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2019 Will Be a Big Year for Regulation Affecting Producers: Here's What You Need to Know about What's Happening in Washington and the States

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The government shutdown has dominated the headlines for weeks, but there is a lot going on behind the scenes in Federal and State regulatory agencies. 2018 was the year the DOL Fiduciary Rule died, but 2019 is shaping up to be the year of new rules that will have a big impact on producers.

AALU is transforming and expanding its focus precisely because the scope and pace of change in our industry keeps increasing. We have been working actively to ensure regulators and legislators at the Federal and State level understand the needs of producers. Here are some of the major legislative and regulatory issues AALU will be working on this year.

- **Final SEC Regulations on Best Interest, Disclosure, and Fiduciary Standards**

Last April, the Securities and Exchange Commission ("SEC") proposed three new rules: a new "best interest" standard for broker-dealers, new client disclosure requirements, and guidance on the fiduciary duties of registered investment advisors. Of these, Regulation Best Interest is the most significant for producers because the SEC regulates producers acting through broker dealers to sell life insurance products and annuities that are classified as securities (variable annuities, variable life insurance, etc.).

Though Regulation Best Interest is described by the SEC as a heightened "suitability" standard rather than a fiduciary standard, there is a lot of confusion and ambiguity about what the proposal would actually require. For example, the SEC didn't define key terms, including "best interest" itself. The proposal also indicates that some compensation arrangements, including traditional insurance commissions, may present conflicts of interest that disclosure alone may not be sufficient to address. These conflicts may need to be "mitigated," but the proposal didn't clarify when such conflicts exist or what mitigation measures would be required.

AALU has met with key SEC officials on multiple occasions to explain producer concerns, such as the importance of preserving traditional forms of compensation related to insurance products. Commission-based compensation provides choice and value for investors. Long-term investors may prefer a single point-in-time payment over an ongoing, annual obligation that increases with the value of their investment account. For many investors, a brokerage relationship is the better value for a particular transaction.

The Federal government's semiannual regulatory agenda released last Fall indicates that the SEC will issue final regulations by September 2019. SEC Chair Clayton confirmed in Congressional testimony and other speeches that finishing these rules is a top priority for him and for the agency. It does not appear that the SEC has made final decisions on many of these key issues, and AALU will remain closely engaged with the agency as their policies develop.

- **<u>DOL Fiduciary Rule 2.0 and Association Retirement Plans</u>**

The Department of Labor ("DOL") may no longer be taking the lead in attempting to regulate financial professionals, but it is still an agency that impacts producers, given its role as the primary regulator for the trillions of dollars in retirement plans and other retirement accounts. There are two significant actions DOL will likely take this year:

Fiduciary Rule 2.0: The DOL Fiduciary Rule is definitely gone, having been struck down by a Federal Circuit Court of Appeals last Spring, and the DOL is deferring to the SEC as the lead agency regulating the conduct of financial professionals. Yet the Fall regulatory agenda contained a surprise announcement that DOL will take some kind of regulatory action related to the Fiduciary Rule by September 2019. Though DOL has not provided any explanation of this action, based on unofficial conversations with DOL officials and the use of the same September deadline as the SEC, AALU believes DOL is coordinating with the SEC on a parallel rule-making complementing what the SEC will ultimately do in Regulation Best Interest.

Specifically, DOL may be working on a new prohibited transaction exemption that would permit commissions and similar variable compensation paid to producers in connection with fiduciary investment recommendations to Individual Retirement Accounts ("IRA") and ERISA retirement plans if advisors comply with the upcoming SEC rules. Such an exemption could be very useful for producers if it allows commissions and other compensation to meet one set of rules that satisfies both securities law and ERISA. It is also possible that DOL may seek to clarify (or expand) rules governing when rollovers from retirement plans and IRAs are fiduciary recommendations. AALU will be working closely with DOL to better understand their intentions and to communicate producers' concerns.

Association Retirement Plans: As directed by President Trump in an Executive Order issued last August, DOL is working on a final regulation designed to expand access to retirement plans, particularly for small businesses, by allowing bona fide trade or professional associations to offer a single retirement plan that their member companies can join and use for their own workers. These Association Retirement Plans ("ARPs") could offer significant economies of scale to small businesses because there would be one plan aggregating all participating employers' employees to gain beneficial pricing and to reduce the compliance burden facing each employer. The final regulation will address several issues flagged in the proposal, including the types of plans and investments permitted in ARPs, as well as the conditions for being a "bona fide" association.

This rule matters for producers because ARPs could be a growing new market for insurance products, but also a means for producers to provide retirement plans for their own employees and businesses.

- **<u>New Standards in the States—NAIC, New York, New Jersey, Nevada, and Beyond</u>**

Unfortunately, the demise of the DOL Fiduciary Rule seems to have inspired a number of States to consider adopting their own fiduciary or best interest standards. As a patchwork of different and potentially conflicting State and Federal standards will make it harder for producers to serve their clients, AALU is engaged with its industry partners to help shape these State activities. The pace of change in the States seems likely to increase in 2019 as several State legislatures and governors' offices saw Democrats take power. Further, the National Association of Insurance Commissioners ("NAIC") is trying to finalize a new "best interest" model rule for annuity sales. Below are States where laws or regulations are already moving, and AALU will be working collaboratively within the industry to identify and address new States of concern throughout 2019.

- ***New York:*** Last year, the New York Department of Financial Services finalized a major regulation creating a "best interest" standard applicable to all life insurance and annuity sales in New York. The annuity portion is set to take effect in August 2019, and the life insurance portion in February 2020. This rule is being challenged in State court, and while it is not yet clear what the outcome of that litigation might be, AALU and our industry partners are engaging with regulators to seek guidance clarifying the rule and to reduce some of its potentially harmful effects.
- ***Nevada:*** In 2017, the Nevada legislature unexpectedly passed a law establishing a fiduciary standard for securities recommendations by registered investment advisors and broker-dealers. The Nevada Securities Division just issued a proposed regulation implementing this law, and the comment period on the proposal will end on March 1st. The proposal is quite broad, and would result in a uniform fiduciary standard for broker-dealers and investment advisors going well beyond the Federal SEC and FINRA requirements. While this rule will not directly affect insurance, it likely will affect variable annuity and variable life insurance products that are securities.
- ***New Jersey:*** At the direction of the governor, the New Jersey Bureau of Securities has begun a regulatory process to consider a uniform fiduciary standard for all securities recommendations by financial professionals, including producers. While the Bureau does not have jurisdiction over insurance, the potential fiduciary standard likely would apply to insurance products that are also classified as securities, such as variable annuity and variable life products. In 2018, the agency took public comments and held hearings on the concept of a fiduciary standard—we anticipate that a specific regulatory proposal will be issued in early 2019.
- ***NAIC Model Rule for Annuity Sales:*** The NAIC, which developed the current model rule suitability standard for annuity sales that has been adopted by the majority of States, is actively meeting to replace the suitability standard with a "best interest" standard. As the NAIC model rule will likely be the basis for many State standards in the coming years, the final makeup of this rule will be very significant for producers. AALU and its partners are actively involved in

these efforts, focusing on a model rule that preserves traditional compensation models and that does not impose undue compliance burdens on producers.

- ***Illinois, California, Maryland, Massachusetts, and other States:*** Legislators and regulators in these and other States have been debating variations of fiduciary or best interest standards for securities or insurance markets. As there is great potential for State standards that conflict with each other, or that conflict with new Federal standards adopted by the SEC, AALU is tracking these and other developments, working with members with relationships in those States to make sure producers' concerns are heard.

- **AALU is Expanding its Focus as the Challenges We Face Increase**

  The pace of legislative and regulatory change is accelerating in 2019, as are the number of States in which substantive debates are happening. AALU is working hard to meet these new challenges and to preserve commission-based compensation, and we are working more closely with our partners in the industry. Engaged and active members are one of the keys to our success. If you have relationships in the legislature or within regulatory agencies in the States noted above, or elsewhere, please let AALU know.