recommend an affiliated or proprietary product when a third-party product would be expected to be better for the customer or client, or to limit products offered in a way that disadvantages some or all of a firm’s customers or clients.” Section 913 of the Dodd-Frank Act explicitly permitted broker-dealers’ recommendations of proprietary products. Likewise, the Act did not require salespersons to offer the cheapest product and did not require salespersons to have access to the entire universe of financial products when making a recommendation. Reg. BI conforms to this aspect of Section 913, and the proposed regulation contradicts these federal standards.

These are just a few examples of statements in the narrative that are inconsistent with the plain wording of the proposed regulation and create administratively incoherent rulemaking.

XIV. A Better Approach: SEC Regulation Best Interest and NAIC Best Interest Initiative

On June 2, 2019, the SEC adopted Reg. BI that establishes a standard of conduct for broker-dealers when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. This enhanced standard of conduct requires broker-dealers to act in the best interests of the retail customer at the time a recommendation is made without placing the financial or other interests of the broker-dealer or natural person who is an associated person making the recommendation ahead of the interests of the retail customer. This obligation is satisfied under Reg. BI if the broker-dealer fulfills a disclosure obligation, a care obligation, a conflict of interest obligation, and a compliance obligation.

Reg. BI is a sensible, principles-based rule governing broker-dealer conduct that properly implements the Dodd–Frank Act by meaningfully safeguarding customers through disclosure about services and material conflicts of interest. This approach provides an effective means to shield consumers and facilitate informed purchase decisions.

Coextensive with Reg. BI, the SEC adopted Form CRS, a streamlined, plain-English, user friendly document about services, fees, and consumers' relationship with broker-dealers and investment advisers, among other things. Form CRS dovetails neatly with the enhanced conduct standards in Reg. BI and significantly buttresses consumer protection and decision making. In a similar vein, the NAIC has coordinated with the SEC to develop parallel regulatory standards in the Suitability in Annuity Transactions Model Regulation. Likewise, the Department of Labor has docketed on its rulemaking agenda a standard of care rule and has pledged to incorporate coordinated standards.

Contrary to the suggestion in the Securities Division notice and request for public comment, dated June 14, 2019 ("[i]n many instances, it appears that the mitigation of conflicts required under the SEC Regulation Best Interest can be accomplished through disclosure, including disclosure via the new Customer Relationship Summary (Form CRS)."), Reg. BI cannot be satisfied by disclosure alone.

While disclosure is required under Reg. BI, it is only one of four obligations including a detailed, substantive care obligation, a conflict of interest obligation, and a compliance obligation. Indeed, on July 8, 2019, SEC Chair Jay Clayton dispelled the notion that disclosure alone satisfied Reg. BI in a public statement. He stated:

> This claim [that disclosure alone fulfills Reg. BI] reflects a fundamental misunderstanding of how the independent component obligations of Reg. BI operate and a misconception of the investment adviser's fiduciary duty.
>
> When making a recommendation, a broker-dealer has a general obligation to act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests. The general obligation is satisfied only if the broker-dealer complies with the four specified component obligations that I discussed—again, the Disclosure, Care, Conflict of Interest and Compliance Obligations.
>
> Similarly, an investment adviser has an obligation to act in the best interest of its client—which is an overarching principle that encompasses both the adviser's duty of care and duty of loyalty. While an adviser may be able to satisfy the duty of loyalty by providing full

and fair disclosure and obtaining informed consent, the adviser could not satisfy its duty of care solely through disclosure. Thus, the fiduciary duty cannot be satisfied by disclosure alone.

The proposal's assertions about disclosure requirements in Reg. BI are incorrect and unsubstantiated.

The NAIC is in the final stages of adopting revisions to the Suitability in Annuity Transactions Model Regulation (Suitability Model Regulation) to impose a best interest standard of care for annuity recommendations that aligns with the SEC's Reg. BI relating to individualized recommendations to retail customers regarding the purchase, exchange or replacement of an annuity.

On December 30th, the NAIC Life Insurance and Annuities (A) Committee (A Committee) voted to approve best interest and related revisions to the Suitability Model Regulation. The full NAIC is expected to vote on and approve the revisions, as approved by the A Committee, in early February 2020.

The revisions to the NAIC Suitability Model Regulation to incorporate a best interest standard of care for annuities and to subject insurers to related new supervisory requirements align well with the best interest standard of care for securities established under the SEC's Reg. BI, though the language and requirements of the two initiatives are not identical.

XV. Conclusion

The proposal will directly harm the very consumers it is intended to help by interfering with their access to valuable retirement products and information about them. It is bad for Massachusetts citizens. The proposed regulation:

- Exceeds the statutory authority of the Securities Division;
- Usurps the legislature's function;
- Violates the exclusion for all insurance, endowment, and annuity contracts from the definition of "security";
- Conflicts with the exclusive authority of the Insurance Commissioner to regulate the issuance and sale of insurance products;
- Contradicts and is preempted by federal securities regulation, new SEC Reg. BI, Form CRS and new SEC investment adviser interpretations;
- Breaches and is preempted by provisions of NSMIA and ERISA;
- Impairs life insurers' capacity for investment, infrastructure, jobs, taxes and the economy in Massachusetts;
- Generates a patchwork of regulatory disparities;
- Muddies legal standards that will diminish the delivery of insurance and annuities in Massachusetts and undermine citizens' access to financial and retirement security; and
- Fails in its mandated economic impact analysis.

Government studies reveal that many individuals and families are not adequately prepared for financial and retirement security. Each day, 10,000 Americans turn age 65 and many can expect to live 20 years or longer in retirement. Massachusetts has 1,071,418 million residents age 65 or older, which reflects 15.8% of the state's total population. Research shows that one-third of Americans approaching retirement have between nothing and $25,000 in savings to supplement Social Security income.

As society and work change, Americans need policy solutions that protect them and help them achieve financial security, regardless of where and how they work, their life stage, or the economic status of their household. People are living longer and financial security into retirement is a big challenge. Government policies that limit consumer choice ignore the fact that financial situations are varied and personal. Life insurers want to help people achieve retirement security with a choice of products that are available, accessible, and affordable for all.

The SEC's Reg. BI is a sensible, principles-based rule governing broker-dealer conduct that properly implements the Dodd–Frank Act. The proposed Massachusetts regulation will conflict with the significant new SEC regulatory actions in Reg. BI and Form CRS and will harm the Massachusetts individuals and families it intends to protect. It will also set a dangerous precedent of patchwork, state-by-state regulations—shattering the uniformity Congress desired in delegating to the SEC the authority to established enhanced protections at the federal level.

ACLI and LIAM support reasonable regulations governing financial professionals that protect consumers in the acquisition of financial products. Efficient and effective best interest standards will broaden consumers' functional access to variable annuities and variable life insurance as financial and retirement solutions. Clarity, consistency and coordination across all regulatory platforms will best serve investors.

We urge the Massachusetts Securities Division to withhold further action on the proposed regulatory changes. The Securities Division should implement regulations parallel to the SEC's Reg. BI and Form CRS instead, and support Massachusetts' adoption of best interest standards under development by the National Association of Insurance Commissioners in its Suitability in Annuity Transactions Model Regulation. This approach will ensure uniform, consumer-protective standards consistently applied across all state and federal regulatory platforms. It will better enable Massachusetts citizens to fulfill their financial and retirement security through informed purchase decisions, a wide array of funding options and different business models.

If you have any questions, please feel free to contact Carl B. Wilkerson, ACLI Vice President & Chief Counsel-Securities.[71] Thank you for your attention to our views.

Sincerely,

Susan K. Neely

Susan K. Neely
President and CEO, American Council of Life Insurers

Luke A. Dillon

Luke Dillon
President, Life Insurance Association of Massachusetts

[71] carlwilkerson@acli.com or 202.624.2118

Appendix A

Life Insurers + Massachusetts

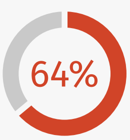
2019 ACLI STATE FACT SHEETS

The life insurance industry's mission is to help all Americans, regardless of where and how they work, their life stage, or their economic status, deal with life's financial challenges and achieve peace of mind. Here's how we help in your state:

DID YOU KNOW?

1/5 of Massachusetts residents are under age 18—typically financially dependent on a loved one or caregiver.

Massachusetts has **1.1 MILLION** residents aged **65 or older**.



64% of Massachusetts residents are of working age.

813,000 Massachusetts residents are dealing with a disability.

INVESTING IN THE ECONOMY

The life insurance industry generates approximately **70,400** jobs in Massachusetts.

Life insurance companies invest approximately **$159 BILLION** in Massachusetts's economy, helping to finance businesses, create jobs, and provide services in the state.

376 life insurers are licensed to do business in Massachusetts and **14** are domiciled in the state.

PROTECTING FAMILIES FROM THE LOSS OF A BREADWINNER

Massachusetts residents have **$916 BILLION** in total life insurance coverage—**90%** from ACLI member companies.

Massachusetts residents own **2 MILLION** individual life insurance policies, with coverage averaging **$235,000** per policyholder.

$2.3 BILLION was paid to Massachusetts life insurance beneficiaries in 2017.

Individual life insurance coverage purchased in Massachusetts in 2017 totaled **$40 BILLION**.

Group life insurance coverage in the state amounts to **$341 BILLION**.

PROVIDING GUARANTEED INCOME AND LONG-TERM CARE TO RETIREES

Annuity benefits paid in the state in 2017 totaled **$2.9 BILLION**.

Long-term care insurance paid in the state in 2017 totaled **$302 MILLION**.

EVERY DAY IN MASSACHUSETTS, LIFE INSURERS PAY OUT **$45.5 MILLION** IN LIFE INSURANCE AND ANNUITIES TO FAMILIES AND BUSINESSES—**96%** FROM ACLI MEMBER COMPANIES.

ACLI
Financial Security...for Life.

101 Constitution Avenue, NW, Suite 700
Washington, D.C. 20001-2133
acli.com I April 2019

Appendix B

March 7, 2017

J.P.Morgan

Important information regarding your investment retirement account(s) ending in:

Dear Valued Client:

As previously communicated, the U.S. Department of Labor announced a new set of industry-wide regulations for retirement and other qualified accounts that are scheduled to go into effect in April 2017. As a result, we are making changes to the way we service and provide investment guidance on your retirement account referenced above.

Please note that this letter reflects your account information as of 01/31/2017—your financial advisor may have already contacted you about these changes and discussed next steps.

What you need to know

- Beginning on or about April 7, 2017, we will transition your retirement account to a Self-Directed Investing Account; no action is required on your part.
- **After this date, your financial advisor will no longer be able to provide investment guidance on this account; however, you may still be able to receive personalized investment guidance from your financial advisor on other accounts you have with us.**
- We will notify you in the event these regulations are not implemented as currently planned, as we may not proceed with this transition.

About your Self-Directed Investing Account

- You will be able to access your account online, anytime at chase.com. If you need help enrolling in Chase Online℠, please call our Internet Service Center at 1-877-242-7372.
- You will also have access to a phone-based Self-Directed Investing Team for any account servicing needs you may have; however, they will not be able to provide investment guidance. After April 7, 2017, they can be reached at the phone number listed on your account statement.

Next steps

Please review the enclosed agreement, which amends your current agreement and will be effective after your account has transitioned to a Self-Directed Investing Account.

Over, please.

Investment products and services are offered through **J.P. Morgan Securities LLC** (JPMS), a member of FINRA and SIPC. JPMS is an affiliate of JPMorgan Chase Bank, N.A. Products not available in all states.

INVESTMENT PRODUCTS ARE:
• NOT FDIC INSURED • NOT A DEPOSIT OR OTHER OBLIGATION OF, OR GUARANTEED BY, JPMORGAN CHASE BANK, N.A. OR ANY OF ITS AFFILIATES • SUBJECT TO INVESTMENT RISKS, INCLUDING POSSIBLE LOSS OF THE PRINCIPAL AMOUNT INVESTED

LC-CWMDOLIRA

If you have any questions about these changes or would like to learn more about our other retirement options, please contact your financial advisor or call us at 1-800-469-1733.

Thank you for your continued trust and confidence.

Sincerely,

Barry Sommers
Chief Executive Officer
Wealth Management

Enclosure: J.P. Morgan Securities LLC Disclosures & Brokerage Account Agreement for Self-Directed Accounts

Summary of Changes

For your reference, we have provided the following overview of what is changing for your investment retirement account:

Account Feature/Service	Effective April 7, 2017	Details
Access to a financial advisor for investment guidance	**Changing**	Your financial advisor will no longer be able to provide investment guidance on this account. Please note: • You may still be able to receive personalized investment guidance from your advisor on other accounts you have with us. • If you have questions about any open orders, please contact the number listed on your account statement.
Service requests (e.g., placing trades or making updates to your account)	**Changing**	Service requests can be made online at chase.com or over the phone; you will no longer be able to contact your financial advisor.
Account agreement	**Changing**	An amended account agreement is enclosed. Please review this document and keep it for your records.
Transaction/commission fees	**Changing**	Your Self-Directed Investing Account may offer reduced trading pricing. Please visit chase.com/RetirementFees to view the updated commission schedule.
Account fees	Not Changing	Your account fees, which are listed in the enclosed agreement, will remain the same.
Account number	Not Changing	Your account number will remain the same.
Online access	Not Changing	Please visit chase.com to view detailed account information.
Statements	Not Changing	Please visit chase.com to view your account statements.

TD Ameritrade

July 24, 2017

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Dear

We consider it no small gesture when you trust us with your investment accounts, and we are committed to improving your investing experience. Because you're a valued client, we are happy to offer you a dedicated, complimentary Senior Financial Consultant. Your Senior Financial Consultant will work with you to answer your questions and help you find the solutions and resources that are right for you so you can pursue your goals.

— **One-on-one Attention**
Complimentary support from your Senior Financial Consultant, with ongoing reviews, goal planning, and check-ins, so you can get the most from your TD Ameritrade experience.

— **Personalized Guidance**
Work with your Senior Financial Consultant to develop an investing plan that helps you identify the right solutions for your unique goals.

— **Extensive Investing Resources**
Your Senior Financial Consultant can guide you to in-depth tools and education, so you can understand what's available to you to pursue your investing goals.

— **Access to Specialists**
Your Senior Financial Consultant can connect you to knowledgeable specialists, providing you with added insight in several areas—annuities, fixed income, trading, and professionally managed portfolios.

It's easy to continue receiving the benefits of working with a Senior Financial Consultant. Simply maintain a balance of $250,000 in your TD Ameritrade account or $100,000 within the Investment Management Services offerings.

It's important to have someone help you with your investment experience. No matter what your plans are, your Senior Financial Consultant is here when you need them so you can pursue your financial goals with confidence.

Ready to get in touch? Contact your Senior Financial Consultant today.

Meredith Witucki
(503) 203-2975
meredith.witucki@tdameritrade.com

Sincerely,

David Lynch
Managing Director, Head of Retail Sales

Merrill Lynch
Bank of America Corporation

Date: May 2017

Review & Retain – Important Information regarding Changes to Merrill Lynch Retirement Accounts Not Enrolled in a Merrill Lynch Investment Advisory Program

We are writing to update you on planned changes to the services that Merrill Lynch and your advisor offer to certain types of brokerage retirement accounts as a result of the pending implementation of the new Department of Labor Fiduciary Rule (DoL Rule).

Since Merrill Lynch's founding more than 100 years ago, we have maintained a commitment to putting our clients' interest first. This is why we support the DoL Rule, which is scheduled to become applicable on June 9, 2017 (the Applicability Date). Please note, however, that the Applicability Date may be pushed out subject to DoL regulation. The DoL Rule requires advisors to apply a fiduciary standard of care when making a recommendation regarding clients' Retirement Accounts. We welcome this new standard and were, in fact, among the first in the industry to lend our support to this initiative.

The changes affect the following Retirement Account types enrolled in our brokerage platform:

- Individual Retirement Account (IRA)
- Roth IRA
- IRRA
- SEP IRA
- SIMPLE IRA
- BASIC
- Retirement Selector® Account (RSA®)
- RCMA Investment Only account
- Self-Direct Brokerage Advisor Advantage Account
- Self-Direct Brokerage Account through Ascensus and Ascensus Trust
- Institutional Trust & Custody Services Advised Brokerage Qualified Plan Account

Preparing for the DoL rule
Merrill Lynch already provides a fiduciary standard of care to those accounts serviced by your advisor that are enrolled in the Merrill Lynch Investment Advisory Program (MLIAP). In this investment advisory program, the advice and guidance is provided by your advisor on a fixed fee basis to remove potential conflicted advice regarding compensation earned. You also receive investment advisory services and ongoing monitoring of your investments. Your advisor stands ready to review your individual circumstances and provide information and guidance about these programs and their benefits and costs.

What this means for your Retirement Accounts that are NOT enrolled in MLIAP or one of our other investment advisory programs
Beginning on the Applicability Date, your existing brokerage Retirement Accounts that are not enrolled in Merrill Lynch's Investment Advisory Program or one of our other investment advisory programs will be subject to the following:

- Your Merrill Lynch account number will remain the same.
- Any existing securities and cash will remain in the account until you take action.
- Cash sweeps will continue according to your existing instructions.
- Cash contributions and withdrawals from and into the account will be allowed (other than for RSA which has been closed to new funds).
- No new securities purchases or transfers in of securities in your existing account will be allowed.
- Sell transactions and transfers of securities out of the account will be allowed.

In addition, we will offer a limited purpose brokerage Retirement Account to enable you, after the Applicability Date, to hold cash and conduct limited securities purchase and sell transactions in certain investment products we determine to make available from time to time.

Working with your advisor
The text of the amendments to the Retirement Account agreements that are related to the DoL Rule and other changes are set forth in the attached Amendment Notification. If you would like a copy of the revised agreement for your Retirement Account, please contact your Merrill Lynch advisor.

We encourage you to work with your Merrill Lynch advisor to better understand the impacts of these changes on your existing accounts and what choices are available to you for the ongoing management of your Retirement Accounts. Some of these changes impact your specific investments and investment choices, like mutual funds and annuities, and may require action within a certain time frame.

Thank you for allowing us to continue to serve you and help you work toward your financial goals. If you have any questions, please contact your Merrill Lynch advisor.

Appendix C

Reg BI and Form CRS Firm Checklist

Compliance Date is June 30, 2020

FINRA is providing this checklist to help members assess their obligations under the SEC's Regulation Best Interest (Reg BI) and Form CRS Relationship Summary (Form CRS). This checklist explains key differences between FINRA rules and Reg BI and Form CRS. The checklist is not a substitute for any rule. Only the rule can provide definitive information regarding its requirements. Interpretive questions should be directed to the SEC, at *IABDQuestions@sec.gov*. You should carefully review the SEC's new rules and interpretations, related *Federal Register* notices and the SEC's Small Entity Compliance Guides, which provide important information on the new obligations.[1]

REG BI

1	Do you have procedures and training in place to assess recommendations using a **best interest** standard?
○ Status Completed ✔	Securities recommendations must be in the retail customer's best interest. The firm and the associated person (AP) may not place their interests ahead of the retail customer's. This is a change from FINRA's suitability standard, which does not have an explicit best interest requirement. The best interest standard is an overarching obligation, which is satisfied only if you comply with four component obligations: Care, Disclosure, Conflict of Interest and Compliance.
2	Do you apply a best interest standard to recommendations of **types of accounts**?
○ Status Completed ✔	Unlike FINRA's suitability rule, the best interest standard explicitly applies to recommendations of types of accounts. A broker-dealer (BD) or AP must have a reasonable basis to believe that a recommendation of a securities account type (*e.g.,* brokerage or advisory, or among the types of accounts offered by the firm, including IRAs) is in the retail customer's best interest at the time of the recommendation and does not place the financial or other interest of the BD or AP ahead of the interest of the retail customer. In general, when considering recommendations of types of accounts, you should consider: (a) services and products provided in the account; (b) projected cost of the account; (c) alternative account types available; (d) services the retail customer requests; and (e) the retail customer's investment profile. With regard to IRAs, in addition to the factors above, you should consider: (a) fees and expenses; (b) level of services available; (c) ability to take penalty-free withdrawals; (d) application of required minimum distributions; (e) protections from creditors and legal judgments; (f) holdings of employer stock; and (g) any special features of the existing account.

1 The SEC's *Federal Register* notices for *Reg BI, Form CRS, Interpretation of Solely Incidental and Interpretation of Investment Advisers' Obligations* are available at *https://www.sec.gov/rules/final.shtml*. The SEC's *Regulation Best Interest, A Small Entity Compliance Guide* is available at *https://www.sec.gov/info/smallbus/secg/regulation-best-interest*, and *Form CRS Relationship Summary; Amendments to Form ADV, A Small Entity Compliance Guide* is available at *https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary*.

3	If you agree to provide **account monitoring**, do you apply the best interest standard to both explicit and **implicit hold recommendations**?

○ Status Completed ✔

Reg BI imposes no duty to monitor a customer's account following a recommendation. However, if you agree to perform account monitoring services, you are taking on an obligation to review and make recommendations regarding the account (*e.g.*, to buy, sell or hold) on the specified, periodic basis that you have agreed to with the retail customer. In such circumstances, Reg BI would apply even where you remain silent (*i.e.*, an implicit hold recommendation).

For example, if you agree to monitor a retail customer's account on a quarterly basis, the quarterly review and resulting recommendation will be subject to Reg BI, including an implicit recommendation to hold if you are silent as to the securities in the account. In addition, if you agree to monitor the customer's account, you are required to disclose the terms of such account monitoring services (including the scope and frequency of such services) pursuant to the Disclosure Obligation. IA registration requirements also might apply if a BD agrees to conduct ongoing monitoring in a manner not reasonably related to providing buy, sell or hold recommendations.

Importantly, you may voluntarily, and without any agreement with your customer, review the holdings in your retail customer's account for the purposes of determining whether to provide a recommendation to the customer. This voluntary review is not considered to be "account monitoring," and would not create an implied agreement with the customer to monitor the account.

4	Do you consider the elements of **care, skill** and **costs** when making recommendations to retail customers?

○ Status Completed ✔

Reg BI incorporates FINRA's reasonable-basis (*i.e.* knowing the product and having a reasonable basis to believe it is appropriate for at least some investors) and customer-specific (*i.e.* knowing the customer and having a reasonable basis to believe a particular recommendation is appropriate for a specific customer based on that customer's investment profile) suitability obligations with important enhancements.

Care, skill and costs (in addition to applying a best interest standard) are new express elements for consideration when making recommendations to retail customers.

Cost must *always* be considered when making a recommendation. Moreover, consideration of cost includes not only the cost of purchase, but also any costs that may apply to the future sale or exchange of the security, such as deferred sales charges or liquidation costs. However, while cost must always be considered, it is not dispositive, and its inclusion in the rule text is not intended to limit or foreclose a recommendation of a more costly product if there is a reasonable basis to believe that product is in the best interest of a particular retail customer.

5	Do you guard against **excessive trading**, irrespective of whether the BD or AP "**controls**" the account?

○ Status Completed ✔

Reg BI incorporates FINRA's quantitative suitability obligation (that a series of recommended transactions are appropriate and not excessive). However, in a change from FINRA's quantitative suitability obligation, Reg BI applies the best interest standard to a series of recommended transactions, irrespective of whether the BD exercises actual or de facto control over a customer's account.

6 Do you consider **reasonably available alternatives** to the recommendation?

Status
Completed
✔

You should consider reasonably available alternatives, if any, offered by your BD in determining whether you have a reasonable basis for making the recommendation. An evaluation of reasonably available alternatives does not require an evaluation of every possible alternative (including those offered outside the firm) nor require BDs to recommend one "best" product.

A BD should have a reasonable process for establishing and understanding the scope of such "reasonably available alternatives" that would be considered by particular APs or groups of APs (*e.g.*, groups that specialize in particular product lines) in fulfilling the reasonable diligence, care and skill requirements under the Care Obligation.

7 Do you consider how to ensure that **high-risk** or **complex products** are in a retail customer's best interest?

Status
Completed
✔

Although not a rule requirement, BDs should consider, as a best practice, applying heightened scrutiny as to whether high-risk or complex investments, such as inverse and leveraged ETFs, are in a retail customer's best interest.

8 Prior to or at the time of the recommendation, do you provide retail customers with full and fair written disclosure of all material facts relating to the scope and terms of the relationship with the retail customer, including:

Status
Completed
✔

The capacity in which you are acting (BD or IA)?

A standalone BD generally may satisfy this requirement by delivering the Form CRS to the retail customer.

For BDs who are dually registered, and APs who are either dually registered or who are not dually registered but only offer BD services through a firm that is dually registered, providing Form CRS will not be sufficient to disclose their capacity, and they must disclose if they are acting as a BD when making a recommendation.

In addition, an AP of a dual registrant who does not offer investment advisory services must disclose that fact as a material limitation. Similarly, an AP registered in a limited capacity (*e.g.*, a Series 6) must disclose that limitation (*i.e.*, she cannot recommend all available products).

Material fees and costs that apply to the retail customer's transactions, holdings, and accounts?

This should build upon the fees and costs disclosure in Form CRS, with more particularity, such as whether fees are deducted from the customer's account per transaction or quarterly. This obligation would not require individualized disclosure for each retail customer. Rather, the use of standardized numerical or other non-individualized disclosure (*e.g.*, reasonable dollar or percentage ranges) is permissible.

◯ **The type and scope of services – whether or not the BD will monitor the retail customer's account and, if so, the scope and frequency of those services?**

Although Form CRS may disclose that the firm provides account monitoring services, Reg BI requires disclosure about whether or not account monitoring would occur for the particular retail customer and the scope and frequency of those services.

◯ **Any requirements for retail customers to open or maintain an account or establish a relationship (*e.g.*, minimum account size)?**

This would include any requirements for retail customers to open or maintain an account, or to avoid additional fees when a threshold is crossed, such as a low account balance.

◯ **Any material limitations on the securities or investment strategies involving securities that may be recommended to the customer?**

Material limitations include recommending only proprietary products or a specific asset class; products with third-party arrangements (revenue sharing, mutual fund service fees); products from a select group of issuers; the fact that IPOs are available only to certain clients; and that an AP of a dually registered firm does not offer investment advisory services or is registered in a limited capacity (*e.g.*, Series 6).

◯ **The general basis for the recommendation (*i.e.*, what might commonly be described as the firm's investment approach, philosophy, or strategy)?**

This may be standardized or a summary; however, the disclosure should also address circumstances when a standardized basis does not apply, and how the BD will notify the customer when that is the case.

As a best practice, firms should encourage APs to discuss the basis for any particular recommendation with their retail customers and the associated risks, particularly when the recommendation is significant to the customer (*e.g.*, the decision to roll over a 401(k) into an IRA).

◯ **Risks associated with the recommendation?**

Standardized disclosure is permitted.

9	At or prior to making a recommendation, do you make full and fair written disclosure of all material facts relating to conflicts of interest?
◯ Status Completed ✔	Material facts regarding conflicts of interest include, for example: conflicts associated with proprietary products, payments from third parties and compensation arrangements. BDs must disclose all material facts relating to conflicts of interest associated with the recommendation. This does not require that information regarding conflicts be disclosed on a recommendation-by-recommendation basis. Standardized written disclosure of this information may be made, provided that it sufficiently identifies the material facts relating to conflicts of interest associated with a particular recommendation.

10	Do you ensure that you do not use the term "advisor" or "adviser" unless you are a registered investment adviser, a registered municipal advisor, a registered commodity trading advisor or an advisor to a special entity?
◯ Status Completed ✔	Use of the terms "advisor" or "adviser" in a name or title by: (a) a BD that is not also an RIA; or (b) a financial professional that is not a supervised person of an RIA, would presumptively violate Reg BI. Exceptions would include a BD/AP that acts on behalf of a municipal advisor or commodity trading advisor, or an advisor to a special entity. In addition, an RR of a dually registered BD may use firm materials when the BD/IA firm has the term "advisor" or "adviser" in its title.
11	Do APs supplement written disclosures with subsequent oral disclosure?
◯ Status Completed ✔	Oral disclosure of a material fact may be required to supplement, clarify or update written disclosure made previously. BDs must maintain a record that oral disclosure was provided to the retail customer (but not the substance of the disclosure). Although not required by Reg BI, the SEC encourages, as a best practice, following oral disclosures with timely, written disclosure summarizing the information conveyed orally.
12	Do you have policies and procedures to **identify** and **address** the firm's conflicts of interest?
◯ Status Completed ✔	Firms must have written policies and procedures reasonably designed to identify and, at a minimum, disclose or eliminate all conflicts of interest associated with recommendations covered by Reg BI. A conflict of interest is an interest that might incline a BD or AP – consciously or unconsciously – to make a recommendation that is not disinterested.
13	Do you have policies and procedures to **identify** and **mitigate** the AP's conflicts?
◯ Status Completed ✔	Conflicts that create an incentive for the AP to place the BD's or AP's interest ahead of the retail customer's interest must be mitigated. Mitigation measures will depend on the nature and significance of the incentives and a variety of factors related to a BD's business model, such as its size and retail customer base, and the complexity of the security or investment strategy that is being recommended.
14	Do you have policies and procedures to **identify** and **disclose** material limitations on products recommended?
◯ Status Completed ✔	Material limitations include, for example, recommending only proprietary products or a specific asset class; products with third-party arrangements; products from a select group of issuers; or making IPOs available only to certain clients.

15

Do you have policies and procedures to prevent material limitations from causing the BD or AP to make recommendations that place the BD's or AP's interest ahead of the retail customer's interest?

Status Completed ✔

Policies and procedures to prevent harm from material limitations could consist of establishing product review processes for products that may be recommended, including establishing procedures for identifying and mitigating the conflicts of interests associated with the product, or declining to recommend a product where you cannot effectively mitigate the conflict, and identifying which retail customers would qualify for recommendations from the product menu.

As part of this process, firms may consider: evaluating the use of "preferred lists"; restricting the retail customers to whom a product may be sold; prescribing minimum knowledge requirements for APs who may recommend certain products; and conducting periodic product reviews to identify potential conflicts of interest, whether the measures addressing conflicts are working as intended, and to modify the mitigation measures or product selection accordingly.

16

Do you have policies and procedures to **identify** and **eliminate** sales contests, bonuses, non-cash compensation and quotas based on the sale of specific securities or specific types of securities within a limited time?

Status Completed ✔

Reg BI bans these practices. This requirement does not apply to compensation practices based on, for example, total products sold, or asset growth or accumulation, and customer satisfaction.

This requirement would not prevent a BD from offering only proprietary products, placing material limitations on the menu of products, or incentivizing the sale of such products through its compensation practices, so long as the incentive is not based on the sale of specific securities or types of securities within a limited period of time.

The requirement also is not intended to prohibit: training or education meetings, provided that these meetings are not based on the sale of specific securities or types of securities within a limited period of time; or receipt of certain employee benefits by statutory employees, as these benefits would not be considered to be non-cash compensation for purposes of Reg BI.

17

Have you updated your policies and procedures to ensure **compliance** with Reg BI?

Status Completed ✔

Reg BI's Compliance Obligation requires that BDs establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with Reg BI.

In addition to the required policies and procedures, depending on the BD's size and complexity, a reasonably designed compliance program generally would also include: controls, remediation of non-compliance, training, and periodic review and testing.

Firms may be able to satisfy the Compliance Obligation by adjusting their current systems of supervision and compliance, rather than creating new ones.

18 Have you updated your policies and procedures and systems to ensure Reg BI's **recordkeeping** obligations are satisfied?

Status Completed ✔

SEA Rules 17a-3(a)(35) and 17a-4(e)(5) codify the recordkeeping requirements associated with Reg BI.

Current recordkeeping practices will not fully satisfy Reg BI. For example, BDs must provide retail customers with additional disclosures that require records. Firms may use a risk-based approach to documenting compliance with Reg BI.

19 Have you implemented **training** to ensure that APs are aware of Reg BI's requirements?

Status Completed ✔

The SEC noted that training generally is an important vehicle to communicate firm culture, specific requirements of a firm's code of conduct and its conflicts management framework.

20 Have you aligned your policies and procedures to the **definitions** in Reg BI?

Status Completed ✔

Retail Customer

Reg BI only applies to recommendations to "retail customers." Reg BI defines a "retail customer" as a natural person, or the **legal representative** of such person, who: (a) receives a **recommendation** for any securities transaction or **investment strategy** from a BD or AP; and (b) **uses** the recommendation primarily for **personal, family or household purposes**.

Legal Representative

"Legal representative" includes the non-professional legal representatives of such a natural person, *e.g.*, a non-professional trustee that represents the assets of a natural person. Reg BI would not apply when the legal representative is acting in a professional capacity as a regulated financial services industry professional retained to exercise independent professional judgment. Therefore, recommendations to registered IAs and BDs or corporate fiduciaries would not trigger Reg BI. On the other hand, recommendations to non-professional trustees, executors, conservators and persons holding power of attorney that represent natural persons are covered.

Recommendation

The final rule release for Reg BI states that this is keyed off of the guidance for FINRA's suitability rule.

Investment Strategy

The final rule release for Reg BI states that this is keyed off of the guidance for the FINRA's suitability rule; however, this will include recommendations of types of accounts.

Receives and Uses

The SEC has stated that "use" means when, as a result of the recommendation:

- the retail customer opens a brokerage account with the BD, regardless of whether the BD receives compensation;
- the retail customer has an existing account with the BD and receives a recommendation from the BD, regardless of whether the BD receives or will receive compensation, directly or indirectly, as a result of the recommendation; or
- the BD receives or will receive compensation, directly or indirectly, as a result of that recommendation, even if that retail customer does not have an account at the firm.

Personal, Family, or Household Purposes

The phrase "primarily for personal, family, or household purposes" covers any recommendation to a natural person for his or her account, other than recommendations to a natural person seeking these services for commercial or business purposes. Reg BI would not cover, for example, an employee seeking services for an employer or an individual seeking services for a small business or on behalf of another non-natural person entity, such as a charitable trust.

Conflict of Interest

A conflict of interest is an interest that might incline a BD or AP – consciously or unconsciously – to make a recommendation that is not disinterested.

Full and Fair

Sufficient information to enable a retail customer to make an informed decision with regard to a recommendation.

1	Have you developed a two-page (four for dual registrants) **relationship summary known as Form CRS**?

○ Status Completed ✔

This applies to both IAs and BDs. Firms must write their relationship summaries in plain language, taking into consideration retail investors' level of financial experience. Firms are encouraged, but not required, to use electronic and graphical formatting.

2	Does your **relationship summary** include:

○ Status Completed ✔

○ **An introduction to the firm?**

This must include: (a) the name of the BD or IA, and whether the firm is registered with the SEC as a BD, IA or both; (b) an indication that BD and IA services and fees differ and that it is important for the retail investor to understand the differences; and (c) a statement that free and simple tools are available to research firms and financial professionals on the SEC's investment education website (Investor.gov/sec), which provides educational materials about BDs, IAs and investors.

○ **A description of services and advice that can be provided?**

The relationship summary must describe all relationships and services offered to retail investors, even if the investor at issue does not qualify for or is not being offered a particular service currently.

○ **A description of fees and costs, applicable standard of conduct, and examples of how the firm makes money and conflicts of interest?**

Firms must summarize the principal fees and costs that retail investors incur with respect to their BD and IA accounts, and the conflicts they create.

○ **Relevant disciplinary history?**

The relationship summary must include a separate section about whether a firm and its financial professionals have reportable disciplinary history and where investors can conduct further research on these events.

○ **How additional information may be obtained?**

Firms must state where retail investors can find additional information about their BD and IA services.

○ **Prescribed "conversation starters" for investors to ask?**

If a required disclosure or conversation starter is inapplicable to your business, or specific wording required by the Form's instructions is inaccurate, you may omit or modify that disclosure or conversation starter.

3	Do you have a process in place to **file** the Form CRS?
◯ Status Completed ✔	Firms must file the relationship summary through Web CRD® (dual registrants will be required to file their relationship summaries using both IARD™ and Web CRD®).
4	**Do you have a process in place to update the Form CRS?**
◯ Status Completed ✔	Firms must update Form CRS and file it within 30 days whenever any information becomes materially inaccurate. Firms must communicate any changes in the updated relationship summary to retail investors who are existing clients or customers within 60 days after the updates are required to be made and without charge. Firms can make the communication by delivering the amended relationship summary or by communicating the information through another disclosure that is delivered to the retail investor. Form CRS General Instruction 8 sets forth requirements for updating the relationship summary, including filing and delivering an exhibit that highlights changes to an updated relationship summary.
5	Are you **delivering** Form CRS to each **new or prospective customer** who is a retail investor before or at the earliest of:
◯ Status Completed ✔	(a) a recommendation of an account type, a securities transaction or an investment strategy involving securities; (b) placing an order for the retail customer; or (c) the opening of a brokerage account for the retail customer? If included in a packet of information, the relationship summary must be placed first. If the relationship summary is delivered electronically, it must be presented prominently in the electronic medium, for example, as a direct link or in the body of an email or message, and must be easily accessible for retail investors.
6	Do you have a process in place to **deliver** the relationship summary to **existing retail customers**?
◯ Status Completed ✔	Firms must deliver the relationship summary to existing retail investor customers before or at the time firms open a new account that is different from the retail investor's existing account. In addition, firms must deliver the relationship summary when they recommend that the retail investor roll over assets from a retirement account, or when they recommend or provide a new service or investment outside of a formal account (*e.g.*, variable annuities or a first-time purchase of a direct-sold mutual fund through a "check and application" process). With respect to existing customers, firms should deliver the relationship summary in a manner consistent with the firm's existing arrangement with that customer and with the SEC's electronic delivery guidance. Firms must initially deliver the relationship summary to each existing retail investor customer within 30 days after the date by which they are first required to electronically file the relationship summary with the SEC.

7	Are you posting the relationship summary on your **public website**?
◯ Status Completed ✔	Firms must post the current version of the relationship summary prominently on your public website, if you have one. The instructions set forth requirements, including design requirements, for a relationship summary that is posted on your website.
8	Have you adjusted your **recordkeeping procedures** to reflect the relationship summary?
◯ Status Completed ✔	BDs must make and keep current a record of the date that each relationship summary was provided to each retail investor, including any relationship summary that was provided before such retail investor opens an account. BDs must maintain and preserve, in an easily accessible place, the following records until at least six years after such record or relationship summary is created: (a) all records of the dates that each relationship summary was provided to each retail investor, including any relationship summary that was provided before such retail investor opens an account, as well as (b) a copy of each relationship summary.

Appendix D

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

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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
March 28, 2017

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 2821to 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.”

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

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

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.

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

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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 .

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 .

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)).

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.

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

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

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 .

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

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

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

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
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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.[1]

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,

[1]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.[2] 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]."[3] 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

[2]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.

[3] *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.[4]

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.[5]

D. Market Conduct Examinations

Nearly every jurisdiction has enacted a version of the NAIC Model Law on Examinations.[6] 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

[4]*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).

[5]*See* NAIC Insurance Fraud Prevention Model Act, NAIC Model Reporting Service at 680-1(1995).

[6]*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.[7]

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.[8]

[7]*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.

[8]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,[9] 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.

[9] *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.[10] 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.[11] 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.

[10] *See* NAIC Model Regulation Service at 215-1 (2015).

[11] *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.