

December 4, 2023

Submitted via email: NASAAComments@nasaa.org

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North American Securities Administrators Association
750 First St. NW Suite 990
Washington, D.C. 20001

Re: Proposed Revisions to NASAA's Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule

Dear Ms. Kopleton, Mr. Bouchard, and Mr. Nix:

On behalf of our members, the American Council of Life Insurers (ACLI)¹ submits these comments regarding the NASAA's Broker- Dealer Section and related Broker Dealer Market and Regulatory

¹ ACLI Members offer life insurance products to customers, including variable annuities. Although these products are primarily regulated by state insurance law, some state securities administrators consider these products securities. Of relevance, certain ACLI members have business models that utilize state registered broker-dealers to distribute life insurance products.

Policy Review Project Group’s proposed revisions to NASAA’s Unethical Business Practices of Broker-Dealers and Agents Model Rule (“the Proposal”).²

Briefly, ACLI supports efforts to align the model regulation with the SEC’s Regulation Best Interest (“Reg BI”) but urges NASAA to withdraw the Proposal due to the inconsistencies between the revisions and both Reg BI and the National Association of Insurance Commissioners (“NAIC”)’s Suitability in Annuity Transactions Model Regulation (“NAIC Best Interest Model Rule”).

ACLI has been an outspoken supporter of regulatory efforts to provide consumer protection, including the support of both the federal adoption and implementation of Reg BI and the NAIC Best Interest Model Rule which provides important consumer protections to purchasers of annuity products in 40 states.³ However, most of this Proposal conflicts with both Reg BI and the NAIC Best Interest Model Rule. Specifically, revisions #2 and #3 provide significant operational challenges to our members and may result in negatively impacting customer choice. This letter provides background information on how variable annuities are regulated and summarizes the ways in which the Proposal departs from Reg BI and the NAIC Best Interest Model Rule.⁴ On December 4, 2023, ACLI joined other trade groups in a comment letter to NASAA. For the reasons detailed in this letter and the joint trade letter, we recommend that NASAA withdraw the Proposal. If NASAA does not withdraw the Proposal, we recommend that changes to the model regulation align with Reg BI and the NAIC Best Interest Model Rule.

1) Background on Variable Insurance Products and Existing Regulations

Life insurance products such as variable annuities can provide guaranteed lifetime income and provide important solutions for retirees that may last decades. Working class Americans rely on annuity products—including variable annuities—to provide longevity protection in retirement. This section provides background on what variable annuities are and how the products are regulated.

What is a Variable Annuity?

A variable annuity is a product offered by an insurance company that includes certain embedded guarantees, including those that can provide periodic payments to consumers either beginning immediately or at some future date.⁵ Consumers purchase a variable annuity by making a single or series of payments.⁶ The variable annuity purchaser has the option to select insurance-dedicated mutual funds that invest in stocks, bonds, money market instruments or a combination of the three options.⁷ Although the purchaser can choose to invest in insurance-dedicated mutual funds (thus providing the consumer with potential market gains), a variable annuity is fundamentally different

² NASAA Proposed Revisions to NASAA’s Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule (Sept. 5, 2023), available here: [Request-for-Public-Comment-on-BD-Best-Interest-Model-Rule.pdf \(nasaa.org\)](https://www.nasaa.org/Request-for-Public-Comment-on-BD-Best-Interest-Model-Rule.pdf).

³ NAIC Suitability in Annuity Transactions Model Regulation (#275) (“NAIC Best Interest Model Rule”) (Feb. 2020), available here: <https://content.naic.org/sites/default/files/inline-files/MDL-275.pdf>; see also, NAIC Suitability in Annuity Transactions Model Regulation Frequently Asked Questions, available here: [Final FAQ July 2021.pdf \(naic.org\)](https://www.naic.org/FAQ/July-2021.pdf).

⁴ See 17 C.F.R. § 240 et. seq. (2019) (“Reg BI”); Regulation Best Interest Adopting Release No. 34-86031 (June 5, 2019), available here: <https://www.sec.gov/files/rules/final/2019/34-86031.pdf>.

⁵ SEC What You Should Know: Guide to Variable Annuities, available here: <https://www.sec.gov/investor/pubs/sec-guide-to-variable-annuities.pdf>.

⁶ *Id.*

⁷ *Id.*

from mutual funds in a number of different ways. First, many variable annuities offer features that will provide periodic payments for the rest of a designated persons' life.⁸ This feature offers protection to variable annuity purchasers against the possibility they may outlive their assets after they retire. Another distinction between variable annuities and mutual funds is a death benefit.⁹ In addition, unlike mutual funds, the contract value within a variable annuity grows on a tax deferred basis.¹⁰

Jurisdiction Over Variable Insurance Products

Many states regulate variable annuities as non-securities insurance products. The McCarran-Ferguson Act provides that states maintain the power to regulate insurance products.¹¹ Similarly, the Uniform Securities Act expressly excludes insurance contracts and annuities from the definition of "securities."¹² In all states, variable annuity and life insurance products are filed and approved like other insurance products by state insurance commissioners. These products are also filed and approved by the Securities and Exchange Commission ("SEC"). In commenting on this Proposal, ACLI does not concede to state securities administrators the authority or jurisdiction over variable annuities, sales practices, or variable insurance products.

Regulations Applicable to Variable Annuities

Variable annuities are highly regulated products. The extensive network of federal and state regulations applicable to variable annuities include the following:

- The NAIC Best Interest Model Rule (#275) (adopted in 40 states)¹³;
- FINRA Rule 2330 governing suitability and supervision in the sale of variable annuities¹⁴;
- FINRA Rule 2320 governing non-cash compensation for variable products and mutual funds¹⁵;
- The NAIC Annuity Disclosure Model Regulation (#245)¹⁶;

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ 15 U.S.C. § 1011, *et. seq.* (1945).

¹² "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay [a fixed sum of] money either in a lump sum or periodically for life or for some other specified period. Uniform Securities Act § 401(m) (*as amended* 1956); *See also* NASAA Commentary: "The last sentence [of the definition of a "security"] has been explicitly phrased so as not to exclude from the definition the so-called "variable annuities" which have recently been developed." NASAA Uniform Securities Act Commentary, available here: <https://www.nasaa.org/wp-content/uploads/2021/10/1956-Uniform-Securities-Act-with-NASAA-Updates-and-Commentary.pdf>. The Uniform Securities Act excludes annuity and life insurance contracts which ACLI maintains would exclude Variable Universal Life Annuities (VULs), Fixed Indexed Annuities (FIAs), variable annuities and other such insurance products from the definition of a "security" for most states.

¹³ Six states have pending legislation that would enact the model. NAIC Suitability in Annuity Transactions Model Regulation (#275) ("NAIC Best Interest Model Rule") (Feb. 2020), available here: <https://content.naic.org/sites/default/files/inline-files/MDL-275.pdf>; *see also*, [NAIC Implementation Map of 2020 Revisions to Model #275 Suitability in Annuity Transactions Model Regulation \(Last updated, Nov. 1, 2023\)](https://content.naic.org/sites/default/files/cmte-a-aswg-mdl-275-adoption-map.pdf), available here: <https://content.naic.org/sites/default/files/cmte-a-aswg-mdl-275-adoption-map.pdf>.

¹⁴ FINRA Rule 2330 Members' Responsibilities Regarding Deferred Variable Annuities, available here: <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2330>.

¹⁵ FINRA Rule 2320 Variable Contracts of an Insurance Company, available here: <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2320>.

¹⁶ NAIC Annuity Disclosure Model Regulation (2021), available here: <https://content.naic.org/sites/default/files/model-law-245.pdf>.

- The NAIC Model Replacements Regulation¹⁷, 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.”¹⁸

Point of Sale and Post-Sale Disclosures

Variable annuities cannot be offered or sold without robust point of sale disclosures and post-sale disclosures that offer consumer-protective features. These disclosures are required by both state insurance and federal securities regulators. This integrated system of disclosure embedded in existing state and federal requirements help consumers understand the nature of their various products and relationships between the consumer and their agent. These disclosures include many product-related materials (e.g., policy contracts, prospectuses, and the NAIC Annuity Buyer’s Guide in applicable states), as well as significant materials describing the firm’s offerings, documents that provide the terms for a brokerage or advisory relationship (e.g., brokerage account agreements, advisory account agreements, Form ADV (for fee-based annuities), Form CRS, and Reg BI disclosure), and other required disclosures. Some of our members offer additional, optional disclosures including insurance sales illustrations. Post-sale disclosures include routine prospectus updates as required by federal securities laws, transaction confirmations, quarterly policy statements, and updated Form ADV brochures (for fee-based variable annuities). Insurance products such as variable annuities are the *only* products in today’s financial marketplace with free-look provisions extending for 10 days (often 30 days if the new variable annuity replaces an existing insurance product). These features give consumers a meaningful opportunity to carefully evaluate purchases after the sale and to change their mind for any reason, including considerations of costs, to receive a refund.

Regulation Best Interest and NAIC Best Interest Model Rule Provide Strong Consumer Protections

Many, if not all, life insurers and product distribution entities have adopted policies and procedures consistent with Reg BI’s requirements regardless of whether they are currently mandated to do so.¹⁹ Reg BI conduct principles require that BDs act in the best interest of clients when making recommendations. Fulfilling this requirement requires a BD to adhere to four obligations: 1) the disclosure obligation; 2) the care obligation; 3) the conflict of interest obligation; and 4) the compliance obligation. Most, if not substantially all, recommendations of variable annuity products are already covered by federal Reg BI conduct principles or the NAIC Best Interest Model Rule. These obligations address the “costs, risks and complexity” in recommendations containing variable annuities.

Other Applicable Federal Regulation

Some variable annuities are federally registered and require significant disclosures through SEC Forms N-3 and N-4. In addition, the SEC has recently released a rule proposal to provide that Registered Index-Linked Annuities (“RILAs”) (a type of index-linked annuity) register on Form N-4.²⁰

¹⁷ NAIC Life Insurance and Annuities Replacement Model Regulation (2015), available here: <https://content.naic.org/sites/default/files/model-law-613.pdf>.

¹⁸ NAIC Unfair Trade Practices Act (2021), available here: <https://content.naic.org/sites/default/files/model-law-880.pdf>.

¹⁹ The NAIC Best Interest Model Rule provides a safe harbor for firms complying with Reg BI.

²⁰ SEC, Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities. 88 FR 71088 (Oct. 13, 2023) , available here: <https://www.federalregister.gov/documents/2023/10/13/2023-21986/registration-for-index-linked-annuities-amendments-to-form-n-4-for-index-linked-and-variable>.

For annuities selected by ERISA plan fiduciaries, the ERISA Section 2550. 404a-4²¹ sets forth requirements for which an ERISA plan fiduciary can satisfy its fiduciary responsibilities when selecting an annuity provider or contract for benefit distributions. One of the requirements of this safe harbor is set forth in 404a-4(b)(3), which instructs the fiduciary to appropriately consider the cost of the annuity contract (including fees and commissions), but where such costs are evaluated in relation to the benefits and administrative services to be provided under the annuity contract. Thus, a professional subject to ERISA’s fiduciary standards must weigh the annuity costs against the benefits and administrative services provided.

Misunderstanding of Variable Annuities

ACLI has recently noted significant misunderstandings about annuities’ fee structures.²² For example, NASAA’s reference to products as “complex, costly, risky” (“CCRs”)²³ displays an unfortunate misunderstanding of these products, including the costs inherent in providing guaranteed benefits, the nature of the guaranteed benefits and how these benefits offset longevity and market risks. This also oversimplifies, mischaracterizes, and disparages the securities professionals who conduct a thorough evaluation of the products to determine whether an annuity matches the goals and objectives of clients. The relationships that securities professionals have with their customers includes an analysis of a customer’s sophistication and suitability. The characterization of variable annuities as CCRs also overlooks the breadth of advice securities professionals provide to their customers, including the concept of diversification in investor portfolios. By describing variable annuities as an inherently unfavorable product, regulators may be limiting investors’ access to a variety of investment and insurance options. Further, the form disclosures and other disclosure obligations currently applicable to most BDs require securities professionals to address costs, risks, and assist purchasers to understand variable annuities.

Changes to Current BD Obligations Should be Supported by Fulsome Data

The NASAA September 2023 Examination Report (“the Report”) and prior NASAA Examination Reports referring to variable annuities as CCRs may have been used to justify the Proposal.²⁴ The Reports collectively allowed for a significant level of discretion on States’ reported data. As with federal rulemaking, an evaluation of the need for changes to rules should contain consistent,

²¹ 29 C.F.R. § 404a-4 (2023), available here: <https://www.ecfr.gov/current/title-29/subtitle-B/chapter-XXV/subchapter-F/part-2550/section-2550.404a-4>.

²² See generally, White House Press Release: The Retirement Security Rule- Strengthening Protections for Americans Saving for Retirement (Oct. 31, 2023), available here: <https://www.whitehouse.gov/cea/written-materials/2023/10/31/retirement-rule/>; Department of Labor, Retirement Security Rule: Definition of an Investment Advice Fiduciary (Oct. 31, 2023), available here: <https://www.regulations.gov/document/EBSA-2023-0014-0001>; Proposed Amendment to Prohibited Transaction Exemption 84-24 (Oct. 31, 2023), available here: <https://www.regulations.gov/document/EBSA-2023-0016-0001>.

²³ NASAA Examination Report on Reg BI (Phase II-B) (“[T]he states focused their attention on four complex, costly, and risky product types: the aforementioned CCRs (leveraged and inverse ETFs, non-traded REITs, private placements, and variable annuities)” [at p. 2]) (Sept. 2023), available here: <https://www.nasaa.org/wp-content/uploads/2023/08/Reg-BI-Phase-II-B-Report-Formatted-8.29.23.pdf>; see also, [NASAA Examination Report on Reg BI \(Phase I\) \(Sept. 2020\)](https://www.nasaa.org/wp-content/uploads/2020/09/Reg-BI-Phase-I-Report.pdf) (“NASAA has focused much of its Reg BI examination focus on complex and high-risk products, namely, private securities, variable annuities ...” [at p. 5]), available here: <https://www.nasaa.org/wp-content/uploads/2020/09/Reg-BI-Phase-I-Report.pdf>; NASAA Examination Report on Reg BI (Phase II-A) (Nov. 2021) (“Reg BI firms that recommended one or more of the select complex, costly, risky products (“CCR firms”) analyzed in this exam initiative, namely, private securities, variable annuities... [at p.2]), available here: https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021_FINAL.pdf.

²⁴ *Id.*

quantitative analysis on whether current regulatory efforts are inadequate. However, the most recent Report released in conjunction with the Proposal indicates that a consistent approach was not utilized across the states:²⁵

[...] The scope of each examination was also unique to each state, with state examiners focusing their efforts on the products of most interest or relevance to their jurisdictions.

In addition, only 25 U.S. states participated in the data firm evaluation process for the most recent report.²⁶ The Report also indicates that “fewer states completed exams reviewing variable annuities...”²⁷ We note that analysis of the report shows that “the states appear to be taking the position that certain provisions of Reg BI establish “clear requirements, and that failures to comply with those requirements should be a presumptive breach.”²⁸ We see assumptions of “clear requirements” where the Proposal bases the revisions on the SEC’s interpretive guidance.

The Report and Proposal Do Not Consider the Existing Regulatory Landscape

The Report and Proposal do not adequately detail market failures from the current regulations applicable to the sale of variable insurance products necessitating a new model proposal additive to Reg BI principles. The Proposal does not consider the significant existing regulations applicable to life insurers offering variable annuities and other variable insurance products, which provide an already consistent regulatory framework. We believe that in light of the inconsistent data collection underpinning the most recent Report and prior examination reports as discussed above, there is no evidence that reflects that the existing regulatory framework governing variable annuities does not adequately provide protection to consumers. In addition, the unnecessary layer of regulatory complexity this Proposal offers states does not align with Reg BI and would confuse the regulations’ principles.

2) The Revisions Do Not Align with Reg BI and Would Cloud Reg BI Principles for BDs and Agents

ACLI echoes the concerns and analysis in the joint trades December 4, 2023 comment letter to NASAA regarding the revisions in the Proposal that depart from Reg BI. To reiterate and summarize these key points, Revisions #2 and #3 directly conflict with Reg BI by:

- Redefining what constitutes a “recommendation”
- Rewriting and expanding requirements under the Conflicts of Interest Obligation
- Adding a presumption on “cash or non-cash compensation”
- Creating a conflict with the “reasonably available alternatives” test and the Care Obligation

We also offer additional commentary on specific issues of importance to our members regarding the Proposal below.

Non-Cash Compensation Provision Changes

²⁵ NASAA Examination Report on Reg BI (Phase II-B), at p. 1 (Sept. 2023), available here: <https://www.nasaa.org/wp-content/uploads/2023/08/Reg-BI-Phase-II-B-Report-Formatted-8.29.23.pdf>.

²⁶ “In total, this Phase II (B) Report used information from over 200 on-site or remote state examinations conducted by 25 states.” *Id.* at 1.

²⁷ *Id.* at 2.

²⁸ Ronak Patel, Regulation BI: Key Perspectives from Recent Report by State Regulators (Sept. 22, 2023), <https://www.jdsupra.com/legalnews/regulation-bi-key-perspectives-from-9414056/>.

We specifically highlight that the changes to the “cash or non-cash compensation” provision that diverge from Reg BI are incredibly concerning to our members who employ statutory employees to distribute products.²⁹ The changes to the non-cash compensation provision could be interpreted to prohibit insurers from providing health and welfare benefits to statutory employees. Through the IRS Tax Code, firms are allowed to provide health and welfare benefits to agents in exchange for meeting annual sales goals or production requirements. This change seems inconsistent with SEC’s intent to not limit employee benefits to statutory employees in Reg BI. In addition, current FINRA rules allow payment of non-cash compensation subject to certain limits.³⁰ Jeopardizing agents’ health and welfare benefits would harm families and small businesses, running contrary to existing public policy.

Dually Registered Agents and Insurance Agents

ACLI members’ state-registered agents who dually act as licensed insurance producers, may more readily confuse their obligations to clients should there be different interpretations and guidance from NASAA as opposed to regulations from SEC and NAIC. If this Proposal were to be adopted, customers may also get confused as to which capacity the agent/producer is acting in and this may further exacerbate the problem that NASAA is trying to solve for. This dilemma would worsen for both agents and customers if there were differences based on which state adopted these provisions.

The Provisions Diverge from the NAIC Best Interest Model Rule

For life insurers specifically, we point out that the Proposal diverges from other state regulators’ efforts to adopt regulations aligned with Reg BI. The NAIC Best Interest Model Rule was developed in 2003 and later revised to include changes from FINRA and changes after the adoption of Reg BI.³¹ The NAIC Annuity Suitability (A) Working Group began developing changes to the model regulation in 2017.³² The goal of the group was to create “clear, enhanced standards for annuity sales, so consumers understand the products they purchase, are made aware of material conflicts of interest and are assured those selling products do not place their financial interests above consumers’ interests.”³³ After over three years of input from industry professionals and organizations, the NAIC Best Interest Model Rule was completed in February 2020. We believe that NAIC’s transparent process contributed to the model’s widespread adoption in 40 states with several states pending adoption this year.

The Proposal Comes Amid New, and Potentially Conflicting Federal Rule Proposals

The timing of this Proposal would over complicate and provide regulatory uncertainty amongst BDs amid potentially significant changes to federal regulations impacting financial services professionals.

Notably, the Department of Labor (“DOL”) recently issued a rule proposal package that would advance a fiduciary-only standard for all investment recommendations made to ERISA plans, plan

²⁹ The IRS has provided a structure that allows firms to offer health and welfare benefits to employees.

³⁰ FINRA Rule 2320(b), available here: <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2320>.

³¹ NAIC Suitability in Annuity Transactions Model Regulation (#275) (Feb. 2020), available here: <https://content.naic.org/sites/default/files/inline-files/MDL-275.pdf>; The NAIC’s process for developing model rules and acts is published on their website, available here: <https://content.naic.org/cipr-topics/naic-model-laws>.

³² *Id.*

³³ *Id.*

participants and IRA owners. The DOL proposal would lead to significant changes in the compliance regimen in connection with sales recommendations.

In addition, the SEC recently closed comments on a rule proposal containing interpretations regarding the conflicts of interest obligation on a broad use of technology in client interactions for BDs and IAs. Finalizing a state model rule that could diverge not only from the existing regulatory landscape but could further clash with new federal rules would add a layer of complexity to the state and federal landscape for our members' products and agents. We respectfully request NASAA wait until federal agencies settle these issues regarding the recommendation of financial products to prevent potentially overlapping and/or inconsistent regulations.

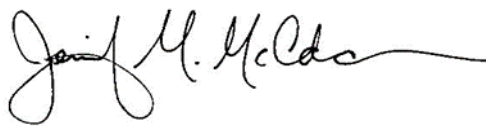
The Proposal Does Not Support the Goals of Uniformity

As proposed, this model regulation with up to 10 different parts providing a menu of options for states to adopt will unnecessarily complicate the securities regulatory regime. Earlier in this letter, we provided background on the many regulatory obligations that apply to the sale of variable annuities at the federal and state level. The significant variation between the existing regulatory landscape applicable to our members' products and agents would unnecessarily add complexity and compliance challenges. In addition, we reiterate from the joint trade letter ACLI joined, that NASAA has an obligation to maintain uniformity for federal and state securities laws and regulations through NSMIA.

Conclusion

We appreciate the opportunity to comment on this Proposal and would similarly appreciate the opportunity to meet with your membership to echo our concerns with the Proposal and how the revisions stray from Reg BI and the NAIC Best Interest Model Rule. We point out to NASAA that the adoption of such expansive provisions like those in revisions #2 and #3 would provide operational challenges to our members and the effect may limit the variety of products for brokerage accounts, thereby negatively impacting customers' access to products that offer lifetime income.

Sincerely,



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