Agenda

CEFLI Compliance & Ethics Committee Meeting
Wednesday, March 18, 2020
2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Dial In: (800) 239-9838
Passcode: 5690858

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

A. Antitrust Statement.

II. Approval of Minutes – February 12, 2020 Meeting. **The Committee**

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

A. Coronavirus (COVID 19).

The world is currently addressing the issues that have arisen as a result of the onset of the Coronavirus (COVID 19) pandemic. Standard workplace and household routines have been disrupted for many and governmental health authorities are encouraging individuals to exercise "social distancing" and other ameliorative efforts to deter the spread of the Coronavirus.

The Coronavirus has already had a negative impact on economic conditions in the United States. The life insurance industry is not immune from these economic developments.

In light of these extraordinary circumstances, we will use this month's Committee meeting to allow Committee members to share their perspectives regarding how the Coronavirus has impacted their company's policies and procedures and steps their companies may be taking over the months ahead to protect the health and safety of their employees, distributors and other stakeholders.

Among the issues that have been presented for discussion by the Committee include:

- *Has your company instructed employees to work from home?*
- *Has your company instituted a travel ban (domestically and/or internationally) for all non-essential travel? If so, for how long?*

- *Has your company prohibited participation by your company's representatives in any conferences/industry gatherings over the next several months? If so, for how long?*

- *Has your company begun to implement business continuity plans in light of the onset of the Coronavirus?*

- *Has your company begun to implement restrictive expense control strategies in light of a 0% interest rate environment?*

- *Will your company's underwriting requirements change to mandate testing for Coronavirus?*

The Committee will be asked to discuss the steps their companies have taken in light of the impact of the Coronavirus (COVID 19) in the US.

B. Requests for Extensions of Time for Premium Payments (Grace Periods) - Emergencies/Natural Disasters.

During periods of national emergencies or natural disasters, life insurance companies will often post notices to their websites to advise policyholders to contact the company to discuss whether extensions of time for premium payments (i.e., grace periods) may be granted due to the extraordinary nature of these events.

Often these requests are reviewed on a case-by-case basis.

Due to the onset of the Coronavirus (COVID 19), a question has been presented concerning whether companies may be planning to implement broader strategies with respect to providing extensions of time for premium payments.

The Committee will be asked to discuss whether their companies are planning to implement broader strategies to allow for extensions of time for premium payments due to the onset of the Coronavirus (COVID 19).

C. Maryland Market Conduct Action – Vaping/E Cigarettes.

The Maryland Insurance Administration recently submitted a market conduct action request to several insurers related to their possible practices with respect to charging smoker rates for life insurance due to Vaping or use of E Cigarettes. (See copy attached.)

The market conduct action poses a series of questions to determine a company's underwriting practices with respect to a prospective insured's use of Vaping or E Cigarettes.

It appears the Maryland Insurance Administration is interested in obtaining information concerning whether perspective insureds who may be Vaping or using E Cigarettes may be treated differently for underwriting purposes.

The Committee will be asked to discuss whether their companies have received a similar letter from the Maryland Insurance Administration concerning their company's underwriting practices with respect to perspective insureds who may be Vaping or using E Cigarettes?

D. Calculation of Interest on Delayed Claim Payments.

Life insurance laws and regulations in several states allow insurers to retain the proceeds of a life insurance policy, under certain conditions, following the death of an insured.

However, these same laws and regulations often outline the conditions under which life insurance companies are required to calculate interest on delayed claim payments.

A key question pertains to whether life insurance companies must compute simple interest or compound interest on delayed claim payments.

It had been generally understood that compound interest may represent a standard practice throughout the industry.

However, a member company has encountered market conduct examinations from two different jurisdictions (Washington and Vermont) indicating that interest on delayed claim payments should be computed using simple interest (rather than compound interest).

The Committee will be asked to discuss their company's practices with respect to the method used to compute interest (i.e., compound interest or simple interest) on delayed claim payments.

IV. Reporting Items. CEFLI Staff.

A. Massachusetts Fiduciary Rule.

The Massachusetts Securities Division has adopted regulations which will apply a fiduciary standard of conduct to broker-dealers and agents when dealing with their customers. (See copy of the Final Regulation and Adopting Release attached.)

The regulation will become effective upon its publication in the Massachusetts Register. The Securities Division has indicated that the Final Regulations will be a forced effective September 1, 2020.

B. NAIC Executive/Plenary Committees Approved Revisions to the NAIC Suitability in Annuity Transactions Model Regulation.

On Thursday, February 13, the NAIC's Executive/Plenary Committees approved recent revisions to the NAIC Suitability in Annuity Transactions Model Regulation. (See copy attached.)

CEFLI has been monitoring the activities of the NAIC's Annuity Suitability (A) Working Group and the NAIC's Life Insurance and Annuities (A) Committee to follow these important developments.

The revised Model Regulation conforms with many of the requirements of the SEC's Regulation Best Interest.

C. Iowa Insurance Division Proposes its version of the revised NAIC Suitability in Annuity Transactions Model Regulation.

The Iowa Insurance Division has been one of the first states to propose its version of the revisions to the NAIC Suitability in Annuity Transactions Model Regulation. (See copy attached.)

If approved, Iowa's proposed rule will be effective January 1, 2021.

The Iowa rule proposal also outlines Best Interest Obligations in the Brokerage Business for broker-dealers and investment advisory firms.

D. FINRA Submits Proposed Rule to Amend FINRA Rule 2111 (Suitability) and Non-Cash Compensation Rules.

FINRA has issued proposed rules to amend FINRA Rule 2111 (Suitability) to state that it will not apply to recommendations subject to the SEC's Regulation Best Interest. (See copy attached.) The Proposed Rule amendments would conform FINRA's rules governing non-cash compensation to Regulation Best Interest's limitations on sales contests, sales quotas, bonuses and non-cash compensation.

The Proposed Rule amendments must be approved by the SEC. If they are approved, they will become effective on June 30, 2020 – – the effective date of the SEC's Regulation Best Interest.

E. SEC Issues Final Rule on Summary Prospectus for Variable Annuities.

The SEC has issued its long-awaited final rule on a Summary Prospectus for variable annuity products. A link to the 713 page final rule can be found through the following URL: https://www.sec.gov/rules/final/2020/33-10765.pdf

The Summary Prospectus rule will allow investors to receive a more concise version of the prospectus accompanying variable annuity products similar to the more concise prospectus provided in conjunction with mutual fund products.

F. FINRA Regulatory Notice 20-08 - Pandemic-Related Business Continuity Planning, Guidance and Regulatory Relief.

FINRA has issued guidance reminding firms to revisit their business continuity planning in light of the Coronavirus (COVID 19) pandemic. (See copy attached.)

FINRA is also providing regulatory relief to those firms that may not be able to meet regulatory filing deadlines due to the pandemic.

G. NAIC Coronavirus Resource Center.

The NAIC has established a robust website with links to additional information concerning the Coronavirus.

The website can be found through the following link:

https://content.naic.org/naic_coronavirus_info.htm

V. CEFLI Activities.

A. CEFLI Educational Summit Meeting - April 8 - Des Moines, Iowa – CANCELLED

CEFLI recently announced the cancellation of its Educational Summit Meeting scheduled to take place on April 8 in Des Moines, Iowa due to the concerns related to the Coronavirus (COVID 19). The Educational Summit Meeting was designed to review the key compliance requirements of the recent revisions to the NAIC Suitability in Annuity Transactions Model Regulation.

CEFLI is exploring the possibility of conducting these sessions “virtually” via a series of webinars in the coming weeks.

B. CEFLI Compliance Fundamentals Training Conference - May 6-8 - Nashville, Tennessee - POSTPONED.

CEFLI recently announced the postponement of its Compliance Fundamentals Training Conference scheduled to take place on May 6-8 in Nashville, Tennessee due to concerns related to the Coronavirus (COVID 19).

CEFLI is exploring possible dates for rescheduling the Compliance Fundamentals Training Conference later in the year.

C. CEFLI Webinar - Fraud Detection and Prevention - Wednesday, March 25 - 1 PM EDT/12 PM CDT/11 AM MDT/10 AM PDT.

CEFLI will be conducting the next session in its Educational Webinar Series to examine Fraud Detection and Prevention practices on Wednesday, March 25 at 1 PM EDT/12 PM CDT/11 AM MDT/10 AM PDT.

We hope you will be able to join us!

VI. Next Meeting.

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

Wednesday, April 15, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

Please mark your calendar and plan to join us!

The remaining Committee meeting dates for 2020 will be as follows:

Wednesday, May 13, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, June 17, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, July 22, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, August 19, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, September 16, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, October 14, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, November 12, 2020 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST
Wednesday, December 16, 2020 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

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
February12, 2020

A meeting of the CEFLI Compliance & Ethics Committee (the "Committee") was held via conference call on Wednesday, February 12, 2020 at 2 PM EDT/1 PM CDT/11 AM PDT.

The following CEFLI member company representatives participated in the meeting:

Dwain Akins, American National
Marcie Allen, Texas Life
Renee Andrews, Southern Farm Bureau
Shannon Aussieker, Country Companies
Jenna Austin, Guggenheim Life
Brendan Bakala, Catholic Order of Foresters
Lauren Barbaruolo, Oxford Life Insurance
Chad Batterson, Athene
Dwight Bold, Southern Farm Bureau
Emmanuelle Brooks, Pacific Life
Jason Broussard, American National
Vickie Bulger, Primerica Life
Laura Bullard, Foresters Financial
Nancy Campbell, Symetra
Dana Cook, Assurity Life
Steve Corbly, Cincinnati Life
Jacquie Crader, CUNA Mutual
John Cunningham, Fidelity Investments Life
Michele Kulish Danielson, American Enterprise
Kathy Deputy, State Farm
Jessica English, Thrivent
Toba Fryer, John Hancock
Paula Gentry, Cincinnati Life
Mark Gill, Southern Farm Bureau
Jim Golembiewski, Sagicor Life
Rachel Gomez, State Farm
Meagan Gonzales, Oxford Life
Steve Harris, Lincoln Financial
Hunter Hawkins, Southern Farm Bureau
Dennis Herchel, SBLI MA
Lisa Holland, State Farm

Belinda Howard, Principal
Emily Jordan, Amalgamated Life
Martin Karp, Oxford Life
De Keimach, Delaware Life
Jason Klee, Guggenheim Life
Nate Kolle, Securian Financial
Hannah Krone, Western & Southern
Kim Kuennen, Cuna Mutual Group
Mark Lasswell, RiverSource
Dan Leblanc, SBLI MA
Laurie Lewis, Amica Life
Jessica Malone, Southern Farm Bureau
Kathy Mangum, Southern Farm Bureau
Stephanie Massad, Globe Life
Ryan Meehan, Riversource
Dave Milligan, American Equity
Rosemary Morgan, Brighthouse Financial
Leigh Mumford, TIAA
Sabrina Olender, Foresters
Liza Perry, USAA Life
Megan Phillips, Principal Life
Tony Poole, AAA Life
Ashley Posner, Southern Farm Bureau
Michelle Ross, Lombard International
Sally Roudebush, Lincoln Heritage
Heather Russo, Illinois Mutual
Stacey Roach, Sammons
Ryan Schwoebel, Protective Life
Devin Smith, Securian Financial
Alison Soderberg, Lombard International
Craig Stille, Country Financial
Kevin Sullivan, Protective Life
Nancy Sweet, CNO Financial
Jill Terry, Cincinnati Life
Kristen Thomas, Jackson National
Bill Turner, American Fidelity
Catherine Valeri, Global Atlantic Financial Group
Laura Vanlaningham, Illinois Mutual
Bart Vitou, Jackson National
Rochelle Walk, Wilton Re
Elizabeth Washington, Southern Farm Bureau
Larry Welch, Citizens Inc
Tracy Whitaker, Homesteaders Life
Stacey White, American National

Kathy Wiggins, Voya Financial
Emily Wilburn, Illinois Mutual
Pam Wilson, Cincinnati Life

Donald J. Walters, President & CEO, and Carla Strauch, Vice President-Compliance & Ethics, also attended the meeting.

I. Welcome and Introduction.

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

II. Approval of Minutes – January 15, 2020.

On motion, duly made and seconded and unanimously carried, the Committee: RESOLVED, that, the Minutes of the January 15, 2020 meeting are hereby approved.

III. Issues for Review.

A. Social Media Advertising Review.

Life insurance companies have established appropriate policies and procedures for the use of social media by their companies as well as their producers. Most life insurance companies have an advertising review procedure that requires all social media postings to go through a review process before the information can be posted to a social media site.

A recent internal audit recommended that all the company's responses to comments on social media should go through the company's advertising review policies and procedures.

The Committee was asked to discuss company practices in this area and whether companies consider corporate comments made via social posts to be deemed advertisements and, therefore, subject to the company's advertising review policies and procedures.

Members of the Committee noted that the nature of the comment would determine whether a post would be considered an advertisement. To the extent a post referenced products, services or financial concepts, companies noted such posts would be considered advertising. However, to the extent such posts were in response to a customer service question or were of a non sales-related nature (e.g. Happy Birthday, etc.) some members noted they would not consider the posts to be advertising.

One Committee member noted a practice of having all social media responses, both adverting and non-advertising, reviewed by the company's legal and compliance team. Another Committee member noted that comments are triaged and reviewed based on the potential for the post to be considered advertising. Another Committee member noted their company's proactive development of preapproved responses to common questions or comments on social media sites. Several companies noted their efforts to monitor for negative comments and to note such comments within their centralized complaint log.

B. Americans with Disabilities Act Compliance.

Life insurance companies are subject to the requirements of the Americans with Disabilities Act (ADA). The ADA mandates accommodations and accessibility for individuals with disabilities.

Over the past several years, life insurance companies have taken steps to ensure that their websites are ADA compliant. The Department of Justice has established standards that state that all electronic and information technology must be accessible to people with disabilities.

Members of the Committee were asked to discuss their practices with respect to establishing policies and procedures to ensure their practices are compliant with the requirements of the ADA.

Committee members noted their efforts to work with outside IT vendors to evaluate their website's level of ADA compliance. Such efforts have been conducted as part of a website rebuild or as part of a review of existing web pages. In such instances, Committee members noted the IT vendor provided feedback (sometimes in the form of a score card or rating) and offered suggestions on how to remedy areas in need of improvement. One Committee member noted they used the learning to train their internal developers and that they work to continue to reinforce the need for ADA compliance at the time new content is being developed.

C. Licensing and Appointment - Role of Compliance / "Just in Time" Appointments.

Producers that distribute life insurance company products must be licensed appropriately at the state and federal level dependent upon the products offered for sale. Life insurance company practices with respect to the licensing and appointment of producers may vary. Additionally, a company's licensing and appointment function may reside within a company's Sales and Marketing, Compliance, Operations or other area.

Given the fact that many jurisdictions allow “just-in-time” appointments (i.e., appointments that may be provided by the company following the submission of an initial application for business), members of the Committee were asked to share information regarding their policies and procedures in this area, along with insight regarding what area of the company is responsible for its licensing and appointment processes.

Two Committee members noted the function resides within their companies’ Operations area while four Committee members noted the function resides within their companies’ Compliance structure. A few Committee members noted they allow “just-in-time” appointments, with one Committee member noting the appointment must occur before an application is approved.

D. Periodic Review and Updating of Policies and Procedures.

One of the key roles of compliance personnel is to develop appropriate policies and procedures to ensure the company’s compliance with applicable laws and regulations.

As new laws and regulations are introduced, companies will update their policies and procedures accordingly. Often these updates are conducted on an “as needed” basis. In other cases, companies maintain a schedule to periodically update their policies and procedures to ensure compliance with applicable laws and regulations.

The Committee was asked to discuss whether their company has a routine process for updating policies and procedures (e.g., quarterly, yearly, etc.) or whether modifications to existing policies and procedures take place solely when necessary (i.e., due to new or amended laws and regulations).

Some members of the Committee shared that their procedures are reviewed as part of a specific schedule, sometimes annually and sometimes less frequently (such every two to three years) and that some reviews may be triggered by recent changes in either company policy or in the underlying laws and regulations.

E. Cannabis-Based Businesses.

Over the past several years, many states have legalized the medical and/or recreational use of cannabis. However, cannabis is still listed as a Schedule I controlled substance under federal guidelines and its use is still prohibited under federal law.

Cannabis-based businesses encounter challenges in attempting to rely upon state and federal financial institutions to deposit funds derived from their cannabis-based businesses and several life insurance companies have reportedly received applications from cannabis based businesses to purchase life insurance and annuity products and also to establish retirement plans. Such companies have been reluctant to accept monies derived from cannabis-based businesses to purchase life insurance company products.

Committee members were asked to discuss their practices with respect to allowing their products to be purchased with money derived form cannabis-based businesses and whether their product application forms had been updated to ask whether the source of funds may be derived from a cannabis-based business.

Members of the Committee noted they do not accept business from cannabis-based businesses due to the Federal government's position. One Committee member shared that it has not updated its product application forms. Committee members also noted receiving approximately 1-2 applications per quarter from cannabis-based businesses.

F. NYDFS Regulation 187 - Life Insurance Compliance - Key Issues and Decisions.

New York's Regulation 187 became effective for life insurance products on February 1st and companies have been exploring various strategies to comply with the life insurance requirements of Regulation 187.

The Committee was asked to discuss their practices and procedures designed to comply with the life insurance compliance requirements of NYDFS Regulation 187.

Committee members shared that their companies' efforts to comply with the annuity requirements of the Regulation last fall allowed for a generally more streamlined approach to implementation on the life insurance side, but that there were unique life insurance challenges. For example, one Committee member shared that their company was challenged to implement certain controls and checks with life product administrative systems that have not had to utilize such controls in the past. A few Committee members noted challenges with ensuring agencies were appropriately trained and maintaining appropriate supporting documentation.

G. NAIC Suitability in Annuity Transaction Model Regulation

During the meeting, it was noted that the NAIC Executive and Plenary Committee will have a call on February 13, 2020 to discuss potential adoption of the revised

NAIC Suitability in Annuity Transaction Model Regulation. Three fourths of the states that vote to approve the revised Model will need to commit to actively promote adoption of the Model in their respective state. Approval of the Model is anticipated and CEFLI will continue to monitor this topic.

H. New York State Governor's Budget

The New York Governor's budget contains a proposal that would allow the NYDFS to increase its fines for willful violation of law from a maximum of $1,000 per incident to a maximum of $10,000 per incident. If adopted, the changes would go into effect on April 1st.

IV. Reporting Items. CEFLI Staff.

A. NAIC Committee Assignments.

The NAIC recently announced their Committee Assignments for 2020. The leadership for two important life insurance Committees will be as follows:

The NAIC Life Insurance and Annuities (A) Committee:

- Chair: Jillian Froment, Director, Ohio Department of Insurance
- Vice Chair: (Pending)

NAIC Market Regulation and Consumer Affairs (D) Committee:

- Chair: Allen Kerr, Commissioner, Arkansas Insurance Department
- Vice Chair: Barbara Richardson, Commissioner, Nevada Department of Business and Industry, Division of Insurance.

B. Highlights of CEFLI's Advisory Committee Meeting.

CEFLI staff will provide an overview of the highlights of the recent CEFLI Advisory Committee Meeting.

C. LIMRA Study indicates Fraudsters are Targeting Life Insurance and Retirement Accounts.

LIMRA recently released a study indicating that fraudsters are increasingly targeting life insurance companies and retirement accounts for fraudulent activities.

In the past, banking institutions and credit card companies were the primary focus of fraudulent activities. However, LIMRA research indicates that criminals

have turned their attention to life insurance and retirement accounts.

D. Personnel Matters.

1. SEC Commissioner Robert Jackson will depart February 14.

SEC Commissioner Robert Jackson, a Democrat, announced that he will be leaving the agency on February 14 to return to teaching at the New York University School of Law.

The White House is expected to nominate Carolyn Crenshaw, currently an attorney at the SEC, to fill Jackson's seat

2. Jessica Hopper is named the new Head of Enforcement at FINRA.

FINRA recently announced that its new Head of Enforcement will be Jessica Hopper. Ms. Hopper replaces Susan Schroeder who departed in September.

Ms. Hopper has worked in FINRA's Enforcement Department for 16 years and is not anticipated to change current FINRA strategy with respect to enforcement activities.

E. New Jersey Enacts Senior Financial Exploitation Law.

Governor Phil Murphy of New Jersey recently signed the Safeguarding Against Financial Exploitation Act.

The new law allows a "qualified individual" who reasonably believes that financial exploitation of an eligible adult has occurred would be required to notify the Bureau of Securities as well as any applicable County Adult Protective Services provider.

The law defines a "qualified individual" as any agent, investment adviser representative or other person that serves in a supervisory, compliance or legal capacity for broker-dealer or investment advisor.

CEFLI will be conducting a webinar on Elder Financial Exploitation on Thursday, February 13 (see below).

V. CEFLI Activities.

A. CEFLI Webinar - Elder Financial Exploitation - Thursday, February 13 - 1 PM EST/12 PM CST/11 AM MST/10 AM PST.

CEFLI will be conducting the next session in its Educational Webinar Series to explore Elder Financial Exploitation on Thursday, February 13 at 1 PM EST/12 PM CST/11 AM MST/10 AM PST.

We hope you will be able to join us!

VI. Next Meeting.

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

Wednesday, March 18, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

Please mark your calendar and plan to join us!

The remaining Committee meeting dates for 2020 will be as follows:

Wednesday, April 15, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, May 13, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, June 17, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, July 22, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, August 19, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT Wednesday, September 16, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT Wednesday, October 14, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT Wednesday, November 12, 2020 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST Wednesday, December 16, 2020 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

VII. Other Business.

There being no additional business the meeting was adjourned.

LARRY HOGAN
Governor

BOYD K. RUTHERFORD
Lt. Governor

MARYLAND
INSURANCE
ADMINISTRATION

AL REDMER, JR.
Commissioner

JAY A. COON
Deputy Commissioner

ERICA BAILEY
Associate Commissioner
Compliance & Enforcement

200 St. Paul Place, Suite 2700, Baltimore, Maryland 21202
Direct Dial: 410-468-2257 Fax: 410-468-2245
Email: mariel.kaufman @maryland.gov
410-468-2000 1-800-492-6116
TTY: 1-800-735-2258
www.insurance.maryland.gov

Sent Via Email [redacted] and Regular Mail

March 9, 2020

[redacted]

RE: MCLH-288-2020-I

Dear [redacted]:

Pursuant to Maryland Code Annotated, Insurance, §2-205 and §2-209(g), and Code of Maryland Regulation ("COMAR") 31.04.20, the Maryland Insurance Administration ("Administration") has initiated a market conduct action relating to charging smoker rates for life insurance due to vaping. Specifically, the market conduct action is to review compliance with §27-208 of the Insurance Article.

Please respond to the following:

1. Does the Company have separate premium rates for those proposed insureds that use E Cigarettes or vape? If so, provide the mortality rate tables.
2. Does the Company apply smoker mortality rates to people who use E Cigarettes or vape?
3. Does the Company consider tobacco usage and E Cigarette or vaping the same or different? Please explain.
4. Does the Company's insurance application(s) include a question asking if the prospective insured used E Cigarettes or vaped? If yes, provide a copy of the insurance application(s).

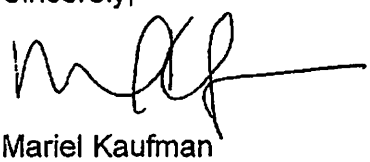
5. Does the Company's Underwriting Guidelines include procedures for handling those who use E Cigarettes or vape? If yes, provide a copy of the section of the Underwriting Guidelines.
6. If a prospective insured answers 'yes' to the smoker question on an insurance application and an explanation is included that the prospective insured used E Cigarettes or vaped, does the Company charge smoker rates in the event the policy is issued?
7. During the review of a claim where the policyholder died within the contestable period and it is found that the policyholder answered 'no' to the Smoker's Question on the application, and during their claim investigation it is found that the policyholder used E Cigarettes or vaped prior to the application date, does the Company 1) refund premiums 2) pay the claim amount and subtract the premiums paid that would have been charged if the Company knew that the policyholder used E cigarettes or vaped or 3) Provide the procedure if it is different than 1) or 2)? If you answer 2, please provide us with your calculation method.

Additionally, and in accordance with COMAR 31.04.20.05E, the company is required to certify the accuracy of all information provided to the Administration by submitting a "Certificate of Compliance" signed by an officer of the company and acknowledging that the information is, "to the best of that individual's knowledge, information and belief, a full complete and truthful response to the Maryland Insurance Commissioner's request" and that the "individual making the certification has undertaken an adequate inquiry to make the required certification". A copy of the Administration's standard Certificate of Compliance is included.

Your response and the Certification of Compliance should be submitted to my attention by close of business on April 8, 2020. You may submit your response by email to lhinform.mia@maryland.gov. If your Company is unable to provide the requested information by the date required, then at least three business days prior to April 8, 2020, please provide a detailed explanation to my attention as to why the information is unable to be provided and state what information can be provided.

If you have any questions regarding this request, please contact me at (410) 468-2257.

Sincerely,



Mariel Kaufman
Market Analyst

MARYLAND INSURANCE ADMINISTRATION
CERTIFICATE OF COMPLIANCE

Pursuant to COMAR 31.04.20.05 E, I hereby certify to the best of my knowledge, information, and belief, that the information hereto submitted to the Administration represents a full, complete and truthful response to the Maryland Insurance Commissioner's request, dated March 9, 2020, that is needed for the Administration's analysis.

I further attest that I am an authorized officer/representative of the Company, that I have undertaken an adequate inquiry to provide this certification to the Commissioner, and am authorized to bind the Company to the responses provided.

Signature: _____

Print Name: _____

Title: _____

Company: _____

Date: _____

ADOPTING RELEASE

DATE: February 21, 2020

RE: Amendments to Standard of Conduct Applicable to Broker-Dealers and Agents – 950 MASS. CODE REGS. 12.200

The Massachusetts Securities Division (the "Division") is adopting the following amendments to 950 MASS. CODE REGS. 12.200 (the "Regulations") as they relate to the standard of conduct applicable to broker-dealers and agents. The adopted amendments to the Regulations (the "Final Regulations") will apply a fiduciary conduct standard to broker-dealers and agents when dealing with their customers, at Section 12.207. The failure to adhere to the fiduciary standard of utmost care and loyalty will be deemed a dishonest or unethical practice under M.G.L. c. 110A, § 204(a)(2)(G). In addition, the Final Regulations will revise certain paragraphs in Section 12.204 to make clear that the existing suitability standard still applies to any relationships or transactions expressly excluded from the fiduciary standard.

The Division conducted a preliminary comment period in which it requested comment on potential amendments to the Regulations that would impose a fiduciary standard of conduct on broker-dealers, agents, investment advisers, and investment adviser representatives. The Division received 53[1] comments from the public in response to this preliminary request for comment.

After reviewing these comments, the Division moved forward and proposed amendments to the Regulations (the "Proposal"). The Division gave notice of the Proposal, the public hearing on the Proposal, and the public comment period on December 13, 2019 via the Division's website and a published notice in The Boston Globe. On its website, the Division provided a summary of its reasons for proposing amendments to the Regulations, as well as copies of the Proposal, and a copy of its initial small business impact statement. Notice of the public hearing and comment period was published in the Massachusetts Register as of December 27, 2019. The Division held a public hearing on the Proposal on January 7, 2020, and the public comment period ended on January 7, 2020. The Division received and reviewed approximately 682[2] written comments, as well as oral testimony from 23 speakers.

The Final Regulations shall become effective upon publication in the Massachusetts Register. The next publication of the Massachusetts Register is scheduled for March 6, 2020. Notwithstanding the Final Regulations becoming effective upon publication in the Massachusetts Register, the Final Regulations shall be enforced as of September 1, 2020.

The following is a summary of the Final Regulations, where applicable, modifications made to the Proposal prior to adoption.

---

[1] The preliminary public comment period began on June 14, 2019 and closed on July 26, 2019. The Division received 52 comments during the preliminary public comment period and one comment after the close of the preliminary public comment period.

[2] The public comment period began on December 13, 2019 and closed on January 7, 2020. The Division received 425 comments during the public comment period and 257 comments after the close of the public comment period.

1. 950 MASS. CODE REGS. 12.207: Imposing a Fiduciary Conduct Standard on Broker-Dealers and Agents

Section 12.207 of the Final Regulations will hold broker-dealers and agents to a fiduciary standard of conduct when making recommendations and providing investment advice to customers. The Division has issued this Adopting Release to provide guidance on how broker-dealers and agents can comply with the Final Regulations.

A. Scope of the Amended Regulations

In response to the Proposal, the Division received many comments asking for clarification on certain parts of the Proposal or requesting that the Division reconsider the scope of the Proposal. The Division has addressed those comments below.

i. Regulated Persons

Section 12.207 of the Proposal covered broker-dealers, agents, investment advisers, and investment adviser representatives. Multiple commenters wrote that the Proposal should not apply to federally-registered investment advisers and their representatives. These commenters wrote that federally-registered investment advisers and their representatives are already held to a fiduciary standard and including them within the scope of the Proposal may create unintended consequences.[3]

Based on comments received, Section 12.207 of the Final Regulations has been revised to remove references to investment advisers and investment adviser representatives, who are already subject to a fiduciary duty. The Final Regulations will continue to make broker-dealers and agents subject to a fiduciary duty when they make recommendations or provide advice with respect to securities.

ii. Commodities and Insurance Products

Sections 12.207(1)(a) and 12.207(2)(d) of the Proposal included references to commodities and insurance products. Multiple commenters wrote that variable annuities and insurance products are excluded from the definition of "security," as defined in M.G.L. c. 110A, § 401(k) and that the Proposal should be limited only to securities. In response, the Division has removed the express language regarding advice on commodities and insurance products from the Final Regulations.

iii. Application of the Fiduciary Duty

Section 12.207(1)(a) of the Final Regulations sets out when a fiduciary duty applies to broker-dealers and agents. Many commenters raised concerns about this section of the Proposal, arguing that it imposed an ongoing duty on a broker-dealer or agent where one otherwise would not exist.

[3] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). Investment advisers also have antifraud liability with respect to prospective clients under § 206 of the Advisers Act and M.G.L. c. 110A, § 102.

In response to these comments, the Division is clarifying the scope of Section 12.207(1)(a)-(b) of the Final Regulations. In Section 12.207(1)(a) of the Final Regulations, the duty runs during the period in which incidental advice is made in connection with the recommendation of a security to the customer. The duty has not been deemed to be ongoing except as set out in Section 12.207(1)(b) of the Final Regulations.

Section 12.207(1)(b) of the Final Regulations extends the duty beyond the recommendation period under certain circumstances. This extended duty is based upon ancillary factors that occur outside the traditional broker-dealer customer relationship.

Section 12.207(1)(b)1. of the Final Regulations states that an ongoing fiduciary duty exists if the broker-dealer or agent has discretionary authority over the customer's account. Under these facts and circumstances, the broker-dealer or agent, by taking control of the account, has assumed a position of trust and confidence. For this reason, the duty has been extended beyond the initial recommendation. Section 12.207(1)(b)2. of the Final Regulations similarly has extended the broker-dealer's or agent's duty when there is a contractual obligation that imposes a fiduciary duty. In such a case, the duty has been extended beyond the initial recommendation, based upon the terms of the contract with the customer.

Section 12.207(1)(b)3. of the Final Regulations likewise extends the broker-dealer's or agent's duty beyond the recommendation period when there is an agreement to monitor the customer's account on a regular or periodic basis. Some commenters requested guidance as to the breadth of the duty set out in Section 12.207(1)(b)3. of the Proposal. Specifically, the concern was whether the duty to monitor must be continuous, even if the agreement set out defined periods of monitoring. In response to these comments, the Final Regulation has been amended to clarify that the duration of the fiduciary duty is determined by the agreement with the customer. For example, if the agreement with the customer is to monitor the account four times a year, the fiduciary duty will commence and end each quarter period when the review is performed.

Section 12.207(1)(b)4. of the Proposal also extended the fiduciary duty beyond the time a recommendation is made. This section of the Proposal imposed a fiduciary duty during any time in which the broker-dealer or agent received ongoing compensation or provided investment advice to the customer in connection with other non-brokerage financial advice. Many commenters wrote that this extended duty may run contrary to the "incidental" exemption from the Investment Advisers Act of 1940 (the "Advisers Act").

These commenters claimed that this section would require broker-dealers and agents to conduct ongoing monitoring, which in turn would be outside the scope of the "incidental" exemption. As such, according to these commenters, broker-dealers would be required to register with the Securities and Exchange Commission ("SEC") as investment advisers.

Commenters also asserted that the ongoing monitoring resulting from Section 12.207(1)(b)4. of the Proposal would impose additional costs for the broker-dealers and their agents, which may then be passed on to the customers. These commenters then predicted that any increased operational costs would be substantial and would result in material restrictions on the broker-dealer model in Massachusetts. They further asserted that this ongoing duty would result in higher costs,

less choice, and limited services for the customer. In response to these comments, the Division has removed Section 12.207(1)(b)4. from the Final Regulations.

Commenters likewise argued that Section 12.207(1)(b)5. extends the fiduciary duty beyond what is agreed upon with the customer, and would impose an ongoing duty where one otherwise would not exist. A number of commenters wrote that any customer contact could lead a customer to have a reasonable expectation that the broker-dealer or agent would monitor their accounts on an ongoing basis. For example, one commenter expressed the concern that the section would prevent them from sending out "helpful reminders" and other informational notices. Similar to the arguments made above, commenters wrote that this would impose an ongoing duty on the broker-dealer or agent that would take them outside the scope of the "incidental" exemption in the Advisers Act. In response to these comments, the Division has removed Section 12.207(1)(b)5. from the Final Regulations.

iv. Use of Certain Titles

Section 12.207(1)(c) of the Proposal addressed the use of certain titles by a broker-dealer or agent and created a presumption that the use of such titles imposed an ongoing duty. Many commenters expressed the concern that the use of certain titles alone does not create an expectation that a broker-dealer or agent will monitor a customer's account, and therefore does not warrant an ongoing duty. The Division disagrees. Broker-dealers advertise themselves today as financial advisers and consultants rather than stockbrokers. These advisory titles imply that they provide much more than "incidental advice." A 2007 study by the Rand Corporation found that customers did not understand the key distinctions between the titles of investment advisers and broker-dealers. The study attributed part of customer confusion to the dozens of titles used in the field, including generic titles, such as *financial advisor* and *financial consultant*.

Holding broker-dealers and agents to a fiduciary standard of conduct as set out in the Final Regulations provides customers with additional protections when receiving a recommendation or investment advice from financial professionals, whether they are investment advisers or broker-dealers. Given the protections provided under the Final Regulations, the Division has removed Section 12.207(1)(c) from the Final Regulations.

v. Definition of "Customer"

Section 12.207(3) of the Final Regulations provides a definition of "customer" for the purpose of this section. Several commenters wrote that the Proposal should explicitly limit its application to retail investors with a legal address in Massachusetts or who reside in Massachusetts. Commenters further wrote that the Proposal would create confusion for investors in Massachusetts and for financial services firms that operate in multiple jurisdictions.

The Division has not made any changes to the Final Regulations in response to these comments. The Massachusetts Uniform Securities Act is clear as to the scope and applicability of the Final Regulations and does not need further clarification.

B. Duty of Care

A majority of commenters did not provide comments with respect to the Division's proposed duty of care, as set out in Section 12.207(2)(a) of the Proposal. However, a few commenters wrote that the language requiring parties to make reasonable inquiry into "[a]ny other relevant information" is overly broad.

The requirement to make reasonable inquiry into what the broker-dealer or agent determines may be relevant to the recommendation is consistent with state and federal regulations. Accordingly, the Division has retained this language in the Final Regulations.

C. Duty of Loyalty

Several commenters presented questions to the Division regarding the duty of loyalty as set out in the Proposal. The Division has addressed these questions below.

i. Disclosure of Conflicts of Interest

Section 12.207(2)(b)1. of the Final Regulations states that a broker-dealer or agent must disclose all material conflicts of interest. Commenters did not raise questions or concerns with this portion of the Proposal. Accordingly, the Division has not made any changes to this section in the Final Regulations. The duty of loyalty cannot be satisfied without disclosure of all material conflicts of interest.

ii. Avoidance, Elimination, and Mitigation of Conflicts of Interest

Section 12.207(2)(b)2. of the Final Regulation states what a broker-dealer or agent must do, in addition to disclosure, when facing conflicts of interest or potential conflicts of interest. Several commenters expressed concerns with this portion of the Proposal, arguing that, as proposed, it was vague and difficult to satisfy. In response to these comments, the Division has provided clarification on how broker-dealers and agents should handle avoidance, elimination, and mitigation of conflicts of interest under the Final Regulations.

Section 12.207(2)(b)2. of the Final Regulations now requires that broker-dealers and agents "[m]ake all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts that cannot *reasonably* be avoided, and mitigate conflicts that cannot *reasonably* be avoided or eliminated [emphases added]…." The Division revised this portion of the Regulations from that which was in the Proposal to clarify that not all conflicts must be avoided. Likewise, not all conflicts must be eliminated. Accordingly, conflicts that arguably could be avoided or eliminated do not need to be if it would not be reasonable for a broker-dealer or agent to do so.

Many commenters wrote that the receipt of compensation in connection with making a recommendation presents a conflict of interest. They raised the concern that they would be unable to receive compensation in this manner under the Proposal. The Division recognizes that professionals who are in the business of making recommendations on the purchase and sale of securities do so for compensation. Arguably, this conflict cannot *reasonably* be avoided or

eliminated. Instead, the broker-dealer and agent may mitigate this conflict by, for example, ensuring that the fee earned for the recommendation is reasonable and complying with the remainder of the fiduciary duty.

Other commenters wrote that the recommendation or sale of proprietary products creates a conflict of interest, as does making a recommendation or sale in a principal transaction. These commenters also raised concerns that they would be unable to engage in these activities under the Proposal. The Division recognizes that broker-dealers and agents engage in these transactions. Arguably, these conflicts cannot *reasonably* be avoided or eliminated. Instead, the broker-dealer or agent may mitigate these conflicts by, for example, ensuring that the fee earned for the recommendation is reasonable and complying with the remainder of the fiduciary duty.

iii. "Without Regard To"

Section 12.207(2)(b)3. of the Final Regulations requires broker-dealers and agents to "[m]ake recommendations and provide investment advice to customers without regard to the financial or any other interest of any party other than the customer." Under this provision, broker-dealers and agents must make a recommendation or provide investment advice to a customer with only the customer's interests in mind. Several commenters raised concerns that the "without regard to" language in the Proposal required broker-dealers and agents to give conflict-free advice. Specifically, these commenters were concerned that transaction-based compensation would be prohibited under this provision.

Section 12.207(2)(b)3. of the Final Regulations, like Section 12.207(2)(b)1.-2., does not prohibit the existence of conflicts, including the receipt of compensation in connection with making a recommendation or providing investment advice. Section 12.207(2)(b)2.-3. of the Final Regulations states that after disclosing and avoiding, eliminating, or mitigating conflicts, a broker-dealer or agent may not factor its own compensation, any of its other interests, or any interest of any other party, into the decision-making process behind the recommendation or investment advice.

iv. Demonstration of the Duty of Loyalty

Section 12.207(2)(c) of the Proposal stated that disclosure or mitigation alone could not meet or demonstrate the duty of loyalty. Several commenters wrote that the statement in Section 12.207(2)(c) of the Proposal was difficult to understand when read together with Section 12.207(2)(b)1.-2.

The Division has revised Section 12.207(2)(c) of the Final Regulations to clarify that disclosure of conflicts alone does not meet or demonstrate the duty of loyalty. In certain situations, conflicts of interest must be avoided or eliminated. In other situations, conflicts may exist, but must be mitigated and disclosed. In no case will disclosing a conflict of interest, without more, satisfy a broker-dealer's or agent's duty of loyalty.

v. Sales Contests, Implied or Express Quota Requirements, or Other Special Incentive Programs

Section 12.207(2)(d) of the Final Regulations creates a presumption that a recommendation made in connection with any sales contest is a breach of the duty of loyalty. In the Proposal, Section 12.207(2)(d) also created the presumption that recommendations made in connection with implied or express quota requirements or other special incentive programs were also breaches of the duty of loyalty. Commenters raised concerns that the presumption in the Proposal was broad enough to cover and effectively prohibit certain compensation systems or a firm's ability to determine health and welfare benefits for certain of its employees.

The Division has seen sales practice abuses in sales contests, both product- and non-product-specific. Accordingly, the presumption of a breach of duty remains for recommendations made in connection with sales contests, whether product-specific or not. However, in response to commenters and given the protections provided under the Final Regulations, implied or express quota requirements and other special incentive programs have been removed from the scope of Section 12.207(2)(d) of the Final Regulations.

vi. Municipal Securities

The Proposal did not specifically address municipal securities. However, commenters expressed concern that the Proposal could have detrimental effects on the markets for municipal securities. Because principal transactions are the most common form of trading in these markets, some commenters expressed concerns that such transactions could not meet the requirements under the Proposal to avoid conflicts and to make recommendations without regard to the interests of any other party. Similar concerns were raised with respect to municipal bond underwriting, which is a form of principal transaction. These commenters argued that the regulation could increase costs in, or potentially disrupt, the markets for municipal securities. These commenters also argued that an increase in costs or disruption could be detrimental to local governments.

As discussed earlier in this Adopting Release, the Division disagrees with these comments and believes the Final Regulations will not have these effects. Moreover, the Division notes that the markets for municipal bonds and other government securities are specialized markets, and that many trades are done on a principal basis. The Division also notes Executive Order 145: *Consultation with cities & towns on administrative mandates* (October 21, 1978), relating consideration of state-local concerns in the formulation of administrative policies and regulations.

Accordingly, Section 12.207(2)(e) of the Final Regulations has been added, which excludes securities issued by U.S. federal, state, and municipal governments from the duty of loyalty provision in Section 12.207(2)(b) of the Final Regulations. The language of this exclusion substantially mirrors the "government securities" exemption provided under M.G.L. c. 110A, § 402(a)(1).

The Division notes that several protective mechanisms are in place with respect to municipal and other government securities. The issuance and trading of municipal securities is subject to

regulation by the Municipal Securities Rulemaking Board. Additionally, recommendations and advice provided in connection with these securities continue to be subject the duty of care under Section 12.207(2)(a) of the Final Regulations, as well as provisions of Section 12.204 of the Final Regulations.

D. Implementation Period

The Proposal did not address an enforcement date or implementation period. However, multiple commenters wrote that the Division should postpone taking any action for one year or more following implementation of SEC Regulation Best Interest ("Reg BI"). Others wrote that an 18-24 month transition period from the effective date would provide sufficient time to comply.

The Division has been careful and deliberate in its approach to the Final Regulations. The Division did not propose its own fiduciary standard until after the SEC adopted Reg BI. The Division then sought comment on its Proposal. After reviewing and considering all of the comments, the Division moved forward with the Final Regulations.

The Final Regulations shall become effective upon publication in the Massachusetts Register. The next publication of the Massachusetts Register is scheduled for March 6, 2020. In response to the comments articulated above, enforcement of the Final Regulations will begin on September 1, 2020.

2. 950 MASS. CODE REGS. 12.204: Clarifying That Existing Suitability Standard Still Applies Where Fiduciary Conduct Standard Does Not Apply

The Division received no substantive comments on the Proposal with respect to Section 12.204 and the Division has adopted the Final Regulations without amendment.

Given that the Division has limited the scope of the Final Regulations from that which was in the Proposal, the Division has not adopted the amendments to the Regulations in Section 12.205.

12.204: Denial, Revocation, Suspension, Cancellation and Withdrawal of Registration

(1) Dishonest and Unethical Practices in the Securities Business.

(a) Broker-dealers. Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Acts and practices, including, but not limited to the following, are considered contrary to such standards and constitute dishonest or unethical practices which are grounds for imposition of an administrative fine, censure, denial, suspension or revocation of a registration, or such other appropriate action:

…

4. Except as provided in 950 CMR 12.207, recommending to a customer an investment strategy, the opening of or transferring of assets to any type of account, or the purchase, sale or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer.

…

29. Failing to act in accordance with the duties and standards described in 950 CMR 12.207.

(b) Agents. Each agent shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of his or her business. Acts and practices, including, but not limited to, the following, are considered contrary to such standards and constitute dishonest or unethical practices in the securities industry and are thereby grounds for imposition of an administrative fine, censure, denial, suspension or revocation of a registration or such other action as is appropriate:

…

8. Engaging in conduct specified in 950 CMR 12.204(1)(a)1., 2., 3., 4., 5., 6., 10., 11., 12., 13., 18., 19., 22., 23., 27., 28., or 29.

12.207: Fiduciary Duty of Broker-Dealers and Agents

(1) The following practices are a non-exclusive list of practices by a broker-dealer or agent which shall be deemed "unethical or dishonest conduct or practices" for purposes of M.G.L. c. 110A, § 204(a)(2)(G):

(a) Failing to act in accordance with a fiduciary duty to a customer when providing investment advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the purchase, sale, or exchange of any security.

(b) Failing to act in accordance with a fiduciary duty to a customer during any period in which the broker-dealer or agent:

1. Has or exercises discretion in a customer's account, unless the discretion relates solely to the time and/or price for the execution of the order;

2. Has a contractual fiduciary duty; or

3. Has a contractual obligation to monitor a customer's account on a regular or periodic basis, as such regular or periodic basis is determined by agreement with the customer.

(2) To meet the fiduciary duty, each broker-dealer or agent shall adhere to duties of utmost care and loyalty to the customer.

(a) The duty of care requires a broker-dealer or agent to use the care, skill, prudence, and diligence that a person acting in a like capacity and familiar with such matters would use, taking into consideration all of the relevant facts and circumstances. For purposes of this paragraph, a broker-dealer or agent shall make reasonable inquiry, including:

1. The risks, costs, and conflicts of interest related to all recommendations made and investment advice given;

2. The customer's investment objectives, risk tolerance, financial situation, and needs; and

3. Any other relevant information.

(b) The duty of loyalty requires a broker-dealer or agent to:

1. Disclose all material conflicts of interest;

2. Make all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts that cannot reasonably be avoided, and mitigate conflicts that cannot reasonably be avoided or eliminated; and

3. Make recommendations and provide investment advice without regard to the financial or any other interest of any party other than the customer.

(c) Disclosing conflicts alone does not meet or demonstrate the duty of loyalty.

(d) It shall be presumed to constitute a breach of the duty of loyalty for a broker-dealer or agent to recommend any investment strategy, the opening of or transferring of assets to a specific type of account, or the purchase, sale, or exchange of any security, if the recommendation is made in connection with any sales contest.

(e) Notwithstanding the foregoing, investment advice or a recommendation regarding the purchase, sale, or exchange of any security in M.G.L. c. 110A, § 402(a)(1) to or for a customer shall be excluded from the scope of 950 CMR 12.207(2)(b).

(3) For purposes of 950 CMR 12.207, the term "customer" shall include current and prospective customers, but shall not include:

(a) A bank, savings and loan association, insurance company, trust company, or registered investment company;

(b) A broker-dealer registered with a state securities commission (or agency or office performing like functions);

(c) An investment adviser registered with the SEC under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or agency or office performing like functions); or

(d) Any other institutional buyer, as defined in 950 CMR 12.205(1)(a)6. and 950 CMR 14.401.

(4) Nothing in 950 CMR 12.207 shall be construed to apply to a person acting in the capacity of a fiduciary to an employee benefit plan, its participants, or its beneficiaries, as those terms are defined in the Employee Retirement Income Security Act (ERISA), 29 U.S.C. §§ 1001 *et seq.*

(5) Nothing in 950 CMR 12.207 shall be construed to establish any requirements for capital, custody, margin, financial responsibility, making and keeping of records, bonding, or financial or operational reporting for any broker-dealer or agent that differ from, or are in addition to, the requirements established under 15 U.S.C. § 78o(i).

(6) 950 CMR 12.207 shall be enforced as of September 1, 2020.

SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION

Table of Contents

Section 1. Purpose
Section 2. Scope
Section 3. Authority
Section 4. Exemptions
Section 5. Definitions
Section 6. Duties of Insurers and Producers
Section 7. Producer Training
Section 8. Compliance Mitigation; Penalties; Enforcement
Section 9. Recordkeeping
Section 10. Effective Date
Appendix A. Insurance Agent (Producer) Disclosure For Annuities
Appendix B. Consumer Refusal to Provide Information
Appendix C. Consumer Decision to Purchase an Annuity Not Based on a Recommendation

Section 1. Purpose

A. The purpose of this regulation is to require producers, as defined in this regulation, to act in the best interest of the consumer when making a recommendation of an annuity and to require insurers to establish and maintain a system to supervise recommendations so that the insurance needs and financial objectives of consumers at the time of the transaction are effectively addressed.

B. Nothing herein shall be construed to create or imply a private cause of action for a violation of this regulation or to subject a producer to civil liability under the best interest standard of care outlined in Section 6 of this regulation or under standards governing the conduct of a fiduciary or a fiduciary relationship.

Drafting Note: The language of Subsection B comes from the NAIC *Unfair Trade Practices Act* (#880). If a state has adopted different language, it should be substituted for Subsection B.

Drafting Note: Section 989J of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") specifically refers to this model regulation as the "*Suitability in Annuity Transactions Model Regulation*" (#275). Section 989J of the Dodd-Frank Act confirmed this exemption of certain annuities from the Securities Act of 1933 and confirmed state regulatory authority. This regulation is a successor regulation that exceeds the requirements of the 2010 model regulation.

Section 2. Scope

This regulation shall apply to any sale or recommendation of an annuity.

Section 3. Authority

This regulation is issued under the authority of [insert reference to enabling legislation].

Drafting Note: States may wish to use the *Unfair Trade Practices Act* (#880) as enabling legislation or may pass a law with specific authority to adopt this regulation.

Section 4. Exemptions

Unless otherwise specifically included, this regulation shall not apply to transactions involving:

A. Direct response solicitations where there is no recommendation based on information collected from the consumer pursuant to this regulation;

B. Contracts used to fund:

(1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);

© 2020 National Association of Insurance Commissioners

(2) 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;

(3) 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; or

(4) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

C. Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or

D. Formal prepaid funeral contracts.

Section 5. Definitions

A. "Annuity" means an annuity that is an insurance product under state law that is individually solicited, whether the product is classified as an individual or group annuity.

B. "Cash compensation" means any discount, concession, fee, service fee, commission, sales charge, loan, override, or cash benefit received by a producer in connection with the recommendation or sale of an annuity from an insurer, intermediary, or directly from the consumer.

C. "Consumer profile information" means information that is reasonably appropriate to determine whether a recommendation addresses the consumer's financial situation, insurance needs and financial objectives, including, at a minimum, the following:

(1) Age;

(2) Annual income;

(3) Financial situation and needs, including debts and other obligations;

(4) Financial experience;

(5) Insurance needs;

(6) Financial objectives;

(7) Intended use of the annuity;

(8) Financial time horizon;

(9) Existing assets or financial products, including investment, annuity and insurance holdings;

(10) Liquidity needs;

(11) Liquid net worth;

(12) Risk tolerance, including but not limited to, willingness to accept non-guaranteed elements in the annuity;

(13) Financial resources used to fund the annuity; and

(14) Tax status.

D. "Continuing education credit" or "CE credit" means one continuing education credit as defined in [insert reference in state law or regulations governing producer continuing education course approval].

© 2020 National Association of Insurance Commissioners

E. "Continuing education provider" or "CE provider" means an individual or entity that is approved to offer continuing education courses pursuant to [insert reference in state law or regulations governing producer continuing education course approval].

F. "FINRA" means the Financial Industry Regulatory Authority or a succeeding agency.

G. "Insurer" means a company required to be licensed under the laws of this state to provide insurance products, including annuities.

H. "Intermediary" means an entity contracted directly with an insurer or with another entity contracted with an insurer to facilitate the sale of the insurer's annuities by producers.

I. (1) "Material conflict of interest" means a financial interest of the producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation.

(2) "Material conflict of interest" does not include cash compensation or non-cash compensation.

J. "Non-cash compensation" means any form of compensation that is not cash compensation, including, but not limited to, health insurance, office rent, office support and retirement benefits.

K. "Non-guaranteed elements" means the premiums, credited interest rates (including any bonus), benefits, values, dividends, non-interest based credits, charges or elements of formulas used to determine any of these, that are subject to company discretion and are not guaranteed at issue. An element is considered non-guaranteed if any of the underlying non-guaranteed elements are used in its calculation.

L. "Producer" means a person or entity required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities. For purposes of this regulation, "producer" includes an insurer where no producer is involved.

M. (1) "Recommendation" means advice provided by a producer to an individual consumer that was intended to result or does result in a purchase, an exchange or a replacement of an annuity in accordance with that advice.

(2) Recommendation does not include general communication to the public, generalized customer services assistance or administrative support, general educational information and tools, prospectuses, or other product and sales material.

N. "Replacement" means a transaction in which a new annuity is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer whether or not a producer is involved, that by reason of the transaction, an existing annuity or other insurance policy has been or is to be any of the following:

(1) Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;

(2) 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;

(3) Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid;

(4) Reissued with any reduction in cash value; or

(5) Used in a financed purchase.

Drafting Note: The definition of "replacement" above is derived from the NAIC *Life Insurance and Annuities Replacement Model Regulation* (#613). If a state has a different definition for "replacement," the state should either insert the text of that definition in place of the definition above or modify the definition above to provide a cross-reference to the definition of "replacement" that is in state law or regulation.

© 2020 National Association of Insurance Commissioners

O. "SEC" means the United States Securities and Exchange Commission.

Section 6. Duties of Insurers and Producers

A. Best Interest Obligations. A producer, when making a recommendation of an annuity, shall act in the best interest of the consumer under the circumstances known at the time the recommendation is made, without placing the producer's or the insurer's financial interest ahead of the consumer's interest. A producer has acted in the best interest of the consumer if they have satisfied the following obligations regarding care, disclosure, conflict of interest and documentation:

(1) (a) Care Obligation. The producer, in making a recommendation shall exercise reasonable diligence, care and skill to:

(i) Know the consumer's financial situation, insurance needs and financial objectives;

(ii) Understand the available recommendation options after making a reasonable inquiry into options available to the producer;

(iii) Have a reasonable basis to believe the recommended option effectively addresses the consumer's financial situation, insurance needs and financial objectives over the life of the product, as evaluated in light of the consumer profile information; and

(iv) Communicate the basis or bases of the recommendation.

(b) The requirements under Subparagraph (a) of this paragraph include making reasonable efforts to obtain consumer profile information from the consumer prior to the recommendation of an annuity.

(c) The requirements under Subparagraph (a) of this paragraph require a producer to consider the types of products the producer is authorized and licensed to recommend or sell that address the consumer's financial situation, insurance needs and financial objectives. This does not require analysis or consideration of any products outside the authority and license of the producer or other possible alternative products or strategies available in the market at the time of the recommendation. Producers shall be held to standards applicable to producers with similar authority and licensure.

(d) The requirements under this subsection do not create a fiduciary obligation or relationship and only create a regulatory obligation as established in this regulation.

(e) The consumer profile information, characteristics of the insurer, and product costs, rates, benefits and features are those factors generally relevant in making a determination whether an annuity effectively addresses the consumer's financial situation, insurance needs and financial objectives, but the level of importance of each factor under the care obligation of this paragraph may vary depending on the facts and circumstances of a particular case. However, each factor may not be considered in isolation.

(f) The requirements under Subparagraph (a) of this paragraph include having a reasonable basis to believe the consumer would benefit from certain features of the annuity, such as annuitization, death or living benefit or other insurance-related features.

(g) The requirements under Subparagraph (a) of this paragraph apply to the particular annuity as a whole and the underlying subaccounts to which funds are allocated at the time of purchase or exchange of an annuity, and riders and similar producer enhancements, if any.

(h) The requirements under Subparagraph (a) of this paragraph do not mean the annuity with the lowest one-time or multiple occurrence compensation structure shall necessarily be recommended.

© 2020 National Association of Insurance Commissioners

(i) The requirements under Subparagraph (a) of this paragraph do not mean the producer has ongoing monitoring obligations under the care obligation under this paragraph, although such an obligation may be separately owed under the terms of a fiduciary, consulting, investment advising or financial planning agreement between the consumer and the producer.

(j) In the case of an exchange or replacement of an annuity, the producer shall consider the whole transaction, which includes taking into consideration whether:

(i) The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits, such as death, living or other contractual benefits, or be subject to increased fees, investment advisory fees or charges for riders and similar product enhancements;

(ii) The replacing product would substantially benefit the consumer in comparison to the replaced product over the life of the product; and

(iii) The consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 60 months.

(k) Nothing in this regulation should be construed to require a producer to obtain any license other than a producer license with the appropriate line of authority to sell, solicit or negotiate insurance in this state, including but not limited to any securities license, in order to fulfill the duties and obligations contained in this regulation; provided the producer does not give advice or provide services that are otherwise subject to securities laws or engage in any other activity requiring other professional licenses.

(2) Disclosure obligation.

(a) Prior to the recommendation or sale of an annuity, the producer shall prominently disclose to the consumer on a form substantially similar to Appendix A:

(i) A description of the scope and terms of the relationship with the consumer and the role of the producer in the transaction;

(ii) An affirmative statement on whether the producer is licensed and authorized to sell the following products:

(I) Fixed annuities;

(II) Fixed indexed annuities;

(III) Variable annuities;

(IV) Life insurance;

(V) Mutual funds;

(VI) Stocks and bonds; and

(VII) Certificates of deposit;

(iii) An affirmative statement on whether the producer is authorized, contracted (or appointed), or otherwise able to sell insurance products, using the following descriptions:

(I) From one insurer;

© 2020 National Association of Insurance Commissioners

(II) From two or more insurers; or

(III) From two or more insurers although primarily contracted with one insurer.

(iv) A description of the sources and types of cash compensation and non-cash compensation to be received by the producer, including whether the producer is to be compensated for the sale of a recommended annuity by commission as part of premium or other remuneration received from the insurer, intermediary or other producer or by fee as a result of a contract for advice or consulting services; and

(v) A notice of the consumer's right to request additional information regarding cash compensation described in Subparagraph (b) of this paragraph;

Drafting Note: If a state approves forms, a state should add language to Subparagraph (a) reflecting such approvals.

(b) Upon request of the consumer or the consumer's designated representative, the producer shall disclose:

(i) A reasonable estimate of the amount of cash compensation to be received by the producer, which may be stated as a range of amounts or percentages; and

(ii) Whether the cash compensation is a one-time or multiple occurrence amount, and if a multiple occurrence amount, the frequency and amount of the occurrence, which may be stated as a range of amounts or percentages; and

(c) Prior to or at the time of the recommendation or sale of an annuity, the producer shall have a reasonable basis to believe the consumer has been informed of various features of the annuity, such as the potential surrender period and surrender charge, potential tax penalty if the consumer sells, exchanges, surrenders or annuitizes the annuity, mortality and expense fees, investment advisory fees, any annual fees, potential charges for and features of riders or other options of the annuity, limitations on interest returns, potential changes in non-guaranteed elements of the annuity, insurance and investment components and market risk.

Drafting Note: If a state has adopted the NAIC *Annuity Disclosure Model Regulation* (#245), the state should insert an additional phrase in Subparagraph (c) above to explain that the requirements of this section are intended to supplement and not replace the disclosure requirements of the NAIC *Annuity Disclosure Model Regulation* (#245).

(3) Conflict of interest obligation. A producer shall identify and avoid or reasonably manage and disclose material conflicts of interest, including material conflicts of interest related to an ownership interest.

(4) Documentation obligation. A producer shall at the time of recommendation or sale:

(a) Make a written record of any recommendation and the basis for the recommendation subject to this regulation;

(b) Obtain a consumer signed statement on a form substantially similar to Appendix B documenting:

(i) A customer's refusal to provide the consumer profile information, if any; and

(ii) A customer's understanding of the ramifications of not providing his or her consumer profile information or providing insufficient consumer profile information; and

(c) Obtain a consumer signed statement on a form substantially similar to Appendix C acknowledging the annuity transaction is not recommended if a customer decides to enter into an annuity transaction that is not based on the producer's recommendation.

© 2020 National Association of Insurance Commissioners

Drafting Note: If a state approves forms, a state should add language to Subparagraphs (b) and (c) of this paragraph reflecting such approvals.

(5) Application of the best interest obligation. Any requirement applicable to a producer under this subsection shall apply to every producer who has exercised material control or influence in the making of a recommendation and has received direct compensation as a result of the recommendation or sale, regardless of whether the producer has had any direct contact with the consumer. Activities such as providing or delivering marketing or educational materials, product wholesaling or other back office product support, and general supervision of a producer do not, in and of themselves, constitute material control or influence.

B. Transactions not based on a recommendation.

(1) Except as provided under Paragraph (2), a producer shall have no obligation to a consumer under Subsection A(1) related to any annuity transaction if:

(a) No recommendation is made;

(b) A recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer;

(c) A consumer refuses to provide relevant consumer profile information and the annuity transaction is not recommended; or

(d) A consumer decides to enter into an annuity transaction that is not based on a recommendation of the producer.

(2) An insurer's issuance of an annuity subject to Paragraph (1) shall be reasonable under all the circumstances actually known to the insurer at the time the annuity is issued.

C. Supervision system.

(1) Except as permitted under Subsection B, an insurer may not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity would effectively address the particular consumer's financial situation, insurance needs and financial objectives based on the consumer's consumer profile information.

(2) An insurer shall establish and maintain a supervision system that is reasonably designed to achieve the insurer's and its producers' compliance with this regulation, including, but not limited to, the following:

(a) The insurer shall establish and maintain reasonable procedures to inform its producers of the requirements of this regulation and shall incorporate the requirements of this regulation into relevant producer training manuals;

(b) The insurer shall establish and maintain standards for producer product training and shall establish and maintain reasonable procedures to require its producers to comply with the requirements of Section 7 of this regulation;

(c) The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its producers;

(d) The insurer shall establish and maintain procedures for the review of each recommendation prior to issuance of an annuity that are designed to ensure there is a reasonable basis to determine that the recommended annuity would effectively address the particular consumer's financial situation, insurance needs and financial objectives. Such review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means including, but not limited to, physical review. Such an electronic or other system may be designed to require additional review only of those transactions identified for

© 2020 National Association of Insurance Commissioners

additional review by the selection criteria;

(e) The insurer shall establish and maintain reasonable procedures to detect recommendations that are not in compliance with Subsections A, B, D and E. This may include, but is not limited to, confirmation of the consumer's consumer profile information, systematic customer surveys, producer and consumer interviews, confirmation letters, producer statements or attestations and programs of internal monitoring. Nothing in this subparagraph prevents an insurer from complying with this subparagraph by applying sampling procedures, or by confirming the consumer profile information or other required information under this section after issuance or delivery of the annuity;

(f) The insurer shall establish and maintain reasonable procedures to assess, prior to or upon issuance or delivery of an annuity, whether a producer has provided to the consumer the information required to be provided under this section;

(g) The insurer shall establish and maintain reasonable procedures to identify and address suspicious consumer refusals to provide consumer profile information;

(h) The insurer shall establish and maintain reasonable procedures to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific annuities within a limited period of time. The requirements of this subparagraph are not intended to prohibit the receipt of health insurance, office rent, office support, retirement benefits or other employee benefits by employees as long as those benefits are not based upon the volume of sales of a specific annuity within a limited period of time; and

Drafting Note: The intent of Subparagraph (h) is to prohibit sales contests, sales quotas, bonuses and non-cash compensation based on the sale of a particular product within a limited period of time, but not to prohibit general incentives regarding the sales of a company's products with no emphasis on any particular product.

(i) The insurer shall annually provide a written report to senior management, including to the senior manager responsible for audit functions, which details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.

(3) (a) Nothing in this subsection restricts an insurer from contracting for performance of a function (including maintenance of procedures) required under this subsection. An insurer is responsible for taking appropriate corrective action and may be subject to sanctions and penalties pursuant to Section 8 of this regulation regardless of whether the insurer contracts for performance of a function and regardless of the insurer's compliance with Subparagraph (b) of this paragraph.

(b) An insurer's supervision system under this subsection shall include supervision of contractual performance under this subsection. This includes, but is not limited to, the following:

(i) Monitoring and, as appropriate, conducting audits to assure that the contracted function is properly performed; and

(ii) Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the manager has a reasonable basis to represent, and does represent, that the function is properly performed.

(4) An insurer is not required to include in its system of supervision:

(a) A producer's recommendations to consumers of products other than the annuities offered by the insurer; or

© 2020 National Association of Insurance Commissioners

(b) Consideration of or comparison to options available to the producer or compensation relating to those options other than annuities or other products offered by the insurer.

D. Prohibited Practices. Neither a producer nor an insurer shall dissuade, or attempt to dissuade, a consumer from:

(1) Truthfully responding to an insurer's request for confirmation of the consumer profile information;

(2) Filing a complaint; or

(3) Cooperating with the investigation of a complaint.

E. Safe harbor.

(1) Recommendations and sales of annuities made in compliance with comparable standards shall satisfy the requirements under this regulation. This subsection applies to all recommendations and sales of annuities made by financial professionals in compliance with business rules, controls and procedures that satisfy a comparable standard even if such standard would not otherwise apply to the product or recommendation at issue. However, nothing in this subsection shall limit the insurance commissioner's ability to investigate and enforce the provisions of this regulation.

Drafting Note: Non-compliance with comparable standards means that the recommendation or sale is subject to compliance with the requirements of this regulation.

(2) Nothing in Paragraph (1) shall limit the insurer's obligation to comply with Section 6C(1) of this regulation, although the insurer may base its analysis on information received from either the financial professional or the entity supervising the financial professional.

(3) For paragraph (1) to apply, an insurer shall:

(a) Monitor the relevant conduct of the financial professional seeking to rely on Paragraph (1) or the entity responsible for supervising the financial professional, such as the financial professional's broker-dealer or an investment adviser registered under federal [or state] securities laws using information collected in the normal course of an insurer's business; and

(b) Provide to the entity responsible for supervising the financial professional seeking to rely on Paragraph (1), such as the financial professional's broker-dealer or investment adviser registered under federal [or state] securities laws, information and reports that are reasonably appropriate to assist such entity to maintain its supervision system.

(4) For purposes of this subsection, "financial professional" means a producer that is regulated and acting as:

(a) A broker-dealer registered under federal [or state] securities laws or a registered representative of a broker-dealer;

(b) An investment adviser registered under federal [or state] securities laws or an investment adviser representative associated with the federal [or state] registered investment adviser; or

(c) A plan fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974 (ERISA) or fiduciary under Section 4975(e)(3) of the Internal Revenue Code (IRC) or any amendments or successor statutes thereto.

Drafting Note: The requirement that a producer be "regulated and acting" as a broker-dealer, a registered representative of a broker-dealer, an investment adviser, an investment adviser representative or a plan fiduciary means that a producer who is not explicitly acting in compliance with the relevant comparable standards, as specified in Paragraph (4) below, is not eligible for this safe harbor and is subject to compliance with the requirements of this regulation.

© 2020 National Association of Insurance Commissioners

(5) For purposes of this subsection, "comparable standards" means:

(a) With respect to broker-dealers and registered representatives of broker-dealers, applicable SEC and FINRA rules pertaining to best interest obligations and supervision of annuity recommendations and sales, including, but not limited to, Regulation Best Interest and any amendments or successor regulations thereto;

(b) With respect to investment advisers registered under federal [or state] securities laws or investment adviser representatives, the fiduciary duties and all other requirements imposed on such investment advisers or investment adviser representatives by contract or under the Investment Advisers Act of 1940 [or applicable state securities law], including but not limited to, the Form ADV and interpretations; and

Drafting Note: State-registered investment advisers in this safe harbor are included in brackets so that each individual state that implements this model regulation may determine whether to include the state-regulated investment advisers. Given the varying treatment of annuities, particularly variable annuities, under state law, the varying structures of state securities and insurance departments, and the varying levels of cooperation between the two agencies, this is a decision best made in each individual state.

(c) With respect to plan fiduciaries or fiduciaries, means the duties, obligations, prohibitions and all other requirements attendant to such status under ERISA or the IRC and any amendments or successor statutes thereto.

Section 7. Producer Training

A. A producer shall not solicit the sale of an annuity product unless the producer has adequate knowledge of the product to recommend the annuity and the producer is in compliance with the insurer's standards for product training. A producer may rely on insurer-provided product-specific training standards and materials to comply with this subsection.

B. (1) (a) A producer who engages in the sale of annuity products shall complete a one-time four (4) credit training course approved by the department of insurance and provided by the department of insurance-approved education provider.

(b) Producers who hold a life insurance line of authority on the effective date of this regulation and who desire to sell annuities shall complete the requirements of this subsection within six (6) months after the effective date of this regulation. Individuals who obtain a life insurance line of authority on or after the effective date of this regulation may not engage in the sale of annuities until the annuity training course required under this subsection has been completed.

(2) The minimum length of the training required under this subsection shall be sufficient to qualify for at least four (4) CE credits but may be longer.

(3) The training required under this subsection shall include information on the following topics:

(a) The types of annuities and various classifications of annuities;

(b) Identification of the parties to an annuity;

(c) How product specific annuity contract features affect consumers;

(d) The application of income taxation of qualified and non-qualified annuities;

(e) The primary uses of annuities; and

(f) Appropriate standard of conduct, sales practices, replacement and disclosure requirements.

© 2020 National Association of Insurance Commissioners

(4) Providers of courses intended to comply with this subsection shall cover all topics listed in the prescribed outline and shall not present any marketing information or provide training on sales techniques or provide specific information about a particular insurer's products. Additional topics may be offered in conjunction with and in addition to the required outline.

(5) A provider of an annuity training course intended to comply with this subsection shall register as a CE provider in this state and comply with the rules and guidelines applicable to producer continuing education courses as set forth in [insert reference to state law or regulations governing producer continuing education course approval].

(6) A producer who has completed an annuity training course approved by the department of insurance prior to [insert effective date of amended regulation] shall, within six (6) months after [insert effective date of amended regulation], complete either:

(a) A new four (4) credit training course approved by the department of insurance after [insert effective date of amended regulation]; or

(b) An additional one-time one (1) credit training course approved by the department of insurance and provided by the department of insurance-approved education provider on appropriate sales practices, replacement and disclosure requirements under this amended regulation.

(7) Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with [insert reference to state law or regulations governing producer continuing education course approval].

(8) Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with [insert reference to state law or regulations governing producer continuing education course approval].

(9) The satisfaction of the training requirements of another state that are substantially similar to the provisions of this subsection shall be deemed to satisfy the training requirements of this subsection in this state.

(10) The satisfaction of the components of the training requirements of any course or courses with components substantially similar to the provisions of this subsection shall be deemed to satisfy the training requirements of this subsection in this state.

(11) An insurer shall verify that a producer has completed the annuity training course required under this subsection before allowing the producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this subsection by obtaining certificates of completion of the training course or obtaining reports provided by commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

Section 8. Compliance Mitigation; Penalties; Enforcement

A. An insurer is responsible for compliance with this regulation. If a violation occurs, either because of the action or inaction of the insurer or its producer, the commissioner may order:

(1) An insurer to take reasonably appropriate corrective action for any consumer harmed by a failure to comply with this regulation by the insurer, an entity contracted to perform the insurer's supervisory duties or by the producer;

(2) A general agency, independent agency or the producer to take reasonably appropriate corrective action for any consumer harmed by the producer's violation of this regulation; and

(3) Appropriate penalties and sanctions.

© 2020 National Association of Insurance Commissioners

B. Any applicable penalty under [insert statutory citation] for a violation of this regulation may be reduced or eliminated [, according to a schedule adopted by the commissioner,] if corrective action for the consumer was taken promptly after a violation was discovered or the violation was not part of a pattern or practice.

Drafting Note: Subsection B above is intended to be consistent with the commissioner's discretionary authority to determine the appropriate penalty for a violation of this regulation. The language of Subsection B is not intended to require that a commissioner impose a penalty on an insurer for a single violation of this regulation if the commissioner has determined that such a penalty is not appropriate.

Drafting Note: A state that has authority to adopt a schedule of penalties may wish to include the words in brackets. In that case, "shall" should be substituted for "may" in the same sentence. States should consider inserting a reference to the NAIC *Unfair Trade Practices Act* (#880) or the state's statute that authorizes the commissioner to impose penalties and fines.

C. The authority to enforce compliance with this regulation is vested exclusively with the commissioner.

Section 9. Recordkeeping

A. Insurers, general agents, independent agencies and producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer, disclosures made to the consumer, including summaries of oral disclosures, and other information used in making the recommendations that were the basis for insurance transactions for [insert number] years after the insurance transaction is completed by the insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of a producer.

Drafting Note: States should review their current record retention laws and specify a time period that is consistent with those laws. For some states this time period may be five (5) years.

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

Drafting Note: This section may be unnecessary in states that have a comprehensive recordkeeping law or regulation.

Section 10. Effective Date

The amendments to this regulation shall take effect [X] months after the date the regulation is adopted or on [insert date], whichever is later.

Chronological Summary of Action (All references are to the Proceedings of the NAIC).

2003 Proc. 3rd Quarter 17-18, 24-27, 32, 213 (adopted).
2006 Proc. 2nd Quarter 40, 90 (amended).
2010 Proc. 1st Quarter Vol. I 105-106, 117, 129-139, 146-159, 313 (amended).
2015 Proc. 1st Quarter, Vol. I 117-118, 131-134, 326-335, 431 (amended).
2020 Proc. Spring (amended).

© 2020 National Association of Insurance Commissioners

APPENDIX A

INSURANCE AGENT (PRODUCER) DISCLOSURE FOR ANNUITIES
Do Not Sign Unless You Have Read and Understand the Information in this Form

Date: _____

INSURANCE AGENT (PRODUCER) INFORMATION ("Me", "I", "My")

First Name: _____ Last Name: _____

Business\Agency Name: _____ Website: _____

Business Mailing Address:_____

Business Telephone Number: _____

Email Address:_____

National Producer Number in [state]:_____

CUSTOMER INFORMATION ("You", "Your")

First Name: _____Last Name: _____

What Types of Products Can I Sell You?
I am licensed to sell annuities to You in accordance with state law. If I recommend that You buy an annuity, it means I believe that it effectively meets Your financial situation, insurance needs, and financial objectives. Other financial products, such as life insurance or stocks, bonds and mutual funds, also may meet Your needs.

I offer the following products:

- ☐ Fixed or Fixed Indexed Annuities
- ☐ Variable Annuities
- ☐ Life Insurance

I need a separate license to provide advice about or to sell non-insurance financial products. I have checked below any non-insurance financial products that I am licensed and authorized to provide advice about or to sell.

- ☐ Mutual Funds
- ☐ Stocks/Bonds
- ☐ Certificates of Deposits

Whose Annuities Can I Sell to You?

I am authorized to sell:

☐ Annuities from Only One (1) Insurer	☐ Annuities from Two or More Insurers
☐ Annuities from Two or More Insurers although I primarily sell annuities from:_____	

© 2020 National Association of Insurance Commissioners

How I'm Paid for My Work:

It's important for You to understand how I'm paid for my work. Depending on the particular annuity You purchase, I may be paid a commission or a fee. Commissions are generally paid to Me by the insurance company while fees are generally paid to Me by the consumer. If You have questions about how I'm paid, please ask Me.

Depending on the particular annuity You buy, I will or may be paid cash compensation as follows:

- ☐ Commission, which is usually paid by the insurance company or other sources. If other sources, describe: _____.
- ☐ Fees (such as a fixed amount, an hourly rate, or a percentage of your payment), which are usually paid directly by the customer.
- ☐ Other (Describe): _____.

If You have questions about the above compensation I will be paid for this transaction, please ask me.

I may also receive other indirect compensation resulting from this transaction (sometimes called "non-cash" compensation), such as health or retirement benefits, office rent and support, or other incentives from the insurance company or other sources.

Drafting Note*: This disclosure may be adapted to fit the particular business model of the producer. As an example, if the producer only receives commission or only receives a fee from the consumer, the disclosure may be refined to fit that particular situation. This form is intended to provide an example of how to communicate producer compensation, but compliance with the regulation may also be achieved with more precise disclosure, including a written consulting, advising or financial planning agreement.*

Drafting Note: *The acknowledgement and signature should be in immediate proximity to the disclosure language.*

By signing below, You acknowledge that You have read and understand the information provided to You in this document.

_____

Customer Signature

_____

Date

_____

Agent (Producer) Signature

_____

Date

© 2020 National Association of Insurance Commissioners

APPENDIX B

CONSUMER REFUSAL TO PROVIDE INFORMATION

Do Not Sign Unless You Have Read and Understand the Information in this Form

Why are You being given this form?

You're buying a financial product – an annuity.

To recommend a product that effectively meets Your needs, objectives and situation, the agent, broker, or company needs information about You, Your financial situation, insurance needs and financial objectives.

If You sign this form, it means You have not given the agent, broker, or company some or all the information needed to decide if the annuity effectively meets Your needs, objectives and situation. You may lose protections under the Insurance Code of [this state] if You sign this form or provide inaccurate information.

Statement of Purchaser:

- ☐ I **REFUSE** to provide this information at this time.
- ☐ I have chosen to provide LIMITED information at this time.

_____
Customer Signature

_____
Date

© 2020 National Association of Insurance Commissioners

APPENDIX C

Consumer Decision to Purchase an Annuity NOT Based on a Recommendation

Do Not Sign This Form Unless You Have Read and Understand It.

Why are You being given this form? You are buying a financial product – an annuity.

To recommend a product that effectively meets your needs, objectives and situation, the agent, broker, or company has the responsibility to learn about You, your financial situation, insurance needs and financial objectives.

If You sign this form, it means You know that you're buying an annuity that was not recommended.

Statement of Purchaser:

I understand that I am buying an annuity, but the agent, broker or company did not recommend that I buy it. If I buy it **without a recommendation,** I understand I may lose protections under the Insurance Code of [this state].

_____
Customer Signature

_____
Date

_____
Agent/Producer Signature

_____
Date

© 2020 National Association of Insurance Commissioners

ITEM 1. Amend rules 191—15.72(507B) to 191—15.78(507B) as follows:

191—15.72(507B) Purpose. The purpose of these rules is to require producers, as defined in rule 15.74, to act in the best interest of the consumer when making a recommendation of an annuity and to require insurers to establish and maintain a system to supervise recommendations ~~and to set forth standards and procedures for recommendations to consumers that result in transactions involving annuity products~~ so that the insurance needs and financial objectives of consumers at the times of the transactions are ~~appropriately~~ effectively addressed. Nothing herein shall be construed to create or imply a private cause of action for a violation of these rules or to subject a producer to civil liability under the best interest standard of care outlined in rule 15.75 of these rules or under standards governing the conduct of a fiduciary or a fiduciary relationship.

191—15.73(507B) Applicability and scope.

15.73(1) These rules shall apply to any sale or recommendation ~~to purchase, exchange or replace~~ of an annuity made to a consumer on or after January 1, ~~2011~~2021~~, by an insurance producer, or by an insurer where no producer is involved, that results in the purchase, exchange or replacement recommended~~.

15.73(2) Unless otherwise specifically included, ~~this rule shall~~ these rules do not apply to transactions involving:

a. Direct-response solicitations where there is no recommendation based on information collected from the consumer pursuant to these rules.

b. Contracts used to fund the following:

(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 Section 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC) if established or maintained by an employer;

(3) 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; or

(4) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

~~(5)~~*c.* Settlements or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or

~~(6)~~*d.* Formal prepaid funeral contracts.

191—15.74(507B) Definitions. For purposes of this division:

"Annuity" means an annuity that is an insurance product under state law, individually solicited, whether the product is classified as an individual or group annuity.

"Cash compensation" means any discount, concession, fee, service fee, commission, sales charge, loan, override, or cash benefit received by a producer in connection with the recommendation or sale of an annuity from an insurer, intermediary, or directly from the consumer.

"Consumer profile information" means information that is reasonably appropriate to determine whether a recommendation addresses the consumer's financial situation, insurance needs and financial objectives, including, at a minimum, the following:

1. Age;

2. Annual income;

3. Financial situation and needs, including debts and other obligations;

4. Financial experience;

5. Insurance needs;

6. Financial objectives;

7. Intended use of the annuity;

8. Financial time horizon;

9. Existing assets or financial products, including investment, annuity and insurance holdings;

10. Liquidity needs;

11. Liquid net worth;

12. Risk tolerance, including but not limited to, willingness to accept non-guaranteed elements in the annuity;

13. Financial resources used to fund the annuity; and

14. Tax status.

"*Continuing education credit*" or "*CE credit*" means one credit as defined in rule 191—11.2(505,522B).

"*Continuing education provider*" or "*CE provider*" means a CE provider as defined in rule 191—11.2(505,522B).

"*FINRA*" means the Financial Industry Regulatory Authority or a succeeding agency.

~~"*Insurance producer*" means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.~~

"*Insurer*" means a company required to be licensed under the laws of this state to provide insurance products, including annuities.

"*Intermediary*" means an entity contracted directly with an insurer or with another entity contracted with an insurer to facilitate the sale of the insurer's annuities by producers.

"*Material conflict of interest*" means a financial interest of the producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation. "Material conflict of interest" does not include cash compensation or non-cash compensation.

"*Non-cash compensation*" means any form of compensation that is not cash compensation, including, but not limited to, health insurance, office rent, office support and retirement benefits.

"*Non-guaranteed elements*" means the premiums, credited interest rates (including any bonus), benefits, values, dividends, non-interest based credits, charges or elements of formulas used to determine any of these, that are subject to company discretion and are not guaranteed at issue. An element is considered nonguaranteed if any of the underlying non-guaranteed elements are used in its calculation.

"*Producer*" means a person or entity required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities. For purposes of these rules, "producer" includes an insurer where no producer is involved.

"*Recommendation*" means advice provided by ~~an insurance~~ a producer~~, or an insurer where no producer is involved,~~ to an individual consumer that was intended to result or does result ~~results~~ in a purchase, an exchange or a replacement of an annuity in accordance with that advice. Recommendation does not include general communication to the public, generalized customer services assistance or administrative support, general educational information and tools, prospectuses, or other product and sales material.

"*Replacement*" means a transaction in which a new ~~policy or contract~~ annuity 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~~ whether or not a producer is involved, that, by reason of the transaction, an existing annuity or other insurance policy ~~or contract~~ has been or is to be any of the following:

1. Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;

2. 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;

3. Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid;

4. Reissued with any reduction in cash value; or

5. Used in a financed purchase.

~~*"Suitability information"* means information that is reasonably appropriate to determine the suitability of a recommendation, including the following:~~

~~1. Age;~~

~~2. Annual income;~~

~~3. Financial situation and needs, including the financial resources used for the funding of the annuity;~~

~~4. Financial experience;~~

~~5. Financial objectives;~~

~~6. Intended use of the annuity;~~

~~7. Financial time horizon;~~

~~8. Existing assets, including investment and life insurance holdings;~~

~~9. Liquidity needs;~~

~~10. Liquid net worth;~~

~~11. Risk tolerance; and~~

~~12. Tax status.~~

"SEC" means the United States Securities and Exchange Commission.

191—15.75(507B) Duties of insurers and ~~of insurance~~ producers.

~~**15.75(1)** 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 the consumer's investments and other insurance products and as to the consumer's financial situation and needs, including the consumer's suitability information, and that there is a reasonable basis to believe all of the following:~~

15.75(1) *Best interest obligations*. A producer, when making a recommendation of an annuity, shall act in the best interest of the consumer under the circumstances known at the time the recommendation is made, without placing the producer's or the insurer's financial interest ahead of the consumer's interest. A producer has acted in the best interest of the consumer if they have satisfied the following obligations regarding care, disclosure, conflict of interest and documentation:

a. Care obligation.

(1) The producer, in making a recommendation shall exercise reasonable diligence, care and skill to:

1. Know the consumer's financial situation, insurance needs and financial objectives;

2. Understand the available recommendation options after making a reasonable inquiry into options available to the producer;

3. Have a reasonable basis to believe the recommended option effectively addresses the consumer's financial situation, insurance needs and financial objectives over the life of the product, as evaluated in light of the consumer profile information; and

4. Communicate the basis or bases of the recommendation.

(2) The requirements under subparagraph 15.75(1)"a"(1) include making reasonable efforts to obtain consumer profile information from the consumer prior to the recommendation of an annuity.

(3) The requirements under subparagraph 15.75(1)"a"(1) require a producer to consider the types of products the producer is authorized and licensed to recommend or sell that address the consumer's financial situation, insurance needs and financial objectives. This does not require analysis or consideration of any products outside the authority and license of the producer or other possible alternative products or strategies available in the market at the time of the recommendation. Producers shall be held to standards applicable to producers with similar authority and licensure.

(4) The requirements under this subrule do not create a fiduciary obligation or relationship and only create a regulatory obligation as established in these rules.

(5) The consumer profile information, characteristics of the insurer, and product costs, rates, benefits and features are those factors generally relevant in making a determination whether an annuity effectively addresses the consumer's financial situation, insurance needs and financial objectives, but the level of importance of each factor under the care obligation of this paragraph may vary depending on the facts and circumstances of a particular case. However, each factor may not be considered in isolation.

(6) The requirements under subparagraph 15.75(1)"a"(1) include having a reasonable basis to believe the consumer would benefit from certain features of the annuity, such as annuitization, death or living benefit or other insurance-related features.

(7) The requirements under subparagraph 15.75(1)"a"(1) apply to the particular annuity as a whole and the underlying subaccounts to which funds are allocated at the time of purchase or exchange of an annuity, and riders and similar product enhancements, if any.

(8) The requirements under subparagraph 15.75(1)"a"(1) do not mean the annuity with the lowest one-time or multiple occurrence compensation structure shall necessarily be recommended.

(9) The requirements under subparagraph 15.75(1)"a"(1) do not mean the producer has ongoing monitoring obligations under the care obligation under this paragraph, although such an obligation may be separately owed under the terms of a fiduciary, consulting, investment advising or financial planning agreement between the consumer and the producer.

(10) In the case of an exchange or replacement of an annuity, the producer shall consider the whole transaction, which includes taking into consideration whether:

1. The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits, such as death, living or other contractual benefits, or be subject to increased fees, investment advisory fees or charges for riders and similar product enhancements;

2. The replacing product would substantially benefit the consumer in comparison to the replaced product over the life of the product; and

3. The consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 60 months.

(11) Nothing in this regulation should be construed to require a producer to obtain any license other than a producer license with the appropriate line of authority to sell, solicit or negotiate insurance in this state, including but not limited to any securities license, in order to fulfill the duties and obligations contained in this regulation; provided the producer does not give advice or provide services that are otherwise subject to securities laws or engage in any other activity requiring other professional licenses.

b. Disclosure obligation.

(1) Prior to the recommendation or sale of an annuity, the producer shall prominently disclose to the consumer on a form substantially similar to Appendix VI:

1. A description of the scope and terms of the relationship with the consumer and the role of the producer in the transaction;

2. An affirmative statement on whether the producer is licensed and authorized to sell the following products:

- Fixed annuities;
- Fixed indexed annuities;
- Variable annuities;
- Life insurance;
- Mutual funds;
- Stocks and bonds; and
- Certificates of deposit;

3. An affirmative statement describing the insurers the producer is authorized, contracted (or appointed), or otherwise able to sell insurance products for, using the following descriptions:

- One insurer;

- From two or more insurers; or
- From two or more insurers although primarily contracted with one insurer.

4. A description of the sources and types of cash compensation and non-cash compensation to be received by the producer, including whether the producer is to be compensated for the sale of a recommended annuity by commission as part of premium or other remuneration received from the insurer, intermediary or other producer or by fee as a result of a contract for advice or consulting services; and

5. A notice of the consumer's right to request additional information regarding cash compensation described in 15.75(1)"b"(2);

(2) Upon request of the consumer or the consumer's designated representative, the producer shall disclose:

1. A reasonable estimate of the amount of cash compensation to be received by the producer, which may be stated as a range of amounts or percentages; and

2. Whether the cash compensation is a one-time or multiple occurrence amount, and if a multiple occurrence amount, the frequency and amount of the occurrence, which may be stated as a range of amounts or percentages; and

(3) Prior to or at the time of the recommendation or sale of an annuity, the producer shall have a reasonable basis to believe ~~*a. The*~~ the consumer has been ~~reasonably~~ informed of various features of the ~~recommended~~ annuity, such as: the potential surrender period and surrender charge; potential tax penalty if the consumer sells, exchanges, surrenders or annuitizes the annuity; mortality and expense fees; investment advisory fees; any annual fees; potential charges for and features of riders or other options of the annuity; limitations on interest returns; potential changes in non-guaranteed elements of the annuity; insurance and investment components; and market risk~~;.~~

~~*b.* The consumer would benefit from certain features of the annuity, such as tax-deferred growth, annuitization, death benefit, or living benefit;~~

~~*c.* The particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of purchase or exchange of the annuity, and riders and similar product enhancements, if any, are suitable (and in the case of an exchange or replacement, the transaction as a whole is suitable) for the particular consumer based on the consumer's suitability information; and~~

~~*d.* In the case of an exchange or replacement of an annuity, the exchange or replacement is suitable, including taking into consideration whether:~~

~~(1) The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death benefit, living benefit, or other contractual benefits), or be subject to increased fees, investment advisory fees or charges for riders and similar product enhancements;~~

~~(2) The consumer would benefit from product enhancements and improvements; and~~

~~(3) The consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 36 months.~~

c. Conflict of interest obligation. A producer shall identify and avoid or reasonably manage and disclose material conflicts of interest, including material conflicts of interest related to an ownership interest.

d. Documentation obligation. A producer shall at the time of recommendation or sale:

(1) Make a written record of any recommendation and the basis for the recommendation subject to this regulation;

(2) Obtain a consumer signed statement on a form substantially similar to Appendix VII documenting:

1. A customer's refusal to provide the consumer profile information, if any; and

2. A customer's understanding of the ramifications of not providing his or her consumer profile information or providing insufficient consumer profile information; and

(3) Obtain a consumer signed statement on a form substantially similar to Appendix VIII acknowledging the annuity transaction is not recommended if a customer decides to enter into an annuity transaction that is not based on the producer's recommendation.

~~**15.75(2)** Prior to the execution of a purchase, exchange or replacement of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain the consumer's suitability information.~~

~~**15.75(3)** Except as permitted under subrule 15.75(4), an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information.~~

e. Application of the best interest obligation. Any requirement applicable to a producer under this subrule shall apply to every producer who has exercised material control or influence in the making of a recommendation and has received direct compensation as a result of the recommendation or sale, regardless of whether the producer has had any direct contact with the consumer. Activities such as providing or delivering marketing or educational materials, product wholesaling or other back office product support, and general supervision of a producer do not, in and of themselves, constitute material control or influence.

15.75~~(4)~~ ~~Exceptions.~~ **(2)** *Transactions not based on a recommendation.*

a. Except as provided under paragraph 15.75~~(4)~~(2)*"b,"* ~~neither an insurance~~ a producer~~, nor an insurer,~~ shall have ~~any~~ no obligation to a consumer under subrule 15.75(1)*"a"* ~~or 15.75(3)~~ related to any annuity transaction if:

(1) No recommendation is made;

(2) A recommendation was made and was later found to have been prepared based on inaccurate material information provided by the consumer;

(3) A consumer refuses to provide relevant ~~suitability~~ consumer profile information and the annuity transaction is not recommended; or

(4) A consumer decides to enter into an annuity transaction that is not based on a recommendation of ~~the insurer or~~ the ~~insurance~~ producer.

b. An insurer's issuance of an annuity subject to paragraph 15.75~~(4)~~(2)*"a"* shall be reasonable under all the circumstances actually known to the insurer at the time the annuity is issued.

~~**15.75(5)** An insurance producer or, where no insurance producer is involved, the responsible insurer representative, shall at the time of sale:~~

~~*a.* Make a record of any recommendation subject to subrule 15.75(1);~~

~~*b.* Obtain a customer-signed statement documenting a customer's refusal to provide suitability information, if any; and~~

~~*c.* Obtain a customer-signed statement acknowledging that an annuity transaction is not recommended if a customer decides to enter into an annuity transaction that is not based on the insurance producer's or insurer's recommendation.~~

15.75(3) *Supervision system.*

a. Except as permitted under subrule 15.75(2), an insurer may not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity would effectively address the particular consumer's financial situation, insurance needs and financial objectives based on the consumer's consumer profile information.

~~**15.75(6)** An insurer's duty to supervise.~~

~~*a.*~~*b.* An insurer shall establish and maintain a supervision system that is reasonably designed to achieve the insurer's and its ~~insurance~~ producers' compliance with rules 191—15.72(507B) through 191—15.78(507B) including, but not limited to, the following:

(1) The insurer shall establish and maintain reasonable procedures to inform its ~~insurance~~ producers of the requirements of these rules and shall incorporate the requirements of these rules into relevant ~~insurance~~ producer training manuals;

(2) The insurer shall establish and maintain standards for ~~insurance~~ producer product training and shall establish and maintain reasonable procedures to require its ~~insurance~~ producers to comply with the requirements of rule 191—15.76(507B);

(3) The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its ~~insurance~~ producers;

(4) The insurer shall establish and maintain procedures for the review of each recommendation prior to issuance of an annuity that are designed to ensure ~~that~~ there is a reasonable basis to determine that ~~a recommendation is suitable~~ the recommended annuity would effectively address the particular consumer's financial situation, insurance needs and financial objectives. Such review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means including, but not limited to, physical review. Such an electronic or other system may be designed to require additional review only of those transactions identified for additional review by the selection criteria;

(5) The insurer shall establish and maintain reasonable procedures to detect recommendations that are not ~~suitable~~ in compliance with subrules (1), (2), (4) and (5). These procedures may include, but are not limited to, confirmation of the consumer's ~~suitability~~ consumer profile information, systematic customer surveys, producer and consumer interviews, confirmation letters, producer statements or attestations, and programs of internal monitoring. Nothing in this subparagraph prevents an insurer from complying with this subparagraph by applying sampling procedures or by confirming the ~~suitability~~ consumer profile information or other required information under this section after issuance or delivery of the annuity; ~~and~~

(6) The insurer shall establish and maintain reasonable procedures to assess, prior to or upon issuance or delivery of an annuity, whether a producer has provided to the consumer the information required to be provided under this section;

(7) The insurer shall establish and maintain reasonable procedures to identify and address suspicious consumer refusals to provide consumer profile information;

(8) The insurer shall establish and maintain reasonable procedures to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific annuities within a limited period of time. The requirements of this subparagraph are not intended to prohibit the receipt of health insurance, office rent, office support, retirement benefits or other employee benefits by employees as long as those benefits are not based upon the volume of sales of a specific annuity within a limited period of time; and

~~(6)~~(9) The insurer shall annually provide a written report to senior management, including to the senior manager responsible for audit functions, which details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.

~~*b.*~~ *c.* Third-party supervisor.

(1) Nothing in this subrule restricts an insurer from contracting for performance of a function (including maintenance of procedures) required ~~under paragraph 15.75(6)"*a.*"~~ this subrule. An insurer is responsible for taking appropriate corrective action and may be subject to sanctions and penalties pursuant to rule ~~191—15.73(507B)~~ 191—15.77(507B) regardless of whether the insurer contracts for performance of a function and regardless of the insurer's compliance with subparagraph ~~15.75(6)"*b*"(2)~~ 15.75(3)"*c*"(2).

(2) An insurer's supervision system under paragraph ~~15.75(6)"*a*"~~ this subrule shall include supervision of contractual performance under this subrule including, but not limited to, the following:

1. Monitoring and, as appropriate, conducting audits to assure that the contracted function is properly performed; and

2. Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the manager has a reasonable basis to represent, and does represent, that the function is properly performed.

~~c.~~*d.* An insurer is not required to include in its system of supervision ~~an insurance~~

(1) A producer's recommendations to consumers of products other than the annuities offered by the insurer~~.~~; or

(2) Consideration of or comparison to options available to the producer or compensation relating to those options other than annuities or other products offered by the insurer.

15.75~~(7)~~ (4) *Prohibited practices*. Neither a producer nor an insurer shall ~~An insurance producer shall not~~ dissuade, or attempt to dissuade, a consumer from:

a. Truthfully responding to an insurer's request for confirmation of the ~~suitability~~ consumer profile information;

b. Filing a complaint; or

c. Cooperating with the investigation of a complaint.

15.75~~(8)~~ ~~Compliance with FINRA.~~ **(5)** *Safe Harbor.*

a. ~~Sales~~ Recommendations and sales of annuities made in compliance with ~~FINRA requirements pertaining to suitability and supervision of annuity transactions~~ comparable standards shall satisfy the requirements under these rules. This subrule applies to ~~FINRA member broker-dealer sales of variable annuities and fixed annuities if the suitability and supervision are similar to those applied to variable annuity sales~~ all recommendations and sales of annuities made by financial professionals in compliance with business rules, controls and procedures that satisfy a comparable standard even if such standard would not otherwise apply to the product or recommendation at issue. However, nothing in this subrule shall limit the insurance commissioner's ability to investigate and enforce ~~(including investigate)~~ the provisions of ~~this regulation.~~ these rules.

b. Nothing in lettered paragraph "a" shall limit the insurer's obligation to comply with 15.75(3)"a", although the insurer may base its analysis on information received from either the financial professional or the entity supervising the financial professional.

~~*b.*~~ *c.* For paragraph 15.75~~(8)~~(5)*"a"* to apply, an insurer shall:

(1) Monitor the ~~FINRA member broker-dealer~~ relevant conduct of the financial professional seeking to rely on lettered paragraph "a" or the entity responsible for supervising the financial professional, such as the financial professional's broker-dealer or an investment adviser registered under federal securities laws using information collected in the normal course of an insurer's business; and

(2) Provide to the ~~FINRA member broker-dealer~~ entity responsible for supervising the financial professional seeking to rely on lettered paragraph "a", such as the financial professional's broker-dealer or investment adviser registered under federal securities laws, information and reports that are reasonably appropriate to assist ~~the FINRA member broker-dealer~~ such entity to maintain its supervision system.

d. For purposes of this subrule, "financial professional" means a producer that is regulated and acting as:

(1) A broker-dealer registered under federal securities laws or a registered representative of a broker-dealer;

(2) An investment adviser registered under federal securities laws or an investment adviser representative associated with the federal registered investment adviser; or

(3) A plan fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974 (ERISA) or fiduciary under Section 4975(e)(3) of the Internal Revenue Code (IRC) or any amendments or successor statutes thereto.

e. For purposes of this subrule, "comparable standards" means:

(1) With respect to broker-dealers and registered representatives of broker-dealers, applicable SEC and FINRA rules pertaining to best interest obligations and supervision of annuity recommendations and

sales, including, but not limited to, Regulation Best Interest and any amendments or successor regulations thereto;

(2) With respect to investment advisers registered under federal securities laws or investment adviser representatives, the fiduciary duties and all other requirements imposed on such investment advisers or investment adviser representatives by contract or under the Investment Advisers Act of 1940, including but not limited to, the Form ADV and interpretations; and

(3) With respect to plan fiduciaries or fiduciaries, means the duties, obligations, prohibitions and all other requirements attendant to such status under ERISA or the IRC and any amendments or successor statutes thereto.

191—15.76(507B) ~~Insurance producer~~ Producer training.

15.76(1) ~~An insurance~~ A producer shall not solicit the sale of an annuity product unless the ~~insurance~~ producer has adequate knowledge of the product to recommend the annuity and the ~~insurance~~ producer is in compliance with the insurer's standards for product training. ~~An insurance~~ A producer may rely on insurer-provided product-specific training standards and materials to comply with this subrule.

15.76(2) Training required.

a. One-time course.

(1) ~~An insurance~~ A producer who engages in the sale of annuity products shall complete a one-time four-credit training course approved by the ~~Iowa insurance division~~ commissioner and provided by an education provider approved by the ~~insurance division~~commissioner.

(2) ~~Insurance producers~~ Producers may not engage in the sale of annuities until the annuity training course required under this rule has been completed.

b. The minimum length of the training required under this rule shall be sufficient to qualify for at least four CE credits, but may be longer.

c. The training required under this rule shall include information on the following topics:

(1) The types of annuities and various classifications of annuities;

(2) Identification of the parties to an annuity;

(3) How fixed, variable, ~~and~~ indexed, and other product specific annuity contract provisions affect consumers;

(4) The application of income taxation of qualified and nonqualified annuities;

(5) The primary uses of annuities;

(6) Appropriate standard of conduct sales practices; and

(7) Replacement and disclosure requirements.

d. Providers of courses intended to comply with this rule shall cover all topics listed in the prescribed outline and shall not present any marketing information or provide training on sales techniques or provide specific information about a particular insurer's products. Additional topics may be offered in conjunction with and in addition to the required outline.

e. A provider of an annuity training course intended to comply with this rule shall register as a CE provider in this state and comply with the rules and guidelines applicable to ~~insurance~~ producer continuing education courses as set forth in 191—Chapter 11.

f. A producer who has completed an annuity training course approved by the commissioner prior to January 1, 2021 shall, before July 1, 2021, complete either:

(1) A new four (4) credit training course approved by the commissioner after January 1, 2021; or

(2) An additional one-time one (1) credit training course approved by the commissioner and provided by the commissioner-approved education provider on appropriate sales practices, replacement and disclosure requirements under this amended regulation.

~~*f.*~~ *g.* Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with 191—Chapter 11.

~~*g.*~~ *h.* Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with 191—Chapter 11.

~~*h.*~~ *i.* Satisfaction of the training requirements of another state that are substantially similar to the provisions of this subrule shall be deemed to satisfy the training requirements of this subrule in this state.

j. The satisfaction of the components of the training requirements of any course or courses with components substantially similar to the provisions of this subsection shall be deemed to satisfy the training requirements of this subrule in this state.

~~*i.*~~ *k.* An insurer shall verify that an ~~insurance~~ producer has completed the annuity training course required under this subrule before allowing the producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this subrule by obtaining certificates of completion of the training course or obtaining reports provided by Iowa insurance commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved continuing education providers.

191—15.77(507B) Compliance; mitigation; penalties~~.~~; enforcement.

15.77(1) An insurer is responsible for compliance with this regulation. If a violation occurs, either because of the action or inaction of the insurer or its ~~insurance~~ producer, the commissioner may order:

a. An insurer to take reasonably appropriate corrective action for any consumer harmed by a failure to comply with these rules by the ~~insurer's~~ insurer, an entity contracted to perform the insurer's supervisory duties, or by ~~its insurance producer's, violation of the rules of this division~~ the producer;

b. A general agency, independent agency or the ~~insurance~~ producer to take reasonably appropriate corrective action for any consumer harmed by the ~~insurance~~ producer's violation of the rules of this division; and

c. Appropriate penalties and sanctions.

15.77(2) Any applicable penalty under Iowa Code chapter 507B for a violation of the rules in Division V of this chapter may be reduced or eliminated if corrective action for the consumer was taken promptly after a violation was discovered or the violation was not part of a pattern or practice.

15.77(3) The authority to enforce compliance with these rules is vested exclusively with the commissioner.

191—15.78(507B) Record keeping.

15.78(1) Insurers, general agents, independent agencies, and ~~insurance~~ producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer, disclosures made to the consumer (including summaries of oral disclosures) and other information used in making the recommendations that were the basis for insurance transactions for ten years after the insurance transaction is completed by the insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of ~~an insurance~~ a producer.

15.78(2) Records required to be maintained by this rule may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

ITEM 2. Adopt **191—Chapter 15**, Appendices VI, VII, and VIII, as follows:

APPENDIX VI

INSURANCE AGENT (PRODUCER) DISCLOSURE FOR ANNUITIES
Do Not Sign Unless You Have Read and Understand the Information in this Form

Date:_____

INSURANCE AGENT (PRODUCER) INFORMATION ("Me", "I", "My")

First Name:_____ Last Name:_____

Business\Agency Name:_____ Website: _____

Business Mailing Address:_____

Business Telephone Number:_____

Email Address:_____

National Producer Number in [state]: _____

CUSTOMER INFORMATION ("You", "Your")

First Name:_____ Last Name:_____

What Types of Products Can I Sell You?

I am licensed to sell annuities to you in accordance with state law. If I recommend that You buy an annuity, it means I believe that it effectively meets Your financial situation, insurance needs, and financial objectives. Other financial products, such as life insurance or stocks, bonds and mutual funds, also may meet Your needs.

I offer the following products:

- ☐ Fixed or Fixed Indexed Annuities
- ☐ Variable Annuities
- ☐ Life Insurance

I need a separate license to provide advice about or to sell non-insurance financial products. I have checked below any non-insurance financial products that I am licensed and authorized to provide advice about or to sell.

- ☐ Mutual Funds
- ☐ Stocks/Bonds
- ☐ Certificates of Deposits

Whose Annuities Can I Sell to You?

I am authorized to sell:

□ Annuities from Only One (1) Insurer	□ Annuities from Two or More Insurers
□ Annuities from Two or More Insurers although I primarily sell annuities from:	

How I'm Paid for My Work:

It's important for You to understand how I'm paid for my work. Depending on the particular annuity You purchase, I may be paid a commission or a fee. Commissions are generally paid to Me by the insurance company while fees are generally paid to Me by the consumer. If You have questions about how I'm paid, please ask Me.

Depending on the particular annuity You buy, I will or may be paid cash compensation as follows:

□ Commission, which is usually paid by the insurance company or other sources. If other sources, describe: _____.

□ Fees (such as a fixed amount, an hourly rate, or a percentage of your payment), which are usually paid directly by the customer.

□ Other (Describe): _____.

If you have questions about the above compensation I will be paid for this transaction, please ask me.

I may also receive other indirect compensation resulting from this transaction (sometimes called "non-cash" compensation), such as health or retirement benefits, office rent and support, or other incentives from the insurance company or other sources.

Drafting Note*: This disclosure may be adapted to fit the particular business model of the producer. As an example, if the producer only receives commission or only receives a fee from the consumer, the disclosure may be refined to fit that particular situation. This form is intended to provide an example of how to communicate producer compensation, but compliance with the regulation may also be achieved with more precise disclosure, including a written consulting, advising or financial planning agreement.*

Drafting Note: *The acknowledgement and signature should be in immediate proximity to the disclosure language.*

By signing below, you acknowledge that you have read and understand the information provided to you in this document.

_____
Customer Signature

_____
Date

_____
Agent (Producer) Signature

_____
Date

APPENDIX VII

CONSUMER REFUSAL TO PROVIDE INFORMATION

Do Not Sign Unless You Have Read and Understand the Information in this Form

Why are you being given this form?

You're buying a financial product – an annuity.

To recommend a product that effectively meets your needs, objectives and situation, the agent, broker, or company needs information about you, your financial situation, insurance needs and financial objectives.

If you sign this form, it means you have not given the agent, broker, or company some or all the information needed to decide if the annuity effectively meets your needs, objectives and situation. You may lose protections under the Insurance Code of [this state] if you sign this form or provide inaccurate information.

Statement of Purchaser:

☐ I **REFUSE** to provide this information at this time.
☐ I have chosen to provide LIMITED information at this time.

_____
Customer Signature

_____
Date

APPENDIX VIII

Consumer Decision to Purchase an Annuity NOT Based on a Recommendation

Do Not Sign This Form Unless You Have Read and Understand It.

Why are you being given this form? You are buying a financial product – an annuity.

To recommend a product that effectively meets your needs, objectives and situation, the agent, broker, or company has the responsibility to learn about you, your financial situation, insurance needs and financial objectives.

If you sign this form, it means you know that you're buying an annuity that was not recommended.

Statement of Purchaser:

I understand that I am buying an annuity, but the agent, broker or company did not recommend that I buy it. If I buy it **without a recommendation,** I understand I may lose protections under the Insurance Code of [this state].

_____

Customer Signature

_____

Date

_____

Agent/Producer Signature

_____

Date

ITEM 3. Adopt the following **new** rule(s) 191—50.104(502):

191—50.104(502) Best Interest Obligations in the Brokerage Business

50.104(1) In addition to the definitions in Iowa Code chapter 502 and those of 191—50.1, the following definitions apply to this rule:

"Retail investor" means a natural person, or the legal representative of such natural person, who receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer or agent primarily for personal, family, or household purposes.

"Investment profile" means the following information, but is not limited to, the retail investor's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the retail investor may disclose to the broker, dealer, or a natural person who is an associated person of a broker or dealer in connection with a recommendation.

"Conflict of interest" means an interest that might incline a broker-dealer or agent —consciously or unconsciously—to make a recommendation that is not disinterested.

"Securities transaction" means an offer, sale, or purchase of securities involving a retail investor.

50.104(2) A broker-dealer or agent failing to comply with the following requirements when recommending a customer purchase, sell or exchange a security engages in an act, practice, or course of business which operates or would operate as a fraud or deceit under Iowa Code section 502.501(3) and a manipulative, deceptive or other fraudulent scheme, device, or contrivance under Iowa Code section 502.501A:

a. A broker-dealer or agent shall have a reasonable basis to believe that a recommendation of any securities transaction or investment strategy involving securities (including account

recommendations) to a retail investor is in the best interest of the retail investor at the time the recommendation is made;

b. A broker-dealer or agent shall have a reasonable basis to believe that a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail investor does not place the financial or other interest of the broker-dealer or agent making the recommendation ahead of the interest of the retail investor;

c. A broker-dealer shall establish, maintain or enforce policies and procedures reasonably designed to:

(1) Identify all conflicts of interest associated with recommendations of any securities transaction or investment strategy involving securities (including account recommendations) to a retail investor;

(2) Eliminate or, at a minimum disclose, in accordance with paragraph 50.104(3)“b” of this section, all conflicts of interest associated with recommendations of any securities transaction or investment strategy involving securities (including account recommendations) to a retail investor;

(3) Mitigate any conflicts of interest associated with recommendations of any securities transaction or investment strategy involving securities (including account recommendations) to a retail investor that create an incentive for an agent to place the interest of the broker-dealer or agent ahead of the interest of the retail investor;

(4) Identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail investor and any conflicts of interest associated with such limitations, in accordance

with paragraph 50.104(3)“b”, and prevent such limitations and associated conflicts of interest from causing the broker-dealer or agent to make recommendations that place the interest of the broker-dealer or agent ahead of the interest of the retail investor; and

(5) 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; and

d. A broker-dealer shall establish, maintain, or enforce policies and procedures reasonably designed to achieve compliance with the obligations in this rule.

50.104(3) The best interest obligation in subrule 50.104(2)“a” and “b” shall be satisfied if the broker-dealer or agent satisfies the following care and disclosure obligations:

a. Care obligation. The broker-dealer or agent, in making a recommendation, exercises reasonable diligence, care, and skill to:

(1) Know and understand the retail investor’s investment profile, including the retail investor’s age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the retail investor may disclose to the broker-dealer or agent in connection with a recommendation;

(2) Know and understand the potential risks, rewards, and costs associated with the recommendation;

(3) Have a reasonable basis to believe the recommendation, including its potential risks, rewards, and costs, effectively addresses the retail investor’s investment profile, including the retail investor’s age, other investments, financial situation and

needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance and other known information, and does not place the financial or other interest of the broker-dealer or agent ahead of the interest of the retail investor;

(4) Have a reasonable basis to believe that a series of recommendations, even if in the retail investor's best interest when viewed in isolation, is not excessive and effectively addresses the retail investor's investment profile, including the retail investor's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance and other known information when taken together in light of the retail investor's investment profile and does not place the financial or other interest of the broker-dealer or agent making the series of recommendations ahead of the interest of the retail investor; and

(5) Have a reasonable basis to believe that prior to or at the time of the recommendation the retail investor has been reasonably informed of the basis of the recommendation and the potential risks, rewards, and costs associated with the recommendation.

b. Disclosure obligation. The broker-dealer or agent, prior to or at the time of the recommendation, provides the retail investor full and fair disclosure of:

(1) All material facts relating to the scope and terms of the relationship with the retail investor, including:

1. That the broker-dealer or agent is acting as a broker-dealer or agent with respect to the recommendation;

2. The material fees and costs that apply to the retail investor's transactions, holdings, and accounts; and

3. The type and scope of services provided to the retail investor, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail investor; and

(2) All material facts relating to conflicts of interest that are associated with the recommendation.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act," or "Exchange Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") is filing with the Securities and Exchange Commission ("SEC" or "Commission") proposed amendments to FINRA Rules 2111 (Suitability), 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements), and Capital Acquisition Broker (CAB) Rule 211 (Suitability). The proposed rule change would: (1) amend the FINRA and CAB suitability rules to state that the rules do not apply to recommendations subject to Regulation Best Interest ("Reg BI"),[2] and to remove the element of control from the quantitative suitability obligation; and (2) conform the rules governing non-cash compensation to Reg BI's limitations on sales contests, sales quotas, bonuses and non-cash compensation.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The FINRA Board of Governors has authorized the filing of the proposed rule change with the SEC; no other action by FINRA is necessary for the filing of the proposed rule change.

---

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.15l-1.

If the Commission approves the proposed rule change, FINRA will announce the approval of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be the compliance date of Reg BI.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Background

On June 5, 2019, the SEC adopted Reg BI, a new rule under the Exchange Act, which establishes a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer (unless otherwise indicated, together referred to as "broker-dealer") when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities.[3] The SEC stated that Reg BI will improve investor protection by enhancing the obligations that apply when a broker-dealer makes a recommendation to a retail customer, and reducing the potential harm to retail customers from conflicts of interest that may affect the recommendation.[4] The date by which broker-dealers must comply with Reg BI is June 30, 2020.[5]

FINRA proposes to amend the suitability and non-cash compensation rules to provide clarity on which standard applies and to address inconsistencies with Reg BI.

---

3 See Securities Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318 (July 12, 2019) (Final Rule; Regulation Best Interest: The Broker-Dealer Standard of Conduct) (the "Release").

4 See Release, 84 FR at 33318-33319.

5 See Release, 84 FR at 33400.

The changes would amend the FINRA suitability rule (Rule 2111) to state that it will not apply to recommendations subject to Reg BI, and to remove the element of control from the quantitative suitability obligation. In addition, the proposed rule change would conform the CAB suitability rule, CAB Rule 211, to the proposed amendments to Rule 2111, and would conform FINRA's rules governing non-cash compensation to Reg BI's limitations on sales contests, sales quotas, bonuses, and non-cash compensation.

As noted below, Reg BI addresses the same conduct that is addressed by Rule 2111, but employs a best interest, rather than a suitability, standard. Absent action by FINRA, a broker-dealer would be required to comply with both Reg BI and Rule 2111 regarding recommendations to retail customers. In such circumstances, FINRA believes that compliance with Reg BI would result in compliance with Rule 2111 because a broker-dealer that meets the best interest standard would necessarily meet the suitability standard. Accordingly, in order to reduce the potential for confusion, FINRA is proposing limiting the application of Rule 2111 to circumstances in which Reg BI does not apply. To do so, FINRA would add new paragraph .08 to the FINRA Rule 2111 Supplementary Material and new paragraph .03 to the CAB Rule 211 Supplementary Material that states that those rules shall not apply to recommendations subject to Reg BI.

Suitability

FINRA Rule 2111 requires that a broker-dealer "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile." The rule further explains that a "customer's investment profile

includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."[6]

Rule 2111 imposes three main suitability obligations: reasonable basis suitability, customer-specific suitability and quantitative suitability. Reasonable basis suitability requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. Customer-specific suitability requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile. Quantitative suitability requires a member or associated person who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile.[7]

Rule 2111(b) provides an exemption to customer-specific suitability for recommendations to institutional customers under specified circumstances. In order for this exemption to apply, three criteria must be satisfied. First, the account must meet the definition of institutional account as defined in FINRA Rule 4512(c).[8] Second, the

---

6 See FINRA Rule 2111(a).

7 See FINRA Rule 2111.05.

8 Rule 4512(c) defines "institutional account" to mean the account of: (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC or with a state

broker-dealer must have a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities. Third, the institutional customer must affirmatively indicate that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decision making authority to an agent, such as an investment adviser or a bank trust department, these factors are applied to the agent.[9]

Reg BI's "best interest" standard requires firms to satisfy four component obligations: Disclosure, Care, Conflict of Interest and Compliance. Reg BI's Care Obligation incorporates and enhances principles that are also found in Rule 2111. Two key enhancements are that Reg BI explicitly imposes a best interest standard and explicitly requires a consideration of costs. In addition, Reg BI places greater emphasis than the suitability rule on consideration of reasonably available alternatives.[10] Moreover, Reg BI explicitly applies to recommendations of types of accounts (e.g., broker-dealer or investment adviser, or among broker-dealer accounts, including

---

securities commission; or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

9 See FINRA Rule 2111(b).

10 See Release, 84 FR at 33381 ("It is our view that such a consideration [of reasonably available alternatives offered by the broker-dealer] is an inherent aspect of making a 'best interest' recommendation, and is a key enhancement over existing broker-dealer suitability obligations, which do not necessarily require such a comparative assessment among such alternatives").

recommendations of IRA rollovers). Reg BI also eliminates the "control" element of the quantitative suitability obligation.

In light of these enhancements and to provide clarity on which standard applies, FINRA proposes that its suitability rule state that it will not apply to recommendations subject to Reg BI.[11] FINRA does not propose to eliminate the suitability rule because it applies broadly to all recommendations to customers whereas Reg BI applies only to recommendations to "retail customers," which Reg BI defines as a natural person, or the legal representative of such natural person, who receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer and uses the recommendation primarily for personal, family, or household purposes.[12] Thus, FINRA's suitability rule is still needed for entities and institutions (e.g., pension funds), and natural persons who will not use recommendations primarily for personal, family, or household purposes (e.g., small business owners and charitable trusts).

In addition, the proposal would modify the quantitative suitability obligation under FINRA Rule 2111.05(c) to remove the element of control that currently must be proved to demonstrate a violation.[13] This change is consistent with Reg BI, which eliminates the control element from its Care obligation.

Finally, the proposed rule change would amend CAB Rule 211 to state that it will not apply to recommendations subject to Reg BI.[14]

---

11 See proposed FINRA Rule 2111.08.

12 See 17 CFR 240.15l-1(b)(1).

13 See proposed FINRA Rule 2111.05(c).

14 See proposed CAB Rule 211.03.

Non-Cash Compensation

FINRA Rules 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) each includes provisions restricting the payment and receipt of non-cash compensation in connection with the sale and distribution of securities governed by those rules. As a general matter, these rules limit non-cash compensation arrangements to:

- Gifts that do not exceed $100 in value and that are not preconditioned on the achievement of a sales target;
- An occasional meal, a ticket to a sporting event or the theater, or other comparable entertainment that does not raise any question of propriety and is not preconditioned on the achievement of a sales target;
- Payment or receipt by "offerors" (generally product sponsors and their affiliates) in connection with training or education meetings, subject to specified conditions, including that the payment of such compensation is not conditioned on achieving a sales target; and
- Internal non-cash compensation arrangements between a member and its associated persons, subject to specified conditions. If the internal non-cash compensation arrangement is in the form of a sales contest, the contest must be based on the total production of associated persons with

respect to all securities within the rule's product category, and credit for those sales must be equally weighted.[15]

Reg BI's Conflict of Interest Obligation requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to 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 time period.[16] As discussed above, FINRA's current non-cash compensation rules permit internal firm sales contests that may not meet this standard, since they permit contests based on sales of specific types of securities (such as mutual funds or variable annuities).

FINRA proposes to modify its rules governing non-cash compensation arrangements to specify that any non-cash compensation arrangement permitted by those rules must be consistent with the requirements of Reg BI. FINRA also proposes to eliminate provisions in Rules 2320 and 2341 that require internal non-cash compensation arrangements to be based on total production and equal weighting of securities sales.[17] Thus, firms generally would no longer be permitted to sponsor or maintain internal sales contests based on sales of securities within a product category within a limited time, even if they are based on total production and equal weighting. This requirement also would apply to the non-cash compensation provisions governing gifts, business entertainment

---

15 See FINRA Rules 2310(c), 2320(g), 2341(l)(5), and 5110(h). Rules 2310(c) and 5110(h) do not require internal non-cash compensation arrangements to be based on total production and equal weighting of securities sales.

16 See 17 CFR 240.15l-1(a)(2)(iii)(D).

17 See proposed amendments to FINRA Rules 2310(c), 2320(g), 2341(l)(5), and 5110(h).

and training or education meetings. As discussed above, these forms of non-cash compensation may not be preconditioned on achievement of a sales target. Nevertheless, FINRA believes that it must make clear that these provisions do not permit arrangements that conflict with Reg BI.

If the Commission approves the proposed rule change, FINRA will announce the approval of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be the compliance date of Reg BI.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[18] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed changes to FINRA's suitability rules will clarify when Reg BI versus the suitability rules apply, eliminating confusion and allowing firms to focus on compliance with the higher standards in Reg BI, when applicable. At the same time, the change will provide continued protection for customers that are not retail customers covered by Reg BI. Moreover, the removal of the element of control from the quantitative suitability obligation will align this standard with the corresponding quantitative component of the Care Obligation under Reg BI. Finally, the proposed amendments to FINRA's rules on non-cash compensation arrangements will eliminate any potential inconsistency with the requirements of Reg BI.

---

[18] 15 U.S.C. 78o–3(b)(6).

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. FINRA has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rulemaking, its potential economic impacts, including anticipated costs and benefits, and the alternatives FINRA considered in assessing how to best meet its regulatory objectives.

Economic Impact Assessment

Reg BI imposes new obligations on broker-dealers and associated persons. As such, FINRA is proposing to modify existing FINRA rules to better align them with the new obligations. The alignment of FINRA rules to Reg BI requirements is expected to provide greater protections to customers against investor abuse from firms and their associated persons. It also reduces uncertainty for firms about which standard applies, thus potentially avoiding unintentional rule violations and reducing compliance costs on the margin. The Economic Impact Assessment analyzes only the impacts directly attributable to the proposed rule change. The impacts attributable to Reg BI are assumed to have been evaluated by the SEC during the adoption process.

The proposed rule changes would better align the existing FINRA suitability rule with Reg BI's obligations. The proposed rule change would provide that the suitability rule does not apply to any recommendation that is subject to Reg BI. The benefits of this approach are that it would reduce regulatory uncertainty for firms and clarify to retail customers that Reg BI's "best interest" standard applies to recommendations they receive from their broker-dealer and its associated persons. FINRA does not believe that this

change will negatively impact firms in any material way, since in almost all cases, retail customer recommendations would be governed by Reg BI, making the application of the suitability rule in these contexts superfluous. Firms also would benefit by focusing their regulatory review of recommendations to retail customers solely on Reg BI, thus increasing the efficiency of such reviews.

The proposed rule change also would eliminate the control element from the quantitative suitability obligation in the suitability rule. This change is consistent with Reg BI, which similarly does not require a showing of control. FINRA had previously analyzed the economic impact of this change when it proposed it in Regulatory Notice 18-13. Potential economic impacts are even less significant at this time, as the SEC has since adopted Reg BI, which expressly excludes the control element and will now apply to a large portion of recommendations (i.e., recommendations to retail customers).

The proposed change is expected to provide greater protections to customers against investor abuse from firms and their associated persons. In cases where excessive trading is alleged, customers would benefit from the reduced burden on FINRA of not having to prove control while firms and associated persons engaged in excessive trading could experience a higher number of findings of violations. FINRA believes the proposed change would impose minimal, if any, additional compliance burdens on members because FINRA staff understands firms generally perform compliance reviews for excessive trading activity without consideration of whether a broker controls the account.

Lastly, the proposed rule change would align FINRA's non-cash compensation rules with Reg BI's Conflict of Interest Obligation. Reg BI requires broker-dealers to

establish, maintain and enforce written policies and procedures reasonably designed to 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 time period, whereas current FINRA non-cash compensation rules permit sales contests for specific types of securities. FINRA believes that this proposed rule change will benefit firms by eliminating regulatory uncertainty created by existing FINRA non-cash compensation rules. To the extent that sales contests and other non-cash compensation arrangements lead brokers to recommend suboptimal investments for customers, banning these practices may benefit customers. However, as for-profit entities, firms may be more limited in their ability to create incentives for their brokers to generate sales.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Comments were neither solicited nor received on this proposed rule change. However, in April 2018, FINRA published Regulatory Notice 18-13, soliciting comment on a proposal to remove the control element from the quantitative suitability obligation in FINRA Rule 2111, consistent with the then-proposed Reg BI. Eleven comments were received in response to the Notice. A copy of the Notice is attached as Exhibit 2a. Copies of the comment letters received in response to the Notice are attached as Exhibit 2c.[19]

Since the publication of Regulatory Notice 18-13, the SEC has adopted Reg BI, which applies to recommendations to retail customers as defined in Reg BI. With the

---

19 See Exhibit 2b for a list of abbreviations assigned to commenters.

proposed changes to FINRA Rule 2111.08, as discussed above, the suitability rule, including the quantitative suitability obligation, will no longer apply to recommendations to retail customers. As a result, the impact of the removal of the control element of the quantitative suitability obligation is significantly less than when originally proposed. Nevertheless, a majority of commenters to Regulatory Notice 18-13 indicated general support for the proposal to remove the control element from the quantitative suitability obligation of FINRA Rule 2111.[20] In general, these commenters expressed that the proposed rule change was a reasonable and effective approach to improving the rule,[21] and believe it would heighten investor protection.[22] Some commenters raised questions with particular aspects of the proposal or potential unintended consequences.[23] Several commenters were not supportive and raised concerns with the proposal.[24] Many of the comments have been rendered moot by the SEC's adoption of Reg BI or the concerns raised have become less relevant given that Reg BI is now the governing standard that applies to recommendations to retail customers. For example, while some commenters supported FINRA's proposal to remove the control element from the quantitative suitability obligation because it was consistent with the approach set forth in the proposed

---

20 See Cornell; FSI; NASAA; Pace; PIABA; SEC OIA.

21 See NASAA.

22 See Cornell; FSI; NASAA; Pace; PIABA.

23 See FSI; PIABA; SER.

24 See Cambridge; Capital Forensics; Keesal; SIFMA.

Reg BI,[25] several commenters indicated that FINRA's proposal was premature and that FINRA should await the outcome of the SEC's proposed rulemaking.[26] FINRA did hold off in filing with the Commission the rule change proposed in Regulatory Notice 18-13. With the final adoption of Reg BI, however, the time is ripe to finalize this change. As a result, for recommendations that remain subject to FINRA Rule 2111 (i.e., recommendations that are not covered by Reg BI), this aspect of the proposed rule change will enable FINRA to more effectively address instances of excessive trading by removing the element of control that currently must be proved to demonstrate a violation and will align this integral element of FINRA's suitability rule with corresponding provision of Reg BI.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in section 19(b)(2) of the Act.[27]

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

---

25 See FSI.

26 See Cambridge; Keesal; SIFMA.

27 15 U.S.C. 78s(b)(2).

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2a. Regulatory Notice 18-13 (April 2018).

Exhibit 2b. List of commenters.

Exhibit 2c. Comment letters received in response to Regulatory Notice 18-13 (April 2018).

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2020-007)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to FINRA's Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on , Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing amendments to FINRA Rules 2111 (Suitability), 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements), and Capital Acquisition Broker (CAB) Rule 211 (Suitability). The proposed rule change would: (1) amend the FINRA and CAB suitability rules to state that the rules do not apply to recommendations subject to

---

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

Regulation Best Interest ("Reg BI"),[3] and to remove the element of control from the quantitative suitability obligation; and (2) conform the rules governing non-cash compensation to Reg BI's limitations on sales contests, sales quotas, bonuses and non-cash compensation.

The text of the proposed rule change is available on FINRA's website at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background

On June 5, 2019, the SEC adopted Reg BI, a new rule under the Exchange Act, which establishes a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer (unless otherwise indicated, together referred to as "broker-dealer") when they make a recommendation to a retail customer of any securities

---

[3] 17 CFR 240.15l-1.

transaction or investment strategy involving securities.[4] The SEC stated that Reg BI will improve investor protection by enhancing the obligations that apply when a broker-dealer makes a recommendation to a retail customer, and reducing the potential harm to retail customers from conflicts of interest that may affect the recommendation.[5] The date by which broker-dealers must comply with Reg BI is June 30, 2020.[6]

FINRA proposes to amend the suitability and non-cash compensation rules to provide clarity on which standard applies and to address inconsistencies with Reg BI. The changes would amend the FINRA suitability rule (Rule 2111) to state that it will not apply to recommendations subject to Reg BI, and to remove the element of control from the quantitative suitability obligation. In addition, the proposed rule change would conform the CAB suitability rule, CAB Rule 211, to the proposed amendments to Rule 2111, and would conform FINRA's rules governing non-cash compensation to Reg BI's limitations on sales contests, sales quotas, bonuses, and non-cash compensation.

As noted below, Reg BI addresses the same conduct that is addressed by Rule 2111, but employs a best interest, rather than a suitability, standard. Absent action by FINRA, a broker-dealer would be required to comply with both Reg BI and Rule 2111 regarding recommendations to retail customers. In such circumstances, FINRA believes that compliance with Reg BI would result in compliance with Rule 2111 because a broker-dealer that meets the best interest standard would necessarily meet the suitability

---

4 See Securities Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318 (July 12, 2019) (Final Rule; Regulation Best Interest: The Broker-Dealer Standard of Conduct) (the "Release").

5 See Release, 84 FR at 33318-33319.

6 See Release, 84 FR at 33400.

standard. Accordingly, in order to reduce the potential for confusion, FINRA is proposing limiting the application of Rule 2111 to circumstances in which Reg BI does not apply. To do so, FINRA would add new paragraph .08 to the FINRA Rule 2111 Supplementary Material and new paragraph .03 to the CAB Rule 211 Supplementary Material that states that those rules shall not apply to recommendations subject to Reg BI.

Suitability

FINRA Rule 2111 requires that a broker-dealer "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile." The rule further explains that a "customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."[7]

Rule 2111 imposes three main suitability obligations: reasonable basis suitability, customer-specific suitability and quantitative suitability. Reasonable basis suitability requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. Customer-specific suitability requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile. Quantitative suitability requires a member

---

7 See FINRA Rule 2111(a).

or associated person who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile.[8]

Rule 2111(b) provides an exemption to customer-specific suitability for recommendations to institutional customers under specified circumstances. In order for this exemption to apply, three criteria must be satisfied. First, the account must meet the definition of institutional account as defined in FINRA Rule 4512(c).[9] Second, the broker-dealer must have a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities. Third, the institutional customer must affirmatively indicate that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decision making authority to an agent, such as an investment adviser or a bank trust department, these factors are applied to the agent.[10]

Reg BI's "best interest" standard requires firms to satisfy four component obligations: Disclosure, Care, Conflict of Interest and Compliance. Reg BI's Care

---

8 See FINRA Rule 2111.05.

9 Rule 4512(c) defines "institutional account" to mean the account of: (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC or with a state securities commission; or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

10 See FINRA Rule 2111(b).

Obligation incorporates and enhances principles that are also found in Rule 2111. Two key enhancements are that Reg BI explicitly imposes a best interest standard and explicitly requires a consideration of costs. In addition, Reg BI places greater emphasis than the suitability rule on consideration of reasonably available alternatives.[11] Moreover, Reg BI explicitly applies to recommendations of types of accounts (e.g., broker-dealer or investment adviser, or among broker-dealer accounts, including recommendations of IRA rollovers). Reg BI also eliminates the "control" element of the quantitative suitability obligation.

In light of these enhancements and to provide clarity on which standard applies, FINRA proposes that its suitability rule state that it will not apply to recommendations subject to Reg BI.[12] FINRA does not propose to eliminate the suitability rule because it applies broadly to all recommendations to customers whereas Reg BI applies only to recommendations to "retail customers," which Reg BI defines as a natural person, or the legal representative of such natural person, who receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer and uses the recommendation primarily for personal, family, or household purposes.[13] Thus, FINRA's suitability rule is still needed for entities and institutions (e.g., pension funds),

---

11 See Release, 84 FR at 33381 ("It is our view that such a consideration [of reasonably available alternatives offered by the broker-dealer] is an inherent aspect of making a 'best interest' recommendation, and is a key enhancement over existing broker-dealer suitability obligations, which do not necessarily require such a comparative assessment among such alternatives").

12 See proposed FINRA Rule 2111.08.

13 See 17 CFR 240.15l-1(b)(1).

and natural persons who will not use recommendations primarily for personal, family, or household purposes (e.g., small business owners and charitable trusts).

In addition, the proposal would modify the quantitative suitability obligation under FINRA Rule 2111.05(c) to remove the element of control that currently must be proved to demonstrate a violation.[14] This change is consistent with Reg BI, which eliminates the control element from its Care obligation.

Finally, the proposed rule change would amend CAB Rule 211 to state that it will not apply to recommendations subject to Reg BI.[15]

Non-Cash Compensation

FINRA Rules 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) each includes provisions restricting the payment and receipt of non-cash compensation in connection with the sale and distribution of securities governed by those rules. As a general matter, these rules limit non-cash compensation arrangements to:

- Gifts that do not exceed $100 in value and that are not preconditioned on the achievement of a sales target;
- An occasional meal, a ticket to a sporting event or the theater, or other comparable entertainment that does not raise any question of propriety and is not preconditioned on the achievement of a sales target;

---

14 See proposed FINRA Rule 2111.05(c).

15 See proposed CAB Rule 211.03.

- Payment or receipt by "offerors" (generally product sponsors and their affiliates) in connection with training or education meetings, subject to specified conditions, including that the payment of such compensation is not conditioned on achieving a sales target; and
- Internal non-cash compensation arrangements between a member and its associated persons, subject to specified conditions. If the internal non-cash compensation arrangement is in the form of a sales contest, the contest must be based on the total production of associated persons with respect to all securities within the rule's product category, and credit for those sales must be equally weighted.[16]

Reg BI's Conflict of Interest Obligation requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to 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 time period.[17] As discussed above, FINRA's current non-cash compensation rules permit internal firm sales contests that may not meet this standard, since they permit contests based on sales of specific types of securities (such as mutual funds or variable annuities).

FINRA proposes to modify its rules governing non-cash compensation arrangements to specify that any non-cash compensation arrangement permitted by those rules must be consistent with the requirements of Reg BI. FINRA also proposes to

---

16 See FINRA Rules 2310(c), 2320(g), 2341(l)(5), and 5110(h). Rules 2310(c) and 5110(h) do not require internal non-cash compensation arrangements to be based on total production and equal weighting of securities sales.

17 See 17 CFR 240.15l-1(a)(2)(iii)(D).

eliminate provisions in Rules 2320 and 2341 that require internal non-cash compensation arrangements to be based on total production and equal weighting of securities sales.[18] Thus, firms generally would no longer be permitted to sponsor or maintain internal sales contests based on sales of securities within a product category within a limited time, even if they are based on total production and equal weighting. This requirement also would apply to the non-cash compensation provisions governing gifts, business entertainment and training or education meetings. As discussed above, these forms of non-cash compensation may not be preconditioned on achievement of a sales target. Nevertheless, FINRA believes that it must make clear that these provisions do not permit arrangements that conflict with Reg BI.

If the Commission approves the proposed rule change, FINRA will announce the approval of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be the compliance date of Reg BI.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[19] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed changes to FINRA's suitability rules will clarify when Reg BI

---

18 See proposed amendments to FINRA Rules 2310(c), 2320(g), 2341(l)(5), and 5110(h).

19 15 U.S.C. 78o–3(b)(6).

versus the suitability rules apply, eliminating confusion and allowing firms to focus on compliance with the higher standards in Reg BI, when applicable. At the same time, the change will provide continued protection for customers that are not retail customers covered by Reg BI. Moreover, the removal of the element of control from the quantitative suitability obligation will align this standard with the corresponding quantitative component of the Care Obligation under Reg BI. Finally, the proposed amendments to FINRA's rules on non-cash compensation arrangements will eliminate any potential inconsistency with the requirements of Reg BI.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. FINRA has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rulemaking, its potential economic impacts, including anticipated costs and benefits, and the alternatives FINRA considered in assessing how to best meet its regulatory objectives.

Economic Impact Assessment

Reg BI imposes new obligations on broker-dealers and associated persons. As such, FINRA is proposing to modify existing FINRA rules to better align them with the new obligations. The alignment of FINRA rules to Reg BI requirements is expected to provide greater protections to customers against investor abuse from firms and their associated persons. It also reduces uncertainty for firms about which standard applies, thus potentially avoiding unintentional rule violations and reducing compliance costs on the margin. The Economic Impact Assessment analyzes only the impacts directly

attributable to the proposed rule change. The impacts attributable to Reg BI are assumed to have been evaluated by the SEC during the adoption process.

The proposed rule changes would better align the existing FINRA suitability rule with Reg BI's obligations. The proposed rule change would provide that the suitability rule does not apply to any recommendation that is subject to Reg BI. The benefits of this approach are that it would reduce regulatory uncertainty for firms and clarify to retail customers that Reg BI's "best interest" standard applies to recommendations they receive from their broker-dealer and its associated persons. FINRA does not believe that this change will negatively impact firms in any material way, since in almost all cases, retail customer recommendations would be governed by Reg BI, making the application of the suitability rule in these contexts superfluous. Firms also would benefit by focusing their regulatory review of recommendations to retail customers solely on Reg BI, thus increasing the efficiency of such reviews.

The proposed rule change also would eliminate the control element from the quantitative suitability obligation in the suitability rule. This change is consistent with Reg BI, which similarly does not require a showing of control. FINRA had previously analyzed the economic impact of this change when it proposed it in Regulatory Notice 18-13. Potential economic impacts are even less significant at this time, as the SEC has since adopted Reg BI, which expressly excludes the control element and will now apply to a large portion of recommendations (i.e., recommendations to retail customers).

The proposed change is expected to provide greater protections to customers against investor abuse from firms and their associated persons. In cases where excessive trading is alleged, customers would benefit from the reduced burden on FINRA of not

having to prove control while firms and associated persons engaged in excessive trading could experience a higher number of findings of violations. FINRA believes the proposed change would impose minimal, if any, additional compliance burdens on members because FINRA staff understands firms generally perform compliance reviews for excessive trading activity without consideration of whether a broker controls the account.

Lastly, the proposed rule change would align FINRA's non-cash compensation rules with Reg BI's Conflict of Interest Obligation. Reg BI requires broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed to 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 time period, whereas current FINRA non-cash compensation rules permit sales contests for specific types of securities. FINRA believes that this proposed rule change will benefit firms by eliminating regulatory uncertainty created by existing FINRA non-cash compensation rules. To the extent that sales contests and other non-cash compensation arrangements lead brokers to recommend suboptimal investments for customers, banning these practices may benefit customers. However, as for-profit entities, firms may be more limited in their ability to create incentives for their brokers to generate sales.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Comments were neither solicited nor received on this proposed rule change. However, in April 2018, FINRA published Regulatory Notice 18-13, soliciting comment on a proposal to remove the control element from the quantitative suitability obligation in

FINRA Rule 2111, consistent with the then-proposed Reg BI. Eleven comments were received in response to the Notice. A copy of the Notice is attached as Exhibit 2a. Copies of the comment letters received in response to the Notice are attached as Exhibit 2c.[20]

Since the publication of Regulatory Notice 18-13, the SEC has adopted Reg BI, which applies to recommendations to retail customers as defined in Reg BI. With the proposed changes to FINRA Rule 2111.08, as discussed above, the suitability rule, including the quantitative suitability obligation, will no longer apply to recommendations to retail customers. As a result, the impact of the removal of the control element of the quantitative suitability obligation is significantly less than when originally proposed. Nevertheless, a majority of commenters to Regulatory Notice 18-13 indicated general support for the proposal to remove the control element from the quantitative suitability obligation of FINRA Rule 2111.[21] In general, these commenters expressed that the proposed rule change was a reasonable and effective approach to improving the rule,[22] and believe it would heighten investor protection.[23] Some commenters raised questions with particular aspects of the proposal or potential unintended consequences.[24] Several commenters were not supportive and raised concerns with the proposal.[25] Many of the

---

20 See Exhibit 2b for a list of abbreviations assigned to commenters.

21 See Cornell; FSI; NASAA; Pace; PIABA; SEC OIA.

22 See NASAA.

23 See Cornell; FSI; NASAA; Pace; PIABA.

24 See FSI; PIABA; SER.

25 See Cambridge; Capital Forensics; Keesal; SIFMA.

comments have been rendered moot by the SEC's adoption of Reg BI or the concerns raised have become less relevant given that Reg BI is now the governing standard that applies to recommendations to retail customers. For example, while some commenters supported FINRA's proposal to remove the control element from the quantitative suitability obligation because it was consistent with the approach set forth in the proposed Reg BI,[26] several commenters indicated that FINRA's proposal was premature and that FINRA should await the outcome of the SEC's proposed rulemaking.[27] FINRA did hold off in filing with the Commission the rule change proposed in Regulatory Notice 18-13. With the final adoption of Reg BI, however, the time is ripe to finalize this change. As a result, for recommendations that remain subject to FINRA Rule 2111 (i.e., recommendations that are not covered by Reg BI), this aspect of the proposed rule change will enable FINRA to more effectively address instances of excessive trading by removing the element of control that currently must be proved to demonstrate a violation and will align this integral element of FINRA's suitability rule with corresponding provision of Reg BI.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

---

26 See FSI.

27 See Cambridge; Keesal; SIFMA.

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2020-007 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2020-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld

from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2020-007 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[28]

Jill M. Peterson
Assistant Secretary

---

28 17 CFR 200.30-3(a)(12).

EXHIBIT 5

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

FINRA RULES

* * * * *

2000. DUTIES AND CONFLICTS

* * * * *

2100. TRANSACTIONS WITH CUSTOMERS

2110. Recommendations

2111. Suitability

(a) through (b) No Change.

• • • Supplementary Material: ----------

.01 through .04 No Change.

.05 Components of Suitability Obligations. Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

(a) through (b) No Change.

(c) Quantitative suitability requires a member or associated person [who has actual or de facto control over a customer account] to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a). No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and

the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation.

.06 through .07 No Change.

.08 Regulation Best Interest. This Rule shall not apply to recommendations subject to SEA Rule 15l-1 ("Regulation Best Interest").

* * * * *

2300. SPECIAL PRODUCTS

2310. Direct Participation Programs

(a) through (b) No Change.

(c) Non-Cash Compensation

(1) No Change.

(2) Restriction on Non-Cash Compensation

In connection with the sale and distribution of direct participation program or REIT securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below [in this provision]. Non-cash compensation arrangements must be consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest") and are limited to the following:

(A) through (B) No Change.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target [or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (c)(2)(D)];

(ii) through (iii) No Change.

(iv) the payment or reimbursement by the offeror is not conditioned by the offeror on the achievement of a sales target [or any other non-cash compensation arrangement permitted by paragraph (c)(2)(D)].

(D) through (E) No Change.

(d) No Change.

2320. Variable Contracts of an Insurance Company

(a) through (f) No Change.

(g) Member Compensation

In connection with the sale and distribution of variable contracts:

(1) through (3) No Change.

(4) No member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided <u>below</u> [in this provision]. Notwithstanding the provisions of paragraph (g)(1), the following non-cash compensation arrangements are permitted <u>provided that they are consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest")</u>:

(A) through (B) No Change.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) No Change.

(ii) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by the member on the achievement of a sales target [or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (g)(4)(D)];

(iii) through (iv) No Change.

(v) the payment or reimbursement by the offeror is not preconditioned by the offeror on the achievement of a sales target [or any other non-cash compensation arrangement permitted by paragraph (g)(4)(D)].

(D) 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, provided that:

[(i) the member's or non-member'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;]

[(ii) the non-cash compensation arrangement requires that the credit received for each variable contract security is equally weighted;]

(i[ii]) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

([iv]ii) the record keeping requirement in paragraph (g)(3) is satisfied.

(E) No Change.

* * * * *

2341. Investment Company Securities

(a) through (k) No Change.

(l) Member Compensation

In connection with the sale and distribution of investment company securities:

(1) through (4) No Change.

(5) No member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided below [in this provision]. Notwithstanding the provisions of paragraph (l)(1), the following non-cash compensation arrangements are permitted provided that they are consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest"):

(A) through (B) No Change.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) No Change.

(ii) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by the member on the achievement of a sales target [or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (l)(5)(D)];

(iii) through (iv) No Change.

(v) the payment or reimbursement by the offeror is not preconditioned by the offeror on the achievement of a sales target [or any other non-cash compensation arrangement permitted by paragraph (l)(5)(D)].

(D) 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, provided that:

[(i) the member's or non-member's non-cash compensation arrangement**,** if it includes investment company securities, is based on the total production of associated persons with respect to all investment company securities distributed by the member];

[(ii) the non-cash compensation arrangement requires that the credit received for each investment company security is equally weighted;]

(i[ii]) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

([iv]ii) the recordkeeping requirement in paragraph (l)(3) is satisfied.

(E) No Change.

(m) through (n) No Change.

* * * * *

5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

5110. Corporate Financing Rule — Underwriting Terms and Arrangements

(a) through (g) No Change.

(h) Non-Cash Compensation

(1) No Change.

(2) Restrictions on Non-Cash Compensation

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash

compensation, except as provided below [in this provision]. Non-cash compensation arrangements must be consistent with the applicable requirements of SEA Rule 15l-1 ("Regulation Best Interest") and are limited to the following:

(A) through (B) No Change.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by the member on the achievement of a sales target [or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (h)(2)(D)];

(ii) through (iii) No Change.

(iv) the payment or reimbursement by the issuer or affiliate of the issuer is not conditioned by the issuer or an affiliate of the issuer on the achievement of a sales target [or any other non-cash compensation arrangement permitted by paragraph (h)(2)(D)].

(D) through (E) No Change.

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by paragraphs (h)(2)(C) through (E). The records shall include: the names of the offerors, non-members or other members 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 member and its associated persons with paragraphs (h)(2)(C) through (E).

(i) No Change.

* * * * *

CAPITAL ACQUISITION BROKER RULES

* * * * *

200. DUTIES AND CONFLICTS

* * * * *

211. Suitability

(a) through (b) No Change.

• • • Supplementary Material: ----------

.01 through .02 No Change.

.03 Regulation Best Interest. This Rule shall not apply to recommendations subject to SEA Rule 15l-1 ("Regulation Best Interest").

* * * * *

Regulatory Notice 20-08

Business Continuity Planning

Pandemic-Related Business Continuity Planning, Guidance and Regulatory Relief

March 9, 2020

Notice Type

- Guidance

Suggested Routing

- Compliance
- Executive Representative
- Finance
- Legal
- Operations
- Registration
- Regulatory Reporting
- Senior Management
- Systems

Key Topics

- Annual Audited Reports
- Business Continuity Plans
- Communicating with Customers
- Communicating with FINRA
- Continuing Education
- Emergency Contact Information
  Emergency Office Relocation
- FOCUS Reporting
- Form BR
- Form U4
- Military Personnel and National Guard
- Regulatory Filings and Inquiries
- Supervision

Referenced Rules & Notices

- Exchange Act Rule 15c3-3
- FINRA Rule 1210
- FINRA Rule 3110
- FINRA Rule 4370
- FINRA Rule 4524
- Regulatory Notice 09-59

Summary

Due to the recent outbreak of coronavirus disease (COVID-19), FINRA reminds member firms to consider pandemic-related business continuity planning, including whether their business continuity plans (BCPs) are sufficiently flexible to address a wide range of possible effects in the event of a pandemic in the United States. Each member firm is also encouraged to review its BCP to consider pandemic preparedness and to review its emergency contacts to ensure that FINRA has a reliable means of contacting the firm. This *Notice* also provides pandemic-related guidance and regulatory relief to member firms from some requirements. As coronavirus-related risks decrease, member firms should expect to return to meeting any regulatory obligations for which relief has been provided.

Questions regarding this *Notice* should be directed to:

- Bill Wollman, Executive Vice President, Head of Office of Financial and Operational Risk Policy, at (646) 315-8496 or *William.Wollman@finra.org*;
- Jeanette Wingler, Associate General Counsel, Office of General Counsel, at (202) 728-8013 or *jeanette.wingler@finra.org*; or
- the FINRA Call Center at (301) 590-6500.

Background and Discussion

Rule Requirements

Rule 4370 (Business Continuity Plans and Emergency Contact Information) requires a member firm to create, maintain, review at least annually and update upon any material change, a BCP identifying procedures relating to an emergency or significant business disruption. BCPs should be reasonably designed to enable a member firm to meet its existing obligations to customers and address existing relationships with other broker-dealers and counterparties. Each member firm needs to conduct its own risk analysis to determine where critical impact points and exposures exist within the firm and with its counterparties and suppliers.

Each member firm has flexibility to tailor its BCP to the size and needs of its business, provided that the BCP addresses the enumerated minimum elements set forth in Rule 4370 to the extent applicable and necessary to the firm's business.[1] Provided the enumerated minimum elements are met, FINRA recognizes that the scope and complexity of BCPs are likely to vary based on member firm size and business model.[2]

Rule 4370 also requires each firm to provide (and promptly update upon any material change) to FINRA via electronic process or other means as FINRA may specify, prescribed emergency contact information, including the designation of two emergency contact persons, both of whom must be associated persons. Member firms may register and update their emergency contact persons through the FINRA Contact System (FCS). Visit FINRA's FCS webpage to access the system.

This requirement is intended to ensure that FINRA has a reliable means of contacting each member firm in the event of an emergency. One contact must be a member of senior management and a registered principal of the member firm and the second contact, if not a registered principal, must be a member of senior management who has knowledge of the firm's business operations. For a firm that has only one associated person (*e.g.*, a sole proprietorship without any other associated persons), the second emergency contact person may be an individual, either registered with another firm or nonregistered, who has knowledge of the member firm's business operations, such as the firm's attorney, accountant or clearing firm contact.

Member Firms are Encouraged to Review their BCPs to Consider Pandemic Preparedness

A pandemic occurs when there is a widespread disease outbreak. While a pandemic may vary in severity and duration, it may present significant financial or operational risks for a member firm for its duration and beyond. A member firm may conduct its own analysis to determine whether a pandemic or any other event constitutes an emergency or significant business disruption for the firm and, thereby, causes the firm to activate its BCP.

Member firms are encouraged to review their BCPs to consider pandemic preparedness, including whether the BCPs are sufficiently flexible to address a wide range of possible effects in the event of a pandemic in the United States. These effects may include staff absenteeism, use of remote offices or telework arrangements, travel or transportation limitations and technology interruptions or slowdowns.

Member firms are encouraged to contact their assigned FINRA Risk Monitoring Analyst to discuss the activation and implementation of their BCPs, as well as to discuss any issues they may be facing, including the disruption of business operations, and whether disruptions are solved or ongoing.

FINRA previously provided guidance on pandemic preparedness in *Regulatory Notice 09-59*.[3] FINRA has had discussions with member firms regarding the present challenges related to COVID-19. Recognizing that health and safety is of paramount importance and that updated guidance and relief may be appropriate given the potential effects of coronavirus in the United States, updated pandemic-related guidance and regulatory relief to member firms from some requirements is below. This *Notice* does not create new rules or obligations on member firms, nor does the regulatory relief provided extend beyond the identified FINRA rules and requirements. Depending on the nature and impact of the COVID-19 outbreak, FINRA may provide additional, specific regulatory relief and guidance.

As coronavirus-related risks decrease, member firms should expect to return to meeting any regulatory obligations for which relief has been provided. When appropriate, FINRA will publish a *Regulatory Notice* announcing a termination date for the regulatory relief that will provide member firms with time to make necessary operational adjustments.

Remote Offices or Telework Arrangements

In an effort to mitigate the impacts of a pandemic, a member firm may consider employing methods such as social distancing, travel restrictions, revised sick leave policies, special pandemic leave time, or specialized seating plans for densely populated floors or buildings.[4] These methods may also involve remote offices or telework arrangements (*e.g.,* working from home or a backup or recovery location) for a broad range of employees.

FINRA understands that the use of remote offices or telework arrangements during a pandemic may necessitate a member firm to implement other ways to supervise its associated persons who change their work locations or arrangements for the duration of the pandemic. In such cases, FINRA would expect a member firm to establish and maintain a supervisory system that is reasonably designed to supervise the activities of each associated person while working from an alternative or remote location during the pandemic. With respect to oversight obligations, a member firm's scheduled on-site inspections of branch offices may need to be temporarily postponed during the pandemic, with FINRA understanding that the ability to complete this annual regulatory obligation in 2020 may need to be re-evaluated depending on the duration and severity of the pandemic.

In addition, a member firm may find it helpful to test broad use of remote offices or telework arrangements by associated persons **prior** to activating its BCP, including regarding the ability to connect to critical firm systems, the adequacy of remote connectivity via residential internet access networks and any potential need to secure premium or dedicated service for connectivity.

Cybersecurity

Member firms should consider the increased risk of cyber events (*e.g.,* systems being compromised through phishing attacks) as part of pandemic-related preparedness. The risk of cyber events may be increased due to use of remote offices or telework arrangements, heightened anxiety among associated persons and confusion about the virus. While member firms are understandably focused on business resiliency and health and safety of individuals, it is important that member firms remain vigilant in their surveillance against cyber threats and take steps to reduce the risk of cyber events. These steps may include: (1) ensuring that virtual private networks (VPN) and other remote access systems are properly patched with available security updates; (2) checking that system entitlements are current; (3) employing the use of multi-factor authentication for associated persons who access systems remotely; and (4) reminding associated persons of cyber risks through education and other exercises that promote heightened vigilance.

Form U4/Form BR

FINRA is temporarily suspending the requirement to maintain updated Form U4 information regarding office of employment address for registered persons who temporarily relocate due to COVID-19. In addition, member firms are not required to submit branch office applications on Form BR for any newly opened temporary office locations or space-sharing arrangements established as a result of recent events.

Emergency Office Relocations

If a member firm relocates personnel to a temporary location that is not currently registered as a branch office or identified as a regular non-branch location, the firm should use its best efforts to provide written notification to its FINRA Risk Monitoring Analyst as soon as possible after establishing a new temporary office or space-sharing arrangement, to include at a minimum the office address, the names of each member firm involved, the names of registered personnel, a contact telephone number and, if possible, the expected duration. The notification should also indicate whether the member firm's personnel will be sharing space with another entity, and if so, the type of business in which it is engaged (*e.g.,* an affiliated investment adviser or an organization in the securities business). FINRA reminds member firms that while a pandemic may create exigent circumstances that result in emergency relocations, firms should take into account the risks associated with sharing office space with another entity (*e.g.,* customer privacy, information security or recordkeeping considerations) and take steps to mitigate the risks during the emergency relocation.

In addition, in instances where a non-branch location or branch office has been relocated, or customer calls are being rerouted to another office, member firms must exercise diligence in validating the identity of the customer (*e.g.,* when accepting orders and request for disbursement of funds) as well as provide heightened supervision of the affected customer accounts.

Communicating With Customers

FINRA understands that member firms may experience significantly increased customer call volumes or online account usage during a pandemic (*e.g.,* due to significant market movements), which may cause temporary operational challenges. Member firms are encouraged to review their BCPs regarding communicating with customers and ensuring customer access to funds and securities during a significant business disruption.

If registered representatives are unavailable to service their customers, member firms are encouraged to promptly place a notice on their websites indicating to affected customers who they may contact concerning the execution of trades, their accounts, and access to funds or securities. Supervisory control policies and procedures should be considered that will mitigate risks that may arise due to the reduced ability to communicate with customers, inability to rely on mail or other disruption to the existing controls over communications with customers.

Communicating With FINRA

As discussed above, member firms are required to provide FINRA with emergency contact information pursuant to Rule 4370. Member firms are encouraged to review their emergency contacts to ensure that FINRA has a reliable means of contacting each member.

If a member firm or another person is unable to contact FINRA through its usual contact due to a pandemic or other significant business disruption, please call FINRA's Call Center at (301) 590-6500. This number will be rerouted in the event of a business disruption at FINRA's primary call center, so that the member firm or associated person will be able to reach an operator or receive recorded instructions.

Regulatory Filings and Responses to FINRA Inquiries, Matters and Investigations

In the event of a pandemic, member firms may have difficulty making timely regulatory filings (e.g., FOCUS filings, Form Custody filings and supplemental FOCUS information pursuant to FINRA Rule 4524 (Supplemental FOCUS Information)) and responding to regulatory inquiries or investigations. Member firms that require extra time to respond to open inquiries, investigations or upcoming filings should contact their Risk Monitoring Analysts or the relevant FINRA department to seek extensions.[5] FINRA may waive any late fees incurred by a member firm based on the member firm's particular circumstance. In addition, if any data communications are disrupted, member firms should retain the relevant data until it can be transmitted to FINRA.

In considering regulatory filing requirements, member firms are reminded of the requirements in Rule 15c3-3 under the Securities Exchange Act of 1934 (Exchange Act) regarding reserve formula computations and required deposits that are intended to protect customer funds and securities.[6]

Qualification Examinations and Regulatory Element Continuing Education

Any affected person who has a qualifications examination or continuing education window that is due to expire is encouraged to contact FINRA regarding an extension. Please contact FINRA's Call Center at (301) 590-6500 with any questions or if you require additional information.

Military Personnel and National Guard

The declaration of an emergency in a specified area due to COVID-19 may result in some persons volunteering or being called into active military duty. FINRA Rule 1210 (Registration Requirements) provides specific relief to persons registered with FINRA who volunteer or are called into active military duty.[7] For information on providing the required notification to FINRA, visit FINRA's Active Military Leave Guidance webpage.

Endnotes

1. Rule 4370(c) requires that each BCP, must at a minimum, address: (1) data back-up and recovery (hard copy and electronic); (2) all mission critical systems; (3) financial and operational assessments; (4) alternate communications between customers and the member; (5) alternate communications between the member and its employees; (6) alternate physical location of employees; (7) critical business constituent, bank, and counter-party impact; (8) regulatory reporting; (9) communications with regulators; and (10) how the member will assure customers' prompt access to their funds and securities in the event that the member determines that it is unable to continue its business.

2. FINRA has provided a Small Firm Business Continuity Plan Template as an optional tool to aid small firms.

3. *See also* FAQs 16 and 18 in the FINRA Business Continuity Planning FAQs.

4. Additional information from the Centers for Disease Controls (CDC) on strategies for businesses and employers to plan for and respond to COVID-19 is available on the CDC's website.

5. For information on requesting extensions of the requirement to file an Annual Audited Report no later than 60 calendar days after the date of a member firm's fiscal year end, visit FINRA's Annual Audit Extension of Time Request Policy webpage.

6. Exchange Act Rule 15c3-3(e)(3) requires a broker-dealer to prepare the reserve formula computations, necessary to determine the amount required to be deposited as specified in Rule 15c3-3(e)(1), to be made weekly, as of the close of the last business day of the week, and the deposit so computed to be made no later than one hour after the opening of banking business on the second following business day.

7. Under Supplementary Material .10 to Rule 1210, these persons would be placed in a specially designated "inactive" status once FINRA is notified of their military call-up, but would remain registered for FINRA purposes.

©2020. FINRA. All rights reserved. Regulatory Notices attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.