

## Agenda

**CEFLI Compliance & Ethics Committee Meeting**  
**Wednesday, July 31, 2019**  
**2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT**  
**Dial In: (800) 239-9838**  
**Passcode: 3646069**

**I. Welcome and Introduction. Donald J. Walters**

A. Antitrust Statement.

**II. Approval of Minutes – May 15 & June 13, 2019 Meetings. The Committee**

**III. Issues for Review. The Committee**

A. NYDFS Regulation 187.

1. August 1, 2019 - Annuity Compliance Effective Date - Discussion of Key Compliance Challenges.

Tomorrow, August 1, 2019, represents the effective date for compliance with the annuity provisions of NYDFS Regulation 187 (“Regulation 187”).

Through our exploration of Regulation 187-related issues over the past several months, it is clear that companies have explored a range of appropriate compliance solutions to address the requirements of the annuity provisions of Regulation 187.

Now that we are on the precipice of tomorrow’s effective date for annuity products, we thought it may be helpful to allow members of the Committee to share the key compliance challenges their companies may have encountered when developing appropriate compliance strategies to address the requirements of Regulation 187.

Issues for possible discussion may include:

- Applicability to In-Force transactions;
- Documenting the facts and analysis to support the recommendation;
- Developing compliant Disclosure documents;
- Supervision and oversight;
- Modifying current suitability/best interest forms; and
- Training.

***The Committee will be asked to discuss the key compliance challenges their companies may have encountered when developing appropriate compliance strategies to address the annuity requirements of Regulation 187.***

2. CEFLI Regulation 187 Issue Forum.

At the July 10, 2019 meeting of the CEFLI Regulation 187 Issue Forum, it was determined that the Issue Forum will no longer be meeting on a regular basis but will instead rely upon meetings of this Committee to raise future issues related to Regulation 187 Compliance.

Therefore, CEFLI will maintain a standing Regulation 187 Issue Forum section on all future Committee agendas through February 1, 2020 (the effective date for life insurance product compliance).

B. Utah House Bill 55 - Section 31 A-21-311 (1)(a) – Delivery of Policy or Certificate.

At our June 13 meeting, we explored key provisions of Utah House Bill 55 which amended Utah’s insurance code and also amended Section 31 A-21-311 (1)(a) concerning policy delivery requirements in Utah.

We have continued to receive expressions of interest in exploring the operational implications of Section 31 A-21-311 (1)(a) which was amended to read:

*(1)(a) An insurer issuing an individual or group life insurance policy or an accident and health insurance policy shall deliver a copy of the policy to the policyholder as soon as practicable but no later than 90 days after the date on which the coverage is effective.*

At the Committee’s June 13 meeting, the Committee discussed how companies may be interpreting the date upon which “coverage is effective.”

Interest also has been expressed in determining the extent to which companies may now be requiring delivery receipts to be completed in Utah in light of the requirement to deliver a copy of the policy to the policyholder no later than 90 days after the date on which the coverage is effective.

***The Committee will be asked to discuss how companies may interpret the phrase “the date on which the coverage is effective” under Utah Insurance Code Section 31 A-21-311 (1)(a) and whether companies now require***

***delivery receipts to be completed in Utah in light of the new delivery requirements under Utah law.***

C. Monitoring Independent Agents Sales Devices.

Life insurance producers often will rely upon a variety of electronic media to conduct various sales activities. The use of a wide range of electronic media to assist the sales process poses unique compliance challenges.

Companies that work with independent agents may confront unique challenges with respect to monitoring producer use of electronic media.

In light of these monitoring challenges, a question has been presented concerning regulatory expectations (specifically, expectations of the NYDFS and other DOI's) regarding whether companies should purchase and implement endpoint device compliance monitoring software for all agent electronic media or whether physical audits may still be deemed to be sufficient.

***The Committee will be asked to discuss appropriate compliance strategies to monitor producer use of electronic media and other sales devices; especially, with respect to independent agents.***

D. Texas House Bill 207.

Texas Governor Greg Abbott recently signed into law Texas House Bill 207 which amended Texas law to include new requirements regarding disclosures and notices relating to life insurance policies with non-guaranteed charges.

The new requirements include a new Section 1101.206 which reads as follows:

*Sec. 1101.206. ANNUAL ILLUSTRATION. Regardless of whether any non-guaranteed charges are changed, an insurer that issues a policy subject to this subchapter must offer to provide to the policy owner at least annually an in-force illustration. If the insurer has changed any non-guaranteed charges or the credited interest rate, the insurer must offer the illustration at no charge.*

A question has been presented concerning whether the annual illustration requirement applies to all existing in-in-force policies or whether this provision will apply only to policies issued after the effective date of the law (i.e., September 1, 2019).

***The Committee will be asked to discuss their compliance strategies to meet the annual illustration requirements under Texas House Bill 207.***

***Specifically, will companies be applying the annual illustration requirements to all existing policies or only those policies issued after September 1, 2019.***

E. Use of CFP Designation by Advisers who Sell Insurance Products.

Insurance producers may hold the Certified Financial Planner (“CFP”) Designation in their work as advisers to clients.

The Certified Financial Planner Board of Standards recently expanded their fiduciary standard applicable to CFP’s but have announced they will delay enforcement of these new standards until June 2020 (in coordination with the effective date of the SEC’s Regulation Best Interest).

A question has been presented concerning whether life insurers may have any objections or concerns to a producer holding the CFP designation and having them act in a fiduciary capacity.

***The Committee will be asked to discuss company practices with respect to allowing/prohibiting insurance producers from using the CFP designation and acting in a fiduciary capacity.***

F. AML Training.

Companies use a variety of different vendors to conduct anti-money-laundering (AML) compliance training, tracking and record-keeping for their producers.

A question has been presented together information regarding life insurance company experiences with various vendors providing AML-related compliance services.

***The Committee will be asked to discuss their experiences with various vendors providing AML-related compliance services.***

#### IV. Reporting Items.

CEFLI Staff.

A. NAIC Annuity Suitability Working Group.

The NAIC Annuity Suitability Working Group continues to meet to explore possible modifications to the NAIC Suitability in Annuity Transactions Model Regulation.

The Working Group met in person on Thursday, June 20 in Columbus, Ohio and also met via two conference calls over the past several weeks in anticipation of

their next in-person meeting to be held at the upcoming NAIC Summer National Meeting in New York.

CEFLI will monitor these developments and provide updated information, as appropriate.

B. SEC Risk Alert - RIA Supervision of Staff with Disciplinary Histories.

The SEC Office of Compliance and Inspections and Examinations recently released a Risk Alert recommending that RIA's increased supervision of staff with disciplinary histories.

A copy of the full Risk Alert is attached.

C. FINRA to Expand Use of Machine Learning for Market Surveillance.

FINRA recently announced it will expand use of machine learning for market surveillance purposes.

FINRA plans to increase its use of artificial intelligence to handle easier to detect instances of fraud.

This is an interesting development in light of the fact that regulators are becoming more sophisticated in their use of technology to conduct market surveillance activities.

D. Vermont Creates Restitution Fund for Investors.

Vermont regulators recently announced the establishment of a restitution fund for investors.

The fund will be funded by a percentage of money derived from settlements of enforcement actions.

E. Personnel Matters.

1. US Department of Labor Secretary Acosta Resigns.

The recent resignation of Department of Labor Secretary Alexander Acosta puts into question the DOL's published timeline for completion of work on a new fiduciary rule by September.

Patrick Pizzella, Acosta's Deputy, has been named as the Acting Secretary. President Trump has nominated Eugene Scalia to replace Acosta as Labor Secretary.

2. NYDFS - James Regalbuto Promoted to Deputy Superintendent for Insurance.

NYDFS Superintendent Linda Lacewell announced that James Regalbuto has been promoted to Deputy Superintendent for Insurance. (Mr. rebel Bodo was previously Deputy Superintendent for Life Insurance.

3. US Senate confirms Allison Lee as SEC Commissioner.

The U.S. Senate confirmed Allison Lee, a Democrat, to serve as SEC Commissioner. Ms. Lee fills the last remaining vacancy on the Commission which is now at full strength.

## **V. CEFLI Activities.**

- A. 2019 CEFLI Annual Conference and Compliance Leadership Forum - Nashville, Tennessee - September 11-13.

Registration is now open for the 2019 CEFLI Annual Conference and Compliance Leadership Forum which will be taking place at the JW Marriott Hotel in Nashville, Tennessee on September 11-13.

The “early bird” registration discounted rate expires on August 9 and the cutoff date for hotel reservations is August 20.

More information concerning the 2019 CEFLI Annual Conference and Compliance Leadership Forum can be found via CEFLI’s website.

We hope you will be able to join us!

- B. Antifraud Webinar - Tuesday, August 13 - 1 PM EDT.

CEFLI will conduct the next session in its Educational Webinar Series on Tuesday, August 13 at 1 PM EDT.

The focus of the webinar will be on current antifraud compliance strategies.

- C. CEFLI Membership Satisfaction Survey.

CEFLI recently released its 2019 member satisfaction survey questionnaire to all member companies.

We are asking that responses to the Survey be submitted not later than close of business on Monday, August 12.

**VI. Next Meeting.**

The next meeting of the Committee is scheduled to take place:

August 21, 2019 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

The Committee will hold its remaining 2019 meetings as follows:

September 25, 2019 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

October 16, 2019 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

November 13, 2019 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

December 18, 2019 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

Please mark your calendar and plan to join us!

**VII. Other Business.**

***The Committee will be asked to identify and discuss any other business to be brought before the Committee.***

**DRAFT**

**Minutes  
Meeting of the  
CEFLI Compliance & Ethics Committee  
May 15, 2019  
2 PM EDT/1 PM CDT/11 AM PDT**

A meeting of the CEFLI Compliance & Ethics Committee (the "Committee") was held via conference call on Wednesday, May 15, 2019 at 2 PM EDT/1 PM CDT/11 AM PDT.

The following CEFLI member company representatives participated in the meeting:

Mechile Adams, Athene USA  
Ro Adebisi, Thrivent  
Renee Ambrosy, CNO Financial  
Shannon Aussieker, Country Companies  
Brendan Bakala, Catholic Order of Foresters  
Lauren Barbaruolo, Oxford Life Insurance  
Chad Batterson, Athene  
Katelynn Blalock, Western & Southern  
Vickie Bulger, Primerica Life Insurance  
Laura Bullard, Forester Financial  
Michael Burke, Cincinnati Life  
Kara Busener, Western and Southern  
Bryan Brewster, Wilton Re  
Amanda Capps, Symetra Life  
Jude Connors, Lincoln Heritage Life  
Dana Cook, Assurity Life  
Allison Corrado, Lombard International  
Jim Cunningham, Fidelity Investments  
David Dougall, State Farm  
William Dunker, Principal  
Bruce Eschbach, Texas Life  
Rita Fenani, Pacific Life  
Mari Ferrer, Symetra  
Jill Fiddler, Assurity Life  
Autumn Ford, Pacific Life  
Paula Gentry, Cincinnati Life  
Jim Golembiewski, Sagacor  
Ken Gould, Protective Life

Minutes – Meeting of the CEFLI Compliance & Ethics Committee  
May 15, 2019

Michelle Holmes, VOYA Financial  
Amariliz Johnson, Jackson National  
Jill Jones, Bankers Fidelity  
Natalie Jones, Guggenheim Life  
Martin Karp, Oxford Life Insurance  
De Keimach, Delaware Life  
Matt Klein, Principal Financial  
Samantha Knackmuhs, State Farm  
Megan Knapp, American Enterprise  
Michele Kulish Danielson, American Enterprise  
Jessica Kump, USAA  
Laurie Lewis, Amica  
Dan Leblanc, SBLI  
Andres Mayorga, USAA Life  
Genevieve Messina, Global Atlantic Financial  
Dave Milligan, American Equity  
Morgan Milner, Modern Woodmen of America  
Mark Neidinger, National Guardian Life  
Jim Odland, Thrivent  
Nancy Perez, CEFLI  
Liza Perry, USAA  
Kathy Pettit, John Hancock  
Megan Phillips, Principal Life  
Daniel Reinecke, Gerber Life Insurance  
Michael Roberson, Pacific Guardian Life  
Darcy Robson, Pacific Life  
Heather Russo, Illinois Mutual  
Cara St. Martin, Allianz  
Rania Sarkis, Pacific Life  
Ryan Schwoebel, Protective Life  
John Sharp, Assurity  
Wayne Smiley, TIAA  
Devin Smith, Securian  
Stephen Smith, Protective  
Carla Strauch, Thrivent  
Bill Turner, American Fidelity  
Catherine Valeri, Global Atlantic  
Laura Van Laningham, Illinois Mutual  
Rosanna Vidaurri, USAA  
Rochelle Walk, Wilton Re  
Michelle Ward, Erie Family Life  
Stacey White, American National  
Emily Wilburn, Illinois Mutual  
Pam Wilson, Cincinnati Life

Mallory Bennett, Kelly Ireland and Donald Walters of CEFLI also participated in the meeting.

**I. Welcome and Introduction.**

The meeting began with a recitation of CEFLI's anti-trust statement.

**II. Approval of Minutes – April 17, 2019 Meeting.**

On motion, duly made and seconded and unanimously carried, the Committee: RESOLVED, that, the Minutes of the April 17, 2019 meeting are hereby approved.

**III. Issues for Review.**

**A. Fraudulent Policy/Contract Withdrawals.**

The Committee reviewed various strategies companies may utilize in instances where fraudsters gain access to account values to withdraw money from life insurance policies and annuity contracts fraudulently.

The Committee reviewed three possible strategies including:

- *“Making the customer whole” as soon as they become aware of the fraudulent withdrawal;*
- *“Making the customer whole” after completing an investigation and determining the customer was not involved in the fraud; and*
- *“Making the customer whole” only if the company was “at fault” in the situation (i.e., procedures were not followed appropriately, agent involvement, etc.)*

A Committee member indicated that when a fraudulent withdrawal has taken place they engage their Special Investigations Unit (SIU) to conduct an investigation which includes not only an investigation of the characteristics of the fraudulent activity but also whether internal controls related to the type of disbursement have been followed appropriately.

The results of the SIU investigation is reviewed by an internal company committee that determines whether the nature of the fraudulent activity warrants reporting to a state insurance department or filing of a Suspicious Activity Report with FinCEN.

Ultimate responsibility for determining whether to reimburse the customer lies within the business unit management. In the event that there may have been a control lapse, the business unit will determine the possible reimbursement strategy.

Another Committee member utilizes a similar process whereby they determine the derivation of the first deposit (i.e., the nature of the banking relationship from

which the deposit arose). This analysis is designed to determine whether a family member may have opened a joint account with the policyholder and whether funds may have been placed into a joint account.

In addition, this company also reviews their internal controls whether any breakdowns had occurred or whether a “red flag” may have been missed.

After this analysis is completed, a recommendation is offered to the business unit regarding whether a reimbursement or “write off” should take place.

In sum, companies conduct a thorough analysis of the facts underlying each case to determine whether company compliance practices have been followed as part of their analysis concerning whether to reimburse a customer in the event of a fraudulent withdrawal of money from their policy/contract.

#### B. Anti-Money-Laundering (AML) Training Programs.

The Committee reviewed a series of questions pertaining to life insurance company anti-money-laundering training programs.

These questions included:

- *How often does your company require producers to complete an AML training course?*
- *Are producers free to select any AML training course to complete or does the company provide a list of “approved” vendors for this purpose?*
- *Does your company offer its own AML training course (i.e., that was developed on an “in-house” basis)?*
- *Upon completing an AML training course, what proof of completion (i.e., a certificate of completion) is required?*
- *Does your company allow producers to undergo an AML training course that does not generate a completion certificate?*

A Committee member indicated that they require their producers to have AML training completed prior to appointment and every two years thereafter. They utilize approved vendors such as LIMRA LOMA and RegEd and require a certification from a vendor that the AML training has been completed.

Another Committee member indicated that they follow a similar process in requiring AML training to be completed when a producer is contracted and appointed with their company. They also require a “refresher course” every two years. The “refresher course” is conducted on an in-house basis. They also have a broad list of approved vendors that provide AML training but a certification is required to confirm completion of required AML training.

Another company indicated that they conduct AML training for all their employees (and producers) annually on an internal learning management system where proof of completion is documented and stored.

C. SIU and Antifraud Examination Activities.

Selected state insurance departments may conduct examinations of life insurers to determine the adequacy and scope of their antifraud policies and procedures and antifraud activities.

The Committee to engage in a discussion of current regulatory practices with respect to conducting examinations of life insurers' anti-fraud practices.

The discussion indicated that the California Department of Insurance appears to be quite active in conducting examinations of life insurers with respect to their antifraud policies and procedures.

The examinations were described by one Committee member as being "very rigorous." The questions presented by the examiners were in depth in nature and included interviews with key personnel.

The examination is designed to identify potential issues for correction which can serve as a "warning" to the life insurer regarding its antifraud policies and procedures. The life insurer enters into a Client Corrective Action Plan which requires insurers to indicate how they are going to address any gaps found through the examination process.

Another Committee member indicated that their company was also examined by California. Upon inquiry, the examiners indicated that the choice of companies for examination was based largely on premium volume.

Another Committee member indicated that they had been subject to an antifraud review by the Maryland Insurance Administration approximately 4-5 years ago. Marilyn did not conduct an examination but requested a copy of the company's SIU plan.

D. Oversight of Third-Party Vendors.

Several members of the Committee indicated their interest in discussing practices associated with oversight of third-party vendor relationships.

A Committee member indicated that third-party vendor relationships (including third-party administrator relationships) are part of an overall risk assessment conducted by the company as a means to conduct appropriate supervision and oversight of their activities.

Other Committee members indicated that their company assigns responsibility to a dedicated team for TPA oversight.

Another Committee member also indicated that they have a risk management team that includes representatives of compliance that conducts quarterly monitoring of their third-party relationships.

Several Committee members indicated that they have systems that provide them with notifications of include date of termination of an existing third-party vendor agreements. Vendors identified for this purpose included systems offered through Archer and MetricStream.

#### E. Reporting of Late Filing Penalties.

A Committee member indicated that, in some instances due to a technological deficiency or other reasons, a company may be unable to submit reports online to a state insurance department.

When these circumstances arise, state insurance departments will sometimes impose a late filing penalty.

The ensuing discussion indicated that the Insurance Division of the Vermont Department of Financial Regulation Bulletin No. 30 requires life insurers to report any late filing penalty fees incurred.

#### IV. Reporting Items.

The Committee heard several reports from CEFLI staff regarding current developments affecting Compliance & Ethics issues in the life insurance industry.

##### A. SEC Chairman Clayton Suggests Regulation Best Interest May Be Released Sooner Than Expected.

SEC Chairman Clayton recently indicated that revisions to the SEC's Regulation Best Interest may be released "sooner than expected."

The SEC had previously projected that Regulation Best Interest would be released in September.

Media reports indicate that the SEC staff is circulating draft versions of Regulation Best Interest for review and possible approval by the SEC Commissioners. These reports indicate that the final version of the rule may be issued within the next several weeks.

B. DOL Plans to Issue New Fiduciary Rules.

In a recent hearing before the House Education and Labor Committee, Labor Secretary Alexander Acosta indicated that the DOL plans to issue new fiduciary rules following the issuance of the SEC's Regulation Best Interest.

Secretary Acosta indicated that the DOL is working with the SEC as it completes work on Regulation Best Interest which is expected to come out soon. (See above.) Secretary Acosta indicated that the new DOL Fiduciary Rules would be issued thereafter and would be designed to work in conjunction with the SEC's Regulation Best Interest.

C. FINRA Announces New Office of Innovation.

FINRA recently announced the establishment of a new Office of Innovation to assist FINRA staff in identifying, understanding and fostering various innovations in the securities markets. The new Office is an outgrowth of the Innovation Outreach Initiative under FINRA360.

Haimera Workie, a senior director at FINRA, will lead the new Office of Innovation. Mr. Workie served previously as the Deputy Associate Director of the Division of Trading and Markets at the US Securities and Exchange Commission.

D. House Passes Senior Security Act of 2019.

The US House of Representatives recently passed HR 1876 the Senior Security Act of 2019 which calls for the SEC Chairman to establish an interdivisional task force to:

- Identify the challenges senior investors encounter, such as cognitive decline and financial exploitation.
- Identify areas in which senior investors would benefit from changes in SEC or FINRA regulations.
- Coordinate with other areas of the SEC and self-regulatory agencies.
- Coordinate with entities outside of the SEC.

While this legislation is significant in terms of its focus on senior financial exploitation, it is also significant to note that the list of entities the SEC could consult with on these matters include state insurance regulators and state securities regulators.

Minutes – Meeting of the CEFLI Compliance & Ethics Committee  
May 15, 2019

E. FINRA Regulatory Notice 19-13 - Electronic Signatures for Discretionary Accounts.

The SEC recently approved a proposed rule to amend FINRA Rule 4512 (Customer Account Information) to permit the use of electronic signatures for discretionary accounts.

Currently, FINRA requires a manual (or “wet”) signature for each person authorized to exercise discretion in a discretionary account.

Due to technological advances in electronic signatures, including authentication and security, FINRA has amended Rule 4512 to permit the use of electronic signatures under the circumstances.

The amendments to FINRA Rule 4512 became effective on May 6.

F. FINRA Regulatory Notice 19-17 - Restricted Firm Obligations.

FINRA is requesting comment on proposed rule that would impose specific obligations on firms that would be designated with a significant history of misconduct. These obligations could include requiring such firms to make deposits of cash or qualified securities that could not be withdrawn without FINRA’s prior written consent.

Comments on the proposed rule are due by July 1, 2019.

G. FINRA Regulatory Notice 19-18 - Anti-Money Laundering (AML) Programs.

FINRA recently issued guidance concerning suspicious activity monitoring and reporting obligations to comply with FINRA Rule 3310 (Anti-Money-Laundering Compliance Program).

The Regulatory Notice provides examples of money-laundering red flags and indicated that anti-money-laundering practices such as customer due diligence and the submission of suspicious activity reports would be reviewed as part of FINRA’s 2019 Exam Priorities.

(Though it is recognized that not all CEFLI member companies are regulated by FINRA, the red flags identified within the Regulatory Notice also include Potential Red Flags in Insurance Products (see, P. 10). Also, other red flags contained within the guidance may be helpful to life insurance company compliance and ethics professionals as well.)

H. SEC Issues Risk Alert - Regulation S-P Compliance Issues.

The SEC's Office of Compliance Inspections and Examinations ("OCIE") recently issued a Risk Alert containing a list of compliance issues related to Regulation S-P to remind investment advisers and broker-dealers of their obligations regarding privacy and opt out notices as well as policies and procedures for safeguarding customer records and information. (See copy attached.)

I. SEC OCIE Director Questions Firms' Compliance Budgets.

In a recent speech, Pete Driscoll, Director of the SEC's Office of Compliance Inspections and Examinations ("OCIE") recently indicated that the SEC is noticing that compliance budgets are being cut or are not commensurate with firms' risk profiles at selected firms.

He also noted that chief compliance officers are often not empowered to ensure a firm's compliance which indicates an insufficient "tone at the top" from senior management in terms of making compliance a priority.

J. Whistleblower Protection Reform Act (HR 2515) - Passed by House Financial Services Committee.

The House Financial Services Committee passed legislation to protect whistleblowers from employee retaliation.

The legislation would amend the definition of whistleblower under the Securities and Exchange Act of 1934 to clarify that whistleblowers who report alleged misconduct internally their employers (but not to the securities and exchange commission) are protected by Dodd Frank's anti-retaliation provisions.

V. CEFLI Activities.

A. CEFLI National Compliance & Ethics Forum - Des Moines, Iowa - June 12-13.

CEFLI is pleased to introduce a new 2019 CEFLI National Compliance & Ethics Forum. The 2019 National Compliance & Ethics Forum will take place at the Renaissance Savery Hotel in Des Moines, Iowa on June 12-13.

The new 2019 National Compliance & Ethics Forum will consolidate and supplant our previous Regional Compliance Forums.

Like our previous Regional Compliance Forums, the agenda for the National Compliance & Ethics Forum will be developed through the submission of issues for discussion by those who register to attend the Forum. Participation will be

Minutes – Meeting of the CEFLI Compliance & Ethics Committee  
May 15, 2019

limited exclusively to member company representatives to establish an open environment for our discussions.

The 2019 CEFLI National Compliance & Ethics Forum is free of charge to all CEFLI member company representatives as a benefit of your company's CEFLI membership.

Registration to attend the Forum is now available via the CEFLI website.

B. Compliance Fundamentals Training Conference - May 8-10 - Austin, Texas.

On May 8-10, CEFLI conducted its Compliance Fundamentals Training Conference at The Driskell Hotel in Austin, Texas.

CEFLI staff provided a brief report regarding the Compliance Fundamentals Training Conference.

**VI.** Next Meeting.

The next meeting of the Committee is scheduled to take place:

June 13, 2019 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

The Committee will hold its remaining 2019 meetings as follows:

July 24, 2019 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

August 14, 2019 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

September 25, 2019 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

October 16, 2019 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

November 13, 2019 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

December 18, 2019 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

Please mark your calendar and plan to join us!

**VII.** Other Business.

Given that there was no other business to be brought before the Committee, the meeting adjourned.

**DRAFT**

**Minutes  
Meeting of the  
CEFLI Compliance & Ethics Committee  
June 13, 2019  
2 PM EDT/1 PM CDT/11 AM PDT**

A meeting of the CEFLI Compliance & Ethics Committee (the "Committee") was held via conference call on Thursday, June 13, 2019 at 2 PM EDT/1 PM CDT/11 AM PDT.

The following CEFLI member company representatives participated in the meeting:

Ro Adebisi, Thrivent\*  
Molly Akin, Ohio National  
Dwayne Akins, American National  
Marcie Allen, Texas Life  
Jenna Austin, Guggenheim Life  
Brendan Bakala, Catholic Order of Foresters\*  
Lauren Barbaruolo, Oxford Life Insurance  
Laurie Bascom, Transamerica\*  
Chad Batterson, Athene USA\*  
Ann Binzer, Cincinnati Life  
Nicole Blakney, State Farm Life\*  
Katelynn Blalock, Western & Southern  
Diane Boyette, Southern Farm Bureau  
Gabrielle Broderick, Sammons\*  
Laura Bullard, Foresters Financial  
Nancy Campbell, Symetra  
Steve Corbly, Cincinnati Life  
Allison Corrado, Lombard International  
Jim Cunningham, Fidelity Investments  
Jill Cusack, American Fidelity  
Dustin DeGroote, Homesteaders Life\*  
William Dunker, Principal Life\*  
Lynn Espeland, Woodmen of the World  
Rita Fenani, Pacific Life  
Jill Fiddler, Assurity Life\*  
Patrick Garcy, Sagicor Life  
Paula Gentry, Cincinnati Life

Minutes – Meeting of the CEFLI Compliance & Ethics Committee  
June 13, 2019

Mark Gill, Southern Farm Bureau  
Jim Golembiewski, Sagicor Life  
Rachel Gomez, State Farm Life  
Leslie Green, Western & Southern  
Natalie Jones Grundy, Guggenheim Life\*  
Cyndi Hall, Sammons\*  
Joel Hansen, RiverSource  
Dennis Herchel, SBLI MA  
Nathan Huss, Sammons\*  
Michelle Kaiser, Transamerica\*  
De Keimach, Delaware Life  
Matt Klein, Principal Life\*  
Samantha Knackmuhs, State Farm Life\*  
Megan Knapp, American Enterprise  
Michele Kryger, AIG  
Michele Kulish Danielson, American Enterprise\*  
Marla Lacey, Homesteaders Life  
Brian Leary, Fidelity Investments  
Dan LeBlanc, SBLI MA  
Laurie Lewis, Amica  
Tammy Marshall, Transamerica\*  
Gregor Maitland, Lincoln Financial  
Christine Maske, EquiTrust Life\*  
Genevieve Messina, Global Atlantic Financial  
Dave Milligan, American Equity\*  
Matt Missik, Pacific Life  
Karoll Moran, Amica Life  
Maureen Mulville, Illinois Mutual  
Deb Naegele, Cincinnati Life  
Mark Neidinger, National Guardian Life  
Jim Odland, Thrivent\*  
Jerie Olson, National Guardian  
Chad Oppedal, Principal Life\*  
Monique Pascual, Pacific Guardian  
Liza Perry, USAA Life  
Amy Peterson, Sammons\*  
Megan Phillips, Principal Life\*  
David Pokorny, EMC National\*  
Tony Poole, AAA Life  
Dina Privitera, Sammons\*  
Tricia Proctor, Sammons\*  
Daniel Reinecke, Gerber Life Insurance  
Julie Remus, Sammons\*  
Stacey Roach, Sammons\*  
Michael Roberson, Pacific Guardian Life  
Sheane Roginski, Cincinnati Life

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June 13, 2019

Sally Roudebush, Lincoln Heritage  
Heather Russo, Illinois Mutual  
Marie Ryan, Athene USA\*  
Rania Sarkis, Pacific Life  
Cara St. Martin, Allianz\*  
Matthew Schmanski, CNO Financial  
Wayne Smiley, TIAA  
Devin Smith, Securian  
Alison Soderberg, Lombard International  
Jamie Stenger, Principal Life\*  
Matt Stiles, EquiTrust Life\*  
Lori Straight, Sammons\*  
Cheryl Strohman, Homesteaders Life\*  
Kelly Stokes, Principal Life\*  
Cindy Stubblefield, Cincinnati Life  
Jason Sweeney, Sammons\*  
Nancy Sweet, CNO Financial  
Jill Terry, Cincinnati Life  
Mary Tresnak, Transamerica\*  
Geno Turek, Catholic Order of Foresters\*  
Bill Turner, American Fidelity  
Laura VanLaningham, Illinois Mutual  
Bart Vitou, Jackson National  
Susan Voss, American Enterprise\*  
Erin Wagner, American Equity\*  
Natalie Wagner, Global Atlantic  
Rochelle Walk, Wilton Re  
Michelle Ward, Erie Family Life  
Jaime Waters, EquiTrust Life\*  
Larry Welch, Citizens Inc.  
Tracy Whitaker, Homesteaders Life\*  
Emily Wilburn, Illinois Mutual\*  
Tomiko Wright, Protective Life

\*Present in person at CEFLI National Compliance & Ethics Forum held at The Renaissance Savery Hotel, Des Moines, Iowa.

Mallory Bennett, Kelly Ireland and Donald Walters of CEFLI also participated in the meeting.

**I. Welcome and Introduction.**

The meeting began with a recitation of CEFLI's anti-trust statement.

**II. Approval of Minutes – May 15, 2019 Meeting.**

On motion, duly made and seconded and unanimously carried, the Committee: RESOLVED, that, the Minutes of the May 15, 2019 meeting are hereby approved.

**III. Issues for Review.**

**A. SEC Regulation Best Interest.**

On Wednesday, June 5, the United States Securities and Exchange Commission (SEC) approved Regulation Best Interest. Regulation Best Interest was one of a package of rule proposals and interpretive guidance approved by the SEC.

Regulation Best Interest may prove to be one of the most significant modifications of the way producers/registered representatives will distribute products within the financial services industry over the years ahead.

The Committee was asked to discuss the potential impact of new obligations under the Regulation, as well as other implications of Reg BI, such as modifications to FINRA Rule 2111 (Suitability) and to the NAIC Suitability in Annuity Transactions Model Regulation.

A Committee member mentioned that with other states going down their own path toward regulation that would create new state-level fiduciary duties for BDs (e.g., MA, NJ, NV) there will likely be a legal challenge somewhere along the way.

SIFMA is of the opinion that the federal rule would pre-empt state efforts and it may be that the courts will ultimately determine the outcome. It was pointed out, however, that NSMIA would only sort out any issues of Reg BI superseding state law with respect to securities, not insurance.

A Committee member stated that they hope that there are not any significant delays in adoption of Reg BI (under Administrative Procedures Act would be 60 days after publication in the Federal Register) as that would impact the work the NAIC is doing on the Suitability Model Regulation and possibly remove the FINRA safe harbor. FINRA is on record saying they would have to strike or significantly modify Rule 2111.

A Committee member reported that Commissioner Ommen (IA) has suggested that the NAIC move past Suitability to a best interest standard. As head of the NAIC Life Insurance and Annuities (A) Committee, it is expected that significant deference will be given to Commissioner Ommen's comments.

Minutes – Meeting of the CEFLI Compliance & Ethics Committee  
June 13, 2019

A joint trades group has met and has reviewed the previous NAIC re-draft and Iowa's suggested revisions to the Suitability Model and support many of Commissioner Ommen's changes.

It is expected that the NAIC Suitability (A) Working Group will hold a few conference calls prior to the NAIC Summer National Meeting to continue to refine a revised draft for consideration by the NAIC Life Insurance and Annuities (A) Committee.

A Committee member indicated that timing of adoption of a revised Suitability Model will be important both in terms of encouraging uniformity among the states in light of some states getting out in front with their own regs, and also with respect to FINRA rule changes and hopefully ensuring that the FINRA safe harbor is maintained as well as the indexed annuity carve out won in the Harkin Amendment.

B. 401(k) Rollover Transactions by Non-Securities Licensed Personnel.

With a growing number of individuals nearing retirement, financial professionals are often presented with questions concerning whether to "roll over" an individual's 401(k) retirement plan into another financial product (or financial products) to meet their retirement needs.

It is not uncommon for 401(k) retirement plans to hold their assets in the form of mutual funds or other securities.

Securities and insurance regulators have recently reminded producers that, to the extent that a producer may be an insurance-only licensee, making a recommendation to "roll over" securities that currently reside within a 401(k) retirement plan in order to purchase non-securities products may constitute a transaction for which the producer is not appropriately licensed.

The Committee was asked to discuss whether issues associated with 401(k) "rollovers" are analyzed at life insurance companies from a licensing perspective in order to determine whether the types of assets being recommended for a "roll over" are securities and, therefore, would require a producer making such a recommendation to be securities licensed (in addition to being insurance licensed if the recommendation is to place the "roll over" proceeds into an insurance product such as an annuity).

A Committee member reported that they have issued field bulletins in some states (e.g., IA, VT) to remind insurance only producers about the limitations on what advice they can offer.

Another Committee member indicated that they have also issued communications to the field. Most Committee members have not seen a state

Minutes – Meeting of the CEFLI Compliance & Ethics Committee  
June 13, 2019

act against insurance-only producers for securities advice but have had to rescind contracts to resolve complaints for this type of sales practice.

Another Committee member has created point of sale disclosure to be given to the consumer by a registered individual or by an insurance-only agent which states that any action taken to liquidate a 401K or any other security product was a decision made without advice to do so by the agent. This disclosure was presented during an examination by a state and the company was told “it couldn’t hurt” to get such a form signed by both the consumer and the agent in these situations.

Some Committee members reported that they ask for source of funds on their suitability form and then check for securities licensing when funds are coming from a security. One has a statement on their form that tells producers to stop if they do not hold a Series 6 or 7 Securities license.

Another Committee member indicated that they built a rules engine process to check the producer against state licensing and FINRA broker check. They did so because of this being asked about in several states (AR, IA, TN, UT, VT).

C. Utah House Bill 55 - Section 31 8-21-311 – Delivery of Policy or Certificate.

Earlier this year, the Utah Legislature passed House Bill 55 which included various amendments to the Utah Insurance Code.

One of the amendments to the Utah Insurance Code pertained to Delivery of [a] Policy or Certificate.

Section 31 A-21-311 was amended to read:

*(1)(a) An insurer issuing an individual or group life insurance policy or an accident and health insurance policy shall deliver a copy of the policy to the policyholder as soon as practicable but no later than 90 days after the date on which the coverage is effective.*

The Committee was asked to discuss its interpretation of the date upon which “coverage is effective” (i.e., is it the date the policy is placed in force or the policy issue date) and compliance strategies associated with the Delivery of Policy or Certificate amendments to the Utah Insurance Code as found within recently enacted Utah House Bill 55.

The Committee offered no comments on this issue at this time.

D. NAIC Lost Life Insurance Policy Locator Service.

As the Committee has discussed in the past, the NAIC established its Lost Life Insurance Policy Locator Service to allow life insurance companies to participate on a voluntary basis to assist their efforts to identify potential beneficiaries of life insurance policy benefits.

Though the NAIC has encouraged all states to participate in its Lost Life Insurance Policy Locator Service, not all states have elected to do so. Notable examples include New York, Illinois and Michigan.

The Committee was asked to discuss their experiences with respect to participating in the NAIC Lost Life Insurance Policy Locator Service and whether their companies also utilize the lost policy locator services provided by individual states.

A Committee member indicated that they have an automated search process in place for OH and MI. For IL, LA and OR they receive weekly requests for reports. Their preference would be for all states to participate with the NAIC Lost Life Insurance Policy Locator Service.

E. South Carolina Bulletin No. 2019-02 - Rescission of a Life Insurance Policy

At a previous Committee meeting, we discussed that South Carolina recently issued Bulletin No. 2019-02 “reminding” life insurers doing business in that state that, per SC Code §38-63-220(d), an insurer can only “vacate” or rescind coverage on an individual life policy by “instituting proceedings.”

The language of the Bulletin seems to suggest that all rescissions must be commenced by judicial action (e.g., DJA or other civil actions). However, the Bulletin also states:

“A letter or other notice to the insured stating that the policy has been canceled or rescinded does not qualify as a *proceeding to vacate a policy* under South Carolina law.” (Underline added.)

The Committee was asked to discuss their practices to comply with the requirements of South Carolina Bulletin No. 2019-02 with respect to rescissions.

A Committee member reported that while this has not yet come up on a claim in SC, their approach would be to file suit.

Minutes – Meeting of the CEFLI Compliance & Ethics Committee  
June 13, 2019

Another Committee member indicated that they recently had a SC rescission and required the policyholder to sign a mutual release. If they had not received the signed release, they would have filed suit for rescission.

A Committee member reported that they had reached out to SC on this issue and it appears that SC realizes they are an outlier and may take some corrective action next session. The ACLI is working with companies to gauge their experience with SC and will act as a go between on this issue.

ACLI has reached out to companies to ask their experience. A Committee member mentioned that two other states prohibit insurers from unilaterally rescinding a policy – New York (NY Cir 1-2017) and TN (56-7-102 (f)).

F. Child Support Data Match.

Life insurers may be subject to requirements to conduct data match searches to ensure that child support payments are being conducted in a compliant manner.

The Committee was asked to discuss their company's practices with respect to child support data match requirements.

A Committee member reported that they recently conducted match searches in CO and DE - only required to check on qualified annuities. For CA, IL and TX you must check on all surrender and cancellation requests including 1035 exchanges.

Another Committee member indicated that NV recently passed a requirement.

**IV. Reporting Items.**

A. NAIC Annuity Suitability Working Group Drafting Session - June 20 - Columbus, Ohio.

CEFLI staff reported that the NAIC Annuity Suitability Working Group has indicated they will conduct a drafting session to consider possible modifications to the NAIC Suitability in Annuity Transactions Model Regulation on Thursday, June 20 in Columbus, Ohio.

The meeting will be moderated by NAIC Annuity Suitability Working Group Chair and Ohio Director, Jillian Froment.

CEFLI will monitor these developments and provide updated information, as appropriate.

B. Department of Labor Will Issue a Revised Fiduciary Rule in December 2019.

CEFLI staff reported that the US Department of Labor has indicated through its Spring regulatory agenda that it plans to issue a revised version of its Fiduciary Rule (and its Prohibited Transactions Exemptions) in December 2019.

Previous media reports indicated that the DOL staff was working closely with the SEC staff in its development of Regulation Best Interest. It is anticipated that a revised DOL Fiduciary Rule will seek to be aligned with the requirements of the SEC's Regulation Best interest.

C. NASAA, FINRA and SEC Issue Senior Safe Act Guidelines.

CEFLI staff reported that the North American Securities Administrators Association, FINRA and the SEC recently issued guidelines for organizations to comply with the provisions of the recently enacted Senior Safe Act. (See copy attached.)

For firms and individuals that satisfy the Senior Safe Act's requirements, the Senior Safe Act provides immunity from liability in any civil or administrative proceeding for reporting potential exploitation of the senior citizen.

D. House Passes SECURE Retirement Bill.

CEFLI staff reported that the US House of Representatives passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act on a bipartisan basis to make it easier for small businesses to offer a retirement plan, ease use of annuities in 401(k) plans and raise the required minimum distribution age.

The bill has been sent to the Senate for its consideration.

**V. CEFLI Activities.**

2019 CEFLI Annual Conference and Compliance Leadership Forum - Nashville, Tennessee - September 11-13.

Registration is now open for the 2019 CEFLI Annual Conference and Compliance Leadership Forum which will be taking place at the JW Marriott Hotel in Nashville, Tennessee on September 11-13.

We hope you will be able to join us!

**VI. Next Meeting.**

The Committee will hold its next meeting on July 31, 2019 - 2 PM EDT/1 PM CDT/12 Noon MST/11 AM PDT.

The Committee will hold further 2019 meetings as follows:

August 14, 2019 - 2 PM EDT/1 PM CDT/12 Noon MST/11 AM PDT  
September 25, 2019 - 2 PM EDT/1 PM CDT/12 Noon MST/11 AM PDT  
October 16, 2019 - 2 PM EDT/1 PM CDT/12 Noon MST/11 AM PDT November  
13, 2019 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST  
December 18, 2019 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

Please mark your calendar and plan to join us!

**VII. Other Business.**

A Committee member asked how other companies accommodate a request for gender change on an in-force policy/contract.

A Committee member indicated that they do not allow for a change of gender or a sex change on in-force business. Will only permit a change if the policy was issued with an incorrect gender at time of issue.

Another Committee member reported that they allow gender changes on inforce business if the request is made in writing and accompanied by supporting documentation (e.g. legal name change). Any change is accompanied by a change in premium on a go-forward basis. While there is some risk of fraud involved, their Legal department feels the volume of requests is low enough that the risk is not significant.

There being no additional business the meeting was adjourned.



# RISK ALERT

OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

July 23, 2019

## Observations from Examinations of Investment Advisers: Compliance, Supervision, and Disclosure of Conflicts of Interest

### I. Introduction

*OCIE encourages advisers, when designing and implementing their compliance and supervision frameworks, to consider the risks presented by hiring and employing supervised persons with disciplinary histories and adopt policies and procedures to address those risks.*

As part of the Office of Compliance Inspections and Examination’s (“OCIE”) focus on protecting retail investors, the staff conducted a series of examinations to assess the oversight practices of SEC-registered investment advisers (“advisers”) that previously employed, or currently employ, any individual with a history of disciplinary events (“Supervision Initiative” or “Initiative”).<sup>1</sup>

The staff conducted over 50 examinations of advisers in 2017 as part of this Initiative. The advisers examined collectively managed approximately \$50 billion in assets for nearly 220,000 clients, the vast majority of whom were retail investors. Advisers were identified for examination through a review of information about disciplinary events and other legal actions involving supervised persons of the adviser, including legal actions that are not required to be reported on

Form ADV (e.g., private civil actions).<sup>2</sup>

The purpose of this Risk Alert is to raise awareness of certain compliance issues that OCIE observed by sharing the staff’s observations from these examinations.

### II. Relevant Regulations

The Supervision Initiative focused on advisers’ practices in certain areas, including:

<sup>1</sup> See [NEP Risk Alert: Examinations of Supervision Practices At Registered Investment Advisers](#) (Sept. 12, 2016). For purposes of the Supervision Initiative, and as referenced in this Risk Alert, “supervised persons” include principals and officers of the adviser, and other individuals performing services on behalf of the adviser (other than clerical), regardless of whether these individuals are independent contractors or employees of the adviser. See also Investment Advisers Act of 1940 (“Advisers Act”) Section 202(a) (25) (defining “supervised person”).

<sup>2</sup> See Form ADV, Part 2A, Item 9 and Part 2B, Item 3 (Disciplinary Information). All registered advisers must promptly disclose any legal or disciplinary events that would be material to a client’s or a prospective client’s evaluation of the adviser’s integrity or its ability to meet its commitments to clients. See also Advisers Act Rules 204-3(b) (4) and 204(2)(a)(14)(iii).

- *Compliance programs and supervisory oversight practices.* The staff reviewed whether compliance policies and procedures were reasonably designed to detect and prevent violations of the Advisers Act by the firm and its supervised persons, particularly those policies and procedures covering the activities of certain previously-disciplined individuals.<sup>3</sup>
- *Disclosures.* The staff focused on whether disclosures in public statements or documents (e.g., marketing materials) and filings were full and fair, included all material facts, and were not misleading.<sup>4</sup> Particular emphasis was placed on reviewing disclosures in these materials related to previously-disciplined individuals and their prior disciplinary events.<sup>5</sup>
- *Conflicts of interest.* The staff assessed whether the adviser identified, addressed, and fully and fairly disclosed all material conflicts of interest that could affect the advisory relationship, particularly those conflicts dealing with compensation arrangements and account management.<sup>6</sup>

The examinations did not focus solely on supervisory practices as they relate to the individuals with prior disciplinary histories. Rather, due to the importance that supervisory practices have in setting a strong “tone at the top” and compliance culture, the staff reviewed the advisers’ supervisory practices firm-wide.

### III. Staff Observations

The Initiative identified a variety of observed deficiencies across a range of topics. Nearly all of the examined advisers received deficiency letters. The vast majority of these deficiencies relate to compliance issues, but many relate to disclosure issues, including undisclosed conflicts of interest.

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<sup>3</sup> Advisers Act Rule 206(4)-7. Section 203(e)(6) of the Advisers Act also highlights that establishing supervisory procedures reasonably designed to prevent and detect such violations and following these procedures are important steps an adviser should take in supervising persons subject to its supervision. The Commission has brought enforcement actions against advisers that did not adopt or implement any policies or procedures regarding their supervision of certain personnel. See, e.g., [In re James T Budden and Alexander Budden](#), Advisers Act Release No. 4225 (Oct. 13, 2015) (settled).

<sup>4</sup> An adviser’s obligation as a fiduciary is enforceable through Advisers Act Section 206. As fiduciaries, advisers must provide full and fair disclosure of all material facts to their clients and prospective clients. Also, it is unlawful for advisers to make untrue statements or omit any material facts in applications or reports filed with the Commission (Advisers Act Section 207) or to have advertising (as defined in Advisers Act Rule 206(4)-1) that is false or misleading or that contains any untrue statement of a material fact.

<sup>5</sup> See, e.g., [SEC v. Capital Gains Research Bureau, Inc.](#), 375 U.S. 180 (1963) and [Amendments to Form ADV](#), Advisers Act Release No. 3060 (Jul. 28, 2010) (“as a fiduciary, an adviser has an ongoing obligation to inform its clients of any material information that could affect the advisory relationship”). See also [General Instruction 3 to Form ADV](#), which states that “[u]nder federal and state law, [an adviser is] a fiduciary and must make full disclosure to [its] clients of all material facts relating to the advisory relationship.”

<sup>6</sup> Advisers Act Section 206. Also, [General Instructions to Form ADV](#), such as General Instruction 3, state that an adviser’s disclosure obligation “...requires that [the adviser] provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest [the adviser has] and the business practices in which [the adviser] engage[s], and can give informed consent to such conflicts or practices or reject them.”

## A. Staff Observations Specific to Disciplinary Histories

Some of the staff's observations related to advisers' oversight of supervised persons with disciplinary histories are discussed below.

- *Full and Fair Disclosure.* The staff observed that nearly half of the disclosure-related deficiencies of the advisers examined were due to the firms providing inadequate information regarding disciplinary events.<sup>7</sup> For example, advisers:
  - Omitted material disclosures regarding disciplinary histories of certain supervised persons or the adviser itself. Often the disciplinary omissions related to supervised persons occurred because the advisers solely relied on these supervised persons to self-report to the firms information about their required disclosures.
  - Included incomplete, confusing, or misleading information regarding disciplinary events. For example, they did not, as applicable: include the total number of events, the date for each event, the allegations, or whether the supervised persons were found to be at fault (i.e., whether fines, judgments or awards, or other disciplinary sanctions were imposed).<sup>8</sup>
  - Did not timely update and deliver disclosure documents to clients, such as updating Form ADV for new disciplinary events of supervised persons reported on CRD (e.g., Form U5s).<sup>9</sup>
- *Effective compliance programs.* The staff observed that many advisers did not adopt and implement compliance policies and procedures that address the risks associated with hiring and employing individuals with prior disciplinary histories. For example, advisers did not have processes reasonably designed to identify:
  - Whether the supervised persons' self-attestations regarding disciplinary events completely and accurately described those events. For example, some self-attestations contained information that did not fully or clearly describe the disciplinary events.
  - Whether the supervised persons' self-attestations that they were not the subject of reportable events or recent bankruptcies was in fact the case. For example, some

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<sup>7</sup> All registered advisers must promptly disclose in Form ADV certain legal or disciplinary events that would be material to a client's or a prospective client's evaluation of the adviser's integrity or its ability to meet its commitments to clients. See [Amendments to Form ADV](#), Advisers Act Release No. 3060 (Jul. 28, 2010). See also generally, [Commission Interpretation Regarding Standard of Conduct for Investment Advisers](#), Advisers Act Release 5248 (June 5, 2019).

<sup>8</sup> See [Form ADV](#), Item 11 and Criminal Disclosure Reporting Page (DRP), which requires advisers to report details regarding certain disciplinary events.

<sup>9</sup> See [General Instructions to Form ADV](#), which specifies that an adviser must promptly file an "other-than-annual amendment" to its Form ADV when certain information becomes inaccurate in any way, including reportable disciplinary events. CRD (Central Registration Depository) is a database maintained by FINRA. It is used to store and maintain information on registered broker-dealers and their associated individuals. Many supervised persons of advisers are representatives of both broker-dealers and advisers.

supervised persons reported incorrectly to the adviser that they were not the subject of any reportable events during the reporting period or did not report information regarding recent bankruptcies.

## **B. Additional Staff Observations**

The staff reviewed advisers' firm-wide practices and observed issues that were not necessarily attributed directly to the firms' hiring and supervision of individuals with disciplinary histories. While some of these deficiencies are commonly identified in OCIE examinations, they were frequently identified during the Supervision Initiative examinations.

### ***Compliance and Supervision***

- *Supervision.* The staff observed that many advisers did not adequately supervise or set appropriate standards of business conduct for their supervised persons. In these instances, advisers' policies and procedures did not sufficiently document the responsibilities of supervised persons or did not clearly outline the expectations for these individuals. Examples include practices where the adviser did not:
  - Oversee whether fees charged by supervised persons were disclosed or assess whether the services clients paid for were performed. At some of these advisers, the staff observed instances in which clients paid for certain services they did not receive or were charged undisclosed fees.
  - Have advertising policies and procedures that provided sufficiently specific guidance to supervised persons who prepared their own advertising materials and websites. At these advisers, the staff observed the dissemination of advertisements that did not comply with the requirements of the advertising rule.<sup>10</sup>
  - Include reviewing activities of supervised persons, including supervised persons with disciplinary histories, working from remote locations as part of its monitoring activities. In many instances, staff observed that, unbeknownst to the advisers, geographically dispersed supervised persons were operating in a self-directed manner that was not consistent with the advisers' policies and procedures.
- *Oversight.* The staff observed that many advisers did not confirm that supervised persons identified as responsible for performing certain compliance policies and procedures were executing their duties, as prescribed. These advisers may have had policies and procedures that clearly assigned the individuals who were responsible for performing particular duties, but the firms did not implement them so that that these individuals performed the duties that were assigned to them, or did not document that these duties were performed according to the advisers' policies and procedures. In some instances, the duties included key regulatory and business responsibilities for advisers managing investor assets, such as:

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<sup>10</sup> Advisers Act Rule 206(4)-1.

- Monitoring the appropriateness of client account types. For example, although outlined within the advisers' policies and procedures, the firms did not review whether at account opening the type of account selected was appropriate (e.g., wrap fee versus separately managed account), document that an assessment of the type of account took place, or document the factors considered in making these assessments.
  - Maintaining true, accurate, and current books and records, including those necessary to provide investment supervisory or management services to clients (e.g., maintaining a list of all accounts in which the adviser is vested with discretionary authority), to determine the financial standing of the firm, or to identify individuals with access to sensitive information.
- *Compliance policies and procedures.* The staff observed that several advisers had adopted policies and procedures that were inconsistent with their actual business practices and disclosures. Areas of inconsistent compliance practices most frequently cited by the staff involved those addressing commissions, fees, and expenses (e.g., solicitation fees, management fees, compensation related to hiring personnel, and oversight of firm compensation practices, including such practices within branch offices).
- *Annual compliance reviews.* The staff observed that advisers' annual reviews were insufficient because the firms did not take steps to adequately document the reviews and appropriately assess the risk areas applicable to the firms, or identify certain risks at all.

#### ***Disclosure of Conflicts of Interest***

- *Compensation arrangements.* The staff observed that several advisers had undisclosed compensation arrangements, which resulted in conflicts of interests that could have impacted the impartiality of the advice the supervised persons gave to their clients. For example, some of these advisers did not disclose that:
  - Forgivable loans were made to the advisers or their supervised persons, the terms of which were contingent upon certain client-based incentives that may have unduly influenced the investment decision-making process, resulted in higher fees and expenses for the affected clients, or both.
  - Supervised persons were required to incur all transaction-based charges associated with executing client transactions, which created incentives for the supervised persons to trade less frequently on behalf of their clients.

#### **IV. Staff Observations on Ways to Improve Compliance**

Some of the compliance and supervisory policies and procedures the staff observed at certain advisers may help other firms address the weaknesses discussed above. For example, advisers that hire or employ supervised persons with disciplinary histories may want to consider, among other things:

- *Adopting written policies and procedures that specifically address what must occur prior to hiring supervised persons that have reported to the adviser disciplinary events.* Most of the examined advisers that had recently hired supervised persons that had reported to the adviser disciplinary histories had written policies and procedures specifically addressing what to do before hiring such individuals. The staff observed that, almost all of the firms' written policies and procedures required investigations of the disciplinary events and several also required ascertaining whether barred individuals were eligible to reapply for their licenses.
- *Enhancing due diligence practices associated with hiring supervised persons to identify disciplinary events.* The examined advisers utilized a wide array of due diligence measures as part of their hiring processes. The staff observed that, while the advisers' practices varied, in addition to the practices noted above, for firms with written hiring policies and procedures, these procedures more consistently included conducting background checks (e.g., the firms confirmed employment histories, disciplinary records, financial background and credit information), conducting internet and social media searches, fingerprinting personnel, utilizing third parties to research potential new hires, contacting personal references, and verifying educational claims. In addition, some advisers:
  - Requested that potential new hires provide the firm with copies of their Form U5s, when applicable.
  - Reviewed new hires' Form U5 filings 30 or more days after they are hired (this type of procedure may identify termination notices the new hire did not disclose that were filed after the hiring decision was made), when applicable.
  - Initially checked CRD/IARD for supervised persons' filings and re-checked the filing information after a designated period of time, such as three months later.
- *Establishing heightened supervision practices when overseeing supervised persons with certain disciplinary histories.* The staff observed that many of the advisers had not adopted supervision practices or compliance procedures that addressed the risks associated with employing supervised persons with prior disciplinary histories (e.g., disciplinary histories relating to misappropriation, unauthorized trading, forgery, bribery, and making unsuitable recommendations). However, the examined advisers with written policies and procedures specifically addressing the oversight of supervised persons with disciplinary histories were far more likely to identify misconduct by supervised persons than advisers without these written protocols.
- *Adopting written policies and procedures addressing client complaints related to supervised persons.* The staff observed that advisers with written policies and procedures addressing client complaints related to their supervised persons were more likely to have reported the receipt of at least one complaint related to their supervised persons. In addition, these advisers were consistently more likely to escalate matters of concern raised in these complaints than advisers without written protocols.

- *Including oversight of persons operating out of remote offices in compliance and supervisory programs, particularly when supervised persons with disciplinary histories are located in branch or remote offices.*

## **V. Conclusion**

The examinations within the scope of this review resulted in a range of actions. In response to the staff's observations, some advisers elected to amend disclosures, revise compliance policies and procedures, or change other practices. OCIE encourages advisers, when designing and implementing their compliance and supervision frameworks, to consider the risks presented by, as well as the disclosure requirements triggered by, the hiring and employing of supervised persons with disciplinary histories and adopt policies and procedures to address those risks and disclosure requirements.

In sharing the information in this Risk Alert, OCIE is encouraging advisers to reflect upon their practices, policies, and procedures and to consider ways that they may improve their supervisory practices and compliance programs.

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*This Risk Alert is intended to highlight for firms risks and issues that OCIE staff has identified. In addition, this Risk Alert describes risks that firms may consider to (i) assess their supervisory, compliance, and/or other risk management systems related to these risks, and (ii) make any changes, as may be appropriate, to address or strengthen such systems. Other risks besides those described in this Risk Alert may be appropriate to consider, and some issues discussed in this Risk Alert may not be relevant to a particular firm's business. The adequacy of supervisory, compliance and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.*

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