Insured Retirement Institute

2024

Regulatory Examination Priorities

Implications for the Insured Retirement Industry

Every year, the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) release documents that review industry hot topics and high-risk categories that will be prioritized during regulatory examinations. In late 2023, the SEC Division of Examinations released their 2024 Examination Priorities and in January, the 2024 FINRA Annual Regulatory Oversight Report was published. This new report from FINRA is a re-branding of their previous publication titled *Report on Examination and Risk Monitoring Program*, which FINRA says better represents their "ongoing efforts to increase both the integration among our regulatory operations programs and the utility of the Report for member firms as an information source they can use to strengthen their compliance programs."

These two documents are extremely helpful and can serve as valuable tools to help organizations when preparing for future regulatory examinations. Oftentimes the priorities of these regulators overlap as they share oversight of certain regulated entities, products and services, and share similar goals in protecting investors. This IRI report is designed to help members identify and highlight where examination priorities overlap and to provide insight on those areas of focus and other hot topics within the industry, including related activity by state regulators.

IRI members should contact Rebecca Plowman, IRI's Director of Compliance and Implementation (rplowman@irionline.org), with any questions about this report, their compliance needs, or questions related to the regulation of annuities or retirement plans.

The Insured Retirement Institute (IRI) is the leading association for the entire supply chain of insured retirement strategies, including life insurers, asset managers, broker-dealers, banks, marketing organizations, law firms, and solution providers. IRI members account for 90 percent of annuity assets in the U.S., include the foremost distributors of protected lifetime income solutions, and are represented by financial professionals serving millions of Americans. IRI champions retirement security for all through leadership in advocacy, awareness, research, and the advancement of digital solutions within a collaborative industry community. Learn more at www.IRIonline.org.

Table of Contents

Standards of Conduct

Throughout 2023, there were several developments across the industry related to the various standards of conduct for financial professionals. Regulation Best Interest (Reg BI) will remain a top priority for the SEC and FINRA, but the industry will also need to consider recent standard of conduct activity from the Department of Labor (DOL) and the North American Securities Administrators Association (NASAA) while continuing to track enforcement action and state standard of conduct activity. In the coming year, compliance with the applicable standards of conduct will be extremely important for the insured retirement industry as a spotlight is being directed toward alleged "gaps" within the current regulatory framework. All organizations and individuals in the insured retirement industry that provide advice or recommendations about annuities or investments should pay close attention to regulatory action in this space and should continue to evaluate current practices and policies and procedures for compliance with the applicable rules and regulations.

REGULATION BEST INTEREST AND FORM CRS

In December 2023, FINRA issued Notice 23-20 to highlight and remind firms of guidance and resources that are available to assist with their compliance efforts, including FINRA's Reg BI and Form CRS Checklist. This notice also reminds firms to review the SEC staff bulletins that provide guidance and FAQs related to account recommendations, conflicts of interest, and the most recent bulletin on care obligations, which was published in April 2023.

The SEC also issued a risk alert, Observations from Broker-Dealer Examinations Related to Regulation Best Interest and published new and updated Form CRS FAQs. The FAQs included several new sections focused on Limited-Purpose Broker-Dealers – CRS delivery obligations to new retail investors in the context of check-and-app (or direct-sold) mutual funds and private placements, Principal Underwriters – Selling Directly to Retail Investors, and Electronic Posting - Posting on "Doing Business As" Websites.

Enforcement Actions

> Reg BI-related enforcement action increased significantly over the past year.

As anticipated, Reg BI-related enforcement action increased significantly over the past year. According to FINRA's Reg BI and Form CRS Enforcement Actions webpage, which tracks both FINRA and SEC enforcement actions, 30 Reg BI-related enforcement actions were brought in 2023, up from just seven such actions in 2022 and none in 2021. We anticipate that these numbers will continue to grow in 2024 and beyond. Conversely, enforcement actions related to Form CRS have decreased year-over-year as firms have learned how to more effectively comply with the requirements of Form CRS.

Summary of Enforcement Actions		
2021	Form CRS Enforcement Actions	Reg BI Enforcement Actions
FINRA	0	0
SEC	27 Firms	0
Total	27 Firms and 0 Representatives	
2022	Form CRS Enforcement Actions	Reg BI Enforcement Actions
FINRA	1 Firm	1 Representative
SEC	12 Firms	1 Firm 5 Representatives
Total	14 Firms and 6 Representatives	
2023	Form CRS Enforcement Actions	Reg BI Enforcement Actions
FINRA	9 Firms*	8 Firms* 10 Representatives**
*includes 3 firms that were charged with both Reg BI and Form CRS violations of which 2 of those firms were also expelled. **includes 1 representative that was barred		
SEC	1 Firm* 2 Representatives**	2 Firms* 10 Representatives**
*includes 1 firm what was charged with both Reg BI and Form CRS violations **includes 2 representatives that were charged with both Reg BI and Form CRS violations		
Total	16 Firms and 20 Representatives	

In May 2023, FINRA expelled its first firm related to violations of Reg BI. A second firm was expelled in July 2023 after one of that firm's representatives was barred in late 2022. Concurrent with the firm's expulsion by FINRA, the SEC charged the barred representative with alleged violations of Reg BI that resulted in approximately $1.79 million in realized losses (of which $1.64 million were fees and commissions largely paid to the representative) and $1.8 million in unrealized losses.

FEDERAL REGULATORY PROPOSALS

During 2023, the SEC and DOL proposed new rules that would have a significant impact on the standards of conduct for firms and financial professionals in the retirement industry.

In July, the SEC proposed a new rule, Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, which would require firms to eliminate or neutralize the effect of certain conflicts of interest associated with the use of predictive data analytics and similar technology when interacting with investors. However, the proposal is built upon overly broad definitions that would cause the proposal to apply to the use of nearly all types of technology in connection with a wide range of customer interactions that are already appropriately regulated. IRI and others within the industry have expressed concerns with the proposal being a departure from, and a back door attempt to significantly expand, Reg BI.

At the end of October, the DOL released its latest attempt to update its rules for fiduciary investment advice, titled the Retirement Security Rule. Much like the now-vacated 2016 fiduciary rule, this proposal would treat all financial professionals who sell retirement planning products and services as fiduciaries. This proposal includes changes to the definition of an investment advice fiduciary under the Employee Retirement Income Security Act (ERISA) (including changes to the 5-part test), amendments to Prohibited Transaction Exemption (PTE) 84-24 and PTE 2020-02, as well as several other PTEs that provide relief for investment advice fiduciaries to receive compensation for certain retirement plan-related transactions.

STATE REGULATORY ACTIVITY

As of the date of publication, 45 states have adopted the 2020 revisions to the National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions Model Regulation (NAIC Model). IRI will continue to track state adoption and engage with any remaining states throughout this year to ensure that progress continues to be made towards full adoption.

In September 2023, NASAA proposed revisions to its Dishonest or Unethical Business Practices of Broker-Dealers and Agents Model Rule (Model Rule) to (1) acknowledge and incorporate by reference the new federal conduct standard applicable to broker-dealer and agents pursuant to Reg BI; (2) define and clarify various obligations or components of this new conduct standard for purposes of state interpretation and enforcement; and (3) prohibit misleading uses of the title "advisor" or "adviser." This proposal goes well beyond and conflicts with Reg BI. The inclusion of a menu of provisions that states could pick and choose to adopt is particularly problematic and concerning from a compliance perspective. IRI submitted comments in December 2023, and will continue to monitor and keep members informed of any developments.

In August 2023, the Massachusetts Supreme Judiciary Court, the highest court in the state, upheld the Massachusetts fiduciary rule, which became effective in 2020, in a case involving Robinhood Financial, LLC (Robinhood), an online trading platform. Robinhood was charged in December 2020 with violations of the fiduciary rule. In January 2024, Robinhood accepted a consent order and agreed to pay a $7.5 million fine. Notably, as part of the consent order Robinhood agreed not to seek an appeal to the U.S. Supreme Court. An overview of these developments and analysis of the application of the Massachusetts fiduciary rule to variable annuities by IRI is available here.

COMPLIANCE CONSIDERATIONS

According to the FINRA and SEC reports, broker-dealer examinations in 2024 will focus on a wide range of topics related to Reg BI and Form CRS, including but not limited to the following:

- recommendations of high-risk and complex products;
- the analysis of reasonably available alternatives, including less costly or lower risk products;
- recommendations of proprietary products;
- whether policies and procedures are reasonably designed to achieve compliance with Reg BI, and if they are tailored to the firm's specific business model;
- policies and procedures related to ensuring the potential risks, rewards, and costs of a recommendation are appropriately considered; and
- recommendations for certain types of customers (e.g., older investors and those saving for retirement).

The SEC report indicated that investment adviser examinations in 2024 will focus on similar topics, including but not limited to the following:

- recommendations related to products viewed by the SEC as complex, high cost, and illiquid, including variable annuities;
- unconventional strategies;
- recommendations for certain types of customers (e.g., older investors and those saving for retirement); and
- the process for determining that investment advice is in the customer's best interest, including initial and ongoing suitability determinations, seeking best execution, evaluating costs and risks, and identifying and addressing conflicts of interest.

Both FINRA and the SEC will continue to focus on compliance programs and ensuring that policies and procedures are designed to reflect and satisfy the requirements of the applicable standards of conduct. Regarding Form CRS, firms should review policies and procedures in place to ensure that their filings adhere to the SEC's prescribed Form CRS Instructions and guidance, and that there is a process in place to review, update and, when applicable, re-file their Form CRS. Additionally, firms need to ensure that Form CRS is being properly delivered to customers and posted on the firm's public website. The SEC indicated they will also focus on the content of Form CRS to review how the firm describes: (1) the relationships and services that it offers to retail customers; (2) its fees and costs; and (3) its conflicts of interest, and whether the broker-dealer discloses any disciplinary history.

Firms should carefully review the section of FINRA's report that describes key findings and best practices with respect to Reg BI and Form CRS. Firms should also review NASAA's published reports on the findings from its Reg BI National Exam Initiative. These reports provide NASAA's analysis of information obtained through industry surveys related to compliance with and implementation of Reg BI. The most recent report, issued in September 2023, focuses on "... qualitative findings to identify areas where FINRA firms were meeting or exceeding state expectations regarding Reg BI compliance (best practices) as well as identifying areas where FINRA firm compliance appeared weak (opportunities for improvement)." IRI and many other industry organizations have raised doubts about the methodology used by NASAA to conduct its surveys as well as the implication that the findings support the need for NASAA's Model Rule proposal. Nevertheless, the findings in the report could provide useful information to help firms assess the effectiveness of their policies and procedures and to determine whether any changes are necessary.

IRI ENGAGEMENT AND RESOURCES

IRI is an industry leader on standard of conduct issues. The IRI Standard of Conduct Working Group, which is led by IRI's Regulatory Affairs Team, covers all federal and state standard of conduct activity (legislative, regulatory, and judicial) applicable to financial professionals who provide advice or recommendations about annuities to retail consumers. IRI also maintains a Standard of Conduct resources page which is continuously updated with the latest developments and resources to help members track and analyze standard of conduct activities.

Variable Annuities

> The SEC and NASAA have characterized variable annuities as complex, risky, illiquid, and costly products.

In several instances, regulators have expressed many concerns with the recommendation and sale of variable annuities. The SEC and NASAA have characterized variable annuities as complex, risky, illiquid, and costly products. With this in mind, firms should take all reasonably appropriate steps to ensure that financial professionals who recommend variable annuities clearly understand (1) the features and benefits of the product they are recommending, and (2) the customer's investment profile, liquidity needs, time horizon, and risk tolerance, and the costs and fees associated with the product being recommended. Further, as required under Reg BI, financial professionals must ensure the costs and fees are sufficiently disclosed to the customer and that there is a reasonable basis to believe the recommendation is in the customer's best interest.

COMPLIANCE CONSIDERATIONS

Firms should expect that SEC and FINRA examinations in 2024 will continue to focus on variable annuity recommendations, with a higher degree of scrutiny on compliance with the requirements of Reg BI and applicable FINRA rules such as Rule 2330, Members' Responsibilities Regarding Deferred Variable Annuities. Examiners will also look more carefully at variable annuity recommendations made to older investors and retirement savers.

FINRA's report specifically encourages firms to focus on the following consideration in the context of variable annuities:

- Process for reviewing rates of variable annuity exchanges;
- Use of standardized review thresholds for rates of variable annuity exchanges;
- Process for confirming variable annuity data integrity with insurance carriers and third-party data providers;
- Use of written supervisory procedures to support determinations that variable annuity exchange recommendations have a reasonable basis;
- Policies and procedures requiring registered representatives to inform customers of the various features of recommended variable annuities;
- The role of registered principals in supervising variable annuity transactions and the processes, forms, documents, and information used by registered principals in conducting such supervision;
- Process for supervision of registered representatives who make recommendations regarding buyout offers;
- Process for supervisory review and documentation when a registered representative recommends additional deposits into existing variable annuity contracts; and
- Maintenance of records regarding retail customers' investment objectives, risk tolerance and other information to support particular recommendations.

In addition, firms should carefully review the section of FINRA's report that describes key findings and best practices with respect to variable annuity recommendations.

Emerging Technology: Artificial Intelligence (AI)

Regulators are focusing on the new compliance risks and regulatory implications that accompany the use of AI.

AI is rapidly evolving, as evidenced by the emergence of generative AI tools such as ChatGPT in recent years. Within the financial services industry, companies are starting to explore and use these technologies to create operational efficiencies and provide better customer experiences. Regulators are working to better understand and determine how best to regulate the use of this relatively new technology by the financial services industry. FINRA and the SEC have taken notice and are focusing on the new compliance risks and regulatory implications that accompany this technological innovation. The SEC is reportedly launching a sweep[1] to learn more about investment advisers' use and oversight of AI in their firms, and FINRA has warned its members that the use of AI can implicate nearly every aspect of a firm's regulatory obligations and urged them to consider these broad implications before deploying such technologies. In particular, FINRA has stated that members should closely focus on the follow areas when using AI:

- Anti-Money Laundering
- Books and Records
- Business Continuity
- Communications With the Public
- Customer Information Protection
- Cybersecurity
- Model Risk Management (including testing, data integrity and governance, and explainability)
- Research
- SEC Regulation Best Interest
- Supervision
- Vendor Management

The SEC also plans to remain focused on automated investment tools, AI, trading algorithms or platforms, broker-dealer mobile applications, and the risk associated with the use of such technologies. As mentioned previously in the Standard of Conduct section of this report, in 2023, the SEC proposed a rule characterized as an attempt to address possible conflicts of interest associated with the use of predictive data analytics and similar technology when interacting with investors. However, the proposed rule is overly broad in its definition of covered technology, scoping in nearly every conceivable technology used in the ordinary course of business, including simple Microsoft Excel spreadsheets.

STATE REGULATORY ACTIVITY

State regulators are also taking a strong interest in the use of AI. In 2023, the NAIC adopted Model Bulletin: Use of Artificial Intelligence Systems by Insurers to provide insurers with guidance as to the development, acquisition, and use of AI technologies. The model bulletin also provides examples of the type of information insurers may be asked to provide during investigations or examinations.

[1](2023, December 30) SEC Probes Investment Advisers' Use of AI, *The Wall Street Journal*

The NAIC adopted Model Bulletin: Use of Artificial Intelligence Systems by Insurers.

Additionally, the Colorado Division of Insurance released a final regulation titled Governance and Risk Management Framework Requirements for Life Insurers' Use of External Consumer Data and Information Sources, Algorithms, and Predictive Models, which establishes governance and risk management requirements for use of these technologies and a draft Algorithm and Predictive Model Quantitative Testing Regulation. While these regulations do not explicitly apply to annuities, Colorado regulators intend to use the rules for life insurance as a starting point for future rules applicable in the annuity space.

COMPLIANCE CONSIDERATIONS

The regulatory framework for AI is still in its infancy, and regulators have yet to adopt any specific rules for the use of AI by the annuity industry. Nevertheless, firms should be developing compliance programs to govern their use of this technology. Several resources are available to assist with this important effort, including:

- FINRA's FinTech Key Topics Page
- FINRA Report: Artificial Intelligence (AI) in the Securities Industry (June 2020)
- National Institute of Standards and Technology (NIST): Artificial Intelligence Risk Management Framework (AI RMF 1.0) (January 2023)

IRI will continue to follow developments regarding the SEC's proposed rule, Conflicts of Interest Associated with the Use of Predictive Data Analytics. When the proposal was first announced it was positioned as an AI proposal, however, it goes far beyond the regulation of AI and would be more appropriately categorized as a new standard of conduct proposal. However, if adopted, this proposal would have a significant impact on a firm's use of AI and other similar technologies.

Emerging Technology: Crypto

In January 2024, FINRA released an update on their targeted exam on crypto asset communications. In this update, FINRA noted several non-compliant communication practices, such as failure to clearly differentiate between crypto assets offered through an affiliate of the member or another third party, and products and services offered directly by the member itself; false statements or implications that crypto assets functioned like cash or cash equivalent instruments; unclear and misleading explanations of how crypto assets work and their core features and risks; and other false or misleading statements or claims about crypto assets. FINRA's update also includes a list of resources that should be reviewed by firms engaging in crypto-related products and services.

COMPLIANCE CONSIDERATIONS

FINRA included a new section in their report this year on crypto, Crypto Asset Developments, and reminded firms to identify and address all the relevant regulatory and compliance challenges and risks associated with crypto asset securities. For example, FINRA stated that firms should review and evaluate their supervisory programs and controls, and compliance policies and procedures, in areas such as cybersecurity, AML compliance, communications with customers, manipulative trading, performing due diligence on crypto asset private placements and supervising their associated persons' involvement in crypto asset-related outside business activities (OBAs) and private securities transactions (PSTs). FINRA's report also specifically calls attention to crypto asset communications and provides firms with effective practices observed during examinations with respect to ensuring crypto communications provide a fair and balanced representation of the risks. Practices observed include disclosing the following information:

- the speculative nature of crypto assets (e.g., their significant volatility, the potential for investors to lose the entire amount they invest);
- the lack of legal or regulatory protections for most crypto assets (e.g., Securities Investor Protection Corporation (SIPC) protections apply only to cash and securities held for an investor for certain purposes in a customer securities account at a SIPC-member broker-dealer and do not apply to crypto assets that do not qualify as Securities Investor Protection Act (SIPA) "securities"), the extent to which the protections provided by transacting through a SEC registered entity will apply;
- regulatory uncertainty concerning the crypto assets; and
- fraud risks that may be present.

Similarly, the SEC will continue to monitor, and when appropriate, conduct examinations focused on crypto assets. Much like FINRA, the SEC is focused on ensuring that appropriate standards of conduct are satisfied when firms and financial professionals recommend crypto assets and that firms routinely review, update, and enhance their compliance and supervisory practices related to crypto assets.

Emerging Technology: Digital Communications

The SEC continues to conduct its sweep on the use of "off channel" digital communications, such as texting via personal devices and use of apps such as WhatsApp. Throughout 2023, the SEC charged 23 firms with recordkeeping failures related to off channel communications and imposed fines totaling just over $390 million.

- SEC Charges 10 Firms with Widespread Recordkeeping Failures (September 2023)
- SEC Charges 11 Wall Street Firms with Widespread Recordkeeping Failures (August 2023)
- SEC Charges Two firms with Widespread Recordkeeping Failures (May 2023)

In statements related to these charges, the Director of the SEC's Division of Enforcement, Gurbir S. Grewal, encouraged firms to self-report, cooperate, and remediate, which can result in better examination outcomes and reduced penalties.

FINRA's report reminds firms of the general books and recordkeeping obligations under Exchange Act Rules 17a-3 and 17a-4, and FINRA rules such as Rules 3110(b)(1) (General Requirements), 3110.09 (Retention of Correspondence and Internal Communications), 2210(b)(4) (Recordkeeping), and 4511(a) (General Requirements). Also, as reported last year, the SEC adopted amendments to the recordkeeping rules under Rule 17a-4, which updated the Third-Party Access Undertaking letter. Firms need to ensure that a new letter, if applicable, has been appropriately filed if they choose to continue using their current third-party access arrangement.

COMPLIANCE CONSIDERATIONS

IRI members should expect to see a continued focus on recordkeeping issues related to off-channel communications in 2024. FINRA plans to share any helpful observations or effective practices that may emerge from its risk-based reviews of member firms' practices related to off-channel communications. Additionally, FINRA provided the following considerations for firms when evaluating electronic communication policies and procedures:

- Are there procedures and controls to maintain, preserve and monitor all business-related correspondence by staff, including that which is conducted via off-channel communication methods?
- Are there processes and procedures to monitor when new electronic communication channels are available to customers and associated persons?
- Is there required training and guidance that your firm's associated persons must complete before they are permitted access to firm-approved electronic communication channels?
- How does your firm communicate to its associated persons, and monitor and surveil for compliance with, the prohibition against using unapproved off-channel communication methods for business communications?
- What corrective or disciplinary measures has your firm implemented to deter its associated persons from circumventing supervisory controls related to off-channel communications?

Emerging Technology: Cybersecurity

FINRA and the SEC have several rules and regulations directly related to cybersecurity, which require firms to adopt and implement supervisory controls and policies and procedures to monitor their cybersecurity practices. Cybersecurity rules to consider include:

- Regulation S-P, Rule 30: This requires members to have written policies and procedures to address administrative, technical and physical safeguards for the protection of customer records and information.
  - SEC Risk Alert: Safeguarding Customer Records and Information at Branch Offices (April 26, 2023)
- Regulation S-ID: This requires firms to develop and implement a written program reasonably designed to detect, prevent and mitigate identity theft in connection with the opening or maintenance of a "covered account "[2]
- FINRA Rule 4370: This serves as a reminder to firms that this rule also applies to denials of service and other interruptions to member firm operations.

On July 26, 2023, the SEC adopted new rules, Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and incidents by public companies that are subject to the reporting requirements of the Securities Exchange Act of 1934. FINRA also published a Cybersecurity Advisory in September related to these new rules and a second Cybersecurity Advisory in December, to highlight effective practices for responding to a cyber incident.

[2]17 CFR 248.201(b)(3), which defines "covered account" as: (i) an account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions, such as a brokerage account with a broker-dealer or an account maintained by a mutual fund (or its agent) that permits wire transfers or other payments to third parties; and (ii) any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.

STATE REGULATORY ACTIVITY

In November 2023, the New York Department of Financial Services (NY DFS) adopted amendments to their cybersecurity regulation (23 NYCRR 500). According to the press release, key changes to the regulation include:

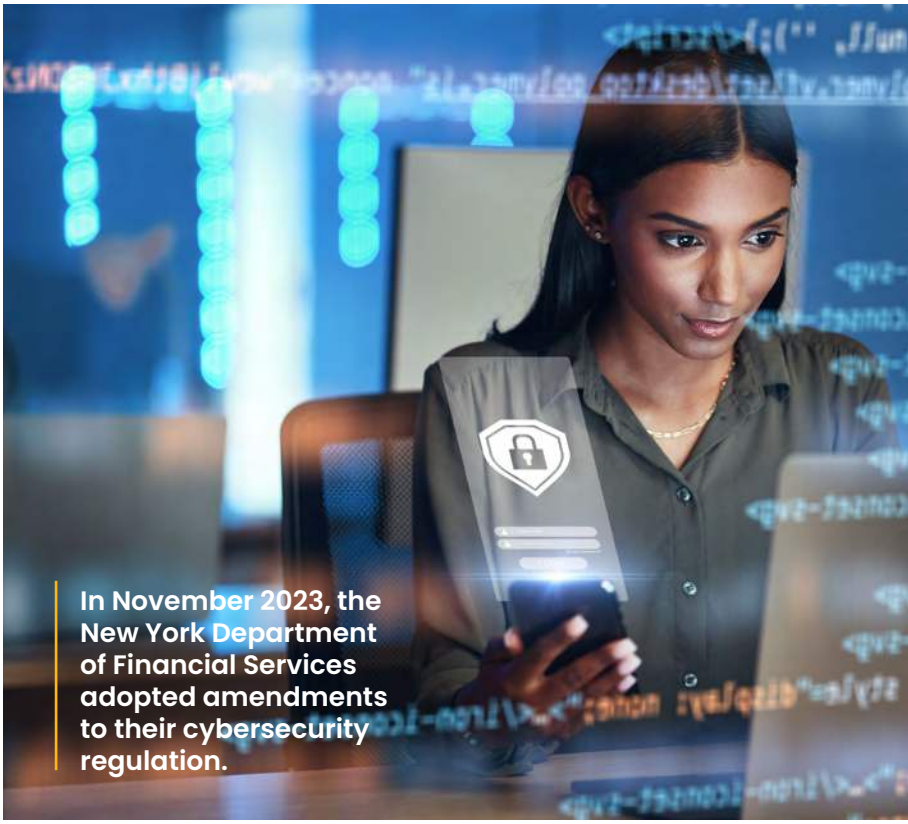
1. Enhanced governance requirements;
2. Additional controls to prevent initial unauthorized access to information systems and to prevent or mitigate the spread of an attack;
3. Requirements for more regular risk and vulnerability assessments, as well as more robust incident response, business continuity, and disaster recovery planning;
4. Updated notification requirements including a new requirement to report ransomware payments; and
5. Updated direction for companies to invest in at least annual training and cybersecurity awareness programs that anticipate social engineering attacks and that are otherwise relevant to their business model and personnel.

The Cybersecurity Resource Center on the NY DFS website provides helpful information related to training and compliance with the amended regulation, including FAQs and industry guidance.

COMPLIANCE CONSIDERATIONS

Cybersecurity remains a significant risk factor for the industry. As technology advances and the use of innovative technologies (such as AI) becomes more prominent, cybersecurity will become increasingly more important. Firms will need to stay vigilant to ensure the integrity and protection of consumer information. Firms should ensure that policies, procedures, and governance practices are continuously reviewed and updated as necessary to reflect evolving best practices for preventing, mitigating, and responding to cyber-attacks and other incidents that could expose and compromise the firm (e.g., account takeovers, ransomware, phishing).

In March 2023, the SEC also proposed new requirements, Cybersecurity Risk Management Rule for Broker-Dealers, Clearing Agencies, Major Security-Based Swap Participants, the Municipal Securities Rulemaking Board, National Securities Associations, National Securities Exchanges, Security-Based Swap Data Repositories, Security-Based Swap Dealers, and Transfer Agents. This proposal would require firms to establish, maintain, and enforce written policies and procedures to reasonably address their cybersecurity risks and, at least annually, review and assess the effectiveness of their cybersecurity policies and procedures. The proposal would also require written electronic notice of significant cyber security incidents.



Other SEC proposed rules related to cybersecurity include:

- Regulation Systems Compliance and Integrity (SCI)
  This is a proposal to make amendments to Regulation SCI to expand the scope of entities subject to Regulation SCI and to update several of the regulation's requirements to account for the evolution of technology and trading since its adoption in 2014.
- Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Customer Information
  This is a proposal to make amendments to Regulation S-P to enhance the protection of consumer information. For example, it would require firms to adopt policies and procedures for an incident response program, including timely notice to individuals whose sensitive information was or is reasonably likely to have been accessed without authorization.

Firms should review training practices to ensure employees are adequately trained on best practices to prevent cyber incidents (e.g., ransomware attacks, phishing) and identity theft incidents. Additionally, firms should review their policies and procedures and processes related to responding to cyber incidents and how they handle oversight of third-party vendors.

Environmental, Social, and Governance (ESG)

ESG-related investments and strategies continue to be a hot topic for the industry. While several ESG-related regulations were finalized this past year at the federal and state level, FINRA has yet to take any substantive action on this topic. However, FINRA is generally concerned with communications that promote ESG factors and reminds firms of their obligations to review ESG-related communications. Firms should ensure claims related to ESG investments are consistent with and supported by applicable offering documents and that statements promoting ESG factors are appropriately balanced through prominent descriptions of the risks associated with ESG funds, including that (1) ESG-related strategies may not result in favorable investment performance; (2) there is no guarantee that the fund's ESG-related strategy will be successful; and (3) the fund may forego favorable market opportunities in order to adhere to ESG-related strategies or mandates.

STATE REGULATORY ACTIVITY

Missouri finalized a new ESG rule, which makes it a dishonest or an unethical business practice for broker-dealers, investment advisers, and their agents and representatives to fail to disclose that social or non-financial objectives were incorporated into discretionary investment decisions and recommendations to buy or sell securities. Notice and consent is required either at the establishment of the relationship or prior to affecting the initial discretionary investment or the recommendation. The disclosure must be provided annually and consented to in writing at least every three years. This new rule took effect on July 30, 2023.

Additionally, Wyoming proposed an ESG rule that would require broker-dealers, securities agents, and investment advisers to disclose any incorporation of a "social objective" into 1) discretionary investment decisions 2) recommendations or solicitations to buy or sell securities or commodities, or 3) advice or a recommendation to a customer regarding the selection of a third-party manager or subadvisor to manage the investments in the customer's account. This proposal is similar to the disclosure rule adopted in Missouri, but it does have some differences, such as what constitutes "social criteria" and the addition of scenario 3) above.

COMPLIANCE CONSIDERATIONS

The SEC also finalized and adopted the Investment Companies Names Rule (Names Rule), which took effect on December 11, 2023, and fund groups with net assets of $1 billion or more will have 24 months to comply with the amendments, while fund groups with net assets of less than $1 billion will have 30 months to comply. The Names Rule is designed to prevent mutual funds from trying to exploit investor interest in ESG investing by using fund names that do not accurately reflect their actual investments or strategies (a practice commonly referred to as "greenwashing"). The rule is reflected in amendments to Rule 35d-1 under the Investment Company Act of 1940 and requires that firms adopt a policy to invest at least 80 percent of their assets in accordance with the investment focus suggested by the fund's name. Funds will also be required to conduct a quarterly review of their investments to ensure consistency with the 80 percent test and will generally have up to 90 days to come back into compliance if the fund departs from the 80 percent test.

The following SEC proposals related to ESG investments and climate-related risks are still pending and will likely be finalized in 2024:

- Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices
  This proposed rule would require registered investment companies, business development companies, registered investment advisers, and certain unregistered advisers to provide additional specific disclosures regarding ESG strategies in fund prospectuses, annual reports, and adviser brochures; the implementation of a layered disclosure approach for ESG funds to allow investors to compare ESG funds; and generally, require certain environmentally-focused funds to disclose the greenhouse gas emissions associated with their portfolio investments.

- The Enhancement and Standardization of Climate-Related Disclosures for Investors
  This proposed rule would require a registered company to include certain climate-related information in its registration statements and periodic reports, including climate-related risks and their actual or likely material impacts on the business, strategy, and outlook; governance of climate-related risks and relevant risk management processes; greenhouse gas emissions; certain climate-related financial statement metrics and related disclosures in a note to its audited financial statements; and information about climate-related targets and goals, and transition plan.

Other Areas of Interest

The SEC and FINRA reports identify other areas of focus not specifically covered in this report, including anti-money laundering, private placements, best execution, and broker-dealer trading practices. If any of these topics are relevant to your business, you should carefully review the SEC and FINRA reports prior to your examinations to ensure that you fully understand their concerns and priorities in these areas.

RISK ALERTS

Throughout the year the SEC released several risk alerts not previously mentioned in this report which may be of interest to IRI members, including the following:

- Observations from Examinations of Newly-Registered Advisers (March 2023)
  This risk alert provides insights to newly registered investment advisers to help them understand what they can expect when undergoing an examination. Since the SEC has a risk-based examination program, new investment advisers have long been a priority and will continue to be a strong focus.
- Examinations Focused on Additional Areas of the Adviser Marketing Rule (June 2023)
  In September 2022, the SEC released a risk alert announcing the initial areas of review during examinations focused on the then newly adopted Marketing Rule. This new risk alert announced that the SEC will continue to focus on those initial areas, but will also start focusing on additional aspects of the rule, such as testimonials and endorsements, third-party ratings, and Form ADV.
- Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents (September 2023)
  This risk alert provides insights to investment advisers on the examination selection process, including which firms to examine and areas of focus. Additionally, the risk alert includes an outline of the information typically included in an initial request for documents and information.

REGULATORY PROPOSALS & FINAL RULES

Below is a list of other regulatory activities that will have an impact on the insured retirement industry. IRI is monitoring activity related to these proposals and provides updates through the appropriate IRI committees.

- Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (Swing Pricing and Hard Close Proposal)

The rule would require that funds manage liquidity risks using "swing pricing," a method to allocate costs from inflows or outflows to the investors engaged in that activity. The proposal would also require a "hard close" for relevant funds. With a hard close, investor orders would need to be received by the fund, its transfer agent, or a registered clearing agency by the time of the fund's pricing, typically 4 p.m. ET, to obtain that day's price. Since the hard close proposal would require those intermediaries to transmit their final trades to the fund before market close and thus also before the fund has determined its new net asset value, retirement plan compliance with the proposed changes as currently proposed would be essentially impossible.

- Regulation Best Execution

The duty of best execution requires a broker-dealer to execute customers' trades at the most favorable terms reasonably available under the circumstances. This duty of best execution derives from common law agency principles and fiduciary obligations and is enforced through the antifraud provisions of the Federal securities laws. The SEC is proposing new rules under the Securities Exchange Act of 1934 ("Exchange Act') relating to a broker-dealer's duty of best execution. Proposed Regulation Best Execution would enhance the existing regulatory framework concerning the duty of best execution by requiring detailed policies and procedures for all broker-dealers and more robust policies and procedures for broker-dealers engaging in certain conflicted transactions with retail customers, as well as related review and documentation requirements.

- Proposed Amendment to Prohibited Transaction Class Exemption 84-14 (the QPAM Exemption)

The QPAM Exemption (also known as PTE 84-14) permits an investment fund holding assets of plans and IRAs that are managed by a "qualified professional asset manager" (QPAM) to engage in transactions with "parties in interest" or "disqualified persons" to a plan or an IRA, subject to protective conditions. The proposed amendment would modify the exemption, incorporating a provision under which a QPAM may become ineligible to rely on the QPAM Exemption for a period of 10 years if the QPAM, various affiliates, or five percent or more owners of the QPAM are convicted of certain crimes, including convictions in foreign jurisdictions. The proposed amendment also: (1) revises the requirements of a QPAM's authority over investment decisions, (2) significantly raises the asset management and equity thresholds in the QPAM definition, and (3) adds a new recordkeeping requirement.

- Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities

The RILA Act was enacted into law at the end of 2022 under Division AA of the Consolidated Appropriations Act, 2023. In accordance with the RILA Act, the SEC issued a proposed rule and related form amendments to provide a tailored registration form for RILAs. The SEC proposed to amend the form currently used by most variable annuity separate accounts, Form N–4, including rules and other related amendments, to require issuers to register RILA offerings on that form. In addition to requiring insurers to register RILAs on Form N-4, the proposal allows RILA issuers to use financial statements based on statutory accounting principles in their filings. The SEC is required to finalize the new RILA registration form by mid-2024 under the RILA Act. If it misses that deadline, issuers will be permitted to register RILAs on the current version of Form N-4.

Additionally, in November 2023, the SEC approved FINRA's proposed rule changes to adopt the Remote Inspections Pilot Program and changes regarding residential supervisory locations under FINRA Rule 3110. In January 2024, FINRA released Notice 24-02 providing firms with information and effective dates for these newly adopted supplemental materials:

- **Rule 3110.18 (Remote Inspections Pilot Program)** establishes a voluntary, three-year remote inspections pilot program (Pilot Program) to allow eligible member firms to fulfill their Rule 3110(c)(1) inspection obligation of qualified branch offices, including offices of supervisory jurisdiction (OSJs) and non-branch locations remotely, without an on-site visit, subject to specified terms. Participation in the Pilot Program required eligible firms to affirmatively "opt-in" and/or "opt-out" via notice to FINRA, subject to specified "open enrollment periods" and "opt-out notification periods." This rule becomes effective on July 1, 2024, and the initial open enrollment period for eligible firms will start on June 1, 2024, and end on June 26, 2024.
- **Rule 3110.19 (Residential Supervisory Location)** will treat a private residence at which an associated person engages in specified supervisory activities, subject to certain safeguards and limitations, as a non-branch location, or otherwise known as, a residential supervisory location (RSL). Among other requirements, these non-branch locations will be subject to regular periodic inspections, instead of annual inspections that are currently required for an OSJ and a firm must conduct and document a risk assessment and provide a list of RSLs to FINRA on a periodic basis. This rule becomes effective on June 1, 2024, with the first list of RSLs due to FINRA on October 15, 2024.

At a state level, the NY DFS issued Circular Letter No. 6 (2023) and its associated filing guidance related to a common practice within the industry to create "different versions" of a product for different distributors, resulting in similarly situated consumers receiving similar policies or contracts, but with different conditions, benefits, fees, or premiums. Companies should review this information to ensure that product development, offerings, and sales practices align with this new guidance from the NY DFS. IRI also created an overview to help members more easily understand the compliance implications and requirements under this new guidance.

IRI and Member Engagement

IRI members that have questions or concerns related to any of the topics covered in this report should feel free to reach out to any staff member of IRI at any time. The staff at IRI is always ready to assist members when working through the complexities of industry regulation. Information about IRI's standing committees and working groups can be located on IRI's website and members can individually manage their participation via the member portal on IRI's website.

Resources: How to log in to my account or How to create an account

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