SUMMIT
COMPLIANCE GROUP LLC

“If you think compliance is expensive, try non-compliance.”

–Paul McNulty, Former U.S. Deputy Attorney General

Top 3 Compliance Risks for 2021 for Independent Distribution

Compliance tends to get a bad rap because it's often associated with laws, regulations, enforcement actions and penalties for those who don't follow the rules. It also takes valuable time, effort and resources from folks who would much rather be focusing on other areas of their business. However, Compliance is not just a necessary evil, it's good for business. Understanding your unique risks and building systems to mitigate them can pay off handsomely; Ignoring Compliance is a gamble you might not be able to afford.

THREE KEY RISKS YOU NEED TO UNDERSTAND TO BETTER MANAGE YOUR PRACTICE

Risk # 1: Advertising

Unless you're one of the lucky few who gets 100% of your business via word of mouth or referrals (and wouldn't that be great!), you likely use at least one or more advertising mediums to engage with consumers in order to solicit business. It might be a seminar, a brochure, a social media blog or post, a software platform, radio show, direct mail, emails, or any other communication.

Guess what? All of that is considered advertising under state and federal regulations and is subject to complex and numerous advertising regulations. And, one of the easiest ways for a producer to find himself/herself on the radar of a regulator is through non-compliant advertising. It's not entirely your fault. Advertising regulations are not intuitive. They are nuanced and often complicated. While you may believe your advertising is fine and you are acting with the best of intentions, unless you are an expert in advertising laws, you are taking a big risk. Your advertising either works for you – by supporting complete, clear and accurate information – or it works against you, essentially creating written documentation that can be used against you during a complaint, litigation or enforcement action.

Remember… regulators are people, too, and they listen to radio shows, receive seminar invitations, and experience all of the other types of advertising created by producers. In addition, your competitors are a common source of advertising complaints.

Whether or not you believe their complaint (often to a state regulator) has merit, you can still face an ugly, or at best, time-consuming investigation into your advertising – and potentially your entire practice. Don't risk what you have worked so hard to build. Have your advertising reviewed by an expert so that you can focus on what you do best, with the assurance that your practice is protected.

Risk # 2: Enhanced Standard of Care

Suitability has been the standard of care in place for many years when it comes to annuity sales. However, we all remember the Department of Labor's Fiduciary Rule ("DOL Fiduciary Rule") from a few years ago that was eventually vacated by the U.S. Court of Appeals for the Fifth Circuit. What the DOL Fiduciary Rule showed us was that many regulators want to move away from the suitability standard of care toward a higher standard of care. We have already seen it happen with the SEC's Regulation Best Interest ("Reg BI") and new laws and regulations in some states.

The National Association of Insurance Commissioners (NAIC) has finalized a "best interest" model regulation and, as of the date of this document, 11 states have adopted it. It is anticipated that several other states will adopt it this year and that the trend will continue.

The NAIC's best interest standard of care is a significantly higher standard of care than a suitability standard and the requirements are more burdensome. For example, the following four obligations are required to meet the best interest standard:

- Care – the producer, when making a recommendation, must exercise reasonable diligence, care, and skill to know the consumer's financial situation, insurance needs, and financial objectives. The producer must not put his/her financial interests or the insurance carrier's financial interests ahead of the consumer's interests. The producer must make reasonable efforts to gather "consumer profile information" from the consumer. Consumer profile information is considered the minimum amount of information a producer should gather before making a recommendation. There are 14 items listed under the definition of consumer profile information. It is also required that the producer understand the annuities that the producer can offer. In addition, the producer must have a reasonable basis to believe the recommended annuity effectively addresses the consumer's financial situation, insurance needs, and financial objectives over the life of the product.
- Disclosure – the producer must prominently disclose certain things to the consumer. Examples include the scope of the relationship with the consumer and the role of the producer, a statement of whether the producer is licensed and authorized to offer certain products, a range of how many insurers the producer sells products for, a description of the sources and types of cash and non-cash compensation to be received by the producer, and a notice of the consumer's rights to request additional information about cash compensation.
- The consumer can also request additional information about the cash compensation to be received by the producer. The model regulation provides a sample form that can be utilized. In addition, the producer must have a belief that the consumer has been adequately informed of the various features of the annuity.
- Conflict of Interest – the producer must identify and avoid, or reasonable manage and disclose, any material conflicts of interest.
- Documentation – the producer must document any recommendation that is made and the basis for the recommendation. This appears to require the producer to document his/her analysis of the consumer's financial situation, insurance needs, and financial objectives, the analysis to determine what product or products to recommend, how the recommended product meets the financial situation, insurance needs, and financial objectives of the consumer, and why it is in the best interest of the consumer.

In addition to the NAIC's model regulation, the DOL has proposed an "investment advice" rule that would expand who would be considered a fiduciary. Insurance agents who provide "advice" regarding retirement plans and IRAs (including rollovers into fixed annuity products) would be considered fiduciaries under this proposal.

To receive compensation, insurance agents need to utilize a prohibited transaction exemption such as 2020-02 or the "old" 84-24 (not the one created under the Obama administration). It is also anticipated that the Biden administration will replace this new rule with another new rule in the near future. A new rule would likely be more burdensome than the existing rule.A best interest standard of care or a fiduciary standard of care will change the way in which our industry does business and create substantial risks for producers and marketing organizations. Independent distribution will need to evaluate their processes to identify changes that will be required not only to comply with new requirements, but to protect their businesses from consumer complaints, commission chargebacks, regulatory sanctions (fines, license revocation, etc.), insurance carrier terminations, and other potentially negative consequences of non-compliance with a higher standard of care.

Top Risk #3: Dismissing Compliance Risk

Failure to adequately address the risks presented by laws and regulations can have serious consequences to a business. Some of the reasons for not properly addressing compliance risk include:

- The regulatory landscape is constantly evolving, and it can be challenging to stay current with all the new requirements. Faced with this challenge, some people choose to stop trying to keep up with all the new laws and regulations and have a lack of awareness/lack of training regarding what is required. This approach can put the entire business at risk. Regulators are inclined to respond more harshly to licensees who have not even attempted to comply with applicable laws and regulations. Further, insurance carriers must evaluate the risk presented by

their distribution partners and are more likely to take negative action against those who present a higher degree of risk.

- Individuals with a lot of experience in our industry may be overconfident in their ability to address compliance risk. Compliance with regulatory requirements involves more than just trying to do the right thing or putting the consumer first. Unfortunately, there are often specific actions that are required that are not intuitive. Good intentions are not the same as achieving compliance.
- Some people understand regulatory requirements but have chosen not to comply or may be putting it off and have not taken any action yet. If a licensee understands the requirements but has not followed through and taken steps to comply, regulators are likely to see that as willfully choosing not to comply.

As you can imagine, that is not likely to lead to a good outcome for the licensee. Protecting your business in this time of increasing regulation is critically important. Compliance is often easier and less expensive than you may think. Like with so many other things, it pays to not procrastinate when it comes to meeting regulatory requirements. Act now so you can sleep better at night and get rid of that nagging feeling in the back of your mind that is telling you to address the compliance risks to your business.

YOU DON'T HAVE TO GO IT ALONE

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