

CHAIR DRAFT OF PROPOSED SAFE HARBOR PROVISION FAQs

XY Planning Network Comments (5/22/2022)

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Comments are being requested on this document on or before Monday, May 23. Comments should be sent to Jolie Matthews by email only to jmatthews@naic.org.

SAFE HARBOR/COMPARABLE STANDARDS PROVISION

QXX. What types of recommendations or sales does the safe harbor provision (contained in Section 6E of the revised model) apply to?

- A. The safe harbor provision in Section 6E of the revised model would allow a producer licensed under other applicable federal or state laws to rely on the safe harbor in making a recommendation or executing an annuities transaction. If the producer is also licensed as an investment adviser representative (IAR) and the consumer in question is an existing financial planning or advisory client, the producer should be aware of recent guidance by the U.S. Securities and Exchange Commission (SEC) that their fiduciary relationship with the client applies to the entire client relationship. Thus the fiduciary duty under the Investment Advisers Act of 1940 (and similar state adviser statutes) would apply to an annuity transaction sold outside of the advisory account because the producer's fiduciary capacity would extend to all areas of the client relationship including product transactions. The safe harbor would be available if the producer/IAR fully complied with all rules and regulations of the federal or state adviser statute.

Similarly, the Section 6E safe harbor would be available to the producer if the recommendation involved a retirement account subject to ERISA or the Internal Revenue Code and the producer was deemed to be a Sec. 3(21) fiduciary to the account holder.

A producer who is also affiliated with a broker-dealer should be aware that a fiduciary relationship may also apply under the common law in certain states, notwithstanding that this regulation disclaims fiduciary capacity for purposes of meeting the rule's compliance requirements. As such, if a court holds that a relationship of trust and confidence exists between the producer/broker and the customer, or case law holds that a securities broker is a fiduciary, then the producer/broker may be subject to fiduciary accountability for any annuity recommendations or transactions.

A producer who is also affiliated with both a broker-dealer AND a registered investment adviser (RIA) should be aware that, as mentioned above with respect to SEC guidance, the fiduciary duty of the IAR would apply to all areas of the client relationship. The IAR's capacity as a fiduciary under state law may also extend to other services provided, such as the sale of annuities.¹

QXX. When would a producer be considered to be acting as a financial professional for purposes of the safe harbor provision?

- A. The producer would be considered acting as a 'financial professional' under Sec. 6E(4) of the revised model rule and thereby subject to the other comparable standard (i.e., applicable law) at the time the recommendation was made.

¹ See, e.g., Van Dyke v. Ill. Secretary of State, (decided Mar. 21, 2019), in which the state Supreme Court held that the investment adviser acted both as an RIA and as a licensed insurance producer when he sold indexed annuities to clients, and thus was subject to legal duties under securities law and the insurance code.

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QXX. What comparable standards meet the criteria for the safe harbor?

- A. The comparable standards in the safe harbor are Regulation Best Interest (and any subsequent amendments) as promulgated by the U.S. Securities and Exchange Commission; under the antifraud provisions of Section 206 of the Investment Advisers Act of 1940, similar state statutes (including states that have adopted NASAA's Unethical Business Practices of Investment Advisers *et al*, as amended), and the applicable fiduciary duty obligations thereto; and with prohibited transaction exemptions (PTEs) and applicable fiduciary duties under ERISA and the Internal Revenue Code.

QXX. If a financial professional makes a recommendation or sale of an annuity in full compliance with a comparable standard, does the financial professional also have to satisfy all of the specific requirements of the revised model?

- A. If a consumer complaint is brought to the attention of the state insurance commissioner, depending on the facts and circumstances of the disputed transaction the commissioner may investigate and enforce the provisions of this regulation.

QXX. Are there specific conditions an insurer must meet for the safe harbor to apply?

- A. As noted in Sec. 6C(2)(i) of the regulation, the insurer shall provide a written report to senior management that details a review, with appropriate testing, to determine the effectiveness of the insurer's policies and procedures with respect to annuity recommendations and transactions. By extension, these conditions would necessarily require that the producers under its supervision furnish documentation demonstrating compliance with the comparable standard, including a written determination why the annuity recommendation was in the best interest of the consumer.

QXX. Do insurers have any other obligations under the revised model with respect to producers seeking to rely on the safe harbor?

This question is redundant to the one immediately above and unnecessary.

QXX. Are insurers required to obtain documentation from the financial professional or entity supervising the financial professional to determine that the professional's or entity's policies and procedures support a comparable standard?

- A. Yes. Unlike the regulation, which doesn't require analysis or consideration of products or investment strategies outside the authority or license of the producer, Regulation Best Interest, certain PTEs under ERISA or the federal tax code, and under an IAR's fiduciary duty, generally require documentation of reasonable alternatives considered by the agent in addition to the final recommendation. Consistent with the supervisory requirements of the Section 6E safe harbor, the insurer should establish policies and procedures that are appropriate in maintaining oversight of annuity transactions under this regulation. As such, written documentation confirming that a reasonable alternative(s) was considered under the comparable standard, and that the final recommendation was in the best interest of the client should be available to the insurer upon request.

QXX. Are insurers required to conduct regular audits, or otherwise verify, that the financial professional or entity supervising the financial professional is complying with the comparable standard?

- A. Under Section 6C(2)(i) of the regulation, insurers are required to conduct periodic audits by random sampling of annuity transactions of producers subject to the insurer's supervisory authority.

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QXX. Do insurers have to require a financial professional or the entity supervising the financial professional to utilize the specific insurer's suitability form?

A. Insurers may require a financial professional to utilize the specific insurer's suitability form as necessary and in addition to any requirements under the comparable standard subject to the Section 6E safe harbor.

QXX. Does Section 6E(2) allow an insurer to simply rely upon a statement by the financial professional or entity supervising the financial statement that the annuity recommendation complies with a comparable standard?

A. No. As discussed in QXX (regarding the Sec. 6C(2)(i) requirement to provide a written report to senior management with respect to compliance), the insurer should obtain documentation from the financial professional demonstrating compliance with the comparable standard. For example, if the producer is also an IAR relying on the Advisers Act safe harbor, the insurer could ask for random copies of disclosures and analyses related to the annuity recommendation. A statement alone by the financial professional that he or she complied with the comparable standard would not satisfy the supervisory obligations of the insurer.

QXX. Do the record-keeping obligations of the revised model apply when the safe harbor provision is invoked? Is the insurer required to maintain a copy of the consumer's financial information and annuity application or may it rely upon the entity supervising the financial professional?

A. An insurer is not required to maintain a copy of the consumer's personally identifiable financial information inasmuch as a financial professional who is a fiduciary under federal or state securities laws may violate his or her confidentiality obligations to the client. This prohibition on access to certain client data is especially significant since the IAR's fiduciary duty applies to the entire client relationship. However, the insurer should obtain any general suitability information as needed (such as the client's age, investment experience, time horizon, and specific financial goals related to the annuity recommendation) in order to evaluate compliance with the safe harbor under Section 6E of this regulation.