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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.

For purposes of this FAQ document, references to "revised model" refer to the 2020 version of Model #275.

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 compatibility with 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 and fixed indexed annuities and provides an exemption for such annuities 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 version to be a successor modification to the model that exceeds the requirements of the 2010 version, 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 version within 5 years after its adoption by the full NAIC membership in February 2020, which, in this case, would require state adoption of the 2020 version by February 2025, to maintain the status of fixed and fixed indexed annuities meeting the requirements of Section 989J as outside the scope of federal securities regulation.

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 version 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, or other mass communication media that does not involve a communication directed to a specific individual.

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 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, the standard can apply, if 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. Activities such as providing or delivering marketing or educational materials, product wholesaling or other back office product support, and general supervision of a producer do not, in and of themselves, constitute material control or influence.

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 or sale of an annuity. Can a producer provide the form at the initial client meeting?

A8. Yes, a producer can satisfy the disclosure obligation by providing a completed form during the initial client meeting.

Q9. Is the producer required to update the "Insurance Agent (Producer) Disclosure for Annuities" form in Appendix A and provide it again or can the producer provide it once and satisfy this obligation?

A9. Yes, if, after the completed form is provided to the client, the information on the completed form becomes out-of-date prior to a recommendation or sale, the producer is expected to provide the consumer with an updated form.

CONFLICT OF INTEREST OBLIGATION

Q10. Why did the NAIC determine that "cash and non-cash compensation" is not a material conflict of interest (as defined in Section 5I(2))?

A10. Under the revised model, a producer is required to act in the best interest of the consumer without placing their or the insurer's financial interest ahead of the consumer's interest. The revised model contains a disclosure requirement in which producers must prominently disclose to a consumer, using a disclosure form (similar to Appendix A), their relationship with the consumer, the role they will play in the transaction and a description of the cash and non-cash compensation they will receive. In light of these robust disclosures, and the fact most consumers recognize producers will be compensated for their work, the NAIC determined that compensation is not a material conflict of interest.

The NAIC also determined that general incentives regarding production levels with no emphasis on any particular product do not create an unanticipated conflict of interest.

However, the NAIC did conclude that sales contests, sales quotas, bonuses and non-cash compensation based on sales of specific annuities within a limited time frame should be avoided. Accordingly, the revised model requires insurers to identify and eliminate these arrangements.

Q11. 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)?

A11. The revised model defines material conflict of interest as "a financial interest of the producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation." Cash and non-cash compensation are not considered to be material conflicts of interest, though the revised model does require disclosure about producer compensation and impose restrictions on certain types of non-cash compensation, as described in Q14/A14 below. An ownership interest (such as where a producer has a material ownership interest in an insurance company whose products the producer is authorized to recommend) is one example of a material conflict of interest that would be subject to the revised model's conflict of interest obligation. Depending on the particular facts and circumstances, a producer could also be deemed to have a material conflict of interest if, for example, he or she borrowed funds directly from a certain insurer (except for loans taken by a producer under his or her own personal insurance policy or contract) or has a spouse, partner or a close relative who works as a senior executive for a particular insurer.

Q12. Under Section 6A(3), to satisfy the conflict of interest obligation, what must a producer do to identify and avoid or reasonably manage and disclose a material conflict of interest? Examples?

A12. The appropriate steps to satisfy the obligation to identify and avoid or reasonably manage and disclose material conflicts of interest will depend on the specific facts and circumstances. In some cases, material conflicts of interest can be effectively managed by a producer by informing his or her client of the conflict and answering any questions the client may have regarding the conflict and confirming that the client is willing to continue working with the producer. In other instances, informed disclosure alone may be insufficient and is not in the client's best interest or that puts the producer's own financial interests ahead of the client's interest. In such instances, a producer could, for example, consult with his or her manager, supervisor or agency principal to assess whether a conflict is inappropriately influencing the impartiality of the producer's recommendations. Finally, there may be material conflicts of interest that cannot be effectively mitigated through informed disclosure and additional measures. In those situations, the producer would have to avoid engaging in the activity or relationship that would give rise to the conflict, or, alternatively, abstain from making the recommendation. In all cases, the producer must ultimately and before making a recommendation have a reasonable basis to believe the producer's professional relationship or capacity along with any related annuity recommendation effectively addresses the consumer's financial situation, insurance needs and financial objectives.

<u>SUPERVISION SYSTEM</u>

Q13. Does the revised model require insurers to set up new supervision systems to ensure producer compliance with this new standard of conduct?

A13. No, but the revised model does 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.

Q14. 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?

A14. As the provision 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. For example, this provision would apply where a producer's eligibility for a particular bonus is tied to his or her sales of a particular annuity product during a particular month. However, 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 the sale of specific annuities within a limited period of time. Section 6C(2)(h) reflects the efforts for these revisions to be compatible with other financial service rule updates, such as the recent prohibition on most sales contests, quotas and bonuses tied to the sales of particular offerings that the SEC and FINRA have implemented. See Reg. BI and FINRA Rules, including Rules 2111, 2320, 2341 and 5110.

PRODUCER TRAINING

Q15. Are there new producer training obligations under the revised model?

A15. Yes, all producers must complete a one-time training course that covers general annuity principles – including the types and uses of annuities, how annuity contract features affect consumers, and tax implications – as well as information about the new standard of conduct and the other requirements of the revised model. The specific training required depends on what prior training the producer has completed.

Q16. How can a producer satisfy the training requirements in the revised model?

A16. A producer who has completed the annuity training requirements under the prior version of the model must complete <u>either</u> a new four-credit training course that meets the requirements of the revised model <u>or</u> the one-credit training course that focuses on the new sales practices, replacement and disclosure requirements established by the revised model. Courses must be approved by the insurance department.

A producer who has <u>NOT</u> completed the annuity training requirements under the prior version of the model must complete the four-credit training course that meets the requirements of the revised model. Producers who have not completed the annuity training requirements under the prior version of the model <u>may not</u> satisfy the training requirement by taking only the one-credit training course.

Q17. Does the training requirement apply to producers who are registered with FINRA?

A17. Yes, all producers who engage in the sale of annuities, including those registered with FINRA, must complete the training required by the revised model.

Q18. When must producers complete the training requirements in the revised model?

A18. A producer who has completed the annuity training requirements under the prior version of the model has six months to take the required training. Such producers may continue to recommend and sell annuities during the six-month grace period.

A producer who has NOT completed the annuity training requirements under the prior version of the model must complete the required training before engaging in the sale of annuities.

Q19. What are the consequences of failing to satisfy the training requirements of the revised model?

A19. A producer who fails to satisfy the training requirements is not permitted to recommend or sell annuities. A producer who recommends or sells annuities without completing the required training may face enforcement action by the insurance department.

Q20. Can a producer requalify to recommend and sell annuities after failing to satisfy the training requirements of the revised model within the six-month grace period?

A20. Yes, a producer who has completed the training required under the prior version of the model can requalify to recommend and sell annuities by completing the new four-credit training course prior to recommending or selling annuities.

Q21. If a producer already completed the new training in another state, will they have to retake the training in every state where they may recommend or sell annuities?

A21. No, completion of substantially similar training in one state satisfies the training requirement in other states. Producers are not required to take the new training multiple times.

Q22. Do producers have to wait for the revised model to take effect in a particular state before taking the new required training?

A22. No, a producer can take the training at any time as long as the course they take has been approved by the insurance department in a state where the producer is licensed.

Q23. Will a producer get CE credit for taking the new training?

A23. A producer who completes the required training will receive CE credit only if the course was approved by their resident state prior to the date the course was taken, and the course provider submits a roster and all applicable fees to the insurance department in the producer's resident state.

Q24. Can a producer satisfy the training requirements by taking a longer course that covers the required training plus additional content?

A24. Yes, the revised model states that a producer can also satisfy the training requirement by completing any course that is approved by the insurance department and includes components that are substantially similar to the one-credit or four-credit training course.

Q25. Will completion of a course that meets the requirements of the revised model also satisfy the training requirement under the prior version of the model in a state which has not yet adopted the revised model?

A25. Yes, completion of the new four-credit training course (but not the one-credit training course) will satisfy the training requirements under the prior version of the model. The new course includes all of the topics that were required to be covered under the prior version of the model (with information on the new requirements established by the revised model). A producer who has completed this course is not required to also complete a course that satisfies the prior version of the model in states that have not yet adopted the revised model.

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