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Comments are being requested on this draft document by Oct. 2, 2020. Comments should be sent only by email to Jolie Matthews at [jmatthews@naic.org](mailto:jmatthews@naic.org).

## ***SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION (#275)***

### **BEST INTEREST STANDARD OF CONDUCT REVISIONS**

#### ***FREQUENTLY ASKED QUESTIONS***

This Frequently Asked Questions (FAQ) document is intended to specifically address those questions that are likely to arise as the states work to adopt the revised *Suitability in Annuity Transactions Model Regulation (#275)* and to assist in the uniform implementation and enforcement of its provisions across all NAIC member jurisdictions. No provision of this FAQ document is intended to supersede the specific language in Model #275.

This FAQ document is offered to any state that chooses to use it. It is not intended to expand the content of the model regulation but provides interpretive guidance regarding certain aspects of its provisions.

#### **GENERAL**

##### **Q1. Why did the NAIC decide to revise the model to include a best interest standard of conduct?**

A1. The revised model was developed, in part, in response to the U.S. Department of Labor's (DOL) fiduciary rule, which was finalized in April 2016 but vacated in its entirety in March 2018. The DOL fiduciary rule would have expanded the scope of who is considered a fiduciary to federal Employee Retirement Income Security Act of 1974 (ERISA) retirement plans and individual retirement accounts (IRAs) to include a broader set of insurance agents, insurance brokers and insurers. Separately, the U.S. Securities and Exchange Commission (SEC) released a proposed rule package in May 2018, which included Regulation Best Interest (Reg BI). The SEC finalized Reg BI in June 2019. The final Reg BI establishes a best interest standard of conduct for broker-dealers beyond the existing suitability obligation that applies to federally registered variable annuities. Recognizing the SEC's and the DOL's role in the regulatory landscape and believing that consumers are better protected when, to the extent possible, there is harmonization of the regulations enforced by the states, the SEC and the DOL, the NAIC revised the model to establish a framework for an enhanced standard of conduct that is more than the model's current suitability standard but not a fiduciary standard.

##### **Q2. How does the Harkin amendment, Section 989J of the Dodd-Frank Act apply to the revised model?**

A2. Section 989J confirms state authority to regulate the sale of fixed indexed annuities and exemption from federal securities regulation when certain conditions are met, including when the state in which the contract is issued or the state in which the insurer issuing the contract is domiciled: 1) has adopted requirements that "substantially meet or exceed the minimum requirements" established by the 2010 version of the NAIC's *Suitability in Annuity Transactions Model Regulation (#275)*; and 2) "adopts rules that substantially meet or exceed the minimum requirements of any **successor modifications** to the model regulation[]" within 5 years of the adoption by the NAIC. The only exception to this requirement is if the product is issued by an insurance company that adopts and implements practices on a nationwide basis that meet or exceed the minimum requirements established by the NAIC's Model #275, "and **any successor thereto**," and is therefore subject to examination by the State of domicile or by any other State where the insurance company conducts sales of such products.

The NAIC considers the 2020 revisions to be a successor modification to the model that exceeds the requirements of the 2010 revisions, which is reflected in a drafting note to Section 1—Purpose:

“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.” 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.”

As such, states need to work toward adopting the 2020 revisions within 5 years after its adoption by the full NAIC membership in February 2020 to maintain their authority to regulate the sale of fixed annuities.

## **EXEMPTIONS**

**Q3. What is the intent of the exemption to the revised model’s provisions under Section 4A to allow a consumer in response to a direct response solicitation to purchase an annuity product where no recommendation is made based on information collected from the consumer?**

A3. This exception from the rule was in the 2010 model rule and was not changed in the 2020 version. A direct-response solicitation is a solicitation through a sponsoring or endorsing entity solely through mails, the Internet, a digital platform, or other mass communication media that does not involve a communication directed to a specific individual by a natural person, or by a simulated human voice.

## **BEST INTEREST STANDARD OF CONDUCT**

**Q4. What is the best interest standard of conduct and how would a producer or insurer satisfy it?**

A4. To satisfy the best interest obligation, a producer or an insurer must satisfy the four obligations: 1) care; 2) disclosure; 3) conflict of interest; and 4) documentation.

To satisfy the four obligations, when making a recommendation, producers must:

- Know the consumer’s financial situation, insurance needs and financial objectives;
- Understand the available recommendation options;
- Have a reasonable basis to believe the recommended option effectively addresses the consumer’s financial situation, insurance needs and financial objectives;
- Communicate the basis of the recommendation to the consumer;
- Disclose their role in the transaction, their compensation, and any material conflicts of interest; and
- Document, in writing, any recommendation and the justification for such recommendation.

**Q5. What types of recommendations fall under the best interest standard of conduct?**

A5. All recommendations made by a producer or insurer to purchase, exchange or replace an annuity product must comply with the best interest standard of conduct. Specifically, as defined in Section 5M, a “recommendation” is 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. A 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.

**Q6. Does the best interest standard of conduct apply to a producer who never meets the client, but assists a producer in making a recommendation to the client?**

A6. Yes, under Section 6A(5), a 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.

### **CARE OBLIGATION**

**Q7. What is the intent of language in Section 6A(1)(c), which states “Producers shall be held to standards applicable to producers with similar authority and licensure?”**

A7. The intent of this language is to help to ensure that in any compliance or enforcement action, a producer’s recommendation is compared only to other producers as opposed to being compared to investment advisers or possibly higher-level fiduciaries, such as trust officers or plan sponsors under the federal Employee Retirement Income Security Act of 1974 (ERISA) for compliance and enforcement purposes.

### **DISCLOSURE OBLIGATION**

**Q8. To satisfy the disclosure obligation, Section 6A(2)(a) requires a producer to provide the completed “Insurance Agent (Producer) Disclosure for Annuities” form in Appendix A prior to a recommendation, can a producer provide the form at the initial client meeting? Is the producer required to update the form and provide it again or can the producer provide it once and satisfy this obligation?**

A8. Yes, a producer can satisfy the disclosure obligation by providing a completed form during the initial client meeting. However, if, after the completed form is provided to the client, the information on the completed form becomes out-of-date prior to a recommendation, the producer is expected to provide the consumer with an updated form.

### **CONFLICT OF INTEREST OBLIGATION**

**Q9. As defined in Section 5I(2), a material conflict of interest does not include cash compensation or non-cash compensation, what other type of financial interest would be considered a material conflict of interest? Is it only an ownership interest as referenced in Section 6A(3)?**

A9. A producer who is also dually registered as an investment advisor under state securities law is required under Section 6A(3) to reasonably manage and disclose the related conflicts of interest. This management must commence when the producer first meets with a potential customer even before the dually licensed producer knows the ultimate capacity in which the producer will be acting. The actual capacity when the producer executes a specific transaction may not be known early in the relationship and the related professional or contractual obligations may not be determined based upon the specific facts and circumstances and the consumer profile information until later in the relationship, thus creating a conflict of interest for the producer. The dually licensed producer should assume that both Model #275 and the Investment Advisers Act apply, and that the producer must manage and disclose the conflict of interest.

**Q10. Under Section 6A(3), to satisfy the conflict of interest obligation, what must a producer do to identify and avoid or reasonably manage a material conflict of interest? Examples?**

A10. The differences in professional and contractual obligations between a producer acting in the consumer's best interest at the time of the transaction and an investment advisor acting in the consumer's best interest over the term of a professional advisory contract are substantial. Managing this conflict of interest will require more than simple disclosure. The dually licensed producer must ensure that the customer has a timely comprehension of the producer's varied interests in the relationship decisions and the producer must ultimately and before making a recommendation have a reasonable basis to believe the producer's recommended professional relationship or

capacity along with any related annuity recommendation effectively addresses the consumer's financial situation, insurance needs and financial objectives.

## **SUPERVISION SYSTEM**

**Q11. Do these revisions require insurers to set up new supervision systems to ensure producer compliance with this new standard of conduct?**

A11. No, but the revisions do add additional insurer supervision requirements by requiring insurers to establish and maintain reasonable procedures in three additional areas:

- To assess whether a producer has provided to the consumer the information required by the revised model.
- To identify and address suspicious consumer refusals to provide consumer profile information.
- 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.

**Q12. Section 6C(2)(h) requires an insurer as part of its supervision system to identify and eliminate sales contests, quotas, bonuses, and non-cash compensation based on the sale of specific annuities within a limited period of time. What type of business practices is provision intended to address?**

A12. The requirements of Section 6C(2)(h) are not intended to prohibit general incentives regarding sales of an insurance company's products where there is no emphasis on a particular product. As the provisions states, insurer business practices involving sales contests, quotas, bonuses and non-cash compensation based on the sale of a specific annuity or annuities within a specified or limited period of time are prohibited and should be identified and eliminated.

## **TRAINING**

**Q13. Do producers complete additional training on the new standard of conduct even if they have already completed the existing annuity training requirements?**

A13. Yes, Section 7 requires a producer who has already completed the existing annuity training requirements prior to a state's effective date of the revised model to complete within 6 months of that date either a four credit training course or an additional one-time one credit training course on the appropriate sales practices, replacement and disclosure requirements under the revised model. In adopting this section, a state could choose a different timeframe for this requirement.