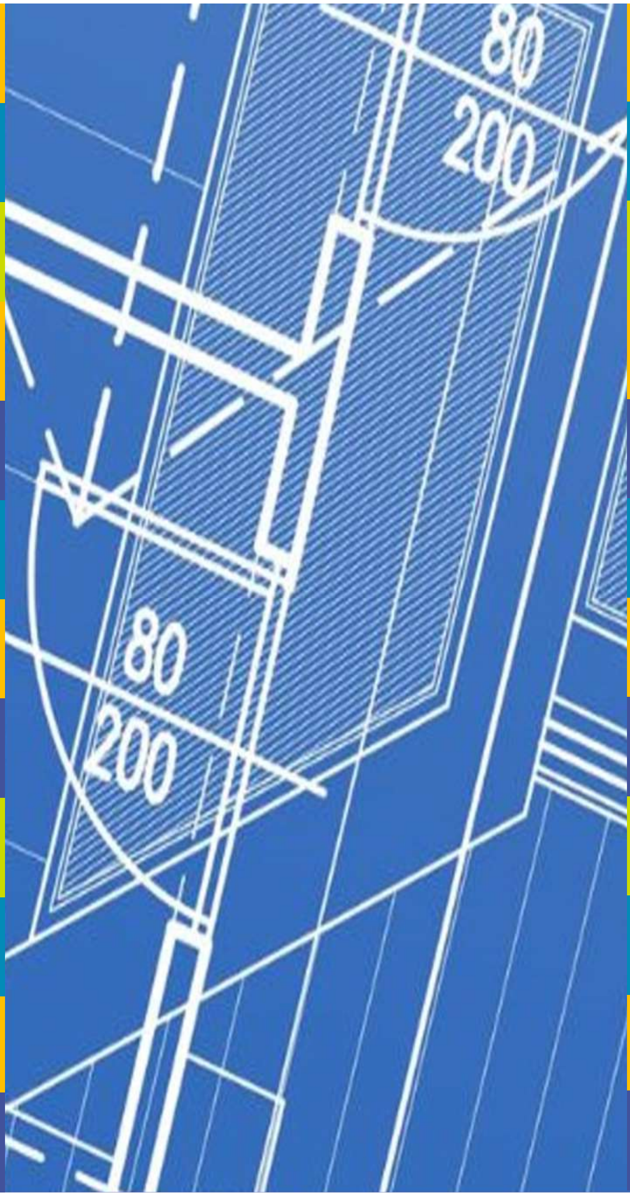
cefli

# 2024 CFTC

# Suitability/Best Interest/Fiduciary Obligations –Evolving State & Federal Sales Standards

#strongfoundation #cftc24



# Faculty

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# AGENDA

- How we got here
- Where are we
- Where are we headed

# How We Got Here

# Suitability –The Early Years

Concerns about inappropriate annuity sales practices came to light in the early 2000s

Federal suitability standards

- FINRA Rule 2111 (originally NASD Rule 2021)

Early state regulatory focus

- Initially aimed at both life and annuity products; evolved to strictly annuities
- 2006 original NAIC model suitability regulation
- Aimed at individuals age 65+

# Suitability –Evolution

Concerns continue to exist

NAIC Suitability In Annuity Transaction Model Regulation

- 2010 revision -applies to all annuity transactions
- Insurance companies responsible for sales activity
- Insurance companies must supervise annuity sales
- Required enhanced producer education

# Department of Labor Involvement

Fiduciary rule proposed in April 2015

- ✓ Creation of "fiduciary" standard of care
- ✓ Trouble for the insurance industry
- ✓ Commission-based sales are a "conflict of interest" under a "fiduciary" standard
- ✓ NAIC re-looks at its Model Suitability Regulation
- ✓ How to make it work in a "fiduciary" world

DOL's Fiduciary Rule vacated by Fifth Circuit court June 2018

Back to the drawing board?

# SEC Regulation Best Interest (REG BI)

Adopted June 5, 2019

*Designed to enhance quality and transparency of retail sales of securities*

Ensure sales and actions are the “best interest” of a consumer

*Required disclosure of conflicts and a description of the products and services being provided (Form CRS)*

# NAIC Redux –What About BI?

Shift of focus from *"suitability" to "best interest"*

- Threw out work being done to shift to a fiduciary standard after Fifth Circuit ruling
- Started over with an eye toward compatibility with SEC Reg BI
- Adopted revised Suitability In Annuity Transaction Model Regulation in 2020
- Incorporates "best interest" standard applicable to the sale of annuity products
- Still called "suitability" while incorporating "best interest" as the standard

# ADOPTIONS

**Adoptions**

As of 04/01/24, 45 states have adopted the Revised Model Regulation, representing +/- 90% of the U.S. population

**Proposed**

Louisiana

Missouri

Nevada

**California**

Let's talk about California

# WHERE ARE WE

# A Patchwork of Requirements

Applicable standards of care depend on:

- The product sold
- The entity or individual selling it
- The state of issuance (or solicitation), and
- Funding sources

Multiple, unrelated entities may have obligations related to the same recommended transaction

# FINRA Requirements

FINRA broker-dealers and their registered representatives are subject to suitability standards for sales of variable life insurance and annuity products to retail investors

These requirements now apply in varying degrees due to SEC Reg BI

*FINRA Rule 2090 (Know Your Customer- KYC)*

Requires that a broker-dealer make reasonable efforts to know essential facts about each customer

The rule applies to all customers of a broker-dealer

# FINRA Requirements

FINRA Rule 2111 (Suitability). Requires that a broker-dealer or registered representative "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security, or securities, is suitable for the customer [...]"

The rule applies to institutional investors only now, due to Reg BI

FINRA Rule 2330 (Variable Annuities). Defines additional, product-specific requirements for broker-dealers and registered representatives to consider when recommending a variable annuity

This is in addition to Reg BI requirements

# SEC Regulation Best Interest

- FINRA-registered broker-dealers were subject to suitability standards
- SEC-registered investment advisers were subject to fiduciary standards
- The SEC issued Regulation Best Interest to establish a uniform sales standard applicable to registered representatives of broker-dealers as well as investment adviser representatives

# SEC Regulation Best Interest

*"Regulation Best Interest codifies the fundamental principle that investment professionals should not put their interests ahead of the interests of their clients and customers."*

-Former SEC Chairman Jay Clayton

# SEC Regulation Best Interest

**Four primary obligations**

1) Disclosure obligation
2) Care obligation
3) Conflict of Interest obligation
4) Compliance obligation

**Effective date** June 30, 2020

Compliance with requirements is a top SEC exam priority

# SEC Regulation Best Interest

CEFLI maintains information and resources on the additional resources page of its website, including:

- ★ Links to SEC content regarding Reg BI
- ★ Links to SEC content regarding SEC Form CRS
- ★ Executive summary of SEC Reg BI & Form CRS roundtable

# SEC Regulation Best Interest

How does this impact insurers?

- Applies to securities recommendations to retail investors
- This could include variable annuity, registered annuity, and variable life recommendations
- Focus is on the broker-dealer or registered investment advisor making the recommendation

# NAIC Suitability Model

The 2020 version of NAIC Suitability In Annuity Transactions Model Regulation establishes a “best interest” standard for any sale or recommendation of an annuity (with certain exceptions noted in the model)

*Revisions made in 2020 represent an effort by the NAIC to follow the core elements of the SEC’s Regulation Best Interest*

45 states have adopted the 2020 Model, while others are operating under a prior (suitability) version, no version at all, or state-specific regulations

# NAIC Suitability Model

The 2020 version sets requirements for agents (who may also be registered representatives or advisors) and insurers

Agents are subject to obligations similar to Reg BI:

- Disclosure obligation
- Care obligation
- Conflict of Interest obligation
- Documentation obligation

Insurers must implement a supervisory system to ensure compliance

# New York Regulation 187

New York maintains a different legal and regulatory structure when compared to other states

The New York Department of Financial Services (NYDFS) did not adopt the NAIC Suitability in Annuity Transactions Model Regulation

NYDFS Regulation 187 applies a "best interest" standard to annuities and life insurance products

- The regulation was the first state insurance department "best interest" standard
- The regulation was the first "best interest" standard to apply to life insurance product sales

# DOL Fiduciary Rule

After several attempts at establishing a fiduciary rule, numerous legal challenges, and a court vacatur, the DOL issued a final Fiduciary Rule.  The rule, entitled “Improving Investment Advice for Workers & Retirees”, became effective February 16, 2021, with enforcement delayed until December 20, 2021.

With the final rule, the DOL reinstated its five-part definition of an investment advice fiduciary and established a new “prohibited transaction exemption.”  To receive compensation for what would otherwise be a “prohibited transaction,” financial Institutions must comply with a number of requirements.

# DOL Fiduciary Rule

Requirements:

- Impartial conduct standards
- Disclosure, including acknowledgment of fiduciary status
- Policies and procedures
- Retrospective review

The industry awaits additional rulemaking guidance related to the DOL's enforcement of its Fiduciary Rule

On March 8th, the Department of Labor sent its Fiduciary Rule proposal to the Office of Management and Budget (OMB)

While OMB reviews can take up to 90 days, industry experts have speculated the rule may be finalized by year-end with a January 1, 2025 effective date

# WHERE ARE WE HEADED

# Structure of an Effective Compliance Program

## Considerations

Carefully review current insurance Model Regulation

*If you sell in NY- review Reg 187 and Reg 60*

Consider your distribution partners' regulatory responsibilities

*Broker-Dealers, other insurers, IMOs, Investment Advisors?*

Are you going to delegate any obligations to a third party?

Contemplate your company's organizational size/structure to assess the who/what/where for addressing regulatory obligations with an eye toward perceived conflicts

# Key Elements of the Program

**Key Elements of the Program:**

- ✓ Informing producers of regulatory obligations
- ✓ Producer training
- ✓ Informing consumers
- ✓ Reviewing recommendations prior to issuance
- ✓ Detecting unsuitable sales
- ✓ Reporting to senior management

# Information & Training Producers

**Consider the following:**

- Do you publish your annuity sales guidelines on a producer-accessible site?
- Can producers access training or FAQs on-demand?
- How often do you review/update?  What are triggers to do so?
- Producer training

# Information & Training Producers

**Consider the following:**

- Track producer activity- are there trends for certain producers or partners?
- Information for producers where you commence relationship– should they attest?
- Regular program communications to producers– maybe use an existing newsletter?
- If you have wholesalers– do you have an oversight program for their activity related to annuity sales?

# Information & Training Producers

**Consider the following:**

- Review wholesaler presentations
- Audit or attend certain wholesaler presentations
- Formal Producer Training Document (internal facing)
- Include suitability/best interest requirements in annuity product training courses
- Review production trends (and complaints) to determine if producers may need further training

# CONSUMER DISCLOSURES & FEEDBACK

**Consider the following:**

- Promote use of consumer-facing education materials
- Including with delivery a short high-level summary of the product
- Consumer surveys
- Use internal resources or external
- Via phone, email or survey (LIMRA?)

# Reviewing Recommendations

**Prior to issuance, consider the following if delegating to a Third Party:**

- Get copies of guidelines/procedures for review as part of due diligence process (before signing agreement)
- Annuity certification process using CEFLI–Standardized forms
- Regularly sample third party files to verify compliance (risk-based and random)

# Reviewing Recommendations

**Prior to issuance, consider the following if performing the review internally:**

- Where review team sits within the organization and team lead
  - CCO, chief supervision officer? Band level?
- Review forms– maybe allow for more information to help assess and defend?
- Hard and soft flags based in part of Model language and 2330
  - Concentration, liquidity limits, age limits, etc.
  - Formal approval if flags tripped?
- Supervision help desk?

# Reporting to Senior Management

## Annual Suitability Report

The Annual Suitability Compliance Report should provide leadership with a snapshot of the program and summarization as to why the program remains well-designed

Length: 3-5 pages likely light; 30+ pages likely excessive; but will vary by company and program (e.g., if supervision is delegated it may be a shorter report)

# Reporting to Senior Management

**Annual Suitability Report**

- Status update and details on the reviews conducted and recommended changes to program
- Results from complaint tracking reports (and corrective actions taken)
- Results from testing
- Report on FINRA firm annual certification process
- Reports on state or federal exams or audits applicable to the suitability program

# Detecting Unsuitable Sales

**You should be tracking complaints, customer questions, early surrender rates, etc.**

- ✓ Think about MCAS data points regulators will review
- ✓ Recognize that MAWG continues to monitor the marketplace & will contact companies as they deem appropriate
- ✓ Anticipate future market conduct exams focused on validating the industry's compliance with the revised Model Regulation

# FUTURE TRENDS & CONSIDERATIONS

Where will we be in 3-5 years?

Regulatory requirements/expectations will only grow!

The questions are:

- How much?
- Timeline (economy changes, political changes, news articles, new industry entrants, Insurtech)?

# QUESTIONS?

# Break

# 10:30 – 10:45