October 21, 2020

The Honorable Doug Ommen, Chair
NAIC Life Insurance and Annuities Committee
1100 Walnut St., Suite 1500
Kansas City, MO 64106

Submitted electronically to jmatthews@naic.org

Re: **Suitability in Annuity Transactions Model Regulation (#275)**
Frequently Asked Questions - 9/4/20 Exposure Draft

Dear Commissioner Ommen and Members of the Committee:

XY Planning Network[1] ("XYPN") wishes to submit comments on the above proposal and apologizes for the late submission. We hope that you will take into consideration our comments and suggestions, which represent a different perspective from the comments of other trade groups and, it is hoped, will assist the Life Insurance and Annuities Committee (the "Committee") in taking a balanced approach to its review of this important Frequently Asked Questions guidance (draft "FAQs"). We focus our comments primarily on three of the draft FAQs: Q7, Q9 and Q10.

Background

The NAIC's recent update to the Suitability in Transactions Model Regulation (the "Model Rule") is long overdue in strengthening the suitability obligations of an insurance producer when acting in a transactional capacity. The rule is similar to Regulation Best Interest ("Reg BI"), which was adopted last year by the Securities and Exchange Commission (the "SEC" or "Commission"). As stated in the preface of the exposure draft, the purpose of the draft FAQs

[1] XY Planning Network is a national education, compliance and advocacy organization representing more than 1,300 financial planning firms in all 50 states and comprised primarily of Generation X and Y financial planners. XYPN members are primarily registered as investment advisory firms ("RIAs") with state securities administrators, take a fiduciary oath as a condition of membership, and receive fee-only compensation for their services. XYPN believes that financial advice provided to individuals should be subject to a fiduciary standard as distinguished from salespersons executing product transactions on behalf of their customers.

to the Model Rule is "to assist in the uniform implementation and enforcement of its provisions" across all state jurisdictions.[2]

XYPN nonetheless opposed Reg BI, both in the rulemaking process and in the courts. The concerns XYPN expressed in its comment letters to the SEC, and in its lawsuit, are generally the same fundamental concerns that it has with the NAIC's Model Rule, principally that consumers are confused by advisor-like titles that imply fiduciary status,[3] as well as the so-called "Best Interest" standard that not only confuses investors, but also makes it difficult for financial intermediaries with divided agency-and-principal loyalties to satisfy under both Rules. Although both the NAIC and Commission attempted to draw from fiduciary principles, both rules fall woefully short by permitting salespersons to provide advice that any reasonable consumer would interpret as advice provided by an industry professional acting in a position of trust and confidence, and not from an arms-length transaction.[4]

As an organization supporting a fiduciary standard for investment and other related financial planning activities, XYPN objects to the use of fiduciary-related terms in market conduct rules such as Reg BI and the Model Rule that not only confuse consumers, but provide sufficient loopholes for industry participants to market their services as trusted advisors, including the delivery of comprehensive financial planning services.

Outside of the above background, our comments on the draft FAQs are directed toward assisting the NAIC with feedback that helps address some of the consumer-protection issues that we do not believe were resolved by the SEC and NAIC rulemakings, and that can help clarify some of the jurisdictional questions raised in the draft FAQs.

FAQs

Q7. Draft Question 7 asks what is the intent of sec. 6A(1)(c) of the Model Rule regarding the applicable standard of care. Sec. 6A(1)(c) does not require insurance producers to analyze or consider analysis of any alternative products outside of those available under their licensure. In response, draft A7 states that the guidance is intended to ensure that compliance and enforcement actions taken for violations of the Model Rule should be compared to the same

[2] FAQ, Sept. 4, 2020, exposure draft, at 1.

[3] Numerous studies confirm that consumers are confused by industry titles and assume wrongly that financial intermediaries not subject to a fiduciary standard nonetheless are legally obligated to serve in a position of trust and confidence as investment fiduciaries. *See*, e.g., Hung et al, "Investor and Industry Perspectives on Investment Advisers and Broker-Dealers," RAND Institute for Civil Justice, Jan. 3, 2008. *Available* at https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

[4] The insurance industry has periodically acknowledged the point that insurance producers are not bound in relationships of trust and confidence to their customers. In an amicus brief filed by the Indexed Annuity Leadership Council ("IALC") supporting vacature of the DOL fiduciary rule, the IALC stated: "The Department [of Labor] conceded that it can regulate such advice only if the parties to the sales are in relationships of trust and confidence. Yet [the DoL] failed to identify substantial evidence that sales of these [annuity] products actually take place in such [trusted advice] relationships." *Chamber of Commerce et al v. Dep't. of Labor*, Indexed Annuity Leadership Council Memorandum of Law in Support of Motion for Summary Judgment, 3:16-cv-01476-M, at 1 (N.D. of Texas, July 18, 2016).

standard applied to other producers, and not deemed to be breaches of fiduciary conduct under federal or state securities laws, or the Employee Retirement Income Security Act of 1974 ("ERISA").

We understand the intent here is to clear up any confusion over regulatory jurisdiction; however, we believe that further discussion of *overlapping* authorities, with respect to market conduct standards, is needed to remind and guide insurance producers holding other licenses that require fiduciary accountability.

Our concern here is that a financial planner who is dually licensed as insurance producer and as an investment adviser representative ("IAR") of an advisory firm, may be held under the Investment Adviser Act ("IAA") or similar state laws to be a fiduciary for their financial advice.[5] We believe that dual-capacity of the producer should be clearly disclosed at the onset of the first meeting with a prospective client, so that the individual can make an informed hiring decision on whether to work with a fiduciary or a financial intermediary subject to a lower market conduct standard. In addition, it should be made clear that in one capacity, that of an IAR, he or she has a fiduciary obligation to consider reasonable products and alternative products or strategies that are best-suited, at the time of the recommendation, in meeting the client's financial goals and objectives. Additional disclosure should be required in the FAQ guidance that, separately in the capacity of an insurance producer, product availability is limited to those insurance contracts for which the producer is licensed to sell.

From a compliance perspective, confusion and regulatory uncertainty frequently occurs when an individual is dually (and sometimes triple) licensed and must avoid or manage a host of material conflicts of interest. For example, as part of the financial planning process, a financial planner will typically identify the various financial goals and objectives of the client, such as financial independence in retirement. As a part of the process the financial planner will identify and analyze various strategies and products before recommending a final course of action. Certain retirement strategies may include the purchase of an annuity product, and depending on the scope of engagement, the planner may implement those recommendations, including the annuity transaction. If monitoring the financial plan is included in the scope of engagement, the planner will likely include the annuity (immediate or deferred) as part of the cash-flow analysis in retirement. To the client, the process may appear to be seamless, from the recommendation to implementation of the advice and then to monitoring, while in the background various regulatory gears are grinding as jurisdictional issues come into play if the advisor's capacity transitions from fiduciary advisory to salesperson in which additional conflicts

[5] For example, in the SEC's discussion of a dually registered broker-adviser's capacity in providing services in connection with Reg BI, the adopting release indicates that Reg BI would not apply to transactions in a retail customer's *advisory* account even if the customer also has a brokerage relationship and the dual-registrant receives transaction-based compensation for executing the advisory account transaction. *See Regulation Best Interest: The Broker-Dealer Standard of Conduct*, (Release No. 34-86031, File No. S7-07-18, SEC, June 5, 2019), at 126. Further, state law may apply to the extent a state-registered investment adviser retains fiduciary status for other financial advice, including specific transaction recommendations. *Supra* note 7. XYPN similarly believes that the fiduciary duty of an investment adviser is broad and encompasses the entirety of the client relationship, similar to the fiduciary duties in the legal and medical professions that prohibit self-dealing.

of interest arise. Simply put, the consumer experiences a continuous advice process, while from a regulatory perspective the advisor's role shifts from advisor to salesperson, with a concomitant shift in the associated legal standard for the ongoing advice being provided.

The good news is that there are no conflicting requirements between the Model Rule and fiduciary accountability under the Investment Advisers Act of 1940 ("IAA"), and its equivalent in state securities laws. In other words, under the Model Rule the dual registrant always has the choice of operating at the higher fiduciary standard. Indeed, the Model Rule recognizes this alternative course of action by creating a safe harbor for an insurance producer who complies with the rules under the IAA or applicable state securities laws in executing the annuity transaction. As such, the response to Q7 should remind dual registrants of their other obligations as multiple license holders. In the financial planning scenario described above, we believe that it is important to disclose when the dual registrant is acting in their capacity as an IAR, and to disclose to the customer that the fiduciary relationship may extend to commission-based transactions, both insurance and securities, under state law or, alternatively, to clearly disclose if the dual registrant is intentionally changing the nature of the relationship and *not* extending the fiduciary relationship that has already been previously established with the client. Since Q9 and Q10 overlap to a certain extent by addressing dual licensing, at a minimum we recommend that a drafting note be added to Q7 advising producers of related jurisdictional guidance in Q9 and Q10.

Q9. Question 9 addresses the capacity of the producer who is also licensed as an IAR of a state-registered advisory firm,[6] and whether a producer is required to disclose this affiliation. The draft response to Q9 states that material conflicts of interest must be "reasonably managed and disclosed." A9 is also helpful guidance by stating this disclosure must be stated upfront given the actual capacity in which the producer executes a transaction may not be known in the initial meeting. As such, the draft guidance states that "this management must commence when the producer first meets with a potential customer…" We agree – and suggest further disclosures under A9.

A9 goes on to elaborate that the "dually licensed producer should assume that (the Model Rule) and the Investment Advisers Act apply, and that the producer must manage and disclose the conflict of interest." XYPN strongly supports Q9 and the draft response. However we would go further to elaborate in the disclosure that extension of the fiduciary duty to annuity transactions may apply. As such, if the question of fiduciary accountability for other services provided by the dual-registrant has already been adjudicated by a state's appellate or

[6] We note that while the draft FAQ focuses solely on state IARs, and not IARs of federally-registered investment advisory firms, federal law permits state licensing and qualifications (i.e., passage of an exam) of federal IARs with a place of business in the state where they maintain their principal place of business. While state securities administrators may not, *per se*, regulate the market conduct activities of a federal IAR, they may enforce state law for fraud or deceit by the federal IAR and its affiliated firm. As such, it would seem that misleading disclosures or omissions of material information to a customer that rises to the level of fraud or deceit would be subject to, at a minimum, enforcement referrals by the state insurance department to its securities counterpart if it did not have standalone authority.

high court, then the guidance in A9 should require affirmatively disclosing the extent to which the dual registrant's fiduciary duty continues to apply. If the state courts have not addressed the issue, or fiduciary status depends on facts and circumstances, then it should be stated in addition to requiring "real-time" disclosure when a dual registrant's fiduciary capacity transitions to the Model Rule's suitability standard. We strongly oppose recommendations by other industry commenters, including new FAQ suggestions that are designed to eliminate or water down this important disclosure-and-capacity guidance.

Accordingly, XYPN believes that, absent any legal clarifications, dual registrants should assume that both the Model Rule and the IAA, or similar state statutes, apply to the transaction by virtue of having marketed themselves as a financial advisor, or providing financial advice preceding the insurance or annuity transaction. Although more research is needed, in at least some states fiduciary accountability may attach to the entirety of the customer relationship, including annuity transactions. For example, the Supreme Court of Illinois last year held that an Illinois-registered investment adviser, in selling indexed annuities to his clients "acted both as a registered investment adviser under the [Illinois Securities] Act and as a licensed insurance producer under the Insurance Code and was subject to the legal duties under each regulatory regime, including the Act's antifraud provisions."[7]

The state Supreme Court went on to elaborate that "[b]ecause the fiduciary duty standard is also a creature of common law, it is not determinative or significant that the [Securities] Department did not have regulations or rules that specifically defined the nature of that duty or the particular obligations owed by an investment adviser."[8] A separate, unpublished opinion by an Illinois appellate court in 2018 corroborated the high court's enforcement view, holding that the Illinois Securities Department had authority under state securities law to investigate and determine "whether investment advisers and broker-dealers had committed fraud *in any business practice* (emphasis added) even if that practice involves the sale of variable annuities."[9]

Q10. Question 10 asks what kinds of conflicts under sec. 6A(3) of the Model Rule must a producer identify and avoid or reasonably manage (i.e. disclose) to satisfy the Conflict of Interest Obligation.

XYPN supports the guidance provided in the response. A10 requires "more than simple disclosure." It correctly notes that the Best Interest under the Model Rule is substantially different from the Best Interest (fiduciary) obligation of a registered investment adviser ("RIA") firm. A10 goes on to state that "[t]he dually licensed producer must ensure that the customer has a timely comprehension of the producer's varied interests…and before making a

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[7] *See Van Dyke v. White*, 131 N.E.3d 511 (Ill. 2019) at 15.

[8] *Id.,* at 16.

[9] *Thrivent Investment Management v. Illinois Securities Dep't.,* No. 1-17-1913 WL 4198879, at 6, (Ill. App. Ct. 1st Aug. 28, 2018). According to the court, the Securities Department had authority to investigate fraud allegations even though the state Department of Insurance had "sole authority to regulate the issuance and sale of variable annuities."

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." We support this analysis, and recommend that "timely" guidance means prior to each annuity transaction – given the reality that capacity can and indeed appears anticipated to change over the course of the advisor-client-producer relationship – and not a blanket, one-time disclosure of conflicts that may occur intermittently over the course of the customer relationship when capacity changes (without any clarity for the client of when such a capacity change has actually occurred). XYPN also strongly opposes other recommendations by industry commenters that would eliminate any references to regulatory capacity or the extent to which fiduciary capacity may apply throughout the customer relationship.

XYPN appreciates this opportunity to provide comment on the draft FAQ and welcomes any questions.

Sincerely,

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