



**Carl B. Wilkerson**  
Vice President & Chief Counsel, Securities

June 14, 2019

Christopher W. Gerold, Bureau Chief  
New Jersey Bureau of Securities  
153 Halsey Street, 6th Floor  
PO Box 47029  
Newark, New Jersey 07101

By Electronic Delivery

Re: Proposed New Jersey Fiduciary Regulation

Dear Mr. Gerold:

On April 16, 2019, the New Jersey Bureau of Securities proposed N.J.A.C. 13:47A-6.4 to establish, by regulation, the common law fiduciary duty and apply it to broker-dealers and agents, and to codify it for investment advisers and investment adviser representatives.<sup>1</sup> The American Council of Life Insurers (“ACLI”) greatly appreciates the opportunity to share its views on the proposed New Jersey rule entitled: *Fiduciary Duty of Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representations* (the “Proposal” or “proposed regulation”).

ACLI is a national trade association representing 280 life insurers that hold over 95 percent of the industry’s total assets. Our members serve 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI’s members offer life insurance, annuities, retirement plans, long-term care, disability income insurance, and reinsurance. Life insurers, therefore, have a significant interest in helping ensure regulatory initiatives enable Americans to achieve financial and retirement security.

**I. Summary of ACLI Position**

- The proposed regulation exceeds the Securities Bureau’s statutory authority, contains ambiguously defined and undefined terms, conflicts with other New Jersey statutes, contradicts Federal securities laws, and constructs an aberrational regulatory patchwork.
- The proposed regulation will muddy the interpretive, compliance and regulatory waters that will cause a contraction in the delivery of financial and retirement products to the detriment of New Jersey citizens.

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<sup>1</sup> The [proposal](https://custom.statenet.com/public/resources.cgi?id=ID:reg:NJ201922172&cuiq=048dca9e-492e-516e-8069-713a069c0bfb&client_md=07bf21fcff38784d41d75017ca308111&mode=current_text) appears at [https://custom.statenet.com/public/resources.cgi?id=ID:reg:NJ201922172&cuiq=048dca9e-492e-516e-8069-713a069c0bfb&client\\_md=07bf21fcff38784d41d75017ca308111&mode=current\\_text](https://custom.statenet.com/public/resources.cgi?id=ID:reg:NJ201922172&cuiq=048dca9e-492e-516e-8069-713a069c0bfb&client_md=07bf21fcff38784d41d75017ca308111&mode=current_text)

- As Americans address their financial and retirement security needs, they need regulatory standards ensuring continued access to a wide variety of retirement products and retirement and financial guidance from professionals acting in their best interest.
- On June 5, 2019, the SEC adopted significant new consumer protections through a best interest standard, conflicts disclosure, a standard of care obligation and a consumer relationship summary. Concomitantly, the National Association of Insurance Commissioners (NAIC) is developing parallel best interest standards within its Suitability in Annuities Transactions Model Regulation. ACLI supports both these initiatives. New Jersey should jettison its proposed regulation in view of these comprehensive developments that address the Proposal's consumer protection objectives.
- The New Jersey Securities Bureau and the New Jersey Division of Banking and Insurance are well positioned to exercise leadership toward a uniform best interest standard across multiple regulatory platforms consistent with the SEC's Best Interest initiative. This approach would augment existing regulatory standards, protect New Jersey citizens, and promote retirement and financial security.
- Aberrational regulatory approaches have proven detrimental to small and moderate retirement savers by driving away financial professionals and creating an advice gap for those most in need of sound guidance.<sup>2</sup> The proposed regulation could provoke similar harm for New Jersey citizens.
- Life insurers contribute significantly to investment, infrastructure, jobs, taxes and the economy in New Jersey. The proposed regulation will impair life insurers' capacity to invest in New Jersey due to diminished business caused by regulatory disorder. The proposal's economic impact analysis fails to address these consequences.

## **II. The Proposed Regulation Exceeds the Authority of the Bureau of Securities**

All initiatives implementing the New Jersey Uniform Securities Law 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 New Jersey Uniform Securities Law is framed. Indeed, the Securities Bureau's website states that:

[t]he Bureau of Securities administers and enforces the Uniform Securities Law (1997) (N.J.S.A. 49:3-47 et seq.), and regulations promulgated thereunder (N.J.A.C. 13:47A-1.1 et seq.) that govern the regulation and registration of securities, broker-dealers, agents of broker-dealers, investment advisers and investment adviser representatives doing business in or from New Jersey. [emphasis added].

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<sup>2</sup> In response to the Department of Labor's "Fiduciary Rule," many distributors ceased offering brokerage services to investors with modest balances. Some retirement service providers moved retirement investors from advised to self-directed products in response to state regulatory initiatives. Others have increased account minimums for advised accounts or will require commission-based account holders to either enter into fee-based arrangements or to go without any advice. These results would be harmful to New Jersey residents and retirees. This phenomenon is discussed in greater detail below.

Similarly, many references within the New Jersey Securities Law underscore the statute's fundamental nexus to securities.<sup>3</sup> The U.S. Court of Appeals in *A.S. Goldman & Co. v. New Jersey Bureau of Securities*<sup>4</sup> stated that the purpose of the "blue sky" laws was to regulate securities.<sup>5</sup>

To recap, regulations issued under the New Jersey Uniform Securities Act must implement the regulation of securities, broker-dealers or investment advisers in New Jersey. The proposed regulation, however, controverts this statutory constraint because several imprecise and undefined terms lack any nexus to securities or securities professionals and, thus, exceeds the authority of the Bureau 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, as further explained below. 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 investment strategy, the opening of, or transfer of assets to, any type of account. 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". 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 Bureau's statutory authority.

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<sup>3</sup> See, for example,

- Section 49:3-63. Filing of materials distributed to prospective investors. The bureau chief may by rule or order require the filing of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature or advertising communication addressed or intended for distribution to prospective investors, including clients or prospective clients of an investment adviser, unless the **security** is not required to be registered by subsection (a) or (f) of section 13 of P.L.1967, c.93 (C.49:3-60).
- Section 49:3-49. Definitions relative to Uniform Securities Law
  - (c) "Broker-dealer" means any person engaged in the business of effecting or attempting to effect transactions in **securities** for the accounts of others or for his own account
  - (g) (1) "Investment adviser" means: (i) any person who, for direct or indirect compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of **securities** or as to the advisability of investing in, purchasing, selling or holding **securities**, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning **securities**; and (ii) any financial planner and other person who provides investment advisory services to others for compensation and as part of a business or who holds himself out as providing investment advisory services to others for compensation.

<sup>4</sup> 163 F.3d 780, 1999 U.S. App. LEXIS 147 (3d Cir. N.J. Jan. 7, 1999).

<sup>5</sup> See Loss, Seligman & Paredes, *Fundamentals of Securities Regulation* at 13 (7th ed. Rev.2018).

The provision's application to the "opening of, or transfer of assets to, any type of account" is similarly vague and lacking a securities nexus. 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 New Jersey Uniform Securities Law. 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 Bureau's statutory authority. These terms are also void for vagueness and would not survive judicial challenge. Financial professionals will be deterred from offering advice or providing financial and retirement solutions due to numerous ambiguities in the proposal.

### **III. The Proposed Regulation Improperly Usurps Legislative Functions**

Neither the New Jersey 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 to investment advisers.<sup>6</sup> The SEC regularly affirms that no rule establishes a fiduciary duty for investment advisers.<sup>7</sup> Indeed, in a June 5, 2019 interpretive release<sup>8</sup>, the SEC stated: [t]he fiduciary duty to which advisers are subject is not specifically defined in the Advisers Act or in Commission rules."<sup>9</sup>

The creation of a fiduciary duty is a legislative function outside the scope of the Bureau's rulemaking authority. Codification of a judicially established fiduciary standard in New Jersey securities regulations represents a significant change in the law. Establishing a fiduciary duty by regulation, therefore, inappropriately usurps the role and responsibilities reserved for the New Jersey legislature and reflects an *ultra vires* action.

### **IV. The Proposed Regulation Conflicts with the New Jersey Insurance Code and the New Jersey Uniform Securities Law**

The undefined terms in the proposed regulation, as discussed above, operate to contradict provisions under the New Jersey Insurance Code and the New Jersey Uniform Securities Law.

#### **A. New Jersey Annotated Statutes Section 17B:28-14 provides that**

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<sup>6</sup> 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."

<sup>7</sup> 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, *Fiduciary Duty: Return to First Principles*, Eighth Annual Investment Adviser Compliance Summit (February 27, 2006) at <https://www.sec.gov/news/speech/spch022706lar.htm#2>.

<sup>8</sup> *Id.*

<sup>9</sup> The SEC cited the seminal case on this point: *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963)

The [insurance] commissioner shall have the sole and exclusive authority to regulate the issuance and sale of separate account contracts; and such contracts, the insurers which issue them and the agents, solicitors or other persons who sell them shall not be subject to the Uniform Securities Law (1967) (P.L.1967, c. 93) as amended or supplemented, in the issuance or sale of such contracts.

This unequivocal statutory provision grants the insurance commissioner sole and exclusive authority to regulate the issuance and sale of variable annuities and variable life insurance contracts. Further, it states that variable contract salespersons shall not be subject to the New Jersey Uniform Securities Law. The proposed regulation directly contradicts the insurance commissioner's exclusive authority because the imprecise and undefined terms could be interpreted to apply to variable contract sales, as explained above in Section II. The Securities Bureau lacks the authority to abrogate the insurance commissioner's exclusive authority in this area. If the Proposal advances further, it must contain a blanket exclusion for the issuance and sale of variable life insurance and variable annuities.

B. New Jersey Uniform Securities Law Section 49:3-49(m) 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 all insurance, endowment policies and annuity contracts outside the scope of the New Jersey Uniform Securities Law and the regulations thereunder. The proposal's imprecise and undefined terms summarized above, however, could pull these statutorily excluded categories into the proposed regulation, as explained above. Again, while we do not support the proposal, if it advances further, it must contain a blanket exclusion for the issuance and sale of variable life insurance and variable annuities.

C. New Jersey Uniform Securities Law Section 49:3-49 (2) provides that

"Investment Adviser" does not include "a broker-dealer registered under this act."

This exclusion is unequivocal and unqualified. All registered broker-dealers are excluded from the definition of investment adviser in New Jersey and the accompanying judicial application of a fiduciary duty. In distinct contrast, the broker-dealer exclusion from the investment adviser definition under federal Investment Advisers Act of 1940 and the Uniform Securities Act promulgated by NCCUSL has a conditional exclusion for activity that is "solely incidental" to broker-dealer functions. New Jersey's 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 on 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 and authority of the New Jersey legislature.

## V. The Proposed Regulation Will Impair Financial and Retirement Security for New Jersey Citizens

Government studies reveal that many individuals and families are not adequately prepared for financial and retirement security.<sup>10</sup> Each day, 10,000 Americans turn age 65 and many can expect to live 20 years or longer in retirement. New Jersey has 1.4 million residents age 65 or older.<sup>11</sup> 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 American's management of retirement and financial risks.<sup>12</sup> Functional best interest standards will ensure that Americans 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.<sup>13</sup>

On this point, the 2017 Treasury Report on Asset Management and Insurance<sup>14</sup> explained that "[b]ecause annuities are the only financial services product that can provide a guaranteed lifetime

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<sup>10</sup> 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/>.

<sup>11</sup> "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.

<sup>12</sup> 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>.

<sup>13</sup> 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 May 27, 2019).

<sup>14</sup> [https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-that-creates-economic-opportunities-asset\\_management-insurance.pdf](https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-that-creates-economic-opportunities-asset_management-insurance.pdf)

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."<sup>15</sup>

Poorly designed rules can have a significant negative impact on life insurers' delivery of insurance and annuities to consumers. 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).<sup>16</sup> Also, in 2017 indexed annuity sales declined by almost 10 percent to \$55 billion.<sup>17</sup>

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.<sup>18</sup>

This scenario began to unfold during the 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.<sup>19</sup> 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 \$50,000.<sup>20</sup>

Concerns about the ramifications for 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,<sup>21</sup> and we

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<sup>15</sup> *Id.* at 70.

<sup>16</sup> LIMRA, Secure Retirement Institute.

<sup>17</sup> *Id.*

<sup>18</sup> See, *Impact of the DOL Fiduciary Rule on the Variable Annuity Market: A Review of Recent LIMRA Research* (June 21, 2017)

<sup>19</sup> 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.

<sup>20</sup> Gallup, 2013 Survey of Owners of Individual Annuity Contracts, 2013.

<sup>21</sup> 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>.

believe that the available alternative services were higher priced in many circumstances.”<sup>22</sup> 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.”<sup>23</sup>

The DOL rule, therefore, 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 New Jersey proposal will diminish the delivery of retirement and financial solutions due to its muddled interpretive, compliance and regulatory waters, and will inflict equivalent harm on New Jersey citizens.<sup>24</sup>

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 customers with smaller portfolios to get advice, meaning that those with assets of less than £50,000 have struggled to find an adviser.<sup>25</sup>

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.”<sup>26</sup>

## VI. Consumer Protections under the New Jersey Securities Code

Effective tools already exist under the New Jersey Securities Code through the definition of “investment adviser.” The investment adviser definition has a functional, three-part test with the

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<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at footnote 33.

<sup>24</sup> 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).

<sup>25</sup> 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> .

<sup>26</sup> *Id.*

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 New Jersey 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.<sup>27</sup>

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<sup>28</sup>. 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 provide uniform interpretations of the application of federal and state investment adviser laws to financial planners and other persons.”<sup>29</sup> New Jersey 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 New Jersey will lead to harmful regulatory arbitrage. A preferable approach that protects consumers currently appears in evolving state and federal initiatives, as explained below.

## **VII. State and Federal Initiatives Under Development Establish Uniform Approaches Protecting Consumers**

Several significant initiatives have been completed at the SEC and are currently in process at the NAIC and DOL to protect consumers in the acquisition of financial advice and products. These developments would ensure uniform, consistently applied standards across state and federal regulatory platforms, and provide more appropriate approaches to protect consumers than the proposed New Jersey regulation.

### **A. SEC Regulation Best Interest**

On June 5, 2019, the SEC adopted Regulation Best Interest (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 interest of the retail customer at the time a recommendation is made without placing the financial or other interest of the broker-dealer or natural person who is an

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<sup>27</sup> 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.

<sup>28</sup> <https://www.sec.gov/rules/interp/1987/ia-1092.pdf>

<sup>29</sup> *Id.* Emphasis added.

associated person making the recommendation ahead of the interest of the retail customer. This obligation is satisfied under Reg. BI if the broker-dealer:

- Before or at the time of such recommendation reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship, and all material conflicts of interest associated with the recommendation [the disclosure obligation];
- In making the recommendation, exercises reasonable diligence, care, and skill, [the care obligation];
- Establishes, maintains, and enforces written policies and procedures reasonably designed to (i) identify, disclose and mitigate, material conflicts of interest arising from financial incentives associated with such recommendations, and (ii) identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time. [the conflict of interest obligation];<sup>30</sup>and,
- Establishes, maintains, and enforces written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest. [the compliance obligation].<sup>31</sup>

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<sup>30</sup> The narrative accompanying Reg. BI explains the SEC's objectives in Reg. BI are to:

- Enhance the quality of recommendations provided by broker-dealers to retail customers, by establishing under the Exchange Act a "best interest" care obligation that encompasses and goes beyond existing broker-dealer suitability obligations under the federal securities laws and that cannot be satisfied through disclosure alone, and further establishing obligations under the Exchange Act that require mitigation, and not just disclosure, of conflicts of interest arising from financial incentives, and thus helps to reduce the potential harm resulting from such conflicts;
- Help retail customers evaluate recommendations received from broker-dealers, as well as address confusion regarding the broker-dealer relationship structure, by improving the disclosure of information regarding broker-dealer conflicts of interest and the material facts relating to scope and terms of the relationship with the retail customer;
- Facilitate more consistent regulation of substantially similar activity, particularly across retirement and non-retirement assets held at broker-dealers, and in this manner help to reduce investor confusion;
- Better align the legal obligations of broker-dealers with investors' reasonable expectations; and,
- Help preserve investor choice and access to affordable investment advice and products that investors currently use.

<sup>31</sup> Reg. BI is more detailed than this brief summary. The SEC's adoption release thoroughly explains the purpose, meaning and nuances. The narrative accompanying Reg. BI explains the SEC's objectives in Reg. BI are to:

- Enhance the quality of recommendations provided by broker-dealers to retail customers, by establishing under the Exchange Act a "best interest" care obligation that encompasses and goes beyond existing broker-dealer suitability obligations under the federal securities laws and that cannot be satisfied through disclosure alone, and further establishing obligations under the Exchange Act that require mitigation, and not just disclosure, of conflicts of interest arising from financial incentives, and thus helps to reduce the potential harm resulting from such conflicts;
- Help retail customers evaluate recommendations received from broker-dealers, as well as address confusion regarding the broker-dealer relationship structure, by improving the disclosure of information regarding broker-dealer conflicts of interest and the material facts relating to scope and terms of the relationship with the retail customer;
- Facilitate more consistent regulation of substantially similar activity, particularly across retirement and non-retirement assets held at broker-dealers, and in this manner help to reduce investor confusion;
- Better align the legal obligations of broker-dealers with investors' reasonable expectations; and,

Regulation Best Interest is a sensible, principles-based rule governing broker-dealer conduct that properly implements the Dodd–Frank Act. Life insurers strongly support protections serving the best interests of customers, which can be meaningfully safeguarded with disclosure about services and material conflicts of interest. This approach provides an effective means to shield consumers and facilitate informed purchase decisions.

Efficient and effective Best Interest standards will broaden consumers' functional access to variable annuities and variable life insurance as financial and retirement solutions. In turn, premiums on variable contracts are invested in capital formation and the economy.<sup>32</sup> The now vacated DOL Fiduciary Rule inflicted a quantifiable negative impact on insurance product sales and impaired the U.S. economy, capital markets, and capital formation.<sup>33</sup> Consequently, life insurers had fewer new assets to invest in U.S. capital formation and the economy. The rule also burdened the economic and retirement security of less affluent and middle-income markets distinctively served by life insurers. With its carefully constructed best interest standard, Reg. BI enables the continuation of life insurers' contributions to capital formation and the economy.

## **B. Additional SEC Regulatory Companions to Regulation Best Interest**

On June 5, 2019, the SEC also adopted Form CRS, a customer relationship summary and interpretive positions concerning investment advisers' fiduciary duty. The SEC's rulemakings and interpretations were designed to enhance the quality and transparency of investors' relationships with investment advisers and broker-dealers while preserving access to a variety of types of advice relationships and investment products.

- Proposed Regulation Best Interest “requires a broker-dealer to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer.”
- Proposed Form CRS “would provide retail investors with simple, easy-to-understand information about the nature of their relationship with their investment professional and would supplement other more detailed disclosures.”
- The proposed investment adviser interpretations “reaffirm SEC positions about the fiduciary duty investment advisers owe to their clients.” Through the reconfirmed interpretations, “investment advisers and their clients would have greater clarity about advisers' legal obligations.”

- 
- Help preserve investor choice and access to affordable investment advice and products that investors currently use.

<sup>32</sup> SEC Division of Investment Management Director, Dalia Blass, recently stated that “[t]he asset management industry is critical to the U.S. economy and for the retirement and financial needs of millions of American investors, particularly our Main Street investors. See, Dalia Blass, [Testimony on Oversight of the SEC's Division of Investment Management](https://www.sec.gov/news/testimony/testimony-2018-09-26-blass) (Sept. 26, 2018) Before the United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment <https://www.sec.gov/news/testimony/testimony-2018-09-26-blass> .

<sup>33</sup> Before its judicial vacatur, DOL's Fiduciary Rule caused a significant reduction in the sale of new insurance products. Variable annuity sales declined 21 percent in 2016 (from \$133 billion in 2015 to \$104.7 billion). Further, in the first quarter of 2017, variable annuity sales declined 8 percent, year-over-year, to \$24.4 billion, and indexed annuity sales were off 13 percent, to \$13.6 billion. The damage inflicted on annuity sales also caused an adverse ripple effect on the contributions of agents and distributors to the economy, tax revenue and small business employment.

### C. NAIC Developments

The NAIC is engaged in ongoing efforts to revise the NAIC Suitability in Annuity Transactions (Annuity Suitability) Model Regulation to significantly enhance the standard of care and disclosure requirements applicable to the purchase, exchange or replacement of annuities. ACLI has strongly supported these efforts. ACLI is pleased that the NAIC's latest draft of proposed revisions to the Annuity Suitability Model Regulation aligns well in many respects with ACLI's policy in support of a best interest standard of care for annuities. ACLI looks forward to continuing to engage with the NAIC as it continues its efforts. The NAIC and the SEC have publicly committed to coordination and cooperation to achieve consistent best interest standards. The NAIC's evolving approach appears to be consistent with the SEC standard.<sup>34</sup>

Recognizing that a uniform, national best interest standard of care for annuities and securities across all regulatory platforms can only be achieved through a coordinated effort among state insurance regulators, the SEC, the Financial Industry Regulatory Authority (FINRA), and the Department of Labor (DOL). ACLI has encouraged and commended the NAIC for pursuing this regulatory collaboration. There is a significant degree of commonality between the latest NAIC draft and the SEC Regulation Best Interest. Life Insurers have encouraged the NAIC to continue its collaboration with the SEC as these important national initiatives reach fruition.

### D. Department of Labor Developments

Recently, the DOL served notice that it too is on the cusp of publishing proposed rulemaking that would update and revise fiduciary standards for qualified retirement plan transactions. The agency's unified rulemaking agenda<sup>35</sup> published May 22, 2019 lists a new rule initiative entitled *Fiduciary Rule and Prohibited Transaction Exemptions*. The DOL website explains this upcoming development in a statement that:

The Department of Labor in 1975 issued a regulation defining who is a "fiduciary" under section 3(21)(A)(ii) of the Employee Retirement Income Security Act (ERISA) as a result of giving investment advice for a fee or other compensation. On April 8, 2016, the Department replaced the 1975 regulation with a new regulatory definition. The new regulatory definition was vacated in toto in *Chamber of Commerce v. Department of Labor*, 885 F.3d 360 (5th Cir. 2018). The Department is considering regulatory options in light of the Fifth Circuit opinion.<sup>36</sup> (emphasis added)

DOL Secretary Acosta testified in a recent hearing before the House Education and Labor Committee that DOL is communicating and collaborating with the SEC on these issues and plans to issue new

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<sup>34</sup> The NAIC leadership has actively continued its coordination with U.S. Labor Secretary Alexander Acosta and SEC Chairman Jay Clayton to to develop a uniform and consistent standard across all annuity product sale platforms regardless of the type of product. See Annuity (A) Suitability Working Group Minutes (July 23, 2018) at 1 [https://www.naic.org/meetings1808/cmte\\_a\\_aswg\\_2018\\_summer\\_nm\\_materials.pdf](https://www.naic.org/meetings1808/cmte_a_aswg_2018_summer_nm_materials.pdf) and Debevoise and Plimpton NAIC Summer 2018 National Meeting at 2 [https://www.debevoise.com/~media/files/insights/publications/2018/08/20180824\\_naic\\_2018\\_summer\\_national\\_meeting.pdf](https://www.debevoise.com/~media/files/insights/publications/2018/08/20180824_naic_2018_summer_national_meeting.pdf).

<sup>35</sup> See [https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION\\_GET\\_AGENCY\\_RULE\\_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=1200&Image58.x=22&Image58.y=16](https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=1200&Image58.x=22&Image58.y=16)

<sup>36</sup> <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201904&RIN=1210-AB82>

rules.<sup>37</sup> This breaking development removes New Jersey's stated need to step in and promulgate a proposal in place of the DOL's judicially vacated fiduciary rule. Moreover, premature action by New Jersey could contradict these evolving DOL fiduciary developments and cause unnecessary regulatory conflicts that discourage life insurers and salespersons from operations in New Jersey due to uncertain legal and compliance standards.

### **E. FINRA Developments**

FINRA developed comprehensive recommendations concerning conflict management for broker-dealers that provides excellent guidance and behavioral expectations in its 44 page [Report on Conflicts of Interest](#).<sup>38</sup> FINRA monitors broker-dealers' compliance frameworks to identify, mitigate and manage conflicts of interest. Following its Report on Conflicts of Interest, FINRA issued an all-industry examination letter<sup>39</sup> on conflicts review focused on compensation and oversight. The Examination Letter required broker-dealers to respond to very granular questions on these topics and gave FINRA on-going barometer about conflict of interest constraints. FINRA indicates that it will continue to focus on conflicts issues through its regulatory programs and will evaluate the effectiveness of firms' conflicts management efforts. If firms make inadequate progress generally, FINRA will put conflicts-focused rulemaking on the table to enhance investor protection.<sup>40</sup>

### **VIII. Life Insurers' Current Regulatory Framework Provides Comprehensive Consumer Protection**

Life insurance companies and their associated persons currently fulfill a broad array of regulations administered by state insurance departments, the SEC, DOL, FINRA, and various state securities departments. Existing comprehensive regulations govern important aspects of the customer relationship, including suitability standards, disclosure, advertising, supervision, maintenance of customer account assets, data collection, training, compensation, and supervision of associated persons. In general, the federal securities laws and FINRA rules govern individual variable insurance contracts. In some cases, insurance products invoke both federal and state laws. Several additional consumer protections are currently pending under the SEC's Regulation BI initiative and parallel developments in the NAIC's Suitability in Annuity Transactions Model Regulation. These regulatory protections are highlighted in Appendix B and collectively provide important consumer protection and strong enforcement tools that buttress the purpose of the New Jersey Uniform Securities Laws.<sup>41</sup>

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<sup>37</sup> See Schoeff, Acosta Says Labor Department Will Revive Fiduciary Rule, InvestmentNews at <https://www.investmentnews.com/article/20190501/FREE/190509987/acosta-says-labor-department-will-revive-fiduciary-rule>. This article summarized testimony DOL Secretary Acosta

<sup>38</sup> <http://www.finra.org/sites/default/files/Industry/p359971.pdf>

<sup>39</sup> <https://www.finra.org/industry/conflicts-interest-review-compensation-and-oversight>

<sup>40</sup> FINRA [Report on Conflicts Management](#) at 36 <http://www.finra.org/sites/default/files/Industry/p359971.pdf>

<sup>41</sup> Distributors of fixed and variable annuities are subject to significant standards in the Suitability in Annuity Transactions Regulation, which is framed on FINRA suitability and supervision standards. In addition, New Jersey's insurance consulting law provides that "[a] financial planner, life or health insurance agent or broker, or insurance consultant shall not charge a fee pursuant to this section except with respect to group life or group annuity products. NAC 686A.330 (2015). New Jersey law also instructs that terms such as "financial planner", "investment adviser," "financial consultant" or "financial counseling" may not be used in a way which implies that the insurance agent is generally engaged in an advisory business in which compensation is unrelated to sales, unless that is actually the case. NAC 686A.425(3) (2015).

## IX. Preemption and Compliance with the National Securities Markets Improvements Act of 1996

The proposed regulation contradicts the National Securities Market Improvements Act of 1996 (NSMIA), which prohibits any state law from establishing requirement “which differ from, or are in addition to, the requirements of federal law.”<sup>42</sup> The proposal establishes standards different from those currently governing broker-dealers and investment advisers under the federal securities laws<sup>43</sup> and contradict the SEC’s Regulation Best Interest, including Form CRS and its reiterated investment adviser interpretations. As such, the proposal would contradict the mandates of NSMIA.

Aspects of the proposal emphasize that a transaction-based fee (commission) would not be a breach of fiduciary duty if the fee is “reasonable” (undefined) and “is the best (undefined) of the reasonably available fee options.” This could be interpreted to be the lowest fee, something in conflict with Section 913 of the Dodd-Frank Act.<sup>44</sup> Emphasis on the lowest fee may generate a poor fitting recommendation to the consumer’s detriment.

Proposed new N.J.A.C. 13:47A-6.4(b) provides that, to meet the fiduciary duty, a broker-dealer, agent, or adviser shall satisfy both the duty of care and duty of loyalty. In its discussion of regulation BI, the SEC expressly declined to include a duty of loyalty in line with Section 913 of the Dodd-Frank Act.<sup>45</sup> 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.”<sup>46</sup> This statement reveals that the SEC chose not to create by regulation a fiduciary duty, in distinct contrast with the New Jersey proposal. Moreover, this SEC statement reveals that the proposed New Jersey 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

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<sup>42</sup> 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)

<sup>43</sup> 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 New Jersey is beyond the scope of this limited authority for state regulators.

<sup>44</sup> 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](http://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.*”

<sup>45</sup> 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.

<sup>46</sup> Reg. BI Release at 21585.

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.<sup>47</sup>

The proposed New Jersey 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 New Jersey proposal violates the wording and intent of NSMIA.

## **X. The Proposal Impairs Life Insurers' Contributions to Capital Formation, Employment and the Economy in New Jersey**

381 life insurers are authorized to conduct business in New Jersey and five are domiciled in New Jersey. Life insurers contribute significantly to the economy in New Jersey, providing, among other things:

- 94,600 jobs,
- \$181 billion in investments, financing business development, job creation, and services, and
- \$1.4 trillion in total life insurance coverage,

Efficient and effective regulatory standards in New Jersey will broaden consumers' functional access to variable annuities and variable life insurance as financial and retirement solutions. 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 New Jersey's economy. The infographic and data chart attached in Appendix C to this letter highlight other significant roles life insurers play in New Jersey's economy.

Government studies reveal that many individuals and families are not adequately prepared for financial and retirement security.<sup>48</sup> Insurance products can play a significant role in American's management of retirement and financial risks.<sup>49</sup> Functional regulation will ensure that New Jersey

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<sup>47</sup> New Jersey [proposal](https://custom.statenet.com/public/resources.cgi?id=ID:reg:NJ201922172&cuig=048dca9e-492e-516e-8069-713a069c0bfb&client_md=07bf21cff38784d41d75017ca308111&mode=current_text) at page 1  
[https://custom.statenet.com/public/resources.cgi?id=ID:reg:NJ201922172&cuig=048dca9e-492e-516e-8069-713a069c0bfb&client\\_md=07bf21cff38784d41d75017ca308111&mode=current\\_text](https://custom.statenet.com/public/resources.cgi?id=ID:reg:NJ201922172&cuig=048dca9e-492e-516e-8069-713a069c0bfb&client_md=07bf21cff38784d41d75017ca308111&mode=current_text) .

<sup>48</sup> 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/> .

<sup>49</sup> 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)

consumers have better exposure to insurance products in building a firm financial foundation throughout life and in retirement.

Poorly designed regulations, however, thwart the delivery of these retirement and financial solutions due to unreasonable compliance burdens and uncertain legal standards.<sup>50</sup> Consequently, the proposal will impair life insurers' capacity to invest in New Jersey due to diminished business caused by regulatory disorder. Nothing in the proposal's statement of economic impact considers the proposal's negative bearing on investment, infrastructure, jobs, taxes and the economy in New Jersey.

## **X. Conclusion**

Like a duck moving smoothly on the water's surface while paddling madly underneath, the proposal is not what it purports to be. It is bad for New Jersey citizens. The proposed regulation:

- Exceeds the statutory authority of the Securities Bureau;
- 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 variable contracts;
- Contradicts Federal securities regulation, new SEC Regulation Best Interest, Form CRS and new SEC investment adviser interpretations;
- Breaches the NSMIA statute;
- Impairs life insurers' capacity for investment, infrastructure, jobs, taxes and the economy in New Jersey;
- Generates regulatory arbitrage exploiting a patchwork of disparities;
- Muddies legal standards that will diminish the delivery of insurance and annuities in New Jersey and undermine citizens' access to financial and retirement security; and,
- Fails in its economic impact analysis.

ACLI supports reasonable regulations governing financial professionals that protect Americans in the acquisition of financial products. The proposal, however, is fundamentally defective. New Jersey should jettison the proposal in view of the SEC's Best Interest Initiative and the parallel developments underway at DOL and the NAIC that provide functional solutions to consumer protection in New Jersey.

Reasonable, uniformly implemented standards would serve the interests of consumers and financial professionals alike, avoid conflicting or duplicative regulatory standards, and preclude harmful

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<https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/ria.pdf> .

<sup>50</sup> 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' Perspective*, LIMRA Secure Retirement Institute (2016).

regulatory arbitrage. Life insurers and their product sales contribute significantly to jobs, taxes and the economy in New Jersey.

Life insurers and their products provide solutions to American's financial and retirement security challenges. Confusing, aberrational regulations are detrimental to small and moderate retirement savers by driving away financial professionals and creating an advice gap for those most in need of sound guidance. A significantly revised approach to regulation is essential in New Jersey. Constructive regulation protecting consumers can be achieved through approaches coordinated with SEC, NAIC and New Jersey Insurance Department initiatives.

Sincerely,

*Carl B. Wilkerson*

Carl B. Wilkerson

# Appendix A

# Life Insurers + New Jersey

## 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 New Jersey residents are under age 18—typically financially dependent on a loved one or caregiver.



New Jersey has **1.4 MILLION** residents aged **65 or older**.



**62%** of New Jersey residents are of working age.

**925,000** New Jersey residents are dealing with a disability.

### INVESTING IN THE ECONOMY

The life insurance industry generates approximately **94,600** jobs in New Jersey.



Life insurance companies invest approximately **\$181 BILLION** in New Jersey's economy, helping to finance businesses, create jobs, and provide services in the state.



**381** life insurers are licensed to do business in New Jersey and **5** are domiciled in the state.

### PROTECTING FAMILIES FROM THE LOSS OF A BREADWINNER

New Jersey residents have **\$1.4 TRILLION** in total life insurance coverage—**92%** from ACLI member companies.



New Jersey residents own **4 MILLION** individual life insurance policies, with coverage averaging **\$238,000** per policyholder.



**\$3.6 BILLION** was paid to New Jersey life insurance beneficiaries in 2017.

Individual life insurance coverage purchased in New Jersey in 2017 totaled **\$68 BILLION**.

Group life insurance coverage in the state amounts to **\$551 BILLION**.



### PROVIDING GUARANTEED INCOME AND LONG-TERM CARE TO RETIREES



Annuity benefits paid in the state in 2017 totaled **\$3.1 BILLION**.

Long-term care insurance paid in the state in 2017 totaled **\$376 MILLION**.

EVERY DAY IN NEW JERSEY, LIFE INSURERS PAY OUT **\$58.8 MILLION** IN LIFE INSURANCE AND ANNUITIES TO FAMILIES AND BUSINESSES—**95%** FROM ACLI MEMBER COMPANIES.



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101 Constitution Avenue, NW, Suite 700  
Washington, D.C. 20001-2133  
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# Appendix B

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

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

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

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

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

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

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

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

B. Principal review and approval obligations;

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

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

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

A. Revised Rule 2330 established the following specific requirements:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

##### A. Supervisory review standards changed

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

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

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

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

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

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

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

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

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

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

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

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

B. Recommendation requirements revised

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

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

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

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

1. Conditional exclusion from rule, however.

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

2. FINRA rationale:

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

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

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

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

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

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

1. FINRA Rationale:

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

F. Generic disclosure allowed

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

2. FINRA rationale:

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

G. "Unique features" requirement relaxed and expanded

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

2. FINRA Rationale:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation  
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**I. NAIC Suitability and Supervision Responsibilities in NAIC Model Regulation Governing Individual Annuity Sales**

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

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

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

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

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

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

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

## II. Approach of the 2006 Revised NAIC Regulation

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

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

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

4. Formal prepaid funeral contracts.

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

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

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

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

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

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

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

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

(3) Fails to provide complete or accurate information.

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

### C. Supervision Standard

#### 1. For insurers:

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

(1) Maintaining written procedures; and

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

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

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

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

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

that the third party is performing the required functions; and

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

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

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

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

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

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

2. For insurance producers:

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

(1) Maintaining written procedures; and

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

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

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

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

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

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

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

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

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

**D. Recordkeeping**

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

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

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

**E. Enforcement Powers and Mitigation Provisions**

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

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

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

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

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

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

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

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation  
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### **I. Scope of Outline**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation  
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**I. NAIC Insurance and Annuities Replacement Model Regulation**

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

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

**B. Approach of the amended regulation**

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

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

#### C. Overview of Issue

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

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

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

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

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

assigned to the replacing insurer or otherwise terminated;

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

F. *Exceptions* from regulation for group contracts

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

direct solicitation of individuals by an insurance producer.

c. Credit life insurance.

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

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

a. Under the regulation, each insurer must:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### H. Selected Definitions

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

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

1. Selected list of parallel regulatory concepts

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

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

e. SEC Examination of Variable Annuity “Bonus” Programs

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- 1.
- 2.
- 3.

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

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

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

\_\_\_\_\_

Applicant's Signature and Printed Name

Date

\_\_\_\_\_

\_\_\_\_\_

Producer's Signature and Printed Name

Date

\_\_\_\_\_

\_\_\_\_\_

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

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

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

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

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

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

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

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

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

OTHER ISSUES TO CONSIDER FOR ALL TRANSACTIONS:

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

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

**(Attachment 2 to Replacement Outline)**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation  
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**I. The Impact of State Insurance Consulting Laws and Related Provisions on  
Insurance Producers Performing Financial Planning Services**

A. Background

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

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

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

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

### C. Insurance Consulting Laws

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

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

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

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

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

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

c) Insurance consulting laws generally fall into two categories:

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

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

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

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

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

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

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

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

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.<sup>1</sup>

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

##### **Commentary:**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## **H. Variable Contract Statutes**

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

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

## **I. Insurance Producer Database**

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

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

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

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

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

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

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

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

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

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

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

# Appendix C

# J.P.Morgan

March 7, 2017

## 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<sup>SM</sup>, 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

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	<b>Changing</b>	Your financial advisor will no longer be able to provide investment guidance on this account. Please note: <ul style="list-style-type: none"> <li>• You may still be able to receive personalized investment guidance from your advisor on other accounts you have with us.</li> <li>• If you have questions about any open orders, please contact the number listed on your account statement.</li> </ul>
Service requests (e.g., placing trades or making updates to your account)	<b>Changing</b>	Service requests can be made online at <a href="http://chase.com">chase.com</a> or over the phone; you will no longer be able to contact your financial advisor.
Account agreement	<b>Changing</b>	An amended account agreement is enclosed. Please review this document and keep it for your records.
Transaction/commission fees	<b>Changing</b>	Your Self-Directed Investing Account may offer reduced trading pricing. Please visit <a href="http://chase.com/RetirementFees">chase.com/RetirementFees</a> 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 <a href="http://chase.com">chase.com</a> to view detailed account information.
Statements	Not Changing	Please visit <a href="http://chase.com">chase.com</a> to view your account statements.



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

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.

Merrill Lynch Wealth Management, Merrill Edge, and The Private Banking and Investment Group offer products and services made available through Merrill Lynch, Pierce, Fenner & Smith Incorporated (MLPF&S). Banking products are provided by Bank of America, N.A. and affiliated banks, members FDIC and wholly owned subsidiaries of Bank of America Corporation.

Investment products:

Are Not FDIC Insured

Are Not Bank Guaranteed

May Lose Value