

Annuity Best Interest Regulatory Guidance and Considerations

Summary

The Life and Annuity (A) Committee of the National Association of Insurance Commissioners offers the following regulatory guidance for state Departments of Insurance (DOIs) to use when reviewing a

the entity supervising the financial professional. Third, for the safe harbor to apply, an insurance company must “[m]onitor the relevant conduct of the financial professional. . . or the entity supervising the financial professional.”⁴ Fourth, an insurance company must also “[p]rovide to the entity responsible for supervising the financial professional . . . information and reports that are reasonably appropriate to assist such entity to maintain its supervision system.” Finally, an insurance company must distinguish between its obligations under the safe harbor from the situation where it has contracted with a third party for supervision.

Requirements of the Safe Harbor

One of the most common situations that will generate the use of the safe harbor is the licensed insurance producer who is also registered as a securities agent and is subject to the supervisory control system of a registered securities broker-dealer. Pursuant to the safe harbor, recommendations and sales of annuities made in compliance with business rules, controls and procedures that would satisfy comparable standards⁵ are deemed to be compliant with the requirements under the Model Regulation. As an example, a financial professional recommending a variable annuity registered with the United States Securities and Exchange Commission (the “SEC”) under the safe harbor is deemed to comply with the Model Regulation if the securities agent’s broker-dealer has established “business rules, controls and procedures” or a supervisory control system pursuant to FINRA Rules 3110, 3120 and 3130⁶ that (1) govern

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- (b) An investment adviser registered under federal [or state] securities laws or an investment adviser representative associated with the federal [or state] registered investment adviser; or
 - (c) A plan fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974 (ERISA) or fiduciary under Section 4975(e)(3) of the Internal Revenue Code (IRC) or any amendments or successor statutes thereto.

⁴ See Section 6(E)(3)(a).

⁵ “Comparable standards” is defined in the Model Regulation in Section 6(E)(5) to mean:

- (a) With respect to broker-dealers and registered representatives of broker-dealers, applicable SEC and FINRA rules pertaining to best interest obligations and supervision of annuity recommendations and sales, including, but not limited to, Regulation Best Interest and any amendments or successor regulations thereto;
- (b) With respect to investment advisers registered under federal [or state] securities laws or investment adviser representatives, the fiduciary duties and all other requirements imposed on such investment advisers or investment adviser representatives by contract or under the Investment Advisers Act of 1940 [or applicable state securities law], including but not limited to, the Form ADV and interpretations; and
- (c) With respect to plan fiduciaries or fiduciaries, means the duties, obligations, prohibitions, and all other requirements attendant to such status under ERISA or the IRC and any amendments or successor statutes thereto.

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

Making a recommendation in compliance with comparable standards means in compliance with the "business rules, controls and procedures that satisfy a comparable standard..." To avail itself of the safe harbor, the insurance company should review the broker-dealer's business rules, processes, and procedures that pertain to the firm's supervisory control system over the registered variable annuities to ensure that they are adequate and that they provide comparable controls as those required under the Model Regulation.

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

- **Onboarding:** Entering into a new contractual relationship with an entity to sell annuities should involve a review of the entity’s business rules, processes, and procedures to ensure that they are adequate and that they address all the annuities that will be sold under the contractual arrangement. Insurers may want to provide guidelines with which the partner must comply as part of the onboarding process to ensure that the entity’s processes are adequate.

- **Audits:** After onboarding a financial partner, insurers need to ensure that the entity’s policies and procedures remain adequate, and that the entity is doing what it says it will do. This will likely involve creating a strong audit program. Hallmarks of a strong audit program include selecting an adequate sample size, auditing each financial partner frequently enough, and escalation procedures for any financial partner that fails to respond, up to and including termination of the relationship. Selection of audit frequency should be risk-based based on the volume that comes through the channel as well as other risk factors available to the insurer. An appropriate audit program will also ensure that all partners are audited on a regular cycle.

- **Due Diligence Questionnaires:** As a supplement to audits, insurers may use due diligence questionnaires as part of their monitoring of their financial partners. These questionnaires may be stand-alone safe harbor questionnaires or wrapped into a larger vendor due diligence process that could include cybersecurity, state specific requirements, and other issues. Due diligence questionnaires are a stronger form of monitoring than certifications.

- **Ongoing Monitoring:** Due diligence questionnaires are not the only form of ongoing monitoring. Sales data, both aggregated and as segregated by partner, can be categorized, and sorted by number of contracts and by premiums to risk rate producers and partners for key elements such as sales to older consumers, free-look cancellations, early surrenders, replacements, and others.

- **Receiving Data:** Insurers might also request data on an ongoing, perhaps quarterly, basis to aid in their monitoring, including:
 - commissions paid to the producer;
 - number of policies issued;
 - number of replacements issued;
 - number of replacements subject to surrender charges at the prior company;
 - Applications that were turned down due to suitability or other concerns; and
 - Number of consumer complaints related to annuity sales received by the entity supervising the financial professional.

Insurance companies may have some of this data, of course, such as commission paid on an annuity, but the idea of this information sharing is broader than re-sharing individual transaction

data. It is, rather, to ensure that both the insurer and entity supervising the financial professional have the holistic information necessary to make supervision decisions.

Provide Information and Reports

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

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

Insurers may be able to offer partners detailed reports and charts that illustrate customer profile

