Financial Security...for Life.

Carl B. Wilkerson
Vice President & Chief Counsel, Securities & Litigation

October 3, 2017

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

Re: SEC Chairman's Request for Information on Standards of Conduct for Investment Advisers and Broker-Dealers

By Electronic Delivery

Dear Mr. Fields:

The American Council of Life Insurers ("ACLI") is a national trade association representing 290 life insurers that hold over 95 percent of the industry's total assets. Our members serve 75 million American families that rely on life insurers' products for financial and retirement security. Our members offer life insurance, annuities, retirement plans, long-term care, disability income insurance, and reinsurance.

We appreciate the opportunity to share our views on the Chairman's Request for Information ("CRFI") on appropriate standards for broker-dealers and investment advisers. Our submission responds to the opening dialog in the CRFI, addresses specific questions in the CRFI, and focuses on a best interest standard of care from the perspective of life insurers and their distributors.

ACLI has fully participated in the evolving dialog about the regulation of broker-dealers and investment advisers, including the SEC's 2011 Study Report in response to Section 913 of the Dodd–Frank Wall Street Reform and Consumer Protection Act[1] ("Dodd Frank Act"), the SEC's 2013 Request for Data and Information on the Duties of Brokers, Dealers, and Investment Advisers,[2] the 2009 Rand Report[3] to the SEC on Investor and Industry Perspectives on Investment Advisers and Broker-

[1] Public Law 111–203, 124 Stat. 1376 (2010).
[2] ACLI Submission on the SEC's Request for Data and Information on the Duties of Brokers, Dealers and Investment Advisers (July 5, 2013); https://www.sec.gov/comments/4-606/4606-3136.pdf (last visited October 6, 2017).
[3] ACLI's RAND Study Submission (and those of other commentators) does not appear to be available on the SEC's website or through RAND. That background may be useful as the SEC proceeds along this evolving continuum. We also note that the RAND report included scant, if any, reference to the role life insurance salespersons play in the distribution of IA and BD services. It will be important to include the insurance industry in the CRFI.

American Council of Life Insurers
101 Constitution Avenue, NW, Washington, DC 20001-2133
(202) 624-2118 t (866) 953-4096 f carlwilkerson@acli.com
www.acli.com

Dealers, and other regulatory initiatives. The CRFI reflects another important element in this vital analytical continuum.

I. Response to the Opening Statements in the CRFI

Life insurers agree with the Chairman's observation that the Department of Labor's Conflict of Interest Rule (i) may have significant effects on retail investors and entities regulated by the SEC, (ii) may have broader effects on U.S. capital markets, and (iii) invokes matters within the SEC's mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation.

ACLI supports the Chairman's statement that clarity, consistency and coordination among regulators are essential elements of effective oversight and regulation.[4] Life insurers commend the mutual coordination expressed by SEC Chair Clayton and DOL Secretary Acosta to develop a best interest standard. We encourage the SEC's continued outreach to state regulators and the National Association of Insurance Commissioners (NAIC) as partners in the development of a best interest standard.

Life insurers agree that "significant developments in the marketplace since the SEC last solicited information from the public in 2013 include financial innovations, changes to investment adviser and broker-dealer business models, and regulatory developments," such as the DOL's adoption of its Conflict of Interest Rule (the "Fiduciary Rule" or the "Rule") in 2016. We concur with the CRFI that "an updated assessment of the current regulatory framework, the current state of the market for retail investment advice, and market trends is important to the SEC's ability to evaluate the range of potential regulatory actions." The SEC's regulatory framework assessment should include the comprehensive network of state insurance regulation.

II. Summary of ACLI's Position

- To meet their financial and retirement security needs, retirement savers deserve standards ensuring continued access to a wide variety of retirement products, retirement savings information and related financial guidance from financial professionals acting in their best interest.[5]

[4] We concur with the SEC Chairman's recent statement in a speech at the New York Economic Club that "it is important that the Commission make all reasonable efforts to bring clarity and consistency to" the issues surrounding the Fiduciary Rule, and the desire to "act in concert with our colleagues at the Department of Labor in a way that best serves the long-term interests of" America's retirement savers . *See* Remarks at the Economic Club of New York -SEC Chairman Jay Clayton (July 12, 2017) https://www.sec.gov/news/speech/remarks-economic-club-new-york [last visited on October 1, 2017].

[5] Unfortunately, DOL's Fiduciary Rule fails these goals and threatens the financial well-being and retirement security of working Americans. The rule's BIC Exemption is unworkably complex and reflects a bias for fee-based investment advice over commission, or transaction-based advice. For all but the wealthiest retail investor community, fee-based advice is frequently inaccessible and unaffordable. The alternate robo-advice envisioned under the rule does not fulfill retirement security and generated a harmful advice gap for moderate income retirement savers under a parallel UK initiative. The rule exposes distributors of financial services and products to a significant risk of widespread private plaintiffs' class action claims. A uniform best interest standard of care across all regulatory platforms, not state courts and the plaintiffs' bar, provides a superior means of consumer protection and retirement security. Our August 7, 2017 and July 21, 2017, submissions to DOL explain in greater detail the Fiduciary Rule's functional deficiencies. *See* https://www.dol.gov/sites/default/files/ebsa/laws-

- ACLI supports appropriately tailored uniform standards requiring all financial sales professionals to act in the best interest of their customers.
- The SEC's depth and decades of experience concerning the regulation of investment advisers and broker-dealers provides an excellent foundation for developing a constructive best interest standard that can be uniformly applied across all regulatory platforms, including state insurance regulations. In this way consumers will enjoy a consistent level of protection and will be able to obtain access to a wide range of retirement products and advice.
- Regulatory circumstances have evolved since the adoption of the Fiduciary Rule, with the SEC and state insurance regulators fully engaged in working toward a uniform "best interest" standard of care.
- DOL's commendable proposal to postpone the effectiveness of the Fiduciary Rule for 18 months provides a significant opportunity for careful further input and analysis, and reconsideration of the Fiduciary Rule's approach.[6] Joint collaborative efforts between the SEC, FINRA, DOL and state insurance regulators will generate a uniform best interest standard across all regulatory platforms that properly protects consumers while advancing financial and retirement security.
- It is constructive to review existing regulatory systems, identify areas in need of improvement, and examine the economic impact of potential modifications. Conscientious evaluation of the many different business models operating in this space will contribute to efficient, effective regulation.

III. Life Insurers' Interest in the CRFI

Life insurers create and market products and services that fulfill consumers' retirement, estate, tax, and financial planning needs[7]. These products and services can implicate the federal securities laws,

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and-regulations/rules-and-regulations/public-comments/1210-AB82/00523.pdf and https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00267.pdf respectively. [last visited on October 1, 2017].

[6] DOL filed with the Office of Management and Budget a Request for Extension of Transition Period and Delay of Applicability Dates From January 1, 2018 to July 1, 2019; Best Interest Contract Exemption; Class Exemption for Principal Transactions; PTE 84-24 (Aug. 9, 2017) https://www.reginfo.gov/public/do/eoDetails?rrid=127484 [last visited on October 1, 2017]. OMB granted the request on August 28, 2017 https://www.reginfo.gov/public/do/eoDetails?rrid=127485 [last visited on August 28, 2017].

[7] With the decline of defined benefit pensions and the uncertain health of federal safety net programs like Social Security and Medicare, financial services consumers in the United States bear increasing personal responsibility for their own financial wellbeing. Life insurers and their affiliates, like other financial services providers, have responded to consumers' needs with a wide range of products and services. These products and services often include:

- term life insurance;
- fixed and variable cash value life insurance;
- disability income insurance;
- long term care insurance;
- many variations of fixed and variable annuity contracts;
- investment brokerage services, including: stocks, bonds, mutual funds, ETF's, and 529 savings plans;
- investment advisory services, including: financial planning, fee based wrap accounts, and separately managed accounts;
- individual and business retirement planning;
- estate planning and trust services;

including broker-dealer regulation by the SEC and FINRA under the Securities Exchange Act of 1934, regulation by the SEC under the Investment Advisers Act of 1940, and regulations administered by DOL under the ERISA statute. ACLI has actively participated in the Federal securities rulemaking process for over four decades. Life insurers must also fulfill a comprehensive set of state insurance laws and regulations in every U.S. jurisdiction, that are highlighted below in Appendix A.

Life insurers fill a unique and important role in providing financial and retirement services to the less affluent and the middle-income markets that are neglected by other financial service institutions. Life insurance agents serve small towns across the country that are beyond the scope of other financial service providers. This broad geographic and economic outreach enhances American's financial and retirement security.

As institutional investors, life insurers contribute significantly to the U.S. economy and capital formation. These important contributions are further explained below in Section IV of this submission.

In sum, life insurers' products, functions, services and regulation fit within the scope and purpose of the CRFI. It is critical, therefore, that the SEC properly include life insurers' unique products, services, regulation and regulators within the CRFI process.

IV. The Role of Life Insurers in U.S. Capital Formation and the Economy

The CRFI notes that the Fiduciary Rule may have a broad impact on the U.S. capital markets and implicates issues within the SEC's jurisdictional charge, such as capital formation. The SEC website emphasizes that "the SEC's regulation of the securities markets facilitates capital formation, which helps entrepreneurs start businesses and companies grow. Last year nearly $2.5 trillion was raised in public and private securities offerings, promoting economic growth and job creation." These are important considerations in evaluating the impact of the Fiduciary Rule and designing a functional best interest standard.

Life insurers are significant institutional investors that have a major role in U.S. capital formation and the U.S. economy. Life insurers' assets supporting fixed insurance products ($4.25 trillion) and variable insurance products ($2.52 trillion) reflect a substantial percentage of the U.S. equities and bond market. Life insurers' assets are invested in corporate bonds (33%), stocks (31%), government bonds (8%), commercial mortgages (6%), and other assets (22%). Life insurers are the largest institutional investor in U.S. corporate bond financing. Approximately 49% of life insurers' $6.7 trillion total assets in 2016 were held in long-term bonds, and over 38% of corporate bonds purchased by life insurers have maturities exceeding 20 years (at the time of purchase).[8] Life insurers, therefore, are one of the principal sources of long-term corporate financing, and have an important impact on the U.S. economy.

As documented below in Section VIII, the Fiduciary Rule has caused a significant reduction in the sale of new insurance products. Variable annuity sales declined 21 percent in 2016 (from $133 billion

- non-qualified employee benefit consulting; and,
- 401(k) and other qualified plan design, funding and administration.

[8] These calculations are based on data from the 2016 NAIC Annual Statement Data and ACLI calculations based on and the U.S. Federal Reserve Board, Flow of Funds Accounts of the U.S.

in 2015 to $104.7 billion). Further, in the first quarter of 2017, variable annuity sales declined 8 percent, year-over-year, to $24.4 billion, and indexed annuity sales were off 13 percent, to $13.6 billion. Consequently, life insurers have fewer new assets to invest in U.S. capital formation and the economy. Fragmented regulatory approaches also burden the economic and retirement security of less affluent and middle-income markets distinctively served by life insurers.

The Fiduciary Rule's profound negative impact on the sale of insurance products, therefore, directly implicates the U.S. economy, capital markets, and the SEC's jurisdictional charge over capital formation, especially concerning long-term bonds. The burden the Fiduciary Rule has inflicted on annuity sales also caused an adverse ripple effect on the contributions of agents and distributors to the economy, tax revenue and small business employment. In place of the Fiduciary Rule, a best interest standard of conduct would both protect consumers and enable the continuation of life insurers' contributions to capital formation and the economy.

V. Life Insurers' Current Regulatory Framework

The CRFI emphasizes that an updated assessment of the current regulatory framework is important to the SEC's ability to evaluate the range of potential regulatory actions. To that end, life insurance companies and their associated persons currently fulfill a broad array of regulation administered by state insurance departments, the Securities and Exchange Commission (SEC), the DOL, the Financial Industry Regulatory Authority (FINRA), and various state securities departments.

Existing comprehensive regulations govern important aspects of the customer relationship, including suitability standards, disclosure, advertising, supervision, maintenance of customer account assets, data collection, training, compensation, and supervision of associated persons. In general, the federal securities laws and FINRA rules govern individual variable insurance contracts, and state insurance laws and regulations apply to fixed insurance products. In some cases, insurance products invoke both federal and state laws. Collectively, this body of regulatory provisions and oversight provide important consumer protection and strong enforcement tools.

We have attached Appendix A to highlight the extensive network of laws and regulations governing insurance product sales activities. Laws and regulations most relevant to the CRFI include:

- The National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions Model Regulation;
- FINRA Rule 2330 governing suitability and supervision in the sale of variable annuities;
- FINRA Rule 2320 governing non-cash compensation for variable products and mutual funds;
- The NAIC Annuity Disclosure Model Regulation;
- The NAIC Model Replacements Regulation, and state insurance regulations such as New York Regulation 60 which governs replacements;
- The NAIC Unfair Trade Practices Act and the prohibition on "unfair financial planning practices;" and,
- State insurance consulting laws governing the simultaneous receipt of product commissions and fees for insurance consulting services.

Life Insurers provide significant written disclosures at the point of sale to satisfy multiple regulators' requirements and to help customers understand the nature of their various products and relationships. These disclosures include many product related materials (insurance sales illustrations, policy contracts, required "buyers' guides," prospectuses), marketing materials describing the firm's offerings, documents that provide the terms for a brokerage or advisory relationship (brokerage account agreements, advisory account agreements, Form ADV, investment policy statements), and other required disclosures.

Life insurers fulfill a considerable amount of post-sale disclosure depending on the nature of products and services provided, such as in-force insurance ledgers, transaction confirmations, periodic performance reporting for investment accounts, and updated Form ADV brochures. Several state and Federal laws are designed to ensure appropriate sales practices and suitable recommendations consistent with customers' financial objectives and best interests.

Insurance products are the only products in today's financial marketplace with free-look provisions extending for 10 or more days. These features give consumers a meaningful opportunity to carefully evaluate purchases after the sale and to change their mind for any reason, including cost factors, to receive a refund.

In its August 7, 2017 response[9] to DOL's July 6, 2017 Request for Information (RFI) about the Fiduciary Rule, the NAIC discussed state insurance regulatory standards and explained that:

> *All annuity contracts, including fee-based annuity contracts, must comply with applicable state laws including those addressing, for example, required policy provisions, prohibited policy provisions, permitted exclusions and prohibited exclusions, policy format requirements, readability requirements and supporting documentation requirements, such as actuarial memorandum requirements.*
>
> *Generally, the policy, application, riders and endorsements are required to be submitted in the filing along with the actuarial documentation to demonstrate compliance with nonforfeiture requirements. Some states will perform prior review and approve the product for sale in advance ("prior approval") while other states permit insurers to file the product and sell it unless the product filing is disapproved by the regulator ("file and use.") In addition, 44 states and Puerto Rico, representing more than 75% of premium volume, are part of an Interstate Insurance Compact (Compact).*
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> *The Compact established a multi-state public entity, the Interstate Insurance Product Regulation Commission (IIPRC), which serves as an instrumentality of the Member States. The IIPRC stands in the shoes of the compacting states and serves as a central point of electronic filing for certain insurance products, including life insurance, annuities, disability income, and long-term care insurance to develop uniform product standards, while at the same time affording a high level of protection to purchasers of asset protection insurance products.*

In summary, an updated assessment of the current state insurance regulatory framework is important

[9] *See* NAIC Comment on RIN 1210–AB82 Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions (Aug. 7, 2017) https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00452.pdf [last visited on October 1, 2017].

to the SEC's ability to evaluate the complete range of potential regulatory actions, as emphasized in the CRFI. Partnership between state insurance regulators, the SEC, DOL and FINRA will fulfill this commendable goal more fully.

VI. Preexisting Mechanisms and Current Endeavors Toward a Uniform State-Federal Best Interest Standard

Currently parallel state-Federal regulations provide a valuable template to build and implement a uniform best interest standard across all regulatory platforms. FINRA Variable Annuity Suitability and Supervision Rule 2330 strictly governs broker-dealers' sale of variable annuity contracts.[10] Rule 2330 is more restrictive and proscriptive than FINRA's general suitability and supervision rules for other securities. For example, unlike the supervision standards for other securities, Rule 2330 requires registered principals to review <u>each</u> variable annuity purchase and approve <u>every</u> purchase or exchange of a deferred variable annuity. In contrast, registered principals are not required to review and approve every registered representative's general securities transactions recommendation.

As further explained in Appendix A, Rule 2330 mandates very detailed standards for recommendations, documentation and signatures, tailored training for both registered representatives and principals, and confirmation that the customer would benefit from the features of a variable annuity. This rule assures that customers' needs are properly matched with products recommended.

In a directly parallel regulatory action, the National Association of Insurance Commissioners (NAIC) incorporated standards from FINRA suitability and supervision rules in the NAIC Suitability in Annuity Transactions Model Regulation. As a result, this Model Regulation ensures levels of protection for fixed annuity customers equal to those found in FINRA rules for variable annuity customers. The Model Regulation, therefore, provides a very effective means to implement a uniform state-Federal best interest standard that may be effectuated through FINRA's suitability and supervision rules.

At the NAIC Summer 2017 National Meeting August 6, 2017, the NAIC's Annuity Suitability Working Group continued discussion about amendments to the Suitability in Annuity Transactions Model Regulation focused on a best interest standard.[11] Accompanying materials for the Working Group's meeting indicate that during a July 26, 2017, conference call the Working Group received an overview of the American Council of Life Insurers' (ACLI) "Uniform Standard of Care" proposal that is designed to ensure common uniform definitions, common disclosure requirements and common guiding elements among the states, the SEC and the DOL for the entities and individuals they regulate as each proceeds to develop new standards of care or revise their existing standards of care.[12] ACLI's recommended process for a uniform State-Federal best standard is depicted in the graphic illustration below (next page).

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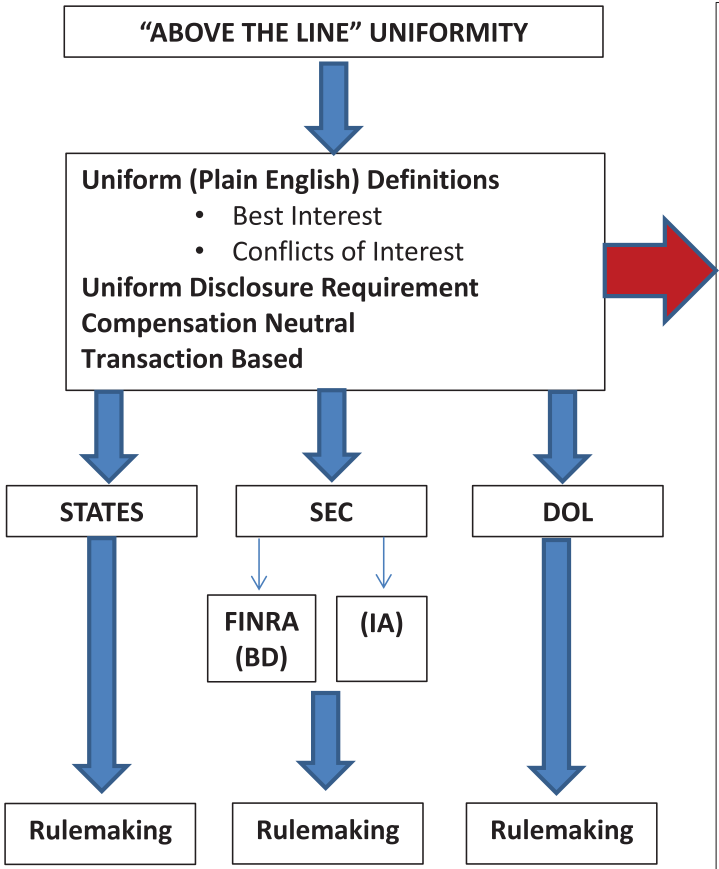
[10] A detailed summary of the very detailed and specifically tailored requirement of FINRA Rule 2330 to variable annuities appears in Appendix A.

[11] *See* Item 3 in the Agenda for the NAIC Annuity Suitability Working Group meeting Aug. 6, 2017 http://naic.org/meetings1708/cmte_a_aswg_2017_summer_nm_agenda.pdf?1503884754509 [last visited on October 1, 2017].

[12] See discussion about Item 2 in materials accompanying NAIC Annuity Suitability Working Group meeting Aug. 6, 2017 http://naic.org/meetings1708/cmte_a_aswg_2017_summer_nm_materials.pdf?1503885101231 [last visited on October 1, 2017].

UNIFORM STANDARD OF CARE

Goal: Approved by Industry, Regulators, and Consumer



Common Uniform Definitions:

A recommendation is in the "Best Interest" of the consumer when the [advisor/rep/broker/insurance producer]:

- puts the consumer's interest first;
- acts with reasonable care, skill, prudence and diligence in gathering and evaluating the Consumer's Profile Information used to make the recommendation;
- makes no misleading statements;
- provides full disclosure of the recommended [investment/insurance product]'s features, fees, and charges;
- fairly discloses how and by who the [advisor/rep/broker/insurance producer] will be compensated; and
- avoids, discloses or reasonably manages Material Conflicts of Interest.

"Material Conflict of Interest" means a financial interest of an [advisor/rep/broker/insurance producer] that makes a recommendation that a reasonable person would expect to affect the impartiality of such recommendation.

Common Disclosure Requirement:

Material Conflicts of Interest must be disclosed at or prior to the point of sale or at the time the recommendation is made (no requirement for more frequent or annual disclosures). This disclosure must include:

- the types and scope of services provided; and
- the types of compensation received by the person making the recommendation [or related party] or that the customer may pay as a result of the recommendation.

Common Guiding Elements:

Neutrality -- The uniform standard of care is neutral to business model, product type, and compensation approach such as commissions, fees, hourly rates, or sales charges, or other fees or variable compensation.

- The fact that an advisor or firm only offers or recommends proprietary or a limited range of products or product types or receives commissions or other variable compensation shall not be inconsistent with this uniform standard of care.
- The uniform standard of care does not require a recommendation of the least expensive or "best" product available.

Transaction Based – Unless otherwise agreed to in writing by the advisor and consumer, the uniform standard of care is a transaction based standard that is applied when a recommendation is made, and there is no further or ongoing obligation under the standard.

In its August 7, 2017 response[13] to DOL's July 6, 2017 Request for Information (RFI) about the Fiduciary Rule, the NAIC explained that:

> *[I]n fulfilling the Congressional intent of Section 989j of the Dodd-Frank Act, we strive for an appropriate amount of regulatory consistency and harmony with other regulators across all uses and sales channels. Coordination and consultation with state and Federal securities regulators with the DOL at this critical juncture would ensure that our approaches are as consistent and compatible as possible to provide effective, clear standards for consumer protection, while avoiding excessive compliance burdens on the industry. We also hope to be a resource to the DOL as its evaluates the existing rule, how it fits with the existing regulation of insurance products and agent sales, and the impact of the rule on the insurance sector and retirement product purchasers.*[14]

Significantly, the NAIC also indicated in its comment on the DOL RFI:

> *[I]f the SEC were to adopt revised standards of conduct for advisers or FINRA were to adopt best interest standards for registered representatives, those standards would involve supervisory systems that are generally recognized by state insurance regulators as complementary. Indeed, insurance regulation is currently in harmony with federal and state securities regulation for shared distribution channels. In addition, consumer protection is the hallmark of the state-based insurance regulatory system, and a robust regulatory framework upon which an exemption could be based already exists with respect to the sale of insurance and annuity products. In particular, state insurance regulators operate locally to their states and consumers, and can respond relative quickly to issues when they arise.*[15]

The NAIC further explained in its comments to DOL's RFI that:

> *Market analysis and risk-based consumer protection by state insurance regulators, and insurance sector compliance, has significantly increased since the passage of Section 989J [of the Dodd-Frank Act]. While reconsideration of insurance adviser standards of conduct is warranted, the NAIC has a strong interest in avoiding insistent market regulation across the business of insurance. Notwithstanding the existing rules, we acknowledge that there is broad consensus among widely disparate groups for an updated and consistent standard for providing personalized investment advice to retail investors. Accordingly, we have been working to update our suitability standards and sales practices for life insurance and annuities. The NAIC is in the process of considering revisions to its suitability rules to potentially include a best interest standard of care… We strongly encourage [Federal] regulators to coordinate with us as we seek to update these rules.*[16]

In sum, state insurance regulations provide a perfect template for consistent, harmonious implementation of a best interest standard across state and Federal regulatory platforms. The NAIC

[13] *See* NAIC Comment on RIN 1210–AB82 Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions (Aug. 7, 2017) https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00452.pdf [last visited on October 1, 2017].
[14] *Id*. at 1.
[15] *Id*. at 2.
[16] *Id*. at 3.

has unequivocally indicated its desire to work with the SEC, FINRA, and DOL to develop a best interest standard. It is incumbent on Federal regulators, therefore, to include state insurance regulators in the multi-regulator development of a best interest standard. A uniform best interest standard would then be jointly and constructively adopted across all regulatory platforms.

VII. A Reasonable, Appropriately Tailored, and Uniform State-Federal Best Interest Standard & America's Financial and Retirement Security Challenges

Retirement savers deserve standards ensuring continued access to a wide variety of retirement products, retirement savings information and related financial guidance from financial professionals acting in their best interest. As explained further in Section VIII of this letter, the Fiduciary Rule thwarts the delivery of advice and financial solutions to retirement savers. With a workable, uniform best interest standard, retirement savers will be able to obtain advice to meet their financial and retirement security needs.

A constructive best interest standard would require financial professionals to put a consumer's interest first by (i) acting with reasonable care, skill, prudence, and diligence in gathering and evaluating information regarding the consumer that is used to make the recommendation; (ii) making no misleading statements; (iii) providing full and fair disclosure of the recommended product's features, fees, and charges; (iv) fairly disclosing how and by whom the financial professional is compensated; and (v) avoiding, disclosing, or otherwise reasonably managing material conflicts of interest.

Unreasonable and poorly tailored rules, such as the Fiduciary Rule, will harm the very retirement savers regulators are trying to help. Annuities are a case in point.

Annuities play a significant part in today's retirement savings marketplace, particularly with respect to the retail IRA market. Indeed, DOL itself found that thirty-one percent of IRAs include investments in annuities.[17] The widespread use of annuities reflects the significant value that retirement investors attach to annuity products as a means to help save for retirement while also managing and balancing different retirement risks.

An annuity is the only form of longevity protection in today's market. It allows investors to convert retirement savings into a stream of monthly guaranteed income for life—a process known as "annuitization." With the shift away from defined-benefit plans, without an annuity, a retiree now bears the risk of outliving his or her retirement savings. That risk is becoming only more significant as Americans live longer. An annuity enables the retirement saver to transfer that longevity risk—the risk they will live longer than expected—to the insurer.

The peace of mind that annuities provide against longevity risk improves retirees' overall well-being and mental health. A study commissioned by the DOL "found that beneficiaries of lifelong-guaranteed income—such as from a privately-purchased annuity…were more satisfied in retirement and suffered from fewer depression symptoms than those without such income."[18] The "boost in well-being became stronger" the longer the person was retired—a finding "consistent with the notion that retirees

[17] *See*, *e.g.,* Fiduciary Investment Advice, Regulatory Impact Analysis 54 (Apr. 2015) ("Proposed RIA").
[18] Michael J. Brien & Constantijn W.A. Panis, *Annuities in the Context of Defined Contribution Plans: A Study for the U.S. Department of Labor, Employee Benefits Security Administration* (Nov. 2011).

who rely on finite savings and [defined-contribution] plan assets grow increasingly worried about funding retirement expenses as they grow older and deplete their assets, whereas recipients of lifelong-guaranteed income, other than from Social Security, are less concerned with outliving their resources."[19]

As noted above, life insurers fill a unique and important role in providing financial and retirement services to the less affluent and the middle-income markets that are neglected by other financial service institutions. Life insurance agents serve small towns across the country that are beyond the scope of other financial service providers.

Importantly, despite the value of annuities to retirees' overall wellbeing, annuities are not well understood by consumers, who often need education about the value of these essential products with guaranteed lifetime income. Continued access to a full range of financial advice under a best interest standard of conduct will enable consumers to obtain essential information for educated purchase decisions. Life insurance salespersons help customers obtain core information through "needs analysis" programs, mandatory disclosures, comparative illustrations, and the elements of state and Federal suitability obligations, among other things. This long-standing advisory and information-sharing process helps Americans conduct informed purchase decisions, and enhances financial and retirement security.

ACLI RESPONSES TO QUESTION GROUPS IN THE CRFI

VIII. The Fiduciary Rule's Harm to Consumers and the Marketplace (Question Group 5)

A. Financial Service Providers Have Already Implemented Minimum Account Balances and/or Eliminated Commission-Based Fee Arrangements to the Detriment of Savers

The ongoing harm to retirement investors because of this rulemaking project is not speculative - it is very real and supported by data and evidence. Due to bias against commission-based compensation arrangements, the Fiduciary Rule has already resulted in restricted consumer access to annuities - the only products available in the marketplace providing guaranteed lifetime income - and has already restricted or eliminated IRA account owners' and qualified plan sponsors' access to financial assistance.

The Fiduciary Rule is already having a harmful impact on small and medium retirement account holders. Several large financial firms have implemented account minimums ranging as high as $250,000 to obtain investment guidance, while others have eliminated commission-based arrangements altogether, in favor of more expensive, actively managed, fee-based arrangements. Attachment B is a letter received by an employee of one of ACLI's members, informing her that,

[19] *Id.*

because of the Fiduciary Rule, her retirement account is being transitioned to a self-directed brokerage account, with no further investment guidance.

American investors are losing access to advice. One need only read the daily financial headlines over the past six months to have observed this concerning trend. For example, it has been reported that JPMorgan Chase wealth management clients with individual retirement accounts were moved from advised to self-directed products on April 7, 2017. That shift in approach appears to have been precipitated entirely by the Regulation's anticipated applicability. Similarly, Merrill Lynch is reportedly requiring retirement investors who are currently served by the firm through transaction, commission-based accounts to either go without any advice, or enter into an agreement where the investor pays an asset-based fee to receive investment advice -- whether or not any transactions occur. A recent study conducted by the LIMRA-LOMA Secure Retirement Institute found that 54 percent of advisors will be forced to drop or turn away small investors.[20]

Most annuities today are sold through a transaction, commission-based compensation structure. The use of commissions to sell annuities also reflects the "buy and hold" nature of annuity products. In a fee-for-advice arrangement, a consumer pays an adviser to manage his or her money on an ongoing basis pursuant to a pre-determined investment strategy. A fee-based arrangement, therefore, makes little sense for broker-dealers and insurance agents who market and sell fixed and fixed-index annuities, as these products do not typically necessitate continual advice and investment management. In addition, fee-based models generally carry account balance minimums (typically between $100,000 and $250,000), and are used with customers who maintain high balances and are engaged in active trading. They are, therefore, more expensive and may be inappropriate for many investors with small or mid-sized accounts who trade or rebalance infrequently.

Citing a study finding that advisors earn 0.54 percent on commission-based accounts versus 1.18 percent on fee-based accounts, the American Action Forum recently estimated that the Fiduciary Rule has the potential to increase consumer costs by $46.6 billion, or $813 per IRA account holder.[21] Indeed, the SEC and FINRA recognize that transitioning clients to fee-based arrangements is suitable only under certain circumstances. In recent years, SEC and FINRA have increasingly scrutinized broker-dealers' placement of investors into accounts that require payment of a fixed fee but generate little or no activity to justify that fee.

B. The Fiduciary Rule Has Already Disrupted Lifetime Income Product Distribution Channels

Given the bias against commission-based products, it is not surprising that the Fiduciary Rule is already disrupting and limiting lifetime income product distribution channels. Prior to the Rule, banks distributed annuities to low and middle-income market. ACLI members report that low and middle-income bank channel sales have significantly decreased due to the risks and compliance costs associated with the Fiduciary Rule and PTEs. A recent study found that 29 percent of banks and credit unions will drop some guaranteed income products, in response to the Rule.[22] Other ACLI

[20] DOL Viewpoints - *The Proposed Fiduciary Rule: Advisors' Pers*pective, LIMRA Secure Retirement Institute (2016).
[21] Meghan Milloy, *The Consequences of the Fiduciary Rule for Consumers*, American Action Forum (Apr. 10, 2017).
[22] DOL Viewpoints – *Banks and Credit Unions: Preparing for Change*, LIMRA Secure Retirement Institute (2016).

members have reported that broker-dealers are dropping variable annuities from their offerings due to the increased liability associated with distributing these products because of the Fiduciary Rule. The Rule also has impacted traditional fixed annuities, as well as the distribution of non-qualified annuity and long-term care combination products. These products not only provide retirement security, but enable consumers to financially prepare for their life insurance and long-term care needs later in life.

Further, the disruption and dislocation due to the Fiduciary Rule is particularly concentrated in the retail advisor community. Retail advisors are losing their jobs and are shuttering their businesses because of the Rule. An ACLI member reports that it has laid off 95 call center employees due to the liabilities associated with the Rule and Prohibited Transaction Exemptions (PTEs).

As DOL has acknowledged, most fixed index annuities are sold by independent insurance agents. Many are supported by independent marketing organizations ("IMOs"), specialized marketing organizations that lend assistance to distributors of life insurance company products, including fixed indexed annuities, through independent agents. Because of the Fiduciary Rule, IMOs and the independent agents that work with IMOs will in most cases no longer be able to distribute fixed indexed annuity products. In fact, DOL's proposed exemption to cover the sale of fixed indexed products imposes financial barriers to entry that are simply too steep and too costly for most IMOs to take advantage of. Absent DOL's commendable 18 month proposed delay of the Fiduciary Rule's January 1, 2018 applicability date, disclosure, and warranty requirements of the Rule's best interest contract exemption (BICE) and the amendments to PTE 84-24, the IMO distribution channel would have been effectively shut down, severely curtaining consumer access to, and choice of, fixed annuity products.

Further, independent insurance agents serve an important role in the sale of group variable annuities, which are a widely-utilized product solution offered by insurance companies to employers that sponsor a workplace retirement plan for their employees. Independent agents serve an essential role with respect to these products by encouraging those employers without plans to sponsor one, and by working with employers to maintain and improve existing plans.

C. The Fiduciary Rule Has Already Restricted Consumer Choice

In response to the Fiduciary Rule, financial service providers have significantly limited share classes available for investment by retirement savers and the number of insurance products available to retirement investors. One ACLI member informed us that it has reduced its proprietary insurance product offerings by 54 percent and its nonproprietary variable annuity offerings available through its broker-dealers by 76 percent. This is just one factual example of the consumer product choice limitations under the Rule. Comment letters and data previously provided to DOL are replete with other examples of consumer choice limitations it causes.

Given the disruption in distribution channels and restrictions in product choice, it is not surprising that variable annuity sales declined 21 percent in 2016 (from $133 billion in 2015 to $104.7 billion). Further, in the first quarter of 2017, variable annuity sales declined 8 percent, year-over-year, to $24.4 billion, and indexed annuity sales were off 13 percent, to $13.6 billion. These significant decreases in the sale of annuities illustrates the harmful effect of the Rule on lifetime income products.

D. The Fiduciary Rule Has Already Resulted in "Orphaned" Plans and Accounts

The Rule has resulted in more "orphaned" accounts. ACLI member companies have already been notified by certain of their distribution partners of the distributors' intention to resign as agent of record to IRA and ERISA plan annuity holders in anticipation of the Rule's applicability. Our members anticipate that this trend is likely to continue and to accelerate as the applicability date approaches, resulting in a significant increase in the number of "orphaned" accounts.

The existence of orphan accounts is not, in and of itself, a new phenomenon. Insurance companies often have a number of orphan, or unassigned, accounts on their books. In the past, these were typically smaller customer accounts that were transferred to the home office in the event of an agent departing the business and leaving the client behind or the death or incapacity of an agent. As the Rule's January 2018 applicability date was approaching, the numbers of orphaned accounts and the average size of those accounts have both increased dramatically. ACLI member companies report that resigning distribution firms typically cite an unwillingness to assume the litigation risks inherent in the BICE as the primary basis for their resignation.

While member companies will provide basic services to orphaned account holders, including the provision of factual responses to customer information requests, most companies are not equipped to replace the levels of personal advisory support formerly provided by the resigning agents. Further, it appears unlikely, given the liabilities associated with the Fiduciary Rule and its associated PTEs, that other agents or advisors would be willing to take on large blocks of orphan accounts, leaving the account holder with no financial advice or guidance, and effectively resulting in a "do it yourself" model.

Moreover, the Fiduciary Rule has already resulted in restricted access by employer-sponsored retirement plans to advice and guidance. One ACLI member has reported that it has no choice but to sever relationships with commission-based plan advisers. Another member reported that it has identified over 250 small retirement plans that have lost access to guidance and advice due to the Rule.

IX. Fee Based Compensation Contrasted with Commissioned Compensation (Question Groups 4, 5, 7, 17)

The CRFI poses questions about trends, regulation, and risks associated with fee-based advice and technology. Compensation in the delivery of financial advice and products has evolved to include different business models and to utilize advances in technology. These market-based developments provide a wide range of choice for both consumers and advisers. Regulation of compensation practices, however, should be unbiased and permit a broad spectrum of compensation arrangements.

The Fiduciary Rule unreasonably elevates fee-based advice and automated robo-advice systems as preferable alternatives because they are cheaper and aligned with the interests of retirement plan participants. These premises are incorrect in many cases. Recommendations under the proposal and may generate the least expensive product that may disserve and impair the participant’s best interests. While fee-based or automated advice are appropriate for some individuals, they are not necessarily appropriate for all.

In truth, financial product recommendations and associated compensation arrangements are most objectively evaluated according to the unique facts and needs of each financial client and the individual compensation arrangement. Financial advisers who obtain their compensation through annual fees based on assets under management ("wrap fees") would not likely recommend certain commission-based products, like annuities, because that purchase is not generally included within the assets under management on which the annual, recurrent fees are assessed by this type of fee-based financial advisor. Recurrent annual fees may be ill-suited to individuals with moderate assets needing little annual advice, and may exceed the total value of a commissioned-based adviser. FINRA issued guidance about fee-based arrangements, recognizing that while fee-based programs are beneficial for some customers, "they are not appropriate in all circumstances."[23] FINRA instructs that:

> Firms must consider the overall needs and objectives of the customer when determining the benefits of a fee-based account for that customer, including the anticipated level of trading activity in the account and non-price factors such as the importance that a customer places on aligning his or her interests with the broker. Additionally, firms must take into account the nature of the services provided, the benefits of other available fee structures, and the customer's fee structure preferences.[24]

As FINRA aptly observes, under some customer circumstances, compensation through commission arrangements may be more appropriate than fee-based arrangements. Quite correctly, FINRA explained that the appropriateness of fee-only financial arrangements should be evaluated on the unique circumstances of each customer and their financial needs. The same is true with evaluations of commissioned recommendations to purchase certain financial products like annuities.[25] There are many customers for whom annuities provide a valuable and appropriate means to achieving retirement security and guaranteed lifetime income.

The fact that the salesperson was compensated by commissions does not diminish the important role annuities play in financial and retirement security. Commission-based compensation can be the most economical and appropriate form of compensation in advisory arrangements with consumers owning

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[23] *See* Notice to Members 03-68, *Fee-Based Compensation-NASD Reminds Members That Fee-Based Compensation Programs Must Be Appropriate*, http://www.finra.org/sites/default/files/NoticeDocument/p003079.pdf .

[24] *See Fee-Based Questions and Answers*, http://www.finra.org/industry/fee-based-account-questions-answers . FINRA stated that

> Certain potential problems have been identified through our examination program. For example, it is not always clear that customers receive adequate disclosure about the distinctions and features of fee-based versus commission-based accounts, including the differences in fee structures and that fees will probably be higher in a fee-based account if the level of activity is modest. Training and education at some firms are minimal, particularly in giving brokers guidance on how to evaluate whether a customer is appropriate for a fee-based account.

[25] Elisse B. Walter, who served as acting SEC chair, SEC Commissioner, and FINRA Senior Executive Vice President, noted:

> In a nutshell, while fee based accounts can be a good thing, they are not always the right thing, or the best thing. We need you to look at each customer and determine what kind of fee works best for him or her. The Tully Report itself recognized that investors with low trading activity would probably be better off with a commission-based program that charges only when trades are made. *See* Elisse Walter, *Current NASD Regulatory Issues on Sales and Marketing* (Sept. 28, 2004) http://www.finra.org/newsroom/speeches/092804-remarks-27th-annual-sia-sales-and-marketing-conference.

moderate amounts of retirement assets, and may be significantly less expensive than non-commissioned forms of compensation, such as asset management fees.

The CRFI asked whether any regulatory developments have occurred in non-U.S. jurisdictions that impacted the market for retail advice in a manner that would be instructive. During the evolution of the Fiduciary Rule, DOL extoled a 2013 initiative in the UK that limited commissioned advice, and cited a significant reduction in commissioned advice. It failed to mention, however, an even greater drop in advice to retirement savers. In 2014, Morningstar UK reported that eleven million investors have fallen through an “advice gap” following industry regulation. In response to this severe problem, the UK launched a comprehensive review of its regulations and its abandoned retirement savers.

During the development of the Fiduciary Rule, DOL suggested that “robo-advisers” will fill any gaps that result from constraints on commissioned advice. Robo-advisers are a relatively new and untested method of providing financial advice and are not necessarily more cost-effective than in-person advice. No rigorous studies have examined whether a robo-adviser is a good substitute for a human being, especially in troubled markets such as the 2008 market crash. Moreover, non-commissioned fee-only advice may cost more for many retirement savers because of asset management fees that are charged year after year.

With these various considerations in mind, any post-CRFI developments should allow the broad range of compensation models without bias for or against any one approach. Disclosure is an important adjunct to helping consumers understand different compensation arrangement.

X. Sales Activity Compared to the Delivery of Advice (Question Groups 5 and 18)

DOL stated in the preamble to the final Regulation that it “rejects the purported dichotomy between a mere ‘sales’ recommendation, on the one hand, and advice, on the other in the context of the retail market for investment products.”[26] We disagree, and concur with SEC Commissioner Piwowar, who stated in a July 25, 2017 comment letter to DOL that:

> The Fiduciary Rule fails to distinguish the securities selling activities that have traditionally been the province of broker-dealers under the U.S. system of market regulation and the advice activities in which regulated investors engage. This distinction was created by Congress over 70 years ago when it enacted distinct regulatory frameworks for selling activities (i.e., in the Exchange Act) and advice activities (i.e., in the Advisers Act).

It is important that SEC and FINRA regulatory actions following the CRFI should endeavor to satisfy the Dodd-Frank Act mandate that it apply only to “personalized investment advice” about securities that is provided to “retail customers.”

“Personalized investment advice” about securities is investment advice about securities that is provided to a retail customer based on the personal financial information provided by such retail customer, including the retail investor’s financial needs, investment objectives, risk tolerance and

[26] 81 Fed. Reg. 20945, 20981 (Apr. 8, 2016).

financial circumstances.[27] It is, therefore, investment advice about securities that is intended to be specific to the retail customer and is intended to meet his or her specific financial circumstances, objectives and needs as well as the securities products or services which he or she is seeking from the BD or IA.

The line between sales activity and advice is not only one that Congress itself has long recognized; it is a line that has constitutional significance. In-person sales conversations are commercial speech protected by the First Amendment of the Constitution.[28] Any regulations should therefore be drawn to further substantial interests in protecting consumers and to avoid unduly restricting or burdening such speech, which can be a critical source of information for many retirement savers. The First Amendment requires that where sales speech is concerned, listeners must be trusted to make their own choices based on accurate, non-misleading commercial information.[29]

A. Advice as Distinguished from General Communications

Any rulemaking in this area should be crafted in a way that avoids the unintended negative consequence of "chilling" contact and interactions between and among BDs, IAs, their respected associated persons and retail customers. There are numerous interactions between such BDs, IAs, their respective associated persons and retail customers that do not constitute personalized investment advice about securities. Accordingly, any SEC or FINRA rulemaking should make clear that such types of non-personalized investment advice about securities with retail customers will not be deemed "personalized investment advice about securities."[30] These include, but are not limited to:

- **General Education/ Impersonal Advice**. BDs, IAs and their associated persons provide general education and impersonal advice about securities and investments to retail customers and to broader audiences. Such information may include general concepts such as modern portfolio theory, asset diversification and asset allocation. This education and impersonal advice is not, however, intended to address the financial circumstances and/or needs of any particular individual(s) within the larger group – in fact it is typically delivered absent such specific retail customer information.

- **Account and Retail Customer Relationship Maintenance.** Depending on the business model and the nature of the relationship with the retail customer, as a matter of good business and compliance practices, financial professionals such as an associated person of a BD or IA may have - and should be encouraged to have - regular and frequent contact

[27] In this connection, we note that the term "impersonal investment advice is defined under Advisers Act Rule 203A-3(a)(3)(ii) as "investment advisory services provided by means of written or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts."
[28] *See Sorrell v. IMS Health Inc.*, 564 U.S. 552, 557-558 (2011); *Edenfield v. Fane*, 507 U.S. 761, 765 (1993).
[29] *See, e.g.*, *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 503 (1996) (plurality); *Edenfield v. Fane*, 507 U.S. 761, 767 (1993); *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 644-647 (1985); *Central Hudson Gas & Elec. Corp. v. Pubic Serv. Comm'n of N.Y.*, 447 U.S. 557, 561-562 (1980); *Linmark Assocs., Inc. v. Willingboro Twp.*, 431 U.S. 85, 96-97 (1977); *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc*., 425 U.S. 748, 769-770 (1976).
[30] A parallel approach to communications should also apply to any non-securities best interest standards implemented by DOL or state insurance regulators.

with applicable retail customers that often does not include the provision of personalized investment advice about securities.

- For example, annual or quarterly contact with a retail customer to remind him or her to rebalance assets held in a variable annuity to match allocations set up at the time of contract purchase should not constitute "personalized investment advice about securities" absent, for example, efforts initiated by the associated person to recommend that the retail customer change the allocations percentages to accommodate changes in the retail customer's individual financial facts and circumstances.

- **Needs Analysis.** Financial professionals should be able to meet with retail customers as necessary to determine their current, and any new, investment objectives and financial needs without concern that doing so would impose an affirmative duty to render personalized investment advice about securities[31] (on an on-going or of an episodic nature) or that a harmonized standard of care would apply to such interactions, unless the retail customer wishes to seek and the associated person is qualified to provide, and does provide, such investment advice about securities.[32] An associated person should also not be affirmatively obligated to provide personalized investment advice simply because, for example, the associated person has communicated with a retail customer about their respective account(s) or contracts.

XI. Disclosures to Retail Customers (Question Groups 1 & 9)

Several CRFI questions invite input on the role of disclosure in the development and application of a best interest standard of conduct. Disclosure has been an essential element of Federal securities regulation, and it provides an important ingredient to the implementation of a best interest standard.

Disclosure should be an essential component of any SEC regulation in this area. When providing personalized advice to retail customers, financial professionals should be required to make balanced and fair disclosure of material facts relevant to the retail customer's investment decision, including material conflicts of interest. As similarly noted above, disclosure will be more effective, useful and helpful to retail customers, if such retail customers receive concise, plain-English summary disclosures. Such disclosures should also refer retail customers seeking more detailed disclosure to the entity's website where they can access such information (or allow them to receive a "hard copy" by request).[33]

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[31] *See* Section 913(g)(1)(k)(1) of the Dodd-Frank Act.

[32] We recognize that any harmonized standard of care would apply if, and when, personalized investment advice about securities is provided to a retail customer.

[33] We would urge that consideration of any additional disclosure requirements would include a thorough analysis of the disclosures that retail customers currently receive. For example, when purchasing a deferred variable annuity, a retail (and other) customer must be informed of the general terms of various features of deferred variable annuities, such as surrender period and surrender charges; potential tax penalties; mortality and expense charges; investment advisory fees; potential charges for and features of riders; the insurance and investment components; and market risk. Additionally, such retail (and other) customers must be provided with a product prospectus, which provides a comprehensive and detailed description of the variable annuity. Finally, such retail (and other) customers are provided prospectuses for the mutual funds underlying the product subaccounts in which they invest. Simply piling more disclosure on top of the above-noted

This position is consistent with current statements of the SEC, in particular those made at the time of the recent amendments to the Form ADV Part 2.[34] The SEC stated in the adopting release that it "will continue to consider different approaches to delivering financial information to investors."[35] The SEC should consider approaches that enable BDs and IAs provide concise and helpful written disclosures to retail customers, by allowing BDs and IAs to reference links to their websites for certain types of additional, detailed information.

The following considerations should govern the types of disclosures the BDs and IAs are required to provide retail customers in connection with the provision of personalized investment advice about securities:

- **Simple, Clear and Concise Descriptions.** Retail customers should receive clear disclosure of the range of securities products and services that are offered to them by the BD or IA and their associated persons. Such disclosures should include a narrative description of the types of fees and costs associated with the securities offerings and the way the BD or IA and its associated person are compensated. Disclosure should be written in plain-English, and the SEC and other regulators should work with the industry and others to identify ways to simplify, and make disclosures more helpful to retail customers.[36]

- **Disclosure of Material Conflicts of Interest.** Perceived or actual conflicts of interest between the BD or IA and their retail customers can arise regardless of the business model. BDs and IAs should take appropriate steps to identify material conflicts and disclose these conflicts to their retail customers.

- **Disclosure of Compensation.** Retail customers should receive a brief narrative description of how an associated person is compensated for the sale of securities products and services so the retail customer can evaluate the personalized investment advice about securities she receives in light of any conflict of interest that may be created and determine the value of securities products and services and related benefits. We believe that retail customers will find most useful concise information regarding <u>how</u> associated persons are

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disclosure information is more likely to result in "information overload" than an enhanced understanding of the product or transaction by retail customers.

[34] Amendments to Form ADV, Investment Advisers Act Release No. IA-3060 (July 28, 2010), *available at* http://www.sec.gov/rules/final/2010/ia-3060.pdf .

[35] *Id.*

[36] ACLI developed comprehensive guidelines and instructions for life insurers on how to prepare disclosure documents for fixed, index, and variable annuities. *See*, Wilkerson, *ACLI Disclosure Initiative for Fixed, Index, and Variable Annuities: Constructive Change on the Horizon*, ALI-ABA Conference on Life Insurance Company Products (2007). The materials provided plain-English, streamlined, user-friendly point-of-sale disclosure. ACLI shared the guidelines with the SEC and FINRA, and incorporated all the constructive suggestions the SEC's Division of Investment Management staff offered in an informal process. Similarly, the NAIC's Annuity Buyers' Guide provides excellent streamlined, plain-English disclosure allowing apples to apples comparison of fixed, index and variable annuities. A copy of the NAIC Buyers' Guide is attached as Appendix B. ACLI's Guidelines and the NAIC Buyers' Guides provide a rich source of disclosure about essential information to an annuity purchase decision that may be useful as the SEC advances initiatives for broker-dealers and investment advisers.

compensated, rather than the exact amount of compensation, to determine whether compensation incentives may lead to a conflict of interest.

XII. Definition of Retail Customer (Question Group 14)

The CRFI elicits comment on whom should be considered to be "retail customers." The Dodd-Frank Act defines "retail customer" as a natural person (or the legal representative of such natural person) who receives personalized investment advice from a BD or IA and who uses such advice primarily for personal, family, or household purposes.

Consistent with this definition, the definition of "retail customer" in any subsequent SEC or FINRA rulemaking should make clear that there is no BD, IA or other obligation or requirement to "look through" defined contribution pension plans to individual participants and their accounts. The overlaying of a different and potentially conflicting fiduciary duty by the SEC would not serve to protect retail customers and potentially could discourage the formation and continuation of pension plans, as well as the continued provision of beneficial educational services to plan participants. Accordingly, for a best interest standard of care it is important that any such rules are not intended to confer ERISA or other fiduciary status on a BD, IA or their associated persons.

Any SEC or FINRA regulatory actions or rulemaking regarding the provision of personalized investment advice should not extend to others beyond "retail customers." A focus on institutional investors would not provide any meaningful benefit and would simply serve to distract from the larger issue of how best to preserve and/or enhance investor protections for retail customers.

As the CRFI moves forward, sales activity should be differentiated from advisory activities. To do otherwise would ignore Congressional intent and unnecessarily blur business models and standards built on decades of regulatory interpretation. Moreover, DOL's reluctance to distinguish sales unnecessarily infringes the commercial speech rights of buyers and sellers under the First Amendment to the Constitution, as ACLI has explained in litigation challenging the Fiduciary Rule's reasonableness and constitutionality.

XIII. Objectives in Developing a Best Interest Standard of Conduct

We offer input on harmonization generally, and principles that should guide the SEC's endeavors in addressing a best interest standard of conduct.

A. Implementing a Best Interest Standard of Care under SEC and FINRA Rules, and Parallels under DOL Rules and State Insurance Regulation

Currently, BDs and IAs and insurance agents are subject to different regulations when they provide personalized investment advice about securities. IAs are subject to a fiduciary standard, while BDs are subject to standards of fair dealing and suitability rules, including the various FINRA regulatory notices and interpretative materials containing additional considerations for specific products and related matters (and, specifically, in the case of variable annuity sales, the rigorous analysis and other requirements mandated by FINRA Rule 2330).

Additionally, BDs and IAs are required to provide different types of disclosures to their retail customers at different times in the investment or engagement process. Furthermore, the advertising rules applying to each are different, as are the applicable record-keeping requirements and numerous other regulatory requirements. Concerning regulatory oversight, IAs are currently directly regulated by the

SEC, while BDs are directly regulated by FINRA and by the SEC. BDs and IAs are also subject to varying types of oversight by state securities regulators.

If after the CRFI, the SEC implements a best interest standard of care applicable to BDs and IAs when providing personalized investment advice to retail customers, it is critical to advance any related SEC or FINRA rulemaking with a view to preserving and/or enhancing:

- Investor protection for retail customers;
- Choice regarding securities products and services for the full spectrum of retail customers; and
- Access to those products and services for the full spectrum of retail customers.

With those tenets in mind, post-CRFI SEC or FINRA rulemaking should focus on the following areas:

- Allowing the retail customer and the BD or IA (and as applicable their associated persons) to determine the scope and cost of services to be provided, including services to provide personalized investment advice about securities;
- Permitting the types and timing of disclosures provided to retail customers to be based upon, among other things, the securities products and/or services being offered and provided; and providing disclosure to retail customers that is useful - and more specifically concise and targeted information with those retail customers seeking more detailed information being able to access such information via a BD's or IA's Website (or by hard copy if so requested); and
- Modernizing and reducing overlapping, duplicative and inconsistent regulation with respect to applicable advertising, recordkeeping and certain other rules.

To these ends, the following principles should guide the SEC's efforts:

- A best interest standard of care under SEC or FINRA regulations must satisfy the Dodd-Frank Act mandate that it apply only to "personalized" investment advice about securities to "retail investors" as those terms are defined.
- Provide clear guidance as to how BDs and IAs, when providing personalized investment advice about securities to retail customers, meet a new best interest standard of care. Specifically, such guidance should be tailored to reflect and preserve the existing and varying business models through which securities products and services are currently provided to retail customers. A one-size-fits-all approach would have the unintended negative consequence of limiting retail customer choice and access to securities products and services, particularly for retail customers with limited assets and those in less populated geographic areas.
- Any regulation in these areas must consider relevant constitutional provisions, such as the First Amendment, as discussed above.
- The Dodd-Frank Act provides that offering a limited range of products, including offering only proprietary products, would be disclosed and permissible under any new standard of care. Any post-CRFI SEC or FINRA rulemaking should not require or mandate that a BD expand the securities products or services it offers.

  Conversely, in implementing this requirement, the SEC or FINRA must also be careful to avoid promulgating rules or guidance that would unnecessarily favor one type of securities product over another or lessen retail customer access to, what some may view as more complicated securities products or, proprietary products when other securities products are available.

For example, any post-CRFI SEC or FINRA rules should discourage BDs and IAs from believing they can gain a competitive advantage through decreased compliance costs by offering a smaller subset of securities products and services than they otherwise would, which would cause unintended negative consequences of limiting retail customer choice and access to certain securities products and services.

By satisfying the guiding principles above, any resulting SEC or FINRA regulations following the CRFI will enhance the ability of BDs and IAs to: (1) meet the increasing needs of an expanding base of diverse and geographically dispersed retail customers across the broad economic spectrum; and (2) provide enhanced protections to those retail customers.

B. Personalized Investment Advice to Retail Customers.

Any post-CRFI SEC or FINRA rulemaking should satisfy the Dodd-Frank Act mandate that it apply only to “personalized investment advice” about securities that is provided to “retail customers.” “Personalized investment advice” about securities is investment advice about securities that is provided to a retail customer based on the personal financial information provided by such retail customer, including the retail investor’s financial needs, investment objectives, risk tolerance and financial circumstances.[37] It is, therefore, investment advice about securities that is intended to be specific to the retail customer and is intended to meet his or her specific financial circumstances, objectives and needs as well as the securities products or services which he or she is seeking from the BD or IA. Any regulation should also be tailored to avoid unnecessarily burdening constitutionally protected commercial speech, including in-person conversations.

C. New Sales Regulations

As we have noted in detail above and in Appendix A, insurance distribution and sales are already subject to a detailed and rigorous framework protecting customers. These rules currently govern all aspects of the customer relationship including gathering information about the customer, disclosure, supervision, maintenance of customer account assets, safeguarding confidential customer information, training and supervision of associated persons.

To the extent that the SEC determines that there are gaps with respect to the detailed rules already in place, the SEC should look to specifically address such gaps. Post-CRFI SEC or FINRA rules should not inadvertently result in a decrease in retail customer choice regarding, and access to, personalized investment advice about securities to retail customers across the broad economic spectrum. Retail customers with seven figures to invest will always be able to find personalized investment advice about securities regardless of the standard of care; a retail customer with under

[37] In this connection, we note that the term “impersonal investment advice is defined under Advisers Act Rule 203A-3(a)(3)(ii) as “investment advisory services provided by means of written or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts.”

$100,000 to invest who resides in a less populated rural geographic area may not be able to do so unless the proper balance is struck in any rulemaking.

Accordingly, any new rules should be crafted with these principles in mind:

- Enable BDs to continue offering their full array of securities products and services to help meet retail customers' financial needs and objectives;
- Preserve retail customer access to BDs, IAs and their associated persons and the securities products and securities services they offer;
- Preserve various means of structuring securities-related compensation and fees (so that retail customers can pay for services the way such retail customers choose to do so); and
- Avoid providing unintended competitive advantages to any particular business models or securities product and services lineups.

To achieve these principles, any new conduct rules should not require BDs, IAs and their associated persons to:

- Recommend or otherwise provide investment advice about securities that simply are the "cheapest" or "less expensive" product or service;[38]
- Limit securities products or services choices it makes available;
- Stop or limit providing personalized investment advice about securities or otherwise providing services to retail customers who have smaller accounts, reside in less populous areas of the country or are not part of the "mass affluent" or "affluent" segment of retail customers; and
- Require a BD to expand its available securities product or services universe.

D. Implementation Dates

In advancing any rulemaking and establishing any compliance dates with respect to such rulemaking, the SEC keep in mind the potential significant implementation issues that would likely be required. We would request that, if any Section 913 related SEC or FINRA rulemaking follows the CFRI,

[38] While we recognize that a particular securities product or services cost and any related expenses are relevant factors for consideration when providing investment advice about securities to retail customers, we strongly believe that providing such investment advice solely in consideration of the lowest costs and any related expenses would often result in retail customer harm and not in fact benefit or provide enhanced investor protections.

compliance dates should provide reasonable implementation periods.

XIV. Conclusion

We greatly appreciate your attention to our views. If any questions develop, please let us know.

Sincerely,

Carl B. Wilkerson

Carl B. Wilkerson

Appendix A

Federal and State Regulations Governing the Sale of Fixed and Variable Annuities:
Comprehensive Protections for Financial and Retirement Product Consumers

Table of Contents

FINRA Rule 2330: Suitability and Supervision in the Sale of Variable Annuity Contracts

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers
March 28, 2017

I. Scope of This Outline Segment

A. FINRA Rule 2330 [Formerly NASD Rule 2821], which governs suitability and supervision in the sale of variable annuity contracts, was approved by the SEC in 2008, and was under development since 2004. The rule evolved through six different stages, five at the SEC, and one at FINRA.

B. This outline segment will summarize the elements of Rule 2330, and discuss its administrative history to illuminate FINRA's purpose and intent.

II. Substantive Overview: Rule 2330 has four primary provisions

A. Requirements governing recommendations, including a suitability obligation, specifically tailored to deferred variable annuity transactions;

B. Principal review and approval obligations;

C. A specific requirement for broker-dealers to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the rule's standards; and,

D. A targeted training requirement for broker-dealers' associated persons, including registered principals.

III. The Rule's Requirements in Greater Detail

A. Revised Rule 2330 established the following specific requirements:

1. *Recommendation Requirements.* When recommending a deferred variable annuity transaction, Rule 2330 requires broker-dealers and salespersons to have a reasonable basis to believe that the: customer *has been informed of, in a general fashion,* the various features of the deferred variable annuity,

a) customer *would benefit from* certain features of a deferred variable annuity (e.g., tax-deferred growth, annuitization or a death benefit); and

b) the deferred variable annuity *as a whole* and the underlying sub-accounts or riders are suitable for the particular customer.

c) the particular deferred variable annuity that the registered representative is recommending, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and the riders and similar product enhancements are suitable (and in the case of an exchange, the transaction as a whole also is suitable) for the customer based on the information the registered representative is required to make a reasonable effort to obtain.

2. Revised Rule 2330 requires these determinations to be *documented and signed* by the salesperson recommending the transaction.

a) Rule 2330 would also require salespersons to make *reasonable efforts* to obtain information concerning customers' age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the variable annuity, investment time horizon, existing investment and insurance holdings, liquidity needs, liquid net worth, risk tolerance, tax status and other information used by the salesperson in making recommendations.

3. *Supervisory Review.* Rule 2330(c) requires that a principal review each variable annuity purchase or exchange within seven business days after the signed application arrives at the broker-dealer's office of supervisory jurisdiction in good order. A registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity.

a) In reviewing the transaction, the registered principal would need to take into account the extent to which:

- the customer would benefit from certain features of a deferred variable annuity;
- the customer's age or liquidity needs make the investment inappropriate; and,
- the customer involved an exchange of a deferred variable annuity: will incur surrender charges, face a new surrender period, lose death or existing benefits,
- have increased mortality and expense fees, appears to have a need for any potential product enhancements and improvements,

or had another deferred variable annuity exchange within the preceding 36 months.

- Under Rule 2330, the supervisory review standards must be signed and documented by the registered principal that reviewed and approved the transaction.

4. *Supervisory Procedures.* Rule 2330 requires broker-dealers to establish and maintain specific written supervisory procedures reasonably designed to achieve and evidence compliance with the standards in Rule 2330. The broker-dealer must have procedures to screen and have principal review of the recommendations requirements in Rule 2330, and determine whether the salesperson has a particularly high rate of effecting deferred variable annuity exchanges.

5. *Training.* Under the proposal, broker-dealers would need to develop and document specific training policies or programs designed to ensure that salespersons recommending transactions, and registered principals who review transactions, in deferred variable annuities comply with the requirements of Rule 2330 and that they understand the material features of deferred variable annuities, including liquidity issues, sales charges, fees, tax treatment, and market risks.

6. *Automated Supervisory Review***.** FINRA's submission on the rule indicated that the rule would not preclude firms from using automated supervisory systems, or a mix of automated and manual supervisory systems, to facilitate compliance with the rule.

a) In addition, FINRA delineated what, at a minimum, a principal would need to do if his or her firm intends to rely on automated supervisory systems to comply with the proposed rule.

b) Specifically, a principal would need to (1) approve the criteria that the automated supervisory system uses, (2) audit and update the system as necessary to ensure compliance with the proposed rule, (3) review exception reports that the system creates, and (4) remain responsible for each transaction's compliance with the proposed rule.

c) Finally, FINRA noted that a principal would be responsible for any deficiency in the system's criteria that would result in the system not being reasonably designed to comply with the rule.

7. *Tax Qualified Plans.* Rule 2330 does not apply to variable annuity transactions made in connection with tax-qualified, employer-sponsored retirement or benefit plans that either are defined as a "qualified plan" under Section 3(a)(12)(C) of the Exchange Act or meet the requirements of Internal Revenue Code Sections 403(b) or 457(b), unless, in the case of any plan, the

broker-dealer makes recommendations to individual plan participants regarding the variable annuity.

IV. Review and Explanation of (Revised) Rule 2330

A. Supervisory review standards changed

1. FINRA enlarged the time period for supervisory review to seven days after the signed application arrives at the broker-dealer's OSJ in good order.

a) Compare to *prior* draft: "Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but *no later than seven business days after the customer signs the application*, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity."

b) Compare to earlier draft: the third amendment required the principal must review and approve the transaction "[n]o later than *two business days following* the date when a member or person associated with a member *transmits a customer's application* for a deferred variable annuity to the issuing insurance company for processing or *five business days from the transmittal date* if additional contact with the customer or person associated with the member is necessary in the course of the review."

2. FINRA rationale: ensuring that all broker-dealers have adequate time to perform a thorough principal review of these transactions.

a) In view of the variety of features and provisions in connection with the issuance of deferred variable annuity contracts, FINRA became persuaded that principal review of variable annuity sales requires greater time than reviews of many other securities transactions.

b) The provision of a reasonable amount of time for pre-transmittal review, however, posed potential problems related to other rules concerning the prompt handling of customer funds.

(1) For instance, FINRA Rule 2330 states generally that member firms shall not make improper use of customer funds, and FINRA Rule 2820 specifically requires member firms to "transmit promptly" the application and the purchase payment for a variable contract to the issuing insurance company.

(2) Similarly, Rules 15c3-1 and 15c3-3 under the 1934 Act require certain member firms to promptly transmit and forward funds.

(3) Rules 15c3-1(c)(9) and (10) under the 1934 Act define the terms "promptly transmit and deliver" and "promptly forward" funds as meaning "no later than noon of the next business day after receipt of such funds."

3. FINRA solution to regulatory conflicts with prompt pricing standards:

a) FINRA asked for, and obtained from the SEC, regulatory relief regarding Rules 15c3-1 and 15c3-3 when the same circumstances exist. As a companion to the rule approval, the SEC provided an exemptive order from the prompt pricing provisions.

b) FINRA made clear that a broker-dealer that is holding an application for a deferred variable annuity and a non-negotiated check from a customer written to an insurance company for a period of seven business days or less would not be in violation of FINRA Rules 2330 if the reason that the application and check are being held is to allow a principal to complete his or her review of the transaction pursuant to proposed Rule 2330.

B. Recommendation requirements revised

1. FINRA revised proposed Rule 2821to state that "[n]o member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member *has a reasonable basis to believe* that the transaction is suitable in accordance with Rule 2310."

2. FINRA is substituting the phrase "has a reasonable basis to believe" for "has determined," which appeared in the prior draft of the rule.

3. FINRA rationale: FINRA softened the review requirement in response to comments that the reasonable basis standard was more strict than with other similar financial products.

C. Non-recommended transactions conditionally excluded. FINRA revised the rule conditionally so that it does not apply to non-recommended transactions, such as situations where the member is acting solely as an order taker. FINRA believed Rule 2821 should not prevent a fully informed customer from making his or her own investment decision.

1. Conditional exclusion from rule, however.

a) A registered principal "may authorize the processing of the transaction if the registered principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the registered principal has not approved the transaction, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity."

2. FINRA rationale:

a) Change allows a customer to decide to continue with the non-recommended purchase or exchange of a deferred variable annuity notwithstanding the broker-dealer's belief that the transaction would be viewed as unsuitable if it had been recommended.

b) The new requirement that the principal independently determine that the transaction was not recommended adds another layer of protection. Requirement "should discourage salespersons from attempting to bypass compliance requirements for recommended sales by simply checking the 'not recommended' box on a form."

c) Customers must indicate an explicit intent to continue with the non-recommended transaction notwithstanding the unsuitability determination, which will help ensure that the customer's decision is an informed one.

D. *"Undue concentration" standard eliminated.* FINRA eliminated prior requirements that registered principals consider "the extent to which the amount of money invested would result in an undue concentration in a deferred variable annuity."

E. The annuity or deferred variable annuities should be evaluated in "the context of the customer's overall investment portfolio."

1. FINRA Rationale:

a) Requirement was unclear and could cause confusion. Because other provisions in Rule 2330 already capture the important aspects of this "undue concentration" determination, FINRA has eliminated it as superfluous.

F. Generic disclosure allowed

1. Under recommendation requirements, FINRA clarified that required disclosure may be generic and not specific to the product. Clarification now requires that "the customer has been informed, *in general terms*, of various features of deferred variable annuities. . . ."

2. FINRA rationale:

a) Simply a clearer statement of original rule's intent.

G. "Unique features" requirement relaxed and expanded

1. Provision now states that salesperson must have "a reasonable basis to believe that . . . the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit."

2. FINRA Rationale:

a) FINRA accepted commenters' position that there are other financial products that have features similar to those of a deferred variable annuity, so a requirement that the customer would benefit from the *unique* features was relaxed to benefiting from *certain* features.

b) Living benefits added to the list of certain features that may be beneficial for customer in addition to death benefit.

H. Required surveillance practices for replacement activities clarified

1. FINRA indicated that principal need not examine *every* transaction when salesperson has a potentially higher rate of replacement sales. FINRA emphasized instead review on a periodic basis via exception reporting rather than as part of the principal review of each exchange transaction

2. FINRA revised the supervisory procedures guarding against inappropriate replacement practices so that, "the member also must (1) implement surveillance procedures to determine if the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable FINRA rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges."

FINRA Rule 2320: FINRA Rules Governing Non-Cash Compensation in the Sale of Variable Contracts and Mutual Funds

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers
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I. Scope of This Outline Segment

A. This Outline Segment addresses the permitted uses of non-cash compensation in the sale of variable contracts and mutual funds. FINRA significantly modified this rule to reduce the range of permitted non-cash compensation arrangements.

B. FINRA's non-cash compensation rule does not apply to fixed annuities because they are excluded from the definition of security under the Federal securities laws.

1. Fixed index annuities are excluded from categorization as securities under the Harkin Amendment to the Dodd-Frank Act, the Harkin Amendment conditions its protections to compliance with the NAIC's Suitability in Annuity Transactions Model Regulation or substantially similar features of that amendment.

2. Absent compliance with the NAIC's Suitability in Annuity Transactions Model Regulation or similar provisions, fixed index annuities could lose their immunity from the Federal securities laws and distributors of this product could, therefore, be subject to FINRA requirements, including the non-cash compensation rule.

II. FINRA Rules Governing Non-Cash Compensation.

A. In 1998, FINRA adopted Rule 2320 which governs non-cash compensation. A parallel non-cash compensation rule exists for mutual funds in FINRA Rule 2341(L)(5). A supplemental FINRA Q & A addresses a number of questions on the rules' applicability to specific situations, and contains a good thumbnail summary about the rules.

B. FINRA Rule 2320 prevents abuses and strictly limits non-cash compensation in the sale of variable insurance products to:

1. Gifts of up to $100 per associated person annually;

2. An occasional meal, ticket to a sporting event or theater, or comparable entertainment;

3. Payment or reimbursement for training and education meetings held by broker-dealers or issuers/sponsors for the purpose of educating associated persons of broker-dealers, so long as certain conditions are met;

4. In-house sales incentive programs of broker-dealers for their own associated persons; and,

5. Contributions by any company or other FINRA member to a broker-dealer's permissible in-house sales incentive program, subject to explicit conditions.

C. Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, are conditioned on:

1. The member's or nonmember's non-cash compensation arrangement, if it includes variable contract securities, is based on the total production of associated persons with respect to all variable contract securities distributed by the member;

2. The non-cash compensation arrangement requires that the credit received for each variable contract security is equally weighted;

3. No unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or nonmember's organization of a permissible non-cash compensation arrangement; and

4. The record keeping requirement in the rule is satisfied. Rule 2320 requires broker-dealers to maintain records of all non-cash compensation received by the broker-dealer or its associated persons in permitted non-cash compensation.

D. FINRA Pending Proposal to Revise Non-Cash Compensation Rules.

1. In August 2016, FINRA proposed several amendments to the non-cash compensation rules that are pending closure and SEC approval. The proposed FINRA amendments would:

a) Consolidate the rules under a single rule series in the FINRA rulebook;

b) Increase the gift limit from $100 to $175 per person per year and include a *de minimis* threshold below which firms would not have to keep records of gifts given or received;

c) Amend the non-cash compensation rules to cover all securities products, rather than only direct participation programs (DPPs), variable insurance contracts, investment company securities and public offerings of securities; and,

d) Incorporate existing guidance and interpretive letters into the rules.

2. Additionally, FINRA proposed a revised approach to internal sales contests for non-cash compensation such that if payment or reimbursement of expenses associated with the non-cash compensation arrangement is preconditioned on achievement of a sales target, the non-cash compensation arrangement must:

a) Be based on the total production with respect to all securities products; and,

b) Not be based on conditions that would encourage an associated person to recommend particular securities or categories of securities.

3. Finally, FINRA proposed to incorporate into the amended rules a principles-based standard for business entertainment that would require firms to adopt written policies and supervisory procedures for business entertainment arrangements.

a) The records must include: the names of the offerors, companies or other broker-dealers making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the broker-dealer and its associated persons with the rule.

NAIC Suitability in Annuity Transactions Model Regulation: A Coordinated Approach to Suitability and Supervision in the Sale of Individual Annuity Contracts

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

I. NAIC Suitability and Supervision Responsibilities in NAIC Model Regulation Governing Individual Annuity Sales

A. The National Association of Insurance Commissioners (NAIC) adopted several evolving sets of revisions to its model regulation governing suitability and supervision in the sale of individual annuity contracts.

1. The NAIC's initial regulation was entitled the Senior Protection in Annuity Transactions Regulation, and governed suitability and supervision in annuity transactions with "senior consumers" age 65 or older.

2. The NAIC's 2006 revision to this regulation applied it to all individual annuity sales. To reflect the broader application of the regulation, it was re-titled the Suitability in Annuity Transactions Model Regulation. This regulation incorporated suitability and supervision practices parallel to those under the federal securities laws and FINRA rules.

3. In 2010, the NAIC added further amendments to the Suitability in Annuity Transactions Model Regulation. Among other things, the 2010 NAIC revisions to the regulation established new restrictions on supervisory delegation to third-party and reliance on producer suitability recommendations, established a new producer training requirement (which must be completed by producers prior to their being able to solicit the sale of annuities), and expanded powers of Commissioners to levy sanctions and penalties.

B. The evolving iterations of the NAIC model regulation can be found at NAIC Model Regulation Service II-275-1 (2010). Over 30 states have implemented the 2010 version of the model regulation and two have proposed the regulation for adoption. 14 states have adopted the 2006 version of the regulation. Over time, these states are expected to incorporate the 2010 revisions as they update their regulations.

C. Because the 2010 amendments to the model regulation are built upon the original 2006 model, the 2006 model is discussed first. The 2010 modifications to the model are summarized separately below, following the 2006 regulation's summary.

D. ACLI supports strong suitability standards to ensure annuity sales recommendations are suitable and will promote consumer confidence in making informed annuity purchase decisions.

II. Approach of the 2006 Revised NAIC Regulation

A. The regulation establishes standards and procedures governing recommendations in annuity transactions, to ensure "that insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed."

B. The regulation imposes suitability and supervision duties for insurers and insurance producers, including requirements for maintaining written procedures and conducting periodic reviews of records to detect and prevent unsuitable sales practices.

III. Scope and Governing Framework of the 2006 Revised NAIC Regulation

A. The regulation applies to any recommendation to purchase or exchange an annuity made to a consumer by an insurance producer, or an insurer where no producer is involved, that results in the purchase or exchange recommended.

1. "Annuity" means a *fixed annuity or variable annuity* that is *individually solicited*, whether the product is classified as an individual or group annuity [Section 5 (A)].

2. "Recommendation" means advice provided by an insurance producer, or an insurer where no producer is involved, to an individual consumer that results in a purchase or exchange of an annuity in accordance with that advice [Section 5(D)].

B. The regulation does not apply to annuity transactions involving:

1. Direct response solicitations where there is no recommendation based on information collected from the consumer under the regulation;

2. Contracts funding specified retirement plans:

a) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);

b) A plan described by Sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer;

c) A government or church plan defined in Section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the IRC;

d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

3. Settlements of, or assumptions of, liabilities associated with personal injury litigation or any dispute or claim resolution process; or

4. Formal prepaid funeral contracts.

IV. Duties Imposed Under the Regulation [Section 6]

A. **Suitability Standard**: In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the insurance producer, or the insurer where no producer is involved, shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to his or her investments and other insurance products and as to his or her financial situation and needs.

1. "Insurer" means a company required to be licensed under the laws of this state to provide insurance products, including annuities.

2. "Insurance producer" means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.

3. Note: this suitability standard directly parallels the general standard of FINRA Suitability Rule 2310(a), set forth at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466 .

B. **Suitability Ingredients** [Section 6(A)]: Prior to the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain information concerning:

1. The consumer's financial status;

2. The consumer's tax status;

3. The consumer's investment objectives; and

4. Such other information used or considered to be reasonable by the insurance producer, or the insurer where no producer is involved, in making recommendations to the consumer.

5. Note: the suitability ingredients above precisely track those in FINRA Suitability Rule 2320(b) set forth at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466 .

6. An insurer or insurance producer's recommendation under the suitability standard and ingredients must be reasonable under all the circumstances actually known to the insurer or insurance producer at the time of the recommendation [Section 6(c)(2)].

a) Neither an insurance producer, nor an insurer where no producer is involved, has any obligation to a consumer under the suitability standard [Section 6(a)] related to any recommendation if a consumer:

(1) Refuses to provide relevant information requested by the insurer or insurance producer;

(2) Decides to enter into an insurance transaction that is not based on a recommendation of the insurer or insurance producer; or

(3) Fails to provide complete or accurate information.

(4) Note: these narrow exclusions directly parallel FINRA approaches to suitability in Rule 2310.

C. **Supervision Standard**

1. For insurers:

a) An insurer either (i) shall assure that a system to supervise recommendations that is reasonably designed to achieve compliance with the suitability standards in the regulation is established and maintained, or (ii) shall establish and maintain such a system, including, but not limited to:

(1) Maintaining written procedures; and

(2) Conducting periodic reviews of its records that are reasonably designed to assist in detecting and preventing violations of this regulation.

b) To fulfill the supervision standard, an insurer may contract with a third party, including a general agent or independent agency, to establish and maintain a system of supervision as required by Section 6(D)(1) regarding insurance producers under contract with, or employed by, the third party.

(1) To utilize a third party for supervision, an insurer must make reasonable inquiry to assure that the third party is performing the functions required under the regulation, and must take reasonable action under the circumstances to enforce the contractual obligation of the third party to perform the functions.

(2) An insurer may comply with its obligation to make reasonable inquiry by doing all of the following:

(a) Annually *obtain a certification* from a third party senior manager who has responsibility for the delegated functions that the manager has a reasonable basis to represent, and does represent, that the third party is performing the required functions; and

(b) Based on reasonable selection criteria, periodically select third parties for review to determine whether the third parties are performing the required functions. The insurer must perform those procedures to conduct the review that are reasonable under the circumstances.

c) Insurers that contract with a third party to perform supervision and that comply with the certification and periodic review procedures will fulfill their supervisory responsibilities under the regulation.

d) Note: the supervisory approaches implemented in the regulation parallel those in FINRA Rule 3010(a).

e) No one may provide a certification under the regulations supervisory delegation unless:

(1) The person is a senior manager with responsibility for the delegated functions; and

(2) The person has a reasonable basis for making the certification

2. For insurance producers:

a) A general agent and independent agency either must (i) adopt a system established by an insurer to supervise recommendations of its insurance producers that is reasonably designed to achieve compliance with the regulation, or (ii) establish and maintain such a system, including, but not limited to:

(1) Maintaining written procedures; and

(2) Conducting periodic reviews of records that are reasonably designed to assist in detecting and preventing violations of this regulation.

3. Scope of required system of supervision for insurers and producers:

a) An insurer, general agent or independent agency is not required to review, or provide for review of, all insurance producer solicited transactions; or

b) An insurer, general agent or independent agency is not required to include in its system of supervision an insurance producer's recommendations to consumers of products other than the annuities offered by the insurer, general agent or independent agency.

c) Note: these clarifications to the scope of the supervisory requirements parallel those applied under FINRA Rule 3010.

4. Deference to FINRA Suitability rule for variable annuity sales:

a) Compliance with FINRA's suitability rule will satisfy the regulation's suitability requirements for variable annuity recommendations.

b) Deference to FINRA suitability standards and practices in variable annuity sales does not, however, limit the insurance commissioner's ability to enforce the regulation.

D. **Recordkeeping**

1. Insurers, general agents, independent agencies and insurance producers must maintain or be able to make available to the commissioner records of the information collected from the consumer and other information used in making the recommendations that were the basis for insurance transactions for [a specified number of] years after the insurance transaction is completed by the insurer.

2. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

3. Records required to be maintained by this regulation may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

E. **Enforcement Powers and Mitigation Provisions**

1. To implement the regulation, the state insurance commissioner may order:

a) An insurer to take reasonably appropriate corrective action for any consumer harmed by the insurer's, or by its insurance producer's, violation of this regulation;

b) An insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this regulation; and

2. Any applicable penalty under the state code may be reduced or eliminated if corrective action for the consumer was taken promptly after a violation was discovered.

V. Overview of the Modifications in the 2010 Revised NAIC Suitability in Annuity Transactions Model Regulation

A. Insurance producers are required to obtain information about the customer's needs and financial objectives when formulating a recommendation for an annuity purchase and must have reasonable belief that the recommendation is suitable. (NAIC Model Sec. 6(A)&(B)).

B. Insurers must assure that a system is in place to supervise compliance with the Model, including review of producers' recommendations. (NAIC Model Sec. 6(F)(1)(d)).

C. An insurer must conduct reviews of its records to assist in detecting and preventing violations of the regulation. (NAIC Model Sec. 6(F)(1)(e).

D. When an insurer contracts with a third party to establish a system of supervision, the insurer must monitor and audit, as appropriate, to assure that the third party is performing the required functions. (NAIC Model Sec. 6(F)(2)(b)(i)).

E. When an insurer relies on a third party to perform required suitability functions, the third party, when requested by the insurer, must give a certification that it is performing the functions in compliance with the regulation. (NAIC Model Sec. 6(F)(2)(b)(ii)).

F. Sales of annuities made in compliance with stringent federal securities rules pertaining to suitability and supervision (FINRA Rule 2330) satisfy the requirements under the Model. (NAIC Model Sec. 6(H)).

G. An insurance producer shall not solicit the sale of an annuity unless the producer has adequate knowledge of the product and shall be in compliance with the insurer's product training standards. (NAIC Model Sec. 7(A).

H. Insurance producers who engage in the sale of annuities must complete an annuity training course approved by the appropriate State. (NAIC Model Sec. 7(B)).

I. The Commissioner may order that an insurer or producer take appropriate corrective action for any consumer harmed by the insurer's, or producer's, violation of the regulation. (NAIC Model Sec. 8(A)(1)&(2)).

The NAIC Annuity Disclosure Model Regulation:
Disclosure Standards in Annuity Distribution

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

I. Scope of Outline

A. This outline summarizes the elements of the NAIC Annuity Disclosure Model Regulation, the required Disclosure Statement and the required NAIC Buyer's Guide to Fixed, Indexed and Variable Annuities.

B. The NAIC Annuity Disclosure Model Regulation can be found at NAIC Model Reporting Service 245-I (April 2016).

II. Objective of the Annuity Disclosure Model Regulation

A. To provide standards for the disclosure of certain minimum information about annuity contracts to protect consumers and foster consumer education.

1. The regulation specifies the minimum information which must be disclosed and the method and timing of delivering it.

2. The regulation seeks to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts.

III. Annuities Covered by the Regulation

A. All group and individual annuity contracts, except:

1. Registered or non-registered variable annuities.

2. Immediate and deferred annuities having only non-guaranteed elements.

3. Annuities used to fund:

a) An employee pension plan which is covered by the Employee Retirement Income Security Act (ERISA);

b) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer,

c) A governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or a tax exempt organization under Section 457 of the Internal Revenue Code; or

d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

4. Structured Settlement Annuities.

5. Note: Under the model regulation, states may optionally elect to exclude charitable gift annuities and structured settlement annuities also.

IV. Information Mandated in Required NAIC Disclosure Statement

A. The generic name of the contract, the company product name, if different, form number, and the fact that it is an annuity;

B. The insurer's name and address;

C. A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate:

1. The guaranteed, non-guaranteed and determinable elements of the contract, and their limitations, if any, and an explanation of how they operate;

2. An explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;

3. Periodic income options both on a guaranteed and non-guaranteed basis;

4. Any value reductions caused by withdrawals from or surrender of the contract;

5. How values in the contract can be accessed;

6. The death benefit, if available, and how it will be calculated;

7. A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and

8. Impact of any rider, such as a long-term care rider.

D. Specific dollar amount or percentage charges and fees, which must be listed with an explanation of how they apply.

E. Information about the current guaranteed rate for new contracts that contains a clear notice that the rate is subject to change.

F. Insurers must define terms used in the disclosure statement in language understandable by a typical person in the target market.

V. Required NAIC Buyer's Guide to Fixed Deferred Annuities (appears at the end of the outline).

A. A Buyer's Guide prepared by the NAIC provides information about different aspects of annuities, such as

1. What an annuity is.

2. Descriptions of the different kinds of annuities.

    a) Single premium or multiple premium.

    b) Immediate or deferred.

    c) Fixed or variable.

3. How interest rates are set for the deferred variable annuity.

    a) Explanation of current interest rate.

    b) Explanation of minimum guaranteed rate.

    c) Explanation of multiple interest rates.

4. Description of charges in the contract.

    a) Surrender or withdrawal charges.

    b) Free withdrawal features.

    c) Contract fee.

    d) Transaction fee.

    e) Percentage of premium charge.

    f) Premium tax charge.

5. Fixed Annuity Benefits

a) Annuity income payments.

b) Annuity payment options.

(1) Life only.

(2) Life annuity with period certain.

(3) Joint and survivor.

VI. Timetable for Delivery of Required Disclosure Statement and Buyers' Guide:

A. At or before the time of application if annuity application is taken in a *face-to-face meeting*.

B. No later than five (5) business days after the completed application is received by the insurer, if annuity application is taken by means *other than in a face-to-face meeting*.

1. With applications received from a *direct solicitation through the mail*:

a) Inclusion of a Buyer's Guide and Disclosure Statement in the direct mail solicitation satisfies the requirement for delivery no later than five (5) business days after receipt of the application.

2. For applications received via the Internet:

a) Taking reasonable steps to make the Buyer's Guide and Disclosure Statement available for viewing and printing on the insurer's website satisfies the requirement for delivery no later than five (5) business day of receipt of the application.

3. Annuity solicitations in other than face-to-face meetings must include a statement that the proposed applicant may contact the insurance department of the state for a free annuity Buyer's Guide. Alternatively, the insurer may include a statement that the prospective applicant may contact the insurer for a free annuity Buyer's Guide.

4. *Extended Free-Look Period*: where the Buyer's Guide and disclosure document are not provided at or before the time of application, a free look period of no less than fifteen (15) days shall be provided for the applicant to return the annuity contract without penalty. The free look runs concurrently with any other free look provided under state law or regulation.

VII. Required Report to Contract Owners

A. For annuities in the payout period with changes in non-guaranteed elements and for the accumulation period of a deferred annuity, the insurer must provide each contract owner with a report, *at least annually*, on the status of the contract that contains at least the following information:

1. The beginning and end date of the current report period;

2. The accumulation and cash surrender value, if any, at the end of the previous report period and at the end of the current report period;

3. The total amounts, if any, that have been credited, charged to the contract value or paid during the current report period; and

4. The amount of outstanding loans, if any, as of the end of the current report period.

VIII. The NAIC Annuity Buyers' Guide Appears in Appendix B.

NAIC Insurance and Annuities Replacement Model Regulation:
A Systemic Approach to Appropriate Sales Practices

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

I. NAIC Insurance and Annuities Replacement Model Regulation

A. In June 2000, the NAIC adopted substantial amendments to the 1998 Insurance and Annuities Replacement Model Regulation. This regulation establishes substantial protections for consumers through required systems of supervision, control, monitoring, and recordkeeping for insurers and producers. Additionally, the regulation requires plain-English notices, and signed disclosure about the replacement transaction.

1. The NAIC's Model Regulation and amendments promote uniformity among state insurance regulations.

2. Citation: Insurance and Annuities Replacement Model Regulation, NAIC Model Regulation Service-July 2006 at III-621-1.

B. **Approach of the amended regulation**

1. The amended regulation establishes duties for insurance producers, replacing insurers, and existing insurers designed to protect consumers.

a. For example, insurers using insurance producers must, among other things:

(1) Maintain a *system of supervision and control*;

(2) Have the *capacity to monitor* each producer's life and annuity replacements for that insurer;

(3) Ascertain that required *sales material and illustrations are complete and accurate*; and

(4) *Maintain records* of required notification forms and illustrations that can be produced.

b. A required notice of replacement must be presented, read to consumers, and signed by the producer and consumer.

2. The regulation lists illustrative violations, and establishes penalties that may include the revocation or suspension of a producer's or company's license, monetary fines, and forfeiture of commissions or compensation. Commissioners may require insurers to make

restitution, and restore policy values with interest when violation are material to the sale. [*See*, Section 8 of the regulation].

C. Overview of Issue

1. A replacement occurs when an individual uses existing life insurance policy or annuity contract values to purchase a new policy or contract.

2. A replacement may involve the use of the entire value of an existing policy or contract, as in the case of a surrender, or it may involve the use of only a portion of the existing values.

3. Under the NAIC Model as amended in 2000, the use of *any* portion of the values of an existing policy or contract to purchase a new policy or contract constitutes replacement, including borrowing, assigning dividends, lapsing, or forfeiting.

    a. External replacement occurs when a company replaces the life or annuity product of another company.

    b. Internal replacement occurs when a company replaces a life or annuity contract that it has already issued.

D. *Purpose* of the Amended NAIC Replacement Regulation

1. To regulate the activities of insurers and producers with respect to the replacement of existing life insurance and annuities.

2. To protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions, and to:

    a. Assure that purchasers receive information with which a decision can be made in his or her own best interest;

    b. Reduce the opportunity for misrepresentation and incomplete disclosure; and

    c. Establish penalties for failure to comply with the regulation.

E. Regulation *Applies to Variable Life Insurance and Variable Annuity Replacements*

1. The term *replacement* is defined in the regulation to mean a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be:

    a. Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;

b. Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;

c. Amended so as to effect either a reduction in force of for which benefits would be paid;

d. Reissued with any reduction in cash value; or

e. Used in a financed purchase.

2. The regulation excuses variable life and variable annuity contracts from requirements in Sections 5(A)(2) and 6(B) to provide illustrations or policy summaries.

   a. In place of the policy summaries and illustrations requirement, the regulation mandates "premium or contract distribution amounts and identification of the appropriate prospectus or offering circular" instead.

   b. In all other respects, the regulation fully applies to individual variable contract replacements.

F. *Exceptions* from regulation for group contracts

1. The regulation does not apply to transactions involving:

   a. Policies or contracts used to fund:

      (1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);

      (2) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer;

      (3) A governmental or church plan defined in Section 414, a governmental or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the Internal Revenue Code; or

      (4) A non-qualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

   b. Group life insurance or group annuities where there is no direct solicitation of individuals by an insurance producer.

c. Credit life insurance.

G. Duties of Producers and Insurers in Replacement Transactions

1. Duties of insurers that use producers [Section 4.]

a. Under the regulation, each insurer must:

(1) *Maintain a system of supervision and control* to insure compliance with the requirements of this regulation that shall *include at least* the following:

(a) *Inform its producers of the requirements of the regulation* and incorporate the requirements of the regulation into all relevant *producer training manuals* prepared by the insurer;

(b) *Provide* to each producer *a written statement of the company's position with respect to the acceptability of replacements* providing guidance to its producer as to the appropriateness of these transactions;

(c) *A system to review the appropriateness* of each replacement transaction *that the producer does not indicate is in accord with the regulation's standards;*

(d) Procedures to *confirm* that the *requirements* of this regulation have been *met*; and

(e) Procedures to *detect transactions that are replacements of existing policies* or contracts by the existing insurer, but that have not been identified as such by the applicant or producer.

(2) *Have the capacity to produce*, upon request, and make available to the Insurance Department, *records of each producer's*:

(a) *Replacements*, including financed purchases, as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(b) *Number of lapses* of policies and contracts by the producer as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(c) Number of transactions that are *unidentified replacements of existing policies* or contracts by the existing insurer detected by the company's monitoring system as required by Section (4)(A)(5) of the regulation; and

(d) *Replacements, indexed by replacing producer and existing insurer*.

(3) Require with or as a part of each application for life insurance or an annuity a signed statement by both the applicant and the producer as to whether the applicant has existing policies or contracts;

(4) Require with each application for life insurance or an annuity that indicates an existing policy or contract a completed notice regarding replacements as contained in Attachment 1 to the regulation;

(5) When the applicant has existing policies or contracts, retain completed and signed copies of the notice regarding replacements in its home or regional office for at least five years after the termination or expiration of the proposed policy or contract;

(6) When the applicant has existing policies or contracts, obtain and retain copies of any sales material as required by Section 3(E) of the regulation, the basic illustration and any supplemental illustrations used in the sale and the producer's and applicant's signed statements with respect to financing and replacement in its home or regional office for at least five years after the termination or expiration of the proposed policy or contract

(7) Records required to be retained by the regulation may be maintained in paper, photograph, microprocess, magnetic, mechanical or electronic media or by any process which accurately reproduces the actual document.

2. Duties of Replacing Insurers that Use Producers [Section 6].

a. Where a replacement is involved in the transaction, the replacing insurer shall:

(1) Verify that the required forms are received and are in compliance with the regulation;

(2) Notify any other existing insurer that may be affected by the proposed replacement within five business days of receipt of a completed application indicating replacement or when the replacement is identified if not indicated on the application, and mail a copy of the available *illustration or policy summary* for the proposed policy or available disclosure document for the proposed contract within five business days of a request from an existing insurer; [*note*: this illustration and policy summary requirement does not apply to variable contracts.]

(3) Be able to produce copies of the notification regarding replacement required in Section 4(B), *indexed by producer, in its home or regional office* for at least five years or until the next regular examination by the insurance department of a company's state of domicile, whichever is later; and

(4) Provide to the policy or contract owner notice of the right to return the policy or contract within thirty (30) days of the delivery of the contract and receive an unconditional full refund of all premiums or considerations paid on it, including any policy fees or charges or, in the case of a *variable or market value adjustment policy or contract*, a payment of the cash surrender value provided under the policy or contract plus the fees and other charges deducted from the gross premiums or considerations or imposed under such policy or contract.

b. In transactions where the replacing insurer and the existing insurer are the same or subsidiaries or affiliates under common ownership or control [*internal replacements*] allow credit for the period of time that has elapsed under the replaced policy's or contract's incontestability and suicide period up to the face amount of the existing policy or contract. With regard to *financed purchases* the credit may be limited to the amount the face amount of the existing policy is reduced by the use of existing policy values to fund the new policy or contract.

c. If an insurer *prohibits the use of sales material other than that approved* by the company, as an alternative to the requirements of Section 3(E) the insurer may:

(1) Require with each application a statement *signed by the producer* that:

- Represents that the producer used only company approved sales material;
- *Lists*, by identifying number or other descriptive language, the *sales material that was used*; and
- States that copies of all sales material were left with the applicant in accordance with Section 3(D); and

- Within ten days of the issuance of the policy or contract:

(a) Notify the applicant by sending a letter or by verbal communication with the applicant *by a person whose duties are* ***separate from the marketing area*** *of the insurer*, that the producer has represented that copies of all sales material have been left with the applicant in accordance with Section 3(D);

(b) Provide the applicant with a *toll free number* to contact *company personnel involved in the compliance function* if such is not the case; and

(c) Stress the importance of retaining copies of the sales material for future reference; and

- Keep a copy of the letter or other verification in the policy file at the home or regional office for at least five years after the termination or expiration of the policy or contract.

3. Duties of the Existing Insurer [Section 6].

a. Where a replacement is involved in the transaction, the existing insurer shall:

(1) Upon notice that its existing policy or contract may be replaced or a policy may be part of a financed purchase, *retain copies* of the notification in its home or regional office, *indexed by replacing insurer*, notifying it of the

replacement for at least five years or until the conclusion of the next regular examination conducted by the Insurance Department of its state of domicile, whichever is later.

(2) Send a letter to the policy or contract owner of the right to receive information regarding the existing policy or contract values including, if available, an in force illustration or policy summary if an in force illustration cannot be produced within five business days of receipt of a notice that an existing policy or contract is being replaced. The information shall be provided within five business days of receipt of the request from the policy or contract owner.

(3) Upon receipt of a request to borrow, surrender or withdraw any policy or contract values, send to the applicant a notice, advising the policy or contract owner of the effect release of policy or contract values will have on the non-guaranteed elements, face amount or surrender value of the policy or contract from which the values are released. The notice shall be sent separate from the check if the check is sent to anyone other than the policy or contract owner. In the case of *consecutive automatic premium loans or systematic withdrawals* from a contract, the insurer is only required to send the notice at the time of the first loan or withdrawal.

4. Duties of Producers [Section 4].

   a. A producer who initiates an application must submit to the insurer, with or as part of the application, a statement signed by both the
   applicant and the producer as to whether the applicant has existing policies or contracts. If the answer is "no," the producer's duties with respect to replacement are complete.

   b. If the applicant answered "yes" to the question regarding existing coverage referred to in Subsection (A), the producer shall present and read to the applicant, not later than at the time of taking the application, a notice regarding replacements in the form as described in Attachment 1 to the regulation or other substantially similar form approved by the commissioner. *The notice shall be signed by both the applicant and the producer* attesting that the notice has been read aloud by the producer or that the applicant did not wish the notice to be read aloud (in which case the producer need not have read the notice aloud) and left with the applicant.

   c. The notice shall list all life insurance policies or annuities proposed to be replaced, properly identified by name of insurer, the insured or annuitant, and policy or contract number if available; and shall include a statement as to whether each policy or contract will be replaced or whether a policy will be used as a source of financing for the new policy or contract. If a policy or contract number has not been issued by the existing insurer, alternative identification, such as an application or receipt number, shall be listed.

d. In connection with a replacement transaction *the producer shall leave with the applicant* at the time an application for a new policy or contract is completed *the original or a copy of all sales material*. With respect to electronically presented sales material, it shall be provided to the policyholder in printed form no later than at the time of policy or contract delivery.

e. Except as provided in Section 5(C) of the regulation, in connection with a replacement transaction the producer shall submit to the insurer to which an application for a policy or contract is presented, a copy of each document required by this section, *a statement identifying any preprinted or electronically presented company approved sales materials used*, and *copies of any individualized sales materials*, including *any illustrations* used in the transaction

H. Selected Definitions

1. Section 2(D) defines the term *financed purchase* as "the purchase of a new policy involving the actual or intended use of funds obtained by the withdrawal or surrender of, or by borrowing from values of an existing policy to pay all or part of any premium due on the new policy."

a. If a withdrawal, surrender, or borrowing involving the policy values of an existing policy are used to pay premiums on a new policy owned by the same policyholder *within thirteen months before or after the effective date of the new policy* and is known by the replacing insurer, or if the withdrawal, surrender, or borrowing is shown on any illustration of the existing and new policies made available to the prospective policyowner by the insurer or its producers, it will be *deemed prima facie evidence of a financed purchase.*

2. Section 2(I) defines the term registered contract as "a variable annuity contract or variable life insurance policy subject to the prospectus delivery requirements of the Securities Act of 1933."

I. Several aspects of the amended NAIC model regulation parallel SEC and FINRA positions concerning Section 1035 exchanges and bonus annuity sales.

1. Selected list of parallel regulatory concepts

    a. FINRA Guideline on Variable Life Insurance Distribution: NTM 00-44 (June 2000).

    b. FINRA Guidelines on Supervisory Responsibilities: NTM 99-45 (June 1999).

    c. FINRA Statement on Variable Annuity Distribution: NTM 99-35 (May 1999).

    d. SEC Office of Compliance Inspections and Examinations: Indicators of "Good" Internal Controls in Variable Contract Distribution.

        (1) A compilation of the SEC's indicators drawn from speeches and seminar comments is discussed in Wilkerson, *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 20.

    e. SEC Examination of Variable Annuity "Bonus" Programs

        (1) Several of the items requested in the SEC's inspection letter requested documents and information that the amended NAIC Model Replacement Regulation also addresses.

            (a) Scope of documents requested in the SEC's examinations was outlined in *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 6.

    a. FINRA and SEC inspection sweeps focusing on "Section 1035 exchanges" of variable contracts and "life financing" arrangements (1998 and 1996.)

        (1) These sweeps and the documentation they elicited were discussed in *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 11 and 15.

Attachment 1 to this Outline on the Model Replacement Regulation

IMPORTANT NOTICE: REPLACEMENT OF LIFE INSURANCE OR ANNUITIES

This document must be signed by the applicant and the producer, if there is one, and a copy left with the applicant.

You are contemplating the purchase of a life insurance policy or annuity contract. In some cases this purchase may involve discontinuing or changing an existing policy or contract. If so, a replacement is occurring. Financed purchases are also considered replacements.

A replacement occurs when a new policy or contract is purchased and, in connection with the sale, you discontinue making premium payments on the existing policy or contract, or an existing policy or contract is surrendered, forfeited, assigned to the replacing insurer, or otherwise terminated or used in a financed purchase.

A financed purchase occurs when the purchase of a new life insurance policy involves the use of funds obtained by the withdrawal or surrender of or by borrowing some or all of the policy values, including accumulated dividends, of an existing policy, to pay all or part of any premium or payment due on the new policy. A financed purchase is a replacement.

You should carefully consider whether a replacement is in your best interests. You will pay acquisition costs and there may be surrender costs deducted from your policy or contract. You may be able to make changes to your existing policy or contract to meet your insurance needs at less cost. A financed purchase will reduce the value of your existing policy or contract and may reduce the amount paid upon the death of the insured.

We want you to understand the effects of replacements before you make your purchase decision and ask that you answer the following questions and consider the questions on the back of this form.
1. Are you considering discontinuing making premium payments, surrendering, forfeiting, assigning to the insurer, or otherwise terminating your existing policy or contract? ___ YES ___ NO

2. Are you considering using funds from your existing policies or contracts to pay premiums due on the new policy or contract? ___ YES ___ NO

> If you answered "yes" to either of the above questions, list each existing policy or contract you are contemplating replacing (include the name of the insurer, the insured, and the contract number if available) and whether each policy will be replaced or used as a source of financing:

INSURER NAME
CONTRACT OR POLICY#
INSURED OR ANNUITANT: REPLACED (R) OR FINANCING (F)

1.

2.

3.

Make sure you know the facts. Contact your existing company or its agent for information about the old policy or contract. [If you request one, an in force illustration, policy summary or available disclosure documents must be sent to you by the existing insurer.] Ask for and retain all sales material used by the agent in the sales presentation. Be sure that you are making an informed decision.

The existing policy or contract is being replaced because ______________________
____.

I certify that the responses herein are, to the best of my knowledge, accurate:

____

Applicant's Signature and Printed Name | Date

____ _______________

Producer's Signature and Printed Name | Date

____ _______________

I do not want this notice read aloud to me. __________ (Applicants must initial only if they do not want the notice read aloud.)

A replacement may not be in your best interest, or your decision could be a good one. You should make a careful comparison of the costs and benefits of your existing policy or contract and the proposed policy or contract. One way to do this is to ask the company or agent that sold you your existing policy or contract to provide you with information concerning your existing policy or contract. This may include an illustration of how your existing policy or contract is working now and how it would perform in the future based on certain assumptions. Illustrations should not, however, be used as a sole basis to compare policies or contracts. You should discuss the following with your agent to determine whether replacement or financing your purchase makes sense:

PREMIUMS:	Are they affordable? Could they change? You're older--are premiums higher for the proposed new policy? How long will you have to pay premiums on the new policy? On the old policy?
POLICY VALUES:	New policies usually take longer to build cash values and to pay dividends. Acquisition costs for the old policy may have been paid, you will incur costs for the new one. What surrender charges do the policies have? What expense and sales charges will you pay on the new policy? Does the new policy provide more insurance coverage?
INSURABILITY:	If your health has changed since you bought your old policy, the new one could cost you more, or you could be turned down. You may need a medical exam for a new policy. Claims on most new policies for up to the first two years can be denied based on inaccurate statements. Suicide limitations may begin anew on the new coverage.

IF YOU ARE KEEPING THE OLD POLICY AS WELL AS THE NEW POLICY:

How are premiums for both policies being paid?
How will the premiums on your existing policy be affected?
Will a loan be deducted from death benefits?
What values from the old policy are being used to pay premiums?

IF YOU ARE SURRENDERING AN ANNUITY OR INTEREST SENSITIVE LIFE PRODUCT:

Will you pay surrender charges on your old contract?
What are the interest rate guarantees for the new contract?
Have you compared the contract charges or other policy expenses?

OTHER ISSUES TO CONSIDER FOR ALL TRANSACTIONS:

What are the tax consequences of buying the new policy?
Is this a tax free exchange? (See your tax advisor.)
Is there a benefit from favorable "grandfathered" treatment of the old policy under the federal tax code?
Will the existing insurer be willing to modify the old policy?

How does the quality and financial stability of the new company compare with your existing company?

(Attachment 2 to Replacement Outline)

NOTICE REGARDING REPLACEMENT
REPLACING YOUR LIFE INSURANCE POLICY OR ANNUITY?

Are you thinking about buying a new life insurance policy or annuity and discontinuing or changing an existing one? If you are, your decision could be a good one--or a mistake. You will not know for sure unless you make a careful comparison of your existing benefits and the proposed policy or contract's benefits.

Make sure you understand the facts. You should ask the company or agent that sold you your existing policy or contract to give you information about it.

Hear both sides before you decide. This way you can be sure you are making a decision that is in your best interest.

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NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation American Council of Life Insurers

I. NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities.

A. This NAIC regulation directly parallels the North American Securities Administrators Association (NASAA) credentialing regulations and was developed in close coordination with NASAA and supported by NASAA.

B. See http://www.nasaa.org/content/Files/Senior_Model_Rule110807.pdf

C. The NAIC regulation and an accompanying bulleting can be obtained on the NAIC website at http://www.naic.org/Releases/2008_docs/senior_sales.htm .

II. Purpose of the NAIC Regulation

A. The regulation establishes standards to protect consumers from misleading and fraudulent marketing practices with respect to the use of senior-specific certifications and professional designations in the solicitation, sale or purchase of, or advice made in connection with, a life insurance or annuity product.

B. The regulation will apply to any solicitation, sale or purchase of, or advice made in connection with, a life insurance or annuity product by an "insurance producer," that is defined as a person required to be licensed under the laws of this State to sell, solicit or negotiate insurance, including annuities.

III. Prohibited Uses of Senior-Specific Certifications and Professional Designations [Section 5]

A. Under the regulation, it will be an unfair and deceptive act or practice in the business of insurance within the meaning of the Unfair Trade Practices Act for an insurance producer to use a senior-specific certification or professional designation that indicates or implies in such a way as to mislead a purchaser or prospective purchaser that insurance producer has special certification or training in advising or servicing seniors in connection with the solicitation, sale or purchase of a life insurance or annuity product or in the provision of advice as to the value of or the advisability of purchasing or selling a life insurance or annuity product, either directly or indirectly through publications or writings, or by issuing or promulgating analyses or reports related to a life insurance or annuity product.

B. The prohibited use of senior-specific certifications or professional designations includes, but is not limited to, the following:

1. Use of a certification or professional designation by an insurance producer who has not actually earned or is otherwise ineligible to use such certification or designation;

2. Use of a nonexistent or self-conferred certification or professional designation;

3. Use of a certification or professional designation that indicates or implies a level of occupational qualifications obtained through education, training or experience that the insurance producer using the certification or designation does not have; and

4. Use of a certification or professional designation that was obtained from a certifying or designating organization that:

   a) Is primarily engaged in the business of instruction in sales or marketing;

   b) Does not have reasonable standards or procedures for assuring the competency of its certificants or designees;

   c) Does not have reasonable standards or procedures for monitoring and disciplining its certificants or designees for improper or unethical conduct; or

   d) Does not have reasonable continuing education requirements for its certificants or designees in order to maintain the certificate or designation.

5. Under the regulation, there is a rebuttable presumption that a certifying or designating organization is not disqualified solely for purposes of subsection A(2)(d) when the certification or designation issued from the organization does not primarily apply to sales or marketing and when the organization or the certification or designation in question has been accredited by:

   a) The American National Standards Institute (ANSI);

   b) The National Commission for Certifying Agencies; or

   c) Any organization that is on the U.S. Department of Education's list entitled "Accrediting Agencies Recognized for Title IV Purposes."

6. In determining whether a combination of words or an acronym standing for a combination of words constitutes a certification or

professional designation indicating or implying that a person has special certification or training in advising or servicing seniors, factors to be considered shall include:

a) Use of one or more words such as “senior,” “retirement,” “elder,” or like words combined with one or more words such as “certified,” “registered,” “chartered,” “advisor,” “specialist,” “consultant,” “planner,” or like words, in the name of the certification or professional designation; and

b) The manner in which those words are combined.

7. For purposes of this NAIC regulation, a job title within an organization that is licensed or registered by a State or federal financial services regulatory agency is not a certification or professional designation, unless it is used in a manner that would confuse or mislead a reasonable consumer, when the job title:

a) Indicates seniority or standing within the organization; or

b) Specifies an individual’s area of specialization within the organization.

8. Under this subsection, financial services regulatory agency includes, but is not limited to, an agency that regulates insurers, insurance producers, broker-dealers, investment advisers, or investment companies as defined under the Investment Company Act of 1940.

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The Impact of State Insurance Consulting Laws and Related Provisions on Insurance Producers Performing Financial Planning Services

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

I. The Impact of State Insurance Consulting Laws and Related Provisions on Insurance Producers Performing Financial Planning Services

A. Background

1. A degree of variability exists in state insurance statutes and regulations concerning financial planning by life insurance agents.

2. Careful review of the various state laws and regulations is valuable in confirming proper procedures and activities.

B. NAIC Unfair Trade Practices Act provisions governing financial planning:

1. §2(M) of the NAIC Unfair Trade Practices Act defines an unfair financial planning practice by an insurance producer to be:

a) Holding himself or herself out directly or indirectly to the public as they "financial planner," "investment advisor," "consulted," "financial counselor," or any other specialists engaged in the business of giving financial planning for advice relating to investments, insurance, real estate tax matters or trust and estate matters when such person is in fact engaged only in the sale of policies.

b) Engaging in the business of financial planning without disclosing to the client prior to the execution of the agreement provided for in paragraph 3 [of this regulation], or solicitation of the sale of a product or service that:

(1) He or she is also an insurance salesperson, and

(2) That a commission for the sale of the insurance products will be received in addition to a fee for financial planning, if such is the case.

c) This NAIC provision forbids fees other than commission for financial planning by insurance producers, unless such fees are based upon a written agreement, signed by the client in advance; a copy of the agreement must be given to the client at the time it is signed.

C. Insurance Consulting Laws

1. Many states have adopted statutes or regulations generally referred to as "insurance consulting" provisions that seek to protect insurance product policyholders by preventing the receipt of insurance commissions and insurance consulting fees concerning the same sale.

2. It is unlikely that this body of law was intended to govern broad-spectrum of financial planning conducted by insurance agents in today's market. Nonetheless, financial planning and investment advisory activities could inadvertently trigger the scope and terms of the insurance consulting laws.

a) Insurance consulting laws evolved to address problems of a traditional life insurance environment, not more recent developments such as financial planning for investment advice.

b) While the application of the insurance consulting laws to financial planning is not clear, potential coverage could be triggered in two ways:

(1) Fee and commission financial planning arrangements that also involve a recommendation and ultimate purchase of insurance product;

(2) Commission only financial planning arrangements that involve the recommendation and ultimate purchase of an insurance product.

c) Insurance consulting laws generally fall into two categories:

(1) States prohibiting insurance agents from receiving both consulting fees and sales commissions in connection with the same assurance product sale.

(a) See, e.g., Connecticut Insurance Code §38 – 92h (an individual serving as a quote certified insurance consultant" is prohibited from receiving both sales commission and a consultant's commission in connection with the sale of insurance).

(2) States permitting insurance agents to obtain both consulting fees and sales commissions in connection with the same insurance product sale, providing clear

disclosure about the joint receipt of a fee and commission is communicated.

(a) See, e.g., Arkansas Insurance Department Bulletin No. 1185 (May 10, 1985): "the obvious intent of this section [§66 -- 3023 (3)] is to permit genuine utilization of the [property/casualty and life/disability] agent's expertise, for compensation, but to require proper disclosure to the client and to prevent price gouging by unscrupulous persons."

(b) See also, New Mexico Insurance Rule 80-3-6 (c) which states that "terms such as financial planner, investment advice or, financial consultant, or financial counseling shall not be used in such a way as to imply that the insurance agent is generally engaged in an advisory business in which compensation is unrelated to sales, unless such is actually the case.

(3) A compilation of state laws and regulations about insurance consulting laws and investment advisor provisions is set forth below.

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A Comprehensive System of State Regulation Governs
the Distribution of Insurance and Annuity Contracts

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

A. State Insurance Regulation

Through a network of statutes and regulations, state insurance departments heavily regulate the operations, products, and sales of life insurance companies. Life insurers and their salespersons must satisfy this regulatory structure in their state of domicile and every jurisdiction in which they distribute life insurance and annuities. Uniformity of regulation is accomplished throughout the states by means of model statutes and regulations promulgated by the National Association of Insurance Commissioners (the "NAIC"). Many of the insurance statutes and regulations promulgated and enforced by state insurance departments fulfill regulatory goals quite similar to those of the state securities administrators. The summary below highlights the broad scope and comprehensiveness of certain state insurance statutes and regulations. While only a small portion of the larger universe of state insurance regulation, this regulations are directly relevant in evaluating the market conduct structure governing insurance salespersons engaged in the delivery of financial planning and broker-dealer services. This discussion is intended to fill in other areas not covered in the preceding outline materials to this submission.

B. Unfair Trade Practices

Virtually every state has enacted a version of the NAIC Model Unfair Trade Fair Practices Act which was developed to regulate trade practices in the insurance business by defining and prohibiting practices that constitute unfair methods of competition or unfair deceptive acts or practices.[1]

A variety of the activities defined to be unfair trade practices directly parallel the purpose and scope of state securities codes. Section 4(A) involves misrepresentations and false advertising of insurance policies, and identifies unfair trade practices to include any estimate, illustration, circular or statement, sales misrepresentation, omission or comparison that misrepresents the benefits, advantages, conditions or terms of any policy, among other things.

Section 4(B) involves false information and advertising generally. This provision defines an unfair trade practice to include making, publishing or disseminating in a newspaper, magazine or other publication, on any radio/television station any assertion,

[1]This model statute governs items previously subject to Section 5 of The Federal Trade Commission Act. Congress observed that continued regulation of insurance by the states was in the public interest. *See*, legislative history of NAIC Unfair Trade Practices Act, NAIC Model Regulation Service at 880-20(1993).

representation or statement about an insurer or its business, which is untrue, deceptive or misleading.

Knowingly making any false statement of any material fact to insurance regulators, or in documents that will be publicly disseminated, is defined to be an unfair trade practice in Section 4(B) of the Model Unfair Trade Practices Act. This proscription is consistent with the truthfulness and accuracy of reports, records and representations required of Broker/Dealers by the NASD and the SEC under the federal securities laws.

Section 4(J) involves the failure to maintain marketing and performance records, and defines as an unfair trade practice the failure of an insurer to maintain its books, records, documents, and other business records in such an order that data regarding complaints, claims, reading, underwriting and marketing are accessible and retrievable for examination by the insurance commissioner. Data for at least the current calendar year in the two preceding years must be maintained under this standard. This provision directly parallels the scope and purpose of NASD Conduct Rule 3110 regarding books and records.

Section 4(K) defines the failure of any insurer to maintain a complete record of all the complaints it received since the date of its last market conduct examination to be an unfair trade practice. The records of complaints must indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint and the time it took to process each.[2] For purposes of this subsection, the term "complaint" means any written communication primarily expressing a grievance.

Like state securities administrators, insurance commissioners have the power to examine and investigate the affairs of every insurer operating in the insurance department's state "in order to determine whether such insurer has been or is engaged in any unfair trade practice prohibited by [the Unfair Trade Practices Act]."[3] Several provisions embellish this important authority.

For example, Section 7 of the Unfair Trade Practices Act gives insurance commissioners extensive authority to initiate hearings concerning unfair trade practices, to compel witnesses, appearances, production of books, and service of process. Section 7 sets forth detailed administrative and procedural practices, in order to assure due process and quasi-judicial formality.

Section 8 of the Unfair Trade Practices statute authorizes insurance commissioners finding insurers guilty of unfair trade practices to issue written findings and enforcement orders requiring the insurer to cease and desist from engaging in the act or practice. The insurance commissioner also has the discretionary authority to suspend and revoke

[2]The NAIC has also promulgated a Model Regulation for Complete Records to be maintained pursuant to Section 4(K) of the NAIC Unfair Trade Practices Act. *See*, NAIC Model Regulation Service at 844-1(1992).This regulation sets forth a complaint record form, content requirements, maintenance requirements, and standards concerning the format of complaint records.

[3] *See* Section 6, Power of Commissioner, Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-9(1993).

the insurer's license if the insurer knew or reasonably should have known that its conduct violated the Unfair Trade Practices Act, and to order penalties of $1,000 for each violation up to an aggregate penalty of $100,000, unless the violation was committed flagrantly in conscious disregard of the act, in which case the penalty may be up to $25,000 for each violation to an aggregate total penalty of $250,000. A similar monetary violation may be imposed under Section 11 for violations of cease and desist orders. The act also provides for judicial review of insurance commissioner orders and authorizes immunity from prosecution for witnesses who attend, testify or produce books, records or other paper correspondence.[4]

These significant powers that may be used by insurance commissioners to enforce violations of unfair trade practice proscriptions, together with the recordkeeping, reporting and inspection powers of the Act, provide a package of regulatory tools directly analogous to state securities codes, the NASD Rules of Conduct and SEC regulations governing market conduct practices and the prosecution of violations. In a sum, the unfair trade practice laws provide meaningful proscriptions that eliminate the need for duplicative regulation of variable contracts.

C. NAIC Model Fraud Laws and Fraud Legislation

Enactment of state fraud statutes represents another significant insurance regulatory development. Recent market conduct issues have resulted in some insurance departments requiring insurer management to assume increased responsibility for supervision of sales activities. Other states have taken an approach similar to that of New York and Pennsylvania by requiring insurer review of market conduct compliance, thus placing direct responsibility at the corporate officer level. This widespread action dovetails with the objectives of the Federal Crime Control Statute and the Federal Sentencing guidelines, discussed below.

While states have taken different approaches to the issue, the majority of states addressing the fraud issue enacted legislation similar to the NAIC Model Fraud Laws.[5]

D. Market Conduct Examinations

Nearly every jurisdiction has enacted a version of the NAIC Model Law on Examinations.[6] This Act is designed to provide an effective and efficient system for examining the activities, operations, financial condition and affairs of all persons transacting the business of insurance in each state and concerning individuals otherwise subject to the insurance commissioner's jurisdiction. The Act is intended to enable commissioners to adopt a flexible system of examinations and allocate resources deemed appropriate and necessary for the administration of the insurance laws of each state. The Model Law on Examinations sets forth standards for the conduct of

[4]*See* Sections 8, 9, 10, 11 and 14 of the Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-10 through 13(1994).

[5]*See* NAIC Insurance Fraud Prevention Model Act, NAIC Model Reporting Service at 680-1(1995).

[6]*See* NAIC Model Regulation Service at 390-1(1991).

examinations, commissioner authority, scope, and scheduling of examinations. It also details the scope of examination reports which shall be comprised of only facts appearing on books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined.[7]

Significantly, this Model Act dovetails with the NAIC Market Conduct Examiner's Handbook, an extremely detailed manual for examiners to assure that examiners follow comprehensive, uniform practices and procedures. The Examiner's Handbook is divided into seven different sections and contains 58 different standards. Among other things, the Examiner's Handbook addresses complaint handling, marketing and sales, producer licensing, and company operations/management.[8]

[7]*See* Sections 3, 4, and 5 of the Model Law on Examinations, NAIC Model Regulation Service at 390-5 (1991). Section 5 also sets forth detailed provisions for orders and administrative procedures in the conduct of hearing and adoption of a report on examination.

[8]Certain standards under the complaint handling section illuminate the depth and scope of the market conduct examination. Several standards are set forth below in this note as representative examples.

Complaint Handling**-Standard 2**

The company has adequate complaint handling procedures in place and communicates such procedures to policyholders.
Review Procedures and Criteria
Review manuals to verify complaint procedures exist. Procedures in place should be sufficient to require satisfactory handling of complaints received as well as internal procedures for analysis in areas developing complaints. There should be a method for distribution of and obtaining and recording response to complaints. This method should be sufficient to allow response within the time frame required by state law.
Company should provide a telephone number and address for consumer inquiries.

Complaint Handling**-Standard 3**

The company should take adequate steps to finalize and dispose of the complaint in accordance with applicable statutes, rules and regulations and contract language.

Review Procedures and Criteria
Review complaints documentation to determine if the company response fully addresses the issues raise. If the company did not properly address/resolve the complaint, the examiner should ask company what corrective action it intends to take.

Commentary:
Reference to the examiner's general instructions on Handbook page VIII-14 (November 1995) reveals that an inquiry broader in scope than the mere resolution of a given complaint is expected. For example, the Handbook contains the following instructions: "The examiner should review the frequency of similar complaints and be aware of any pattern of specific type of complaints....Should the types of complaints generated be cause for unusual concern, specific measures should be instituted to investigate other areas of the company's operation."

Complaint Handling**-Standard 4**

Throughout most of 1995 and 1996, the NAIC significantly revised the Market Conduct Examiner's Handbook. The NAIC, together with industry input, sought to expand and enhance tools fostering the detection and prevention of marketplace abuse in the life insurance industry. Market conduct examinations are extremely comprehensive and serve as a means of positive reinforcement, by discouraging deficient practices that will be detected on examination, resulting in remedial action, and insurance department intervention.

E. Agents' Licensing and Testing

The NAIC Agents and Brokers Licensing Model Act,[9] which appears virtually in every state, governs the qualifications and procedures for licensing insurance and annuity agents and brokers. This model law sets forth examination and licensing standards in great detail, and has a specific category for variable annuities and variable life insurance contracts. Licensed salespeople must be deemed by the insurance commissioner to be competent, trustworthy, financially responsible, and of good personal and business reputation. Insurance brokers must also fulfill experience requirements. Section 8 of this regulation governs license denial, non-renewal and termination, giving the insurance commissioner broad discretion to suspend, revoke or refuse to issue or renew a license upon finding any of a variety of conditions including materially untrue statements, violation or noncompliance with insurance laws, withholding, misappropriating or converting customer moneys, conviction of a felony or misdemeanor involving moral turpitude, forgery, or cheating on licensing examinations, among other things.

F. Agent Investigation: Character and Background Investigation Requirements

Most jurisdictions require that insurance producer license applicants be competent, trustworthy, and of good moral character in order to obtain a license. However, some now expressly require appointing insurers to certify that they have investigated the applicant's character and background and have found the applicant to be qualified and worthy of a license. Similar to FINRA, some jurisdictions implement fingerprinting as part of the background check. Related to these requirements is the portion of the NAIC Producer Licensing Model Act that allows the commissioner to refuse to issue an insurance producer's license if the commissioner finds that the individual has committed any act that is a ground for denial, suspension or revocation of the license. A law survey on this topic appears at the end of this segment of the appendix.

G. Continuing Education for Agents and Brokers

In granting insurance agents and brokers licenses, most states also impose significant continuing education standards that parallel in objective and scope the continuing

The time frame within which the company responds is in accordance with applicable statutes, rules, and regulations.

Review Procedures and Criteria
Review complaints to ensure company is maintaining adequate documentation. Determine if the company response is timely. The examiner should refer to state laws for the required time frame.

[9]*See* NAIC Model Regulation Service at 210-1 (2008).

education standards recently developed by the securities industry together with the NASD. As in other areas seeking uniformity, the NAIC has promulgated the Agents and Brokers Licensing Model Act.[10] Under Section 5 of this model regulation, licensed agents must annually satisfy courses or programs of instruction approved by insurance commissioners in each state according to a minimum number of classroom hours, which typically is in the range of 25 class room hours per year for life and annuity salespersons. The courses include those presented by the Life Underwriter Training Council Life Course Curriculum, the American College's Chartered Life Underwriter and Chartered Financial Planner curriculum, and the Insurance Institute of America's programs in general insurance, for example. Like FINRA's initial and ongoing educational requirements for registered representatives, state insurance regulators understand that testing, licensing and demonstration of continued competence through continuing education is critically important in the distribution of insurance and annuity products. A law survey on this topic appears at the end of this segment of the appendix.

H. Variable Contract Statutes

Life insurance companies are authorized to issue separate accounts funding variable life insurance and annuity contracts upon fulfilling a variable contract statute in their domestic state, which typically follows the NAIC Model Variable Contract Law.[11] This NAIC model statute gives the insurance commissioner exclusive authority to regulate the issuance and sale of variable contracts and to issue rules and regulations appropriate to carry out the act's purpose. This model act and associated regulations that appear under state insurance law gives an additional, important measure of regulatory scrutiny and purchaser protection.

Collectively, the NAIC statutes and regulations provide a significant network of comprehensive regulation over many important aspects affecting the marketing and sale of variable contracts that closely reflect the purpose and scope of analogous concepts of securities regulation.

I. Insurance Producer Database

From a market conduct perspective, life insurers have committed to a single, industry-accessible national producer database to facilitate their ability to track pertinent information regarding licensed producers. Access to information having a bearing on the producer's background, qualifications and competency is a valuable tool to insurers in the employment/appointment screening process. Moreover, widespread availability of such information makes it more difficult for a producer with significant disciplinary history to continue illegal or unethical practices by "company jumping."

NIPR (National Insurance Producer Registry) is a non-profit affiliate of the National Association of Insurance Commissioners (NAIC). It was created in October 1996 to develop and operate a national repository for producer license information (PDB) and to establish a network to facilitate the electronic exchange of producer information.

[10] *See* NAIC Model Regulation Service at 215-1 (2015).

[11] *See* NAIC Model Regulation Service at 260-1 (2015).

The Producer Database (PDB) is an electronic database consisting of information relating to insurance agents and brokers (producers) accessible through the NIPR Gateway on a subscription basis through the Internet. Internet PDB links participating state regulatory licensing systems into one common system establishing a repository of producer information. Internet PDB also contains or references producer information from sources such as the Regulatory Information Retrieval System (RIRS) of the NAIC. Its development is based, in part, on the belief that the widespread availability of such information will make it more difficult for a producer with significant disciplinary history to continue illegal or unethical practices.

The NIPR Gateway is an electronic communication network that links state insurance regulators with the entities they regulate to facilitate the electronic exchange of producer information; including license applications, appointments, and terminations. To date, data standards have been developed for the exchange of appointment and not-for-cause termination information. All data flowing through the NIPR Gateway will conform to these standards.

Through Internet PDB, industry is able to access all public information related to a producer provided by participating states, including licensing, demographics and final regulatory actions. The product is designed to assist insurers in exercising due diligence in the monitoring of agents and brokers to reduce the incidence of fraud. Currently, Internet PDB contains information on over 2.9 million producers. Information available includes:

- Demographics-name, date of birth, addresses
- License Summary-state of license, license number, issue date, expiration date, license type/class, residency, lines of authority, status, status reason, status/reason effective date.
- Continuing Education-CE compliance indicator, CE renewal date, CE credits needed.
- Certificates and Clearance-date issued, issuing state, receiving state, certification or clearance indicator.
- Regulatory Actions-State of action, entity role, origin of action, reason for action, enter date penalty/fine/forfeiture, effective date, file reference, time/length of dates.
- Appointment Information-Effective date, termination date, reasons for termination.

Currently all 50 states, DC and PR participate in the PDB.

In many respects, this producer data base parallels the purpose and scope of FINRA's Central Records Depository or CRD. Through the NIPR data base, problem producers can be tracked and deterred from the insurance business.

Buyer's Guide for

Deferred Annuities

GET SMART ABOUT INSURANCE

INSURE U

NAIC

National Association *of* Insurance Commissioners

Prepared by the

NAIC

National Association of Insurance Commissioners

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various insurance departments to coordinate insurance laws for the benefit of all consumers.

This guide does not endorse any company or policy.

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NAIC Buyer's Guide for Deferred Annuities

It's important that you understand how annuities can be different from each other so you can choose the type of annuity that's best for you. The purpose of this Buyer's Guide is to help you do that. This Buyer's Guide isn't meant to offer legal, financial, or tax advice. You may want to consult independent advisors that specialize in these areas.

This Buyer's Guide is about deferred annuities in general and some of their most common features. It's not about any particular annuity product. The annuity you select may have unique features this Guide doesn't describe. It's important for you to carefully read the material you're given or ask your annuity salesperson, especially if you're interested in a particular annuity or specific annuity features.

This Buyer's Guide includes questions you should ask the insurance company or the annuity salesperson (the agent, producer, broker, or advisor). Be sure you're satisfied with the answers before you buy an annuity.

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NAIC Executive Office
444 North Capitol Street, NW
Suite 701
Washington, DC 20001-1509
202.471.3990

NAIC Central Office
1100 Walnut Street
Suite 1500
Kansas City, MO 64106-2197
816.842.3600

NAIC Capital Markets &
Investment Analysis Office
48 Wall Street, 6th Floor
New York, NY 10005-2906
212.398.9000

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What Is an Annuity?

An annuity is a contract with an insurance company. All annuities have one feature in common, and it makes annuities different from other financial products. ***With an annuity, the insurance company promises to pay you income on a regular basis for a period of time you choose***—including the rest of your life.

When Annuities Start to Make Income Payments

Some annuities begin paying income to you soon after you buy it (an **immediate** annuity). Others begin at some later date you choose (a **deferred** annuity).

How Deferred Annuities Are Alike

There are ways that *most* deferred annuities are alike.

- They have an **accumulation** period and a **payout** period. During the accumulation period, the value of your annuity changes based on the type of annuity. During the payout period, the annuity makes income payments to you.
- They offer a basic death benefit. If you die during the accumulation period, a deferred annuity with a basic death benefit pays some or all of the annuity's value to your survivors (called beneficiaries) either in one payment or multiple payments over time. The amount is usually the greater of the annuity account value or the minimum guaranteed surrender value. If you die after you begin to receive income payments (**annuitize**), your chosen survivors may not receive anything *unless*: 1) your annuity guarantees to pay out at least as much as you paid into the annuity, or 2) you chose a payout option that continues to make payments after your death. For an extra cost, you may be able to choose enhanced death benefits that increase the value of the basic death benefit.
- You usually have to pay a charge (called a **surrender** or **withdrawal charge**) if you take some or all of your money out too early (usually before a set time period ends). Some annuities may not charge if you withdraw small amounts (for example, 10% or less of the account value) each year.
- Any money your annuity earns is **tax deferred.** That means you won't pay income tax on earnings until you take them out of the annuity.
- You can add features (called **riders**) to many annuities, usually at an extra cost.
- An annuity salesperson must be licensed by your state insurance department. A person selling a variable annuity also must be registered with FINRA[1] as a representative of a broker/dealer that's a FINRA member. In some states, the state securities department also must license a person selling a variable annuity.

Sources of Information

Contract: *The legal document between you and the insurance company that binds both of you to the terms of the agreement.*

Disclosure: *A document that describes the key features of your annuity, including what is guaranteed and what isn't, and your annuity's fees and charges. If you buy a variable annuity, you'll receive a prospectus that includes detailed information about investment objectives, risks, charges, and expenses.*

Illustration: *A personalized document that shows how your annuity features might work. Ask what is guaranteed and what isn't and what assumptions were made to create the illustration.*

1. FINRA (Financial Industry Regulatory Authority) regulates the companies and salespeople who sell variable annuities.

- Insurance companies sell annuities. You want to buy from an insurance company that's financially sound. There are various ways you can research an insurance company's financial strength. You can visit the insurance company's website or ask your annuity salesperson for more information. You also can review an insurance company's rating from an independent rating agency. Four main firms currently rate insurance companies. They are A.M. Best Company, Standard and Poor's Corporation, Moody's Investors Service, and Fitch Ratings. Your insurance department may have more information about insurance companies. An easy way to find contact information for your insurance department is to visit *www.naic.org* and click on "**States and Jurisdictions Map**."

- Insurance companies usually pay the annuity salesperson after the sale, but the payment doesn't reduce the amount you pay into the annuity. You can ask your salesperson how they earn money from the sale.

How Deferred Annuities Are Different

There are differences among deferred annuities. Some of the differences are:

- Whether you pay for the annuity with one or more than one payment (called a **premium**).

- The types and amounts of the **fees**, **charges**, and **adjustments**. While almost all annuities have *some* fees and charges that could reduce your account value, the types and amounts can be different among annuities. ***Read the Fees, Charges, and Adjustments section in this Buyer's Guide for more information.***

- Whether the annuity is a **fixed** annuity or a **variable** annuity. How the value of an annuity changes is different depending on whether the annuity is fixed or variable.

  Fixed annuities guarantee your money will earn at least a minimum interest rate. Fixed annuities may earn interest at a rate higher than the minimum but only the minimum rate is guaranteed. The insurance company sets the rates.

  Fixed indexed annuities are a type of fixed annuity that earns interest based on changes in a market index, which measures how the market or part of the market performs. The interest rate is guaranteed to never be less than zero, even if the market goes down.

  Variable annuities earn investment returns based on the performance of the investment portfolios, known as "subaccounts," where you choose to put your money. The return earned in a variable annuity isn't guaranteed. The value of the subaccounts you choose could go up or down. If they go up, you could make money. But, if the value of these subaccounts goes down, you could lose money. Also, income payments to you could be less than you expected.

- Some annuities offer a **premium bonus**, which usually is a lump sum amount the insurance company adds to your annuity when you buy it or when you add money. It's usually a set percentage of the amount you put into the annuity. Other annuities offer an **interest bonus**, which is an amount the insurance company adds to your annuity when you earn interest. It's usually a set percentage of the interest earned. You may not be able to withdraw some or all of your premium bonus for a set period of time. ***Also, you could lose the bonus if you take some or all of the money out of your annuity within a set period of time.***

How Does the Value of a Deferred Annuity Change?

Fixed Annuities

Money in a fixed deferred annuity earns interest at a rate the insurer sets. The rate is **fixed** (won't change) for some period, usually a year. After that rate period ends, the insurance company will set another fixed interest rate for the next rate period. ***That rate could be higher or lower than the earlier rate.***

Fixed deferred annuities ***do*** have a guaranteed minimum interest rate—the lowest rate the annuity can earn. It's stated in your contract and disclosure and can't change as long as you own the annuity. Ask about:

- The ***initial interest*** rate – What is the rate? How long until it will change?
- The ***renewal interest*** rate – When will it be announced? How will the insurance company tell you what the new rate will be?

Fixed Indexed Annuities

Money in a fixed indexed annuity earns interest based on changes in an index. Some indexes are measures of how the overall financial markets perform (such as the S&P 500 Index or Dow Jones Industrial Average) during a set period of time (called the **index term**). Others measure how a specific financial market performs (such as the Nasdaq) during the term. The insurance company uses a formula to determine how a change in the index affects the amount of interest to add to your annuity at the ***end of each index term***. Once interest is added to your annuity for an index term, those earnings usually are locked in and changes in the index in the next index term don't affect them. If you take money from an indexed annuity before an index term ends, ***the annuity may not add all of the index-linked interest for that term to your account.***

Insurance companies use different formulas to calculate the interest to add to your annuity. They look at changes in the index over a period of time. See the box "***Fixed Deferred Indexed Formulas***" that describes how changes in an index are used to calculate interest.

The formulas insurance companies use often mean that interest added to your annuity is based on only ***part*** of a change in an index over a set period of time. **Participation rates, cap rates,** and **spread rates** (sometimes called margin or asset fees) all are terms that describe ways the amount of interest added to your annuity may not reflect the full change in the index. But ***if the index goes down over that period, zero interest is added to your annuity.*** Then your annuity value won't go down as long as you don't withdraw the money.

Fixed Deferred Indexed Formulas

Annual Point-to-Point – *Change in index calculated using two dates one year apart.*

Multi-Year Point-to-Point – *Change in index calculated using two dates more than one year apart.*

Monthly or Daily Averaging – *Change in index calculated using multiple dates (one day of every month for monthly averaging, every day the market is open for daily averaging). The average of these values is compared with the index value at the start of the index term.*

Monthly Point-to-Point – *Change in index calculated for each month during the index term. Each monthly change is limited to the "cap rate" for positive changes, but not when the change is negative. At the end of the index term, all monthly changes (positive and negative) are added. If the result is positive, interest is added to the annuity. If the result is negative or zero, no interest (0%) is added.*

When you buy an indexed annuity, you aren't investing directly in the market or the index. Some indexed annuities offer you more than one index choice. Many indexed annuities also offer the choice to put part of your money in a fixed interest rate account, with a rate that won't change for a set period.

Variable Annuities

Money in a variable annuity earns a return based on the performance of the investment portfolios, known as "**subaccounts**," where you choose to put your money. Your investment choices likely will include subaccounts with different types and levels of risk. Your choices will affect the return you earn on your annuity. Subaccounts usually have no guaranteed return, but you may have a choice to put some money in a fixed interest rate account, with a rate that won't change for a set period.

The value of your annuity can change every day as the subaccounts' values change. If the subaccounts' values increase, your annuity earns money. But ***there's no guarantee that the values of the subaccounts will increase. If the subaccounts' values go down, you may end up with less money in your annuity than you paid into it.***

An insurer may offer several versions of a variable deferred annuity product. The different versions usually are identified as **share classes**. The key differences between the versions are the fees you'll pay every year you own the annuity. The rules that apply if you take money out of the annuity also may be different. Read the prospectus carefully. Ask the annuity salesperson to explain the differences among the versions.

How Insurers Determine Indexed Interest

Participation Rate – *Determines how much of the increase in the index is used to calculate index-linked interest. A participation rate usually is for a set period. The period can be from one year to the entire term. Some companies guarantee the rate can never be lower (higher) than a set minimum (maximum). Participation rates are often less than 100%, particularly when there's no cap rate.*

Cap Rate – *Typically, the maximum rate of interest the annuity will earn during the index term. Some annuities guarantee that the cap rate will never be lower (higher) than a set minimum (maximum). Companies often use a cap rate, especially if the participation rate is 100%.*

Spread Rate – *A set percentage the insurer subtracts from any change in the index. Also called a "margin or asset fee." Companies may use this instead of or in addition to a participation or cap rate.*

What Other Information Should You Consider?

Fees, Charges, and Adjustments

Fees and charges reduce the value of your annuity. They help cover the insurer's costs to sell and manage the annuity and pay benefits. The insurer may subtract these costs directly from your annuity's value. Most annuities have fees and charges but they can be different for different annuities. Read the contract and disclosure or prospectus carefully and ask the annuity salesperson to describe these costs.

A **surrender** or **withdrawal charge** is a charge if you take part or all of the money out of your annuity during a set period of time. The charge is a percentage of the amount you take out of the annuity. The percentage usually goes down each year until the surrender charge period ends. Look at the contract and the disclosure or prospectus for details about the charge. Also look for any waivers for events (such as a death) or the right to take out a small amount (usually up to 10%) each year without paying the charge. If you take all of your money out of an annuity, you've surrendered it and no longer have any right to future income payments.

Some annuities have a **Market Value Adjustment (MVA).** An MVA could increase or decrease your annuity's account value, cash surrender value, and/or death benefit value if you withdraw money from your account. In general, if interest rates are ***lower*** when you withdraw money than they were when you bought the annuity, the MVA could *increase* the amount you could take from your annuity. If interest rates are *higher* than when you bought the annuity, the MVA could *reduce* the amount you could take from your annuity. Every MVA calculation is different. Check your contract and disclosure or prospectus for details.

How Annuities Make Payments

Annuitize

At some future time, you can choose to **annuitize** your annuity and start to receive guaranteed fixed income payments for life or a period of time you choose. After payments begin, you can't take any other money out of the annuity. You also usually can't change the amount of your payments. For more information, see "*Payout Options*" in this Buyer's Guide. If you die before the payment period ends, your survivors may not receive any payments, depending on the payout option you choose.

Full Withdrawal

You can withdraw the cash surrender value of the annuity in a lump sum payment and end your annuity. *You'll likely pay a charge to do this if it's during the surrender charge period*. If you withdraw your annuity's cash surrender value, your annuity is cancelled. Once that happens, you can't start or continue to receive regular income payments from the annuity.

Partial Withdrawal

You may be able to withdraw *some* of the money from the annuity's cash surrender value without ending the annuity. Most annuities with surrender charges let you take out a certain amount (usually up to 10%) each year without paying surrender charges on that amount. Check your contract and disclosure or prospectus. Ask your annuity salesperson about other ways you can take money from the annuity without paying charges.

Living Benefits for Fixed Annuities

Some fixed annuities, especially fixed indexed annuities, offer a **guaranteed living benefits** rider, usually at an extra cost. A common type is called a guaranteed lifetime withdrawal benefit that guarantees to make income payments you can't outlive. While you get payments, the money still in your annuity continues to earn interest. You can choose to stop and restart the payments or you might be able to take extra money from your annuity. Even if the payments reduce the annuity's value to zero at some point, you'll continue to get payments for the rest of your life. If you die while receiving payments, your survivors may get some or all of the money left in your annuity.

Annuity Fees and Charges

Contract fee – *A flat dollar amount or percentage charged once or annually.*

Percentage of purchase payment – *A front-end sales load or other charge deducted from each premium paid. The percentage may vary over time.*

Premium tax – *A tax some states charge on annuities. The insurer may subtract the amount of the tax when you pay your premium, when you withdraw your contract value, when you start to receive income payments, or when it pays a death benefit to your beneficiary.*

Transaction fee – *A charge for certain transactions, such as transfers or withdrawals.*

* * *

Mortality and expense (M&E) risk charge – *A fee charged on* ***variable annuities.*** *It's a percentage of the account value invested in subaccounts.*

Underlying fund charges – *Fees and charges on a* ***variable*** *annuity's subaccounts; may include an investment management fee, distribution and service (12b-1) fees, and other fees.*

Living Benefits for Variable Annuities

Variable annuities may offer a benefit at an extra cost that guarantees you a minimum account value, a minimum lifetime income, or minimum withdrawal amounts regardless of how your subaccounts perform. See *"Variable Annuity Living Benefit Options"* at right. Check your contract and disclosure or prospectus or ask your annuity salesperson about these options.

How Annuities Are Taxed

Ask a tax professional about your individual situation. The information below is general and should not be considered tax advice.

Current federal law gives annuities special tax treatment. Income tax on annuities is deferred. That means you aren't taxed on any interest or investment returns while your money is in the annuity. This isn't the same as tax-free. You'll pay ordinary income tax when you take a withdrawal, receive an income stream, or receive each annuity payment. When you die, your survivors will typically owe income taxes on any death benefit they receive from an annuity.

There are other ways to save that offer tax advantages, including Individual Retirement Accounts (IRAs). You can buy an annuity to fund an IRA, ***but you also can fund your IRA other ways and get the same tax advantages***. When you take a withdrawal or receive payments, you'll pay ordinary income tax on all of the money you receive (not just the interest or the investment return). You also may have to pay a 10% tax penalty if you withdraw money before you're age 59½.

Finding an Annuity That's Right for You

An annuity salesperson who suggests an annuity must choose one that they think is right for you, based on information from you. They need complete information about your life and financial situation to make a suitable recommendation. Expect a salesperson to ask about your age; your financial situation (assets, debts, income, tax status, how you plan to pay for the annuity); your tolerance for risk; your financial objectives and experience; your family circumstances; and how you plan to use the annuity. If you aren't comfortable with the annuity, ask your annuity salesperson to explain why they recommended it. Don't buy an annuity you don't understand or that doesn't seem right for you.

Variable Annuity Living Benefit Options

Guaranteed Minimum Accumulation Benefit (GMAB) – *Guarantees your account value will equal some percentage (typically 100%) of premiums less withdrawals, at a set future date (for example, at maturity). If your annuity is worth less than the guaranteed amount at that date, your insurance company will add the difference.*

Guaranteed Minimum Income Benefit (GMIB) – *Guarantees a minimum lifetime income. You usually must choose this benefit when you buy the annuity and must annuitize to use the benefit. There may be a waiting period before you can annuitize using this benefit.*

Guaranteed Lifetime Withdrawal Benefit (GLWB) – *Guarantees you can make withdrawals for the rest of your life, up to a set maximum percentage each year.*

Payout Options

You'll have a choice about how to receive income payments. These choices usually include:

- *For your lifetime*
- *For the longer of your lifetime or your spouse's lifetime*
- *For a set time period*
- *For the longer of your lifetime or a set time period*

Within each annuity, the insurer ***may*** guarantee some values but not others. Some guarantees may be only for a year or less while others could be longer. Ask about risks and decide if you can accept them. For example, it's possible you won't get all of your money back ***or*** the return on your annuity may be lower than you expected. It's also possible you won't be able to withdraw money you need from your annuity without paying fees ***or*** the annuity payments may not be as much as you need to reach your goals. These risks vary with the type of annuity you buy. All product guarantees depend on the insurance company's financial strength and claims-paying ability.

Questions You Should Ask

- Do I understand the risks of an annuity? Am I comfortable with them?
- How will this annuity help me meet my overall financial objectives and time horizon?
- Will I use the annuity for a long-term goal such as retirement? If so, how could I achieve that goal if the income from the annuity isn't as much as I expected it to be?
- What features and benefits in the annuity, other than tax deferral, make it appropriate for me?
- Does my annuity offer a guaranteed minimum interest rate? If so, what is it?
- If the annuity includes riders, do I understand how they work?
- Am I taking full advantage of all of my other tax-deferred opportunities, such as 401(k)s, 403(b)s, and IRAs?
- Do I understand all of the annuity's fees, charges, and adjustments?
- Is there a limit on how much I can take out of my annuity each year without paying a surrender charge? Is there a limit on the ***total*** amount I can withdraw during the surrender charge period?
- Do I intend to keep my money in the annuity long enough to avoid paying any surrender charges?
- Have I consulted a tax advisor and/or considered how buying an annuity will affect my tax liability?
- How do I make sure my chosen survivors (beneficiaries) will receive any payment from my annuity if I die?

If you don't know the answers or have other questions, ask your annuity salesperson for help.

When You Receive Your Annuity Contract

When you receive your annuity contract, carefully review it. Be sure it matches your understanding. Also, read the disclosure or prospectus and other materials from the insurance company. Ask your annuity salesperson to explain anything you don't understand. In many states, a law gives you a set number of days (usually 10 to 30 days) to change your mind about buying an annuity after you receive it. This often is called a **free look** or **right to return** period. Your contract and disclosure or prospectus should prominently state your free look period. If you decide during that time that you don't want the annuity, you can contact the insurance company and return the contract. Depending on the state, you'll either get back all of your money or your current account value.

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