November 8, 2024

Submitted electronically to jmatthews@naic.org

To: NAIC Annuity Suitability Working Group

Re: Comments on Annuity Best Interest Regulatory Guidance and Considerations - September 23, 2024, Chair Draft

On behalf of our collective members, the undersigned trades write to provide comments on the Chair Draft of Annuity Best Interest Regulatory Guidance and Considerations ("Draft Guidance"). Since the National Association of Insurance Commissioners ("NAIC") amended the Suitability in Annuity Transactions Model Regulation ("Model") in early 2020, we have been vocal supporters of this enhanced standard. We have pursued uniform adoption across the states, and we support robust enforcement of the Model to protect consumers and to ensure compliance with the requirements. We appreciate the Working Group's efforts to provide greater clarity on the safe harbor provisions of the Model for state examiners, and our review of the Draft Guidance is focused on ensuring consistency with the Model. It is important that any guidance fully conform to the Model without imposing any new or different requirements on the industry.[1] To achieve this end, we respectfully submit the comments below on the Draft Guidance for the Working Group's consideration.

Our general recommendations and key concerns on the Draft Guidance are outlined below, but we are also including a redline document with specific recommended changes and comments for your review and consideration.

[1] We'd like to note at the outset of this letter that, given that this is guidance for state examiners, the Working Group may wish to consider whether this type of guidance is more appropriate as an addendum to the NAIC Market Conduct Guidelines.

1) **<u>The Draft Guidance should provide greater clarity as to the distinctions between an insurer's responsibilities under the safe harbor, and the provision that permits insurers to contract with third parties to perform the insurers' supervisory obligations. The Draft Guidance should also clarify how insurers can satisfy their obligations under Section 6(C)(1) in either scenario.</u>**

The Model establishes multiple methods by which insurers can comply with their supervisory obligations:

i. The insurer can directly supervise sales of its annuities by performing the specific requirements set forth in Section 6(C)(1) and Section 6(C)(2).

ii. The insurer can rely on Section 6(C)(3) to contract with a third party to perform any or all of the requirements set forth in Section 6(C)(1) and Section 6(C)(2).

iii. The insurer's distribution partner can satisfy the requirements of the safe harbor set forth in Section 6(E) by supervising sales of the insurer's annuities in compliance with a comparable standard, in which case, the requirements of Section 6(C)(2) need not be separately performed. Subsection (2) of the safe harbor requires that the insurer still satisfy its obligations under Section 6(C)(1), and subsection (3) of the safe harbor requires the insurer to monitor the conduct of the financial professional or the firm responsible for supervising the financial professional. This method is the primary focus of the Draft Guidance.

We appreciate the effort made in the Draft Guidance to acknowledge and explain these different compliance methods in the section titled, **Safe Harbor or Contracting for Performance of Supervision**, but we believe even greater clarity is necessary to avoid any confusion and duplicative supervision. To that end, we have suggested several specific modifications to the Draft Guidance in the attached redline. In particular, we believe the Draft Guidance is overbroad and misaligned with the text of the Model with respect to the interpretation of the insurer's responsibilities under Section 6(C)(1) in connection with safe harbor transactions.

In our view, the insurer can satisfy its obligations under Section 6(C)(1) by either (a) performing the required reasonable basis analysis based on information received from either the financial professional or the entity supervising the financial professional (the supervising distributor) (as permitted by Section 6(E)(2)), or (b) contracting with the supervising distributor to perform the required reasonable basis analysis on behalf of the

insurer (as permitted by Section 6(C)(3)). In the latter case, the insurer need not perform its own analysis as to whether the recommended annuity would effectively address the particular consumer's financial situation, insurance needs, and objectives, as this would be the third party's responsibility pursuant to the contract with the insurer.

Instead, the insurer's role is to supervise the contractual performance of the distribution partner as required by Section 6(C)(3)(a) and (b). The insurer can satisfy this supervision obligation by, for example, assessing the compliance policies and procedures of potential distribution partners before entering into selling agreements, taking steps to make sure its distribution partners are aware of and complying with the requirements of the safe harbor, and/or monitoring and exchanging information with its distribution partners. To be clear, these are just a few examples. Each insurer must have the flexibility to determine the most appropriate way to supervise the contractual performance of their distribution partners with respect to the reasonable basis analysis required under Section 6(C)(1).

We believe this is consistent with the Working Group's intention, but to avoid any confusion, we recommend making it abundantly clear in the Draft Guidance that performance of Section 6(C)(1) is permitted under the Model to be contracted out. The Draft Guidance should explicitly state that insurers can contract out their obligations under Section 6(C)(1), including to firms relying on the safe harbor under Section 6(E). Our suggested edits make it clear that in the event of such a scenario, the insurer would only be responsible for compliance with Section 6(C)(3)(a) and (b) and would not need to separately perform the other supervisory functions pursuant to the safe harbor provisions. It is crucial that the Draft Guidance not suggest otherwise. The reason for this is not to relieve insurers of their ultimate responsibility regarding recommendations and sales, but simply to ensure that the Draft Guidance is consistent with what is allowed under the Model.

The Working Group may wish to consider charting out the insurer's specific requirements depending on which provision they are operating under, as opposed to discussing it in a narrative format. This may be a clearer way to communicate the information for the state examiners that will be utilizing the Draft Guidance. In Appendix A, we provide a chart that outlines the various responsibilities or requirements, which we encourage you to utilize as appropriate.

On a related note, and as discussed in greater detail below, Section 6(C)(2)(d) makes clear that the required reasonable basis analysis can be performed through application of a screening system designed to identify selected transactions for additional review. This is true regardless of the approach used by an insurer to satisfy its obligations under Section 6(C)(1). In practice, this enables insurers to direct their resources to those transactions where additional scrutiny may be necessary or appropriate. However, the Draft Guidance,

as written, seems to assert that every single transaction must be subject to the same extensive review, which would obviously not be compatible with the use of a screening system as contemplated by Section 6(C)(2)(d). We do not believe this was the NAIC's intent in adopting the safe harbor, as it would be unnecessary and duplicative with no commensurate benefit to consumers. Our redlines to the Draft Guidance are intended to make this clear. As mentioned above, it is critically important that the Draft Guidance not change the requirements of or the options available under the Model. We do not want to impair the effectiveness of the Model, and therefore, we are focused on ensuring that examiners have the clarity they need when reviewing for compliance under the Model.

2) **The Draft Guidance should make clear that insurers do not need to separately determine that compliance with a "comparable standard" matches the requirements under the Model.**

In our redline, we recommend several key changes to make clear that insurers do not need to separately determine that compliance with a comparable standard as defined under the Model matches the specific terms and obligations under the Model. The Model distinctly enumerates three rules that are deemed to be "comparable standards." Through its robust process in developing the updated Model, the NAIC made the determination that recommendations and sales of annuities made by financial professionals in compliance with these rules, one of which is Reg BI, satisfies the requirements of the Model. While broker-dealers have an independent obligation to comply with Reg BI and are subject to oversight from, as applicable, the SEC and FINRA, nothing in Section E limits the insurance commissioner's ability to investigate and enforce the provisions of the Model.

The insurer does not need to make a separate determination that the procedures, if they comply with a comparable standard like Reg BI, are then comparable to the requirements of the Model. Such an approach would be contradictory to the purpose of the safe harbor, which is to avoid duplicative and inefficient processes while still protecting consumers. The NAIC has already decided that the requirements of Reg BI are comparable to the Model. The insurer does need to make this redetermination. Our redline edits make this clear and are consistent with the Model.

Also, we appreciate the Draft Guidance confirming that the safe harbor is available for recommendations of annuities that are not securities, which is consistent with the language of the Model. The Draft Guidance should, however, make it clear that the Model only requires business rules, controls, and procedures to satisfy a comparable standard. The standard does not need to otherwise apply to the product or recommendation at hand. Utilizing a process for a sale of a fixed annuity that complies with Reg BI, for example, satisfies the Model, and the Draft Guidance should make this clear.

3) **<u>The Draft Guidance should make clear that insurers reviewing recommendations falling under the safe harbor can rely on a screening system, as allowed by the Model.</u>**

For recommendations falling under the safe harbor, where the insurer has not contracted for the performance of functions under Section 6(C), the **Reasonable Basis** section should make clear that an insurer's "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." This language is consistent with Section 6(C)(2)(d) of the Model and should be included in the Draft Guidance as a way for insurers to meet their obligation under Section 6(C)(1). The current language implies that insurers would need to review and separately analyze each recommendation, which goes beyond what is required under the Model even for non-safe harbor transactions. Where the insurer has not contracted for the performance of the functions under Section 6(C), utilizing a screening system or sampling is one option to meet an insurer's obligations under Section 6(C)(1), and the Draft Guidance should make this clear. A screening system is also appropriate as the insurer is relying on a broker-dealer to run their recommendations through its Reg BI process, which already requires supervision of a financial professional by his/her broker-dealer under FINRA rules. As such, we strongly recommend that the Working Group incorporate our redline edits for this section.

4) **<u>The Draft Guidance should provide adequate flexibility for companies to develop compliance programs that meet their particular business models and circumstances.</u>**

We appreciate that the Working Group has provided examples throughout the Draft Guidance and overall, we are supportive of the clarification provided for state examiners. The Draft Guidance, however, should take a principles-based approach and avoid being too prescriptive in a manner that is inconsistent with the Model. An insurer should be able to determine what makes the most sense for its business and its distribution partners while still complying with the Model. Several of our suggested edits are meant to make it clear that the listed examples/approaches are simply some ways in which an insurer could satisfy its obligations under the Model, and that such examples/approaches are not intended to be prescriptive. One example of this is in the **Provide Information and Reports** section, where we suggest removal of the specific list of items that could be provided. Our members indicated that there are numerous other data points that they could or would potentially provide, so rather than trying to have a comprehensive list of all possible data points, we suggest deleting the list and focusing this section on ensuring that the examiners understand the objective of the section. This ensures less of a "check

the box" approach when it comes to what specific data is being provided, and more of a broader view of the importance of data sharing.

A principles-based approach allows insurers and distributors to develop robust compliance programs that meet their particular business models and circumstances. This is consistent with the intent of the Model.

Impact on Financial Professionals and Consumers

On a final note, we'd also like to briefly address the impact on financial professionals and consumers. We appreciate the Working Group's effort to clarify the safe harbor provisions of the Model. However, without addressing the concerns outlined above, changes to the Model requirements could place an undue burden on financial professionals, and therefore their clients, by adding obligations that may be both confusing and duplicative when making an annuity recommendation. Safeguards are certainly necessary to ensure consumer protection, but they should not make compliance so difficult as to create confusion for consumers. The Model's compliance standards are designed to protect consumers, but inconsistent requirements beyond the Model could undermine this goal by complicating the regulatory landscape. Clear and consistent guidance for insurers, as reflected in our suggestions, would promote more uniform annuity sales practices, reduce consumer confusion and make sure their needs are adequately considered during recommendation.

We appreciate your consideration of our recommendations as described above, and we recommend that the Working Group expose another draft with any changes made for stakeholder comments ahead of finalizing any guidance. We look forward to continuing engagement on the Working Group's efforts. Should you have any questions or concerns, please reach out to Sarah Wood at the Insured Retirement Institute at swood@irionline.org.

Submitted on behalf of the following trades,

American Council of Life Insurers (ACLI)
Committee of Annuity Insurers (CAI)
Finseca
Financial Services Institute (FSI)
Indexed Annuity Leadership Council (IALC)
Institute for Portfolio Alternatives (IPA)
Insured Retirement Institute (IRI)
National Association for Fixed Annuities (NAFA)
National Association for Insurance and Financial Advisors (NAIFA)
Securities Industry and Financial Markets Association (SIFMA)

Defined Terms

NAIC Model means the requirements and obligations set forth under the NAIC Suitability in Annuity Transaction Model Regulation, as updated in 2020.

NAIC Model Supervision means the insurer supervisory requirements as outlined in Section 6C of the NAIC Model.

- Section 6C(1) outlines the requirement of the insurer to ensure there is a reasonable basis for the recommendation.
- Section 6C(2) outlines the supervisory requirements of the insurer when they are not relying upon the Safe Harbor for supervision of annuities.
- Section 6C(3) outlines the requirements of the insurer when they have contracted with a third-party to perform the supervisory function.
    - The insurer must: (1) monitor and, as appropriate, conduct audits, and (2) obtain an annual certification from a senior manager who has responsibility for the contracted function that they have a reasonable basis to represent that the function is being properly performed.

Comparable Standard as defined in Section 6E(5) of the NAIC Model, includes, but is not limited to, Regulation Best Interest, and the fiduciary duties and requirements imposed under the Investment Advisers Act of 1940, and the duties, obligations, prohibitions, and other requirements imposed upon plan fiduciaries under ERISA or the IRC.

Comparable Standard Supervision means the supervisory function performed by the entity (e.g., BD) responsible for supervising the financial professional's conduct under a Comparable Standard.

Safe Harbor as defined in Section 6E of the NAIC Model, allows the sales of annuities made in compliance with a Comparable Standard to be viewed as satisfying the requirements of the NAIC Model.

- Section 6E outlines the requirements of insurer when they are relying upon the Safe Harbor for supervision of annuities.
    - The insurer must: (1) monitor the relevant conduct of the financial professional relying upon the Safe Harbor or the entity responsible for supervision of the financial professional, (2) provide information and reports to the entity responsible for supervision of the financial professional that assist the entity in maintaining its supervision system, and (3) comply with Section 6C(1).

Contracting for Performance of a Function (Contracting) refers to when the insurer contracts with a third-party for the performance of all or part of the NAIC Model Standard Supervision.

NAIC Model Supervision	Safe Harbor Supervision	Contracting Supervision
The insurer must comply with all requirements of the NAIC Model, which includes the supervisory requirements under Section 6C of the NAIC Model. • The insurer is not relying upon the Safe Harbor for supervision of annuity sales and recommendations. • The insurer has not contracted the NAIC Model Supervision function to a third party.	The insurer must comply with the Safe Harbor requirements listed under Section 6E, which includes compliance with Section 6C(1). • The insurer does not need to comply with Section 6C(2) because the financial professional is subject to Comparable Standard with respect to recommendation, sales, and supervision by the supervising entity. • The insurer has not contracted the NAIC Model Standard Supervision function to a third-party. • Recommendations and sales of annuities are made in compliance with a Comparable Standard.	The insurer has contracted with a third-party to perform its supervisory obligations under Section 6(C)(3) of the NAIC Model. The third party is responsible for complying with the appropriate supervision requirements as outlined in the NAIC Model. • If the third party is <u>not</u> relying upon the Safe Harbor, they must comply with the NAIC Model Supervision requirements. • If the third-party is relying upon the Safe Harbor, they must comply with the Safe Harbor supervision requirements, including compliance with Section 6C(1). In the above scenarios, the insurer must comply with the requirements under Section 6C(3).
The financial professional must act in the best interest of the consumer, as defined in Section 6A the NAIC Model, which includes compliance with the Care, Disclosure, Conflict of Interest, and Disclosure Obligations.	The financial professional must conduct business in compliance with the requirements of a Comparable Standard, which would satisfy the requirements set forth under Section 6A of the NAIC Model.	The financial professional must conduct business in compliance with the appropriate standard as set forth by Section 6A of the NAIC Model or a Comparable Standard.

Chair Draft – September 23, 2024

Annuity Best Interest Regulatory Guidance and Considerations

Summary

The Life and Annuity (A) Committee of the National Association of Insurance Commissioners offers the following regulatory guidance for state Departments of Insurance (DOIs) to use when reviewing a life insurer's compliance with the *Suitability in Annuity Transactions Model Regulation*, Model 275-1 (the "Model Regulation"). The regulatory guidance is focused on offering guidance concerning insurance company obligations under the safe harbor provisions embodied in Section 6E—Safe Harbor of the Model Regulation, which provides:

> 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.[1]

Generally, the safe harbor would be available to an insurance producer who is also registered as a financial professional under securities law and is subject to ~~an~~other comparable standards and supervisory control system when recommending and selling annuities~~as a result~~.

This regulatory guidance and consideration document addresses five elements of the safe harbor in the Model Regulation. First, ~~to avail itself of the safe harbor, and to create a circumstance where an~~in order for an insurance producer to ~~may~~ reasonably rely on the safe harbor, the insurance company must determine that the conditions of the safe harbor have been met. Second, in each annuity transaction the insurance company must still have "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] although the insurer may base its analysis on information received from either the financial professional[3]

Commented [SW1]: The listing of these elements in this manner creates the appearance of a sequential order that needs to be followed. We recommend making this a bulleted list listing out the elements of the safe harbor.

Commented [SW2]: The guidance should make clear that performance of this supervisory function can be contracted out to a third party.

[1] Section 6(E)(1). The prohibited practices in Section 6(D) still apply in Safe Harbor transactions.
[2] *See* Section 6(C)(1); *see also* Section 6(E)(2)("Nothing in Paragraph (1) shall limit the insurer's obligation to comply with Section 6(C)(1) of this regulation. . . ."
[3] A financial professional is 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;

or the entity supervising the financial professional. Third, for the safe harbor to apply, an insurance company must "[m]onitor the relevant conduct of the financial professional. . . or the entity supervising the financial professional…using information collected in the normal course of an insurer's business."[4] Fourth, an insurance company must also "[p]rovide to the entity responsible for supervising the financial professional . . . information and reports that are reasonably appropriate to assist such entity to maintain its supervision system." When evaluating an insurer's compliance with the Model Regulation, it is important to ~~Finally, an insurance company must~~ distinguish between its obligations under the safe harbor from the situation where it has contracted with a third party for supervision.

Commented [SW3]: This key point may need to be addressed upfront, so that is abundantly clear at the outset as to what obligations apply when.

Requirements of the Safe Harbor

One of the most common situations that will generate the use of the safe harbor is the licensed insurance producer who is also registered as a securities agent and is subject to the supervisory control system of a registered securities broker-dealer. Pursuant to the safe harbor, recommendations and sales of annuities made in compliance with business rules, controls and procedures that would satisfy comparable standards[5] are deemed to be compliant with the requirements under the Model Regulation. As an example, a financial professional recommending a variable annuity registered with the United States Securities and Exchange Commission (the "SEC") under the safe harbor is deemed to comply with the Model Regulation if the securities agent's broker-dealer has established "business rules, controls and procedures" or a supervisory control system pursuant to FINRA Rules 3110, 3120 and 3130[6] that (1) govern

(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.

[4] *See* Section 6(E)(3)(a).

[5] "Comparable standards" is defined in the Model Regulation in Section 6(E)(5) to mean:
(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
(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.

[6] https://www.finra.org/finramanual/rules/r3110; https://www.finra.org/finramanual/rules/r3120; https://www.finra.org/finramanual/rules/r3130

the appropriate recommendation of an SEC- ~~-~~registered ~~variable~~ annuity and (2) that satisfies the SEC's Regulation Best Interest ("Reg BI").[7]

Making a recommendation in compliance with comparable standards means in compliance with the "business rules, controls and procedures that satisfy a comparable standard…" ~~To avail itself of the safe harbor, the insurance company should review t~~The broker-dealer's business rules, processes, and procedures that pertain to the firm's supervisory control system over the registered ~~variable~~ annuities ~~to ensure that they are adequate and that they~~must satisfy a comparable standard. An insurer could confirm this by [list examples]…. ~~provide comparable controls as those required under the Model Regulation.~~

Another common dual license situation involves a licensed insurance agent who is also registered as an investment adviser representative. ~~To avail itself of the safe harbor in this circumstance in a recommendation involving a SEC registered variable annuity, the insurance company should review t~~The business rules, controls, and procedures of the investment adviser ~~to ensure they are adequate and provide comparable controls as those required under the Model Regulation~~must satisfy a comparable standard. An insurer could confirm this by [list examples]. The fact that an investment adviser by law is a fiduciary and carries potential liabilities for breach of those duties does not in and of itself meet the requirements of the safe harbor. The investment adviser that is in the contractual relationship with the investment adviser representative must have written business rules, controls and procedures that pertain to recommendations of the registered ~~variable~~ annuity that ~~are~~ satisfy a comparable standard. ~~comparable to the controls that the insurance company would need to directly establish under the Model Regulation but for the safe harbor.~~

The safe harbor is also available for recommendations of annuities not registered with the SEC, such as fixed annuities or fixed indexed annuities, if the insurance company has been able to determine that the securities broker-dealer or investment adviser has established business rules, controls and procedures that satisfy a comparable standard ~~were specifically and expressly designed to apply to fixed indexed annuities~~. As stated in the Model Regulation, an insurance company and insurance producer may avail themselves of the comparable standards safe harbor "even if such standard would not otherwise apply to the product or recommendation at issue." Even though Reg BI does not apply to unregistered insurance products, the safe harbor allows insurance producers who are also regulated under securities laws to operate under those securities business rules, controls, and procedures so long as they satisfy a comparable

Commented [SW4]: While a review of procedures could be part of a robust monitoring program, this is not explicitly required by the Model. The language should be clear that this is merely an example of how insurers could monitor pursuant to the safe harbor provision. A "review of procedures" could also be accomplished via different methods, whether that's through an actual review, verbal interviews with the firms, or through certifications (or through a combination of these). Flexibility with the language here will allow insurers to choose which methods to employ.

Commented [SW5]: While a review of procedures could be part of a robust monitoring program, this is not explicitly required by the Model. The language should be clear that this is merely an example of how insurers could monitor pursuant to the safe harbor provision.

[7] 17 CFR 240.15l-1 (§ 240.15l-1 Regulation best interest)

standard.~~are substantially similar to those otherwise required under the Model Regulation~~. It is important to note that these systems must be adapted to recognize the very significant differences in features and characteristics of ~~fixed indexed~~these annuities from securities. ~~I~~For example,~~t would be problematic for~~ an insurance company that~~to~~ allows a broker-dealer agent/insurance producer to recommend its fixed ~~index~~ annuities under the terms of the safe harbor would typically need to ascertain that ~~if~~ the broker-dealer's policies and procedures ~~were narrowly designed to address the sale of securities under Reg BI, but do not reference fixed index annuities or~~ take into consideration the ~~their~~ particular features and characteristics of such products. Insurers may want to provide guidelines or coordinate with ~~which~~ the partner ~~must comply as part of the onboarding process~~ to ensure that the entity's processes are adequate.

Commented [SW6]: We recommend revamping this section to make clear that compliance with a comparable standard, even if it doesn't apply to the product at hand, is sufficient to meet the requirements of the Model.

Reasonable Basis

When analyzing a safe harbor transaction where the insurer has not contracted out its supervisory function in Section 6(C)(1) as permitted by Section 6(C)(3), the model regulation is not pre~~e~~scriptive about how an insurer comes to have a reasonable basis to believe that an annuity would effectively address the particular consumer's financial situation, insurance needs and objectives. That said, given that the rule says that the insurer may base its analysis on information received from the financial professional or the entity supervising the financial professional using information collected in the normal course of an insurer's business, it is clear that the rule expects the insurer to conduct an analysis that goes beyond blind adherence to the analysis and conclusions of the entity supervising the financial professional.

What should this analysis consist of? An insurance company must ascertain that a recommendation was made and documented as required by the other comparable standard~~. The insurer must receive adequate consumer profile information and other~~ , including evidence of a reasonable~~good faith~~ basis for the transaction to determine that the annuity would effectively address the consumer's financial situation, insurance needs and objectives. Pursuant to Section 6(C)(2)(d), any review procedures established and maintained by the insurer for the review of each recommendation 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. ~~In light of this responsibility and its more general underwriting responsibilities, an insurer should receive, review, and retain transactional customer profile and underwriting information~~. Of course, insurers may not always receive precisely the same data

Commented [SW7]: To answer this question, it might be helpful to list out examples of ways an insurer could comply with their Section 6C(1) obligations.

Commented [SW8]: Recommend deletion since underwriting is not applicable to annuities.

points from the entity supervising the financial professional as it collects on the transactions it directly supervises. ~~The more divergent the data an insurer reviews on safe harbor transactions compared to transactions it directly supervises, the more questions a regulator may have about whether the company is able to comply with Section 6(C)(1) of the Model Regulation on safe harbor transactions.~~

Monitor the Relevant Conduct

To avail themselves of the safe harbor, insurance companies must monitor the business conduct of the financial professional or the entity supervising the financial professional using information collected in the normal course of an insurer's business. As the following aspects of a successful monitoring program will make clear, simply relying on the statement of a financial professional that he or she complied with a comparable standard falls short of the monitoring required of an insurer. Aspects of a successful monitoring program may include:

- **Onboarding**: Entering into a new contractual relationship with an entity to sell annuities ~~should~~ may involve a review of the entity's business rules, processes, and procedures to ensure that they are adequate and that they address all the annuities that will be sold under the contractual arrangement. ~~Insurers may want to provide guidelines with which the partner must comply as part of the onboarding process to ensure that the entity's processes are adequate.~~
- **Audits**: After onboarding a broker-dealer or entity~~financial partner~~, insurers ~~need to ensure that the entity's policies and procedures remain adequate, and that the entity is doing what it says it will do~~have ongoing obligations. This ~~will likely~~may involve creating a strong audit program. Hallmarks of a strong audit program include selecting an adequate sample size on a~~, auditing each financial partner~~ frequent basis~~ly enough~~, and escalation procedures for any ~~financial partner~~ broker-dealer or entity that fails to respond, up to and including termination of the relationship. Selection of audit frequency should be risk-based based on the volume that comes through the channel as well as other risk factors available to the insurer. An appropriate audit program ~~will~~ may also ensure that all partners are audited on a regular cycle.
- **Due Diligence Questionnaires**: As a supplement to audits, insurers may use due diligence questionnaires as part of their monitoring of broker-dealers or entities~~their financial partners~~. These questionnaires may be stand-alone safe harbor questionnaires or wrapped into a larger vendor due diligence process that could include cybersecurity, state specific requirements, and other issues. ~~Due diligence questionnaires are a stronger form of monitoring than certifications.~~

Commented [SW9]: We recommend deletion. NAIC Model allows for different approaches and one shouldn't be favored over another. An examiner should evaluate a particular case on its own merits rather than viewing it in comparison to other cases.

Commented [SW10]: The NAIC Model says this can be done "using information collected in the normal course of an insurer's business." We suggest this language be reiterated here, while also making clear the below list is of examples of ways to monitor the relevant conduct.

Commented [SW11]: Please note that distributors generally have relationships with multiple insurers and will develop one process that satisfies their compliance requirements. This could lead to conflicting guidance from various insurers. As such, we recommend removal of this sentence.

Commented [SW12]: We recommend including language acknowledging that registered broker-dealers are frequently subject to regulatory examinations/audits by FINRA, SEC, etc.. This could play into the risk assessment by an insurer as to how often audits need to be conducted.

Commented [SW13]: This statement appears to contradict the statement that selection of audit frequency should be risk-based. We agree with the previous statement and suggest that this be removed or adjusted since it currently implies that auditing should occur on a set frequency as opposed to being risk-based.

Commented [SW14]: We recommend removal of this statement as it would be inappropriate to make a value judgement about which one of these approaches is better than another. A certification, for example, could be crafted to provide strong assurances, specific representations, and legal protections. It could also serve as a mechanism for the insurer to cover costs and expenses if something that was certified to turned out not to be true.

- **Ongoing Monitoring**: Due diligence questionnaires are not the only form of ongoing monitoring available to an insurer. Sales data, both aggregated and as segregated by ~~partner,~~broker-dealer or entity can be categorized, and sorted by number of contracts and by premiums to ~~risk rate~~review producers and ~~partners~~ broker-dealers or entities for key elements such as sales to older consumers, free-look cancellations, early surrenders, replacements, and others. Review of sales data should be risk-based dependent upon the volume that comes through the channel as well as other risk factors available to the insurer.
- **Receiving Data**: Insurers might also request data on an ongoing ~~, perhaps quarterly,~~ basis to aid in their monitoring, including:
    - commissions paid to the producer;
    - number of annuities~~policies~~ issued;
    - number of replacements issued;
    - number of replacements subject to surrender charges at the prior company;
    - Applications that were rejected~~turned down~~ due to suitability or other concerns; and
    - Number of consumer complaints related to annuity sales received by the entity supervising the financial professional.

Insurance companies may have some of this data, of course, such as commission paid on an annuity, but the idea of this information sharing is broader than re-sharing individual transaction data. It is, rather, to ensure that both the insurer and entity supervising the financial professional have the holistic information necessary to make supervision decisions.

The Model Regulation is a principles-based regulation, and the examples described above for monitoring relevant conduct are intended to illustrate potential options for incorporation in successful insurer programs and not to require inclusion of any specific element. Successful insurers will craft reasonably appropriate procedures tailored to their business that are designed to comply with the requirements of the Model Regulation.

Provide Information and Reports

The insurance company must also give information to the entity supervising the financial professional to ensure that that entity has as much information as practicable~~possible~~ in making supervisory decisions. ~~Information the insurer might share with the supervising entity includes the following:~~

Commented [SW15]: A quarterly review may not be workable for small volumes by entity. We suggest removing this phrase or making it clear that the insurer could make a reasonable determination as to the frequency of the requests.

- ~~Total contracts issued through the producer over the period, including number and type of annuity;~~
- ~~Amount of commissions paid for each sale to that producer over the period;~~
- ~~Identify whether the insurer issued any other annuities for the same producer, and if so, how many;~~
- ~~Identify how many internal replacements were issued by the same producer;~~
- ~~Number of consumer complaints or lawsuits received by the insurer related to the producer;~~
- ~~Number of contracts for the producer that were surrendered less than 2 years from policy issue, years 2-5, years 6-10 and more than 10 years from issuance;~~
- ~~Whether any surrenders were subject to surrender charges.~~

An ~~I~~insurer~~s~~ may be able to offer broker-dealers or entities~~partners~~ detailed reports and charts that illustrate customer profile factors for the variety of~~fixed and variable~~ annuities it offers, including issue age, share class, withdrawal charges, rider elections, and free look information.

As mentioned in the last section, the idea of this information sharing requirement is not to duplicate individual transaction data the other party already has. Insurers may make decisions about what individual transaction data to share, and there is no prescribed list of data points that must always be included. ~~It is~~The goal of this requirement is, rather, to ensure that both the insurer and entity supervising the financial professional have the holistic information necessary to make supervision decisions.

The Model Regulation is a principles-based regulation, and the examples described above for information and reporting are intended to illustrate potential options for incorporation in successful insurer programs and not to require inclusion of any specific element. Successful insurers will craft reasonably appropriate procedures tailored to their business that are designed to comply with the requirements of the Model Regulation.

Safe Harbor or Contracting for Performance of Supervision

The Model Regulation has two ~~different~~ mechanisms in which third parties perform part or all the supervisory process for insurers. ~~They appear superficially similar, but are actually quite different, and i~~It is important that insurers understand under which provision of the Model Regulation they are operating. In general, insurers have obligations under Section 6(C) to supervise a producer's obligations under the Model Regulation. When the safe harbor applies, an insurer's obligations are limited to the obligations set forth in Section 6(E)(2) and (3). In addition

to the safe harbor, insurers may contract for performance of a part or all its supervisory function pursuant to Section 6(C)(3)(a). Where an insurer contracts for performance, it must monitor the conduct of the party to whom it outsourced its supervision, including by conducting audits, as appropriate.[8] As a result, these two circumstances seem similar, but they differ in important ways.

In a safe harbor transaction, although the financial professional and the entity supervising the financial professional make the decision that the annuity is in the best interest of the customer, unless the insurer has contracted for performance of supervisory functions under Section 6(C), the final responsibility to decide whether an annuity would effectively address the particular consumer's financial situation, insurance needs and objectives resides with the insurance company. The insurer is almost certainly basing its decision on customer profile information and the basis for the transaction collected by the entity supervising the financial professional, but the safe harbor does not relieve the insurer of its obligation to only issue annuities where it has 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."[9] Because of the safe harbor, however, the intent of the disclosure and procedural requirements that are found in the Model Regulation may be achieved by ~~comparable business rules and procedures~~compliance with business rules, controls and procedures that satisfy a comparable standard. For example, a broker-dealer agent would have given Form CRS to his or her client but would not have to give Appendix A to the client when selling an annuity. The onboarding, audits, due diligence questionnaires, contractual policies, and other methods that an insurer may use~~s~~ to monitor the entity are to ensure that the entity's policies, procedures, and implementation of those policies and procedures are ~~truly "comparable" to what is required under the Model Regulation.~~in compliance with a comparable standard.

On the other hand, where an insurer has contracted for performance, all the provisions of the Model Regulation apply. If the insurer has ~~delegated~~ contracted out any or all of the requirements set forth in Section 6(C)(1) or Section 6(C)(2)~~the entire supervisory process by contract~~, the entity with which the insurer has contracted for performance would be the one that decides whether the annuity is in the best interest of the consumer on behalf of the insurer. These~~is~~ contracted~~delegated~~ supervision obligations cannot just be simply transactions-based and must incorporate all aspects of the supervision that the insurer would have otherwise performed

Commented [SW16]: We suggest reiterating that an insurer can apply a screening system, pursuant to the Model. Please see our suggested edits in the "Reasonable Basis" section - it would be appropriate to have a reference to Section 6C(2)(d) here as well.

Commented [SW17]: We need language here to make it clear that if an insurer is contracting out their supervision obligations, then they only need to comply with 6(C)(3)(a) and (b). This sentence needs to be modified to make clear that the contracted third party can comply with a comparable standard under the safe harbor.

Commented [SW18]: It is unclear what the Working Group is trying to convey here.

[8] Section 6(C)(3)(b)(1).
[9] *See* Section 6(C)(1); *see also* Section 6(E)(2)("Nothing in Paragraph (1) shall limit the insurer's obligation to comply with Section 6(C)(1) of this regulation. . . ."

directly~~incorporated~~. The entity may utilize comparable standards, such as Reg BI, in fulfilling its contractual obligations and in determining whether a reasonable basis exists to issue the recommended annuity. The insurer must monitor the entity's conduct, including audits, as appropriate, to ensure that the supervisory system the entity has built "is reasonably designed to achieve the insurer's and its producers' compliance with this regulation."[10] ~~And if the insurer is delegating to an entity that otherwise stands to benefit from the transaction, that potential conflict must be reasonably addressed.~~

Commented [SW19]: It's unclear what is intended by this language, which isn't in the Model. We'd propose removing this sentence but are open to hearing more about the Working Group's intent here.

[10] Section 6(C)(2).