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EXPECTFOCUS®

LEGAL ISSUES AND DEVELOPMENTS FROM CARLTON FIELDS

v II Inside

EXPECTFOCUS®

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EXPECTFOCUS® is a review of developments in the life, annuity, and retirement solutions industry, provided on a complimentary basis to clients and friends of Carlton Fields.

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Builder of Investment Models Deviates From Blueprints

Employee's Rogue Remodeling Costs Builder Plenty

BY NATALIE NAPIERALA AND AUSTIN JACKSON

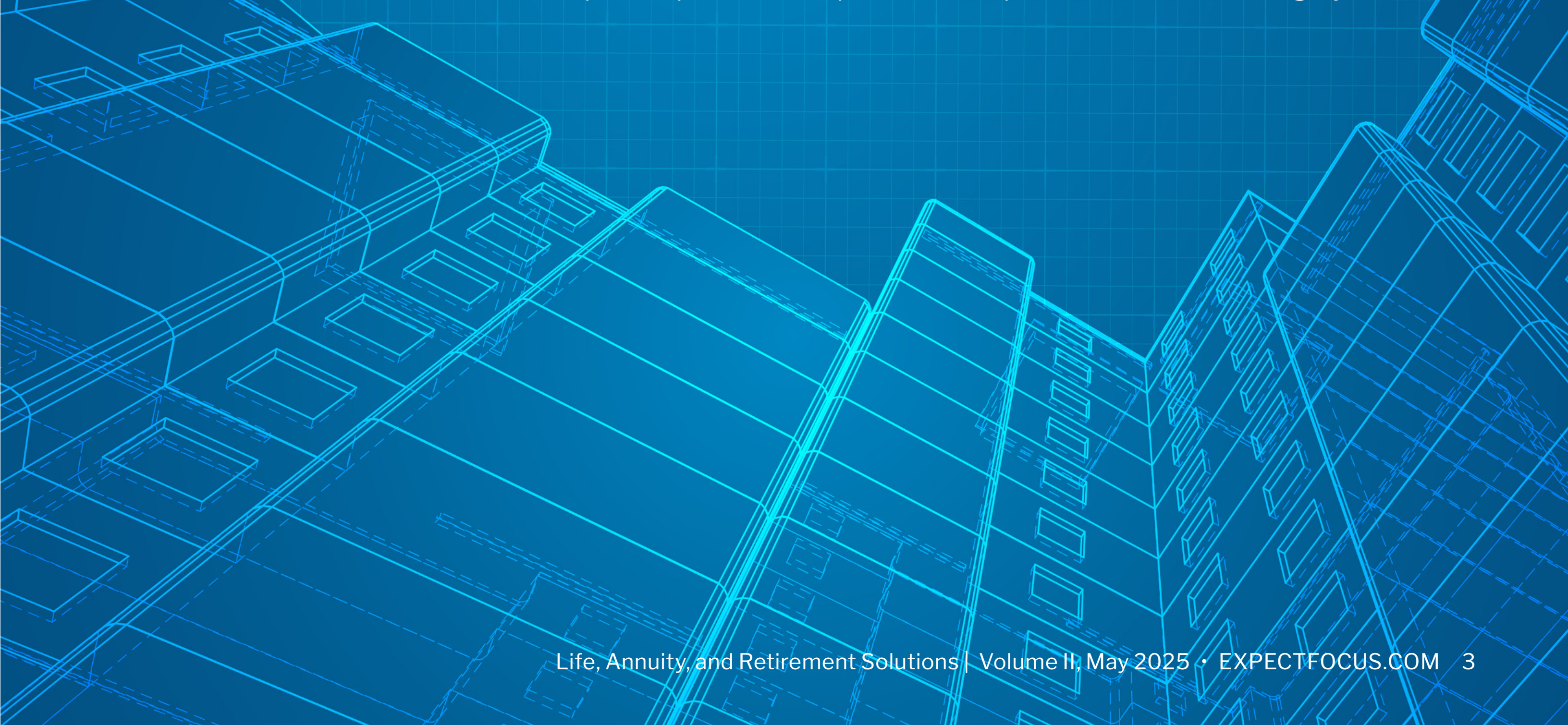
The SEC's recent order instituting administrative and cease-and-desist proceedings (OIP) against registered investment advisers Two Sigma Investments LP and Two Sigma Advisers LP illustrates significant risks for investment model providers whose employees have access to the algorithmic investment models that drive firms' investment decisions.

Two Sigma, a prominent quantitative investment adviser managing more than $150 billion, employs computer-based algorithmic models to guide investment decisions across private funds and separately managed accounts. The SEC alleged that, beginning in 2019, Two Sigma knew that certain of its employees had unfettered access to a database storing the models' parameters, i.e., variable inputs that impact the model's stock predictions. Employees had warned the firm's senior management of such access; however, Two Sigma allegedly delayed implementing effective safeguards until the vulnerabilities materially impacted investment performance.

According to the SEC, between 2021 and 2023, one employee made dozens of unauthorized changes to the model parameters, which materially affected 14 of Two Sigma's live trading models — models developed by either the employee or those reporting directly to him. These changes caused the models to deviate significantly from intended investment strategies and resulted in an approximately $165 million loss for some clients and more than $400 million in unintended gains for others.

The OIP alleged that Two Sigma willfully violated the anti-fraud provisions of the Investment Advisers Act of 1940. Without admitting or denying wrongdoing, Two Sigma consented to a cease-and-desist order, censure, and a $90 million civil penalty. Two Sigma cooperated with the SEC staff and took remedial actions during its investigation, which included repaying the negatively impacted and underperforming client funds in the total amount of approximately $165 million. So the firm paid a hefty total price, despite the fact that the OIP acknowledged its cooperation and remedial efforts.

The SEC's action against Two Sigma highlights a perhaps underappreciated risk for providers of investment models, especially where a provider's compensation arrangements could incentivize employee tampering. Certainly, such providers must maintain and enforce strong model access controls and compliance policies, and diligently supervise employees who could impact critical investment processes. Moreover, in light of the substantial damage to investors that may result from corrupted investment models, it also behooves funds and investment advisers that rely on investment models provided by other firms to consider whether they should take any additional steps to satisfy themselves as to the adequacy of such third parties' practices and procedures to protect their models' integrity.



SEC Continues Renewal Project for Registered Capital Raises

Expanding Use of Draft Filings May Counter Abandonment of Public Securities Market

BY DEAN CONWAY AND W. THOMAS CONNER

More than a decade has passed since the enactment of the Jumpstart Our Business Startups (JOBS) Act, which encouraged small-company capital formation through a reduction in costly regulatory burdens on SEC registrants. In response to the JOBS Act, the SEC streamlined the capital formation process for emerging growth companies by, among other things, making available to certain issuers the option to submit draft registration statements to the SEC for a "confidential, nonpublic staff review." In 2017, the SEC greatly expanded the category of companies that were eligible for the nonpublic review process to include all issuers rather than only small companies. Building on these developments (and in support of the SEC's renewed mission to facilitate capital formation), the SEC announced on March 3, 2025, that it would provide "enhanced accommodations" for the nonpublic review process.

The enhanced accommodations include:

1. Expanding the availability of the nonpublic review process for the initial registration of securities under sections 12(b) and 12(g) of the Securities Exchange Act of 1934 (Exchange Act) on Forms 10, 20-F, or 40-F.
2. Permitting issuers to submit draft registration statements regardless of how much time has passed since they became subject to the reporting requirements of section 13(a) or 15(d) of the Exchange Act.
3. Expanding the availability of the nonpublic review process for a "de-SPAC" transaction in situations in which the SPAC is the surviving entity.
4. Permitting issuers to omit the name of the underwriter(s) from their initial draft registration statement submissions, when otherwise required by Items 501 and 508 of Regulation S-K.

While the SEC indicated that issuers should take "all steps to ensure that a draft registration statement is substantially complete when submitted," it also noted that it "will not delay processing if an issuer reasonably believes omitted financial information will not be required at the time the registration statement is publicly filed."

These enhanced accommodations are likely to speed up the access to capital for companies both small and large.

DOL ESG Rule Withstands Demolition of *Chevron* Deference

BY GINA ALSDORF

In *Loper Bright Enterprises v. Raimondo*, the U.S. Supreme Court knocked down *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, leaving the doctrine of *Chevron* deference in rubble. The doctrine stated that, when a law was ambiguous, an agency administering that law would be entitled to deference for any permissible interpretation of the ambiguity. Chief Justice Roberts ultimately focused the majority opinion on the specific wording in the Administrative Procedure Act (APA), which states that courts should "hold unlawful and set aside agency action, findings, and conclusions" when they are not in accordance with the law. Nowhere in the APA is there language requiring deference to agency interpretations.

Loper Bright has put many other court decisions that relied on *Chevron* deference on shaky ground. Among these cases is one involving the Department of Labor's (DOL) environmental, social, and governance (ESG) rule under the Employee Retirement Income Security Act (ERISA).

In the final days of President Trump's first term, the DOL promulgated a rule that essentially prohibited, as a practical matter, the use of nonpecuniary (nonmonetary) factors by ERISA plan fiduciaries in making decisions about plan investments. The rule contained a narrow carve-out permitting the use of collateral nonpecuniary factors only when a fiduciary was deciding between investments whose relative merits, based solely on pecuniary factors, were indistinguishable. This carve-out, however, was fraught with uncertainties, not least because it was unclear to what extent ESG factors could ever be considered pecuniary. Additionally, "indistinguishable" was an exceedingly high bar. The rule reflected concerns that ESG investments chosen by plan fiduciaries could violate ERISA's duty of loyalty because they could be adverse to participants' and beneficiaries' financial interests.

Loyalty is a mainstay of ERISA's fiduciary duties. To meet the loyalty standard, an ERISA fiduciary must discharge his or her "duties with respect to a plan <u>solely</u> in the interest of the participants and beneficiaries" and "for the exclusive purpose of … providing benefits." In 2022, under the Biden administration and in an effort to counteract any "chilling effect" from the confusion surrounding the Trump-era rule, the DOL finalized a revised rule. Unlike its predecessor, the 2022 rule is not ambiguous. It expressly allows consideration of nonpecuniary factors (including ESG factors) when two or more investments "equally serve the financial interest of the plan over an appropriate time horizon." This is a lower threshold than the previous "indistinguishable" standard.

The 2022 rule has been repeatedly challenged by a coalition of 26 attorneys general from Republican-led states, oil companies, and individuals. A decision in one such case, *Utah v. Micone* in the Northern District of Texas, is the first decision on ERISA rulemaking since *Loper Bright*. The attorneys general argued, among other things, that the 2022 rule exceeded the DOL's statutory authority, was contrary to law, and was arbitrary and capricious. Their arguments were based in part on the claim that the "sole-benefit" requirement is not met when any factors besides pecuniary benefits are considered. They also contend that the rule was designed to build out Biden administration climate change policy rather than to benefit plan participants and beneficiaries. The case was initially dismissed on summary judgment in favor of the DOL, and the coalition appealed to the Fifth Circuit. Because of the interceding decision in *Loper Bright*, the Fifth Circuit declined to rule on the appeal and remanded the case to the district court for reconsideration.

In February, the district judge once again dismissed the case on summary judgment, finding that the 2022 rule does not violate ERISA, because it requires fiduciaries to maximize the financial benefits to plans. He posits that, if two investments equally serve a plan's financial interests, it does not advance non-beneficiary interests, nor is it a breach of loyalty, for a fiduciary to choose between them based on nonpecuniary factors.

The case has not yet been appealed. However, even if the 2022 rule ultimately withstands judicial scrutiny, it may still be razed as part of the Trump administration's broader efforts to dismantle Biden-era ESG initiatives.

NAIC Big Data Working Group Continues Building a Regulatory Structure

BY ANN BLACK

During the NAIC Spring National Meeting, the Big Data and Artificial Intelligence (H) Working Group reviewed its blueprint to build an overarching regulatory edifice to oversee insurers' use of artificial intelligence systems. The group solicited input from both regulators and stakeholders on its blueprint.

Four foundational pillars provide support for the regulatory structure.

- **Define Principles and Assess AI Use**. This pillar is nearing completion. The NAIC adopted its principles for artificial intelligence in 2020 and has since conducted surveys of private passenger auto, homeowners, life, and health insurance companies to assess AI usage. Survey results revealed that about 90% of health and auto insurers are likely to use, plan to use, or are exploring the use of AI, compared to only 58% of life insurers. From post-survey discussions, insurers indicated a need for more guidance on regulatory expectations related to governance, AI testing, and oversight of their AI programs.

- **Develop AI Risk Evaluation Tools**. The main vertical support for this pillar is the NAIC's model bulletin on the use of AI systems by insurers, which sets forth expectations for the governance, development, acquisition, and use of AI. To further reinforce this pillar, the working group seeks to develop standardized data collection methods and regulatory tools to identify and assess financial and market risks associated with AI use. Additionally, the group is working on an insurer self-audit questionnaire to provide guidance on meeting regulator expectations.

- **Regulatory Oversight and Accountability**. While construction of this pillar has not yet begun, the working group is "pouring the footers" based on governance, transparency, and accountability. Once completed, this pillar will uphold regulator expectations on matters such as including guidance on when a human should be in the loop and reliance on AI alone would not be permitted. It would also promote the types of disclosures that should be made to stakeholders regarding the use of AI, data use, reasons for decisions, and adverse consumer outcomes. In building this pillar, the working group will invite other NAIC trades to collaborate.

- **Identify and Address Gaps in AI Evaluation**. This pillar looks toward the future, as it aims to support the identification of emerging AI risks and the development of solutions to address them. Continuing the collaborative effort across the NAIC, this pillar seeks to provide regulators with a framework to identify potential issues before they arise, sealing any gaps between this pillar and the current NAIC structure.

During its meeting, the Innovation, Cybersecurity, and Technology (H) Committee emphasized the importance of the second pillar — developing AI risk evaluation tools — and the need for regulatory evaluation tools and the self-audit questionnaire. The committee sees the self-audit questionnaire as a level for insurers to ensure that their use of AI aligns with regulator expectations and identified it is a key priority for the working group.

All told, the AI regulation project continues to be built out. The working group has begun surveying the land, preparing tools to assess risks and set forth regulator expectations. All the while, other NAIC trades continue to be brought together, helping to support the pillars for a strong regulatory structure. The group's blueprint is detailed, which will help to keep construction on track.

This article was co-authored by Carlton Fields law clerk Jake Heiges.

Is SEC Whistleblower Program Topping Out?

BY THOMAS LAUERMAN

Since its establishment more than a dozen years ago, the SEC's whistleblower program has grown substantially — in terms of the number of whistleblower tips received by the SEC, as well as the number and dollar amount of awards paid to whistleblowers. The **annual report** that the SEC Office of the Whistleblower has filed with Congress covering fiscal year 2024, however, suggests the program has recently been leveling off.

For example, the report states that, apart from two particular whistleblowers, the SEC received approximately 11,000 tips, complaints, and referrals (TCRs) in both 2024 and 2023. The two whistleblowers in question, however, submitted a total of approximately 14,000 TCRs in 2024 and 7,000 TCRs in 2023. Accordingly, although the total number of TCRs was significantly higher in 2024 than in 2023, the increase seems basically attributable to these two individuals, and the usefulness of those individuals' tips seems questionable.

According to the report, although the SEC paid a total of approximately $255 million in awards to whistleblowers in 2024, this was only the third-largest annual payout of such awards. Thus, the overall whistleblower payout level does not appear to be consistently growing from year to year.

Interestingly, the SEC barred one claimant from participation in the whistleblower program for having filed applications for awards that the SEC found to be "frivolous or lacking a colorable connection between the claimant's tips and the [c]overed [a]ctions for which the claimant sought awards." It is not apparent whether this banned claimant was one of the above-mentioned individuals who have been submitting extraordinarily large numbers of TCRs.

At least one aspect of the SEC's whistleblower-related activities does continue to grow, however. Specifically, in 2024, the SEC brought 11 enforcement actions against entities and individuals for taking actions to impede whistleblowers from communicating with the SEC, including through the use of restrictive agreements of various types. The Office of the Whistleblower reports that this was more enforcement actions than in any previous year and more than twice the number brought in 2023. Moreover, one of the 2024 cases resulted in an $18 million fine, the highest ever for a case of this kind.

We have repeatedly warned our readers about these serious and continuing SEC concerns over perceived suppression of whistleblowers. *See* "SEC Penalizes Anti-Whistleblower Provision in Customer Settlement Agreements," *Expect Focus – Life, Annuity, and Retirement Solutions* (May 2024), and "Juggling Act: SEC Fines Three Employers for Potentially Discouraging Whistleblowers," *Expect Focus – Life, Annuity, and Retirement Solutions* (January 2024).

Investment Adviser Hedge Clauses: A Suitable Tool to Limit Liability or an SEC Enforcement Red Flag?

BY DEAN CONWAY

A "hedge clause," when incorporated into an investment advisory agreement, is designed to limit an adviser's liability to its advisory client. Even carefully worded hedge clauses, however, can attract unwanted SEC enforcement attention.

For example, a recently settled SEC enforcement action involved hedge clauses that a registered investment adviser and fund manager, ClearPath Capital Partners LLC, included in investment advisory agreements and in documents of investment funds that were principally distributed to retail investors. The SEC found that these hedge clauses violated the Investment Advisers Act's negligence-based anti-fraud provision because they were "misleading statements" about the scope of ClearPath's "unwaivable fiduciary duty" under the act.

The SEC discussed in detail the nature of this federal law fiduciary duty in its 2019 final interpretive release regarding the standard of conduct for investment advisers, which was published as a companion to the adopting release for what is commonly referred to as the SEC's Regulation Best Interest for broker-dealers. The SEC's settled order with ClearPath purportedly relied on the guidance set forth in the interpretive release, including the following quoted language: "[T]here *are few (if any) circumstances* in which a hedge clause in *an agreement with a retail client* would be consistent with [the Advisers Act] antifraud provisions, where the hedge clause purports to relieve the adviser from liability for conduct as to which the client has a non-waivable cause of action against the adviser … [and] [s]uch a hedge clause generally is *likely to mislead those retail clients* into not exercising their legal rights, in violation of the antifraud provisions." Notwithstanding the fact that the SEC's order articulated that its determination was based on a "facts and circumstances" test, the order could be read as virtually foreclosing such an individualized factual analysis in favor of a rigid bright-line test where retail investors are concerned. Even if the SEC indeed intends such a restrictive application of the interpretive release, however, it is not certain that (in a litigation posture) a federal court would agree with that view. Among other reasons, a court now may accord less weight to the SEC's views on the subject than it would have prior to the recent *Loper Bright* decision in which the U.S. Supreme Court overturned its *Chevron* deference doctrine.

With respect to institutional clients, however, the interpretive release's view of what constitutes full and fair disclosure clearly was less restrictive and more flexible in that such disclosure "can differ, in some cases significantly, from full and fair disclosure for a retail client because institutional clients generally have a *greater capacity and more resources than retail clients* to analyze and understand complex conflicts and their ramifications." The SEC added that whether "a hedge clause in an agreement with an institutional client [violates the] antifraud provisions will be determined based on the particular facts and circumstances." Nonetheless, regardless of whether a hedge clause is tailored for an intended retail or institutional audience, the SEC's order stated that "even if there is a disclaimer (sometimes known as a 'savings clause' or 'non-waiver' disclosure) stating that compliance with the state or federal securities laws is not waivable," such a disclaimer would not necessarily shield an adviser from a potential enforcement action.

In the case of ClearPath, the firm used two different hedge clauses in its advisory agreements, which stated, among other things, that it was "not liable to its clients for 'any action or inaction,' with exceptions for 'gross negligence' or 'willful malfeasance' and violations of 'applicable law.'" Each agreement also included a "savings clause" stating, among other things, that the "indemnification provided for herein shall be available only as and to the extent that it is not prohibited by applicable law governing rights of indemnification" and "nothing herein shall in any way constitute a waiver or limitation of any rights which Client may have under any federal or state securities laws." Despite this arguably balanced and transparent language used by ClearPath in its hedge clauses (including the savings statements), the SEC still concluded that each hedge clause "when read in its entirety, is inconsistent with an adviser's fiduciary duty because it may mislead ClearPath's retail clients into not exercising their non-waivable legal rights."

The takeaway: although the SEC's findings in the ClearPath enforcement order in some respects seem to go beyond what the interpretive release provides and may be subject to challenge, advisers should thoroughly analyze whether the regulatory risks associated with any hedge clauses they are using — especially in the context of retail investors — outweigh their benefits. This is particularly prudent in the current SEC regulatory environment, in which the SEC's then-acting chair delivered public remarks on February 24, 2025, emphasizing that "breaches of fiduciary duty by investment advisers" are among the enforcement priorities that the agency will be pursuing.

Construction Update: NAIC's Privacy Protections and Cybersecurity Working Groups Keep Building

BY PATRICIA CARREIRO

The NAIC's privacy protections and cybersecurity working groups have continued their building efforts.

Project 1: New Privacy Model

Construction Stage: Framing.

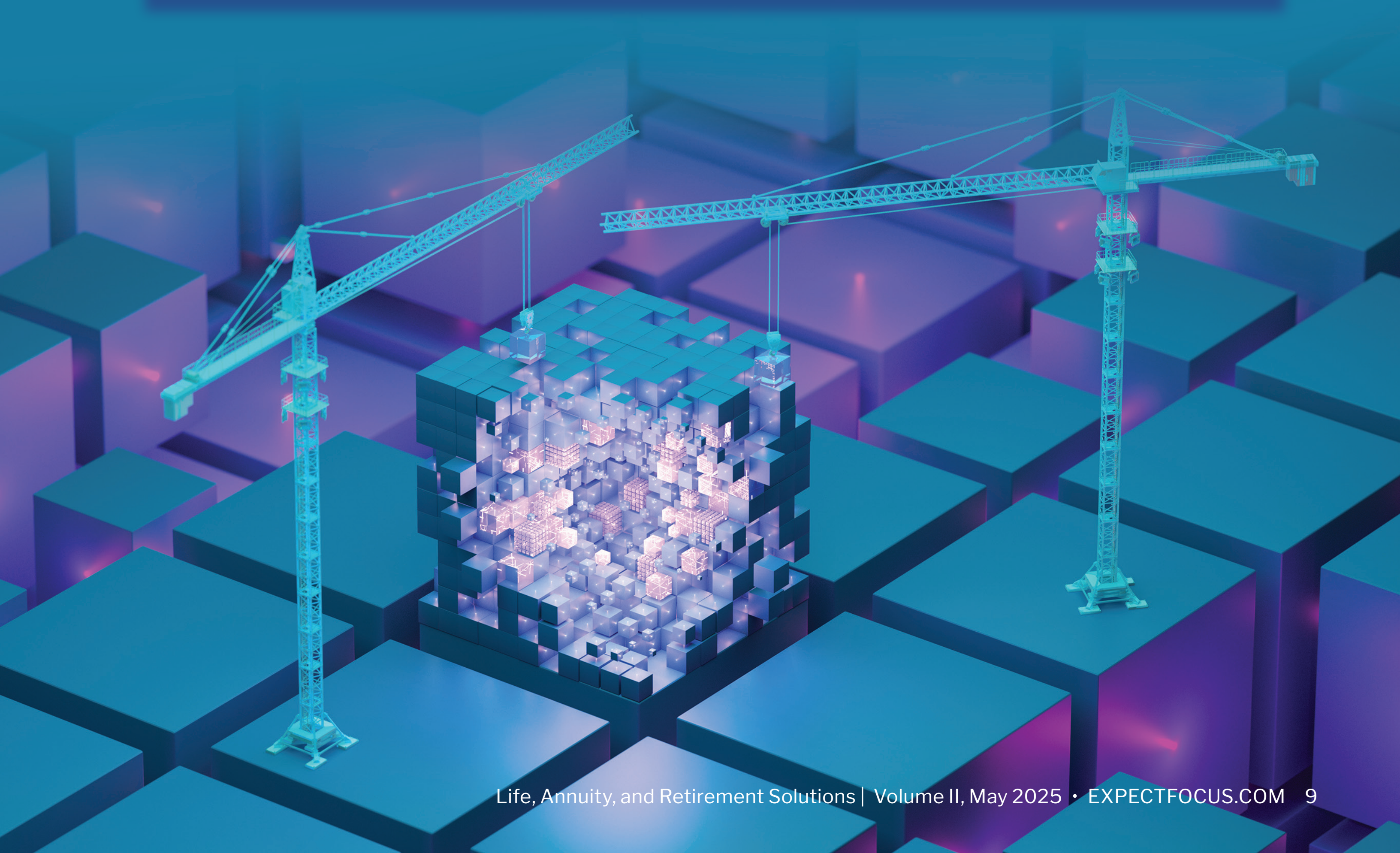
The NAIC Privacy Protections Working Group has continued framing out its new draft privacy model. With some plumbing and electric installed for sections related to third-party service provider arrangements and consumer rights, it's clear from discussions that some change orders are needed. As with prior building efforts, there are conflicting visions of what the new privacy model should look like. From the blueprints, it appears likely we will see features such as enhanced disclosure and privacy rights and a greater focus on vendor oversight and contracting. When it comes to the specifics, however, much of what was proposed in the draft sections might not pass inspection.

Project 2: Cybersecurity Event Reporting Portal

Construction Stage: Design.

Among the NAIC Cybersecurity Working Group's building plans is working with architects to determine how to construct their vision for a Confidential Cybersecurity Event Repository & Portal. The portal seeks to provide licensees with a single reporting mechanism for cybersecurity events.

For both working groups, construction delays are expected.



Recent SEC AML Enforcement Actions and Likely Continued AML Emphasis Under New Administration

BY BRIAN MORRIS

Registered investment advisers have until January 1, 2026, to comply with the anti-money laundering (AML) compliance provisions of the Bank Secrecy Act (BSA). However, the SEC has recently charged two investment advisers with securities law violations arising out of their failed AML compliance programs.

On January 14, 2025, the SEC announced charges against investment adviser Navy Capital Green Management LLC arising out of misrepresentations related to Navy Capital's AML program and associated compliances failures. The SEC found that Navy Capital had stated in offering and other documents provided to private fund investors that the firm was voluntarily complying with AML due diligence laws despite those laws not yet applying to investment advisers, including by conducting specific types of AML due diligence on prospective investors and conducting ongoing AML due diligence monitoring on existing investors. According to the SEC's order, Navy Capital's private fund investors included multiple foreign-based entities with opaque beneficial ownership and sources of wealth. The order further found that Navy Capital did not, in fact, always conduct the AML due diligence as described, including with respect to an entity owned by an individual publicly reported to have suspected connections to money laundering activities. Indeed, as noted in the order, a foreign court eventually froze the assets of one of Navy Capital's private funds because it held funds from that investor. Finally, the order found that Navy Capital failed to adopt and implement written policies and procedures reasonably designed to ensure the accuracy of offering and other documents provided to prospective and existing investors. To resolve the charges, Navy Capital paid a monetary penalty in the amount of $150,000.

Three days later, on January 17, 2025, the SEC announced charges against broker-dealer and investment adviser LPL Financial LLC for multiple failures related to its AML program. In its order, the SEC found that LPL Financial experienced long-standing failures in its customer identification program, including a failure to timely close accounts for which it had not properly verified the customer's identity. According to the order, LPL Financial failed to close or restrict thousands of high-risk accounts, such as cannabis-related and foreign accounts, which were prohibited under LPL Financial's AML policy. To resolve the charges, LPL Financial paid a monetary penalty in the amount of $18 million and agreed to implement improvements in its AML policies and procedures.

Although the change in administration has cast some doubt on the regulatory landscape, these companion cases reflect the SEC's continued scrutiny of AML compliance programs, consistent with the agency's stated examination priorities for 2025.

Those priorities expressly include reviewing whether broker-dealers and registered investment companies are:

- Appropriately tailoring their AML program to their business model and associated AML risks.
- Conducting independent testing.
- Establishing an adequate customer identification program, including for beneficial owners of legal entity customers.
- Meeting their suspicious activity report (SAR) filing obligations.

And additionally with respect to investment advisers:

- Monitoring and complying with the Department of the Treasury's Office of Foreign Assets Control (OFAC) sanctions regime.

In addition, at the Investment Adviser Association's 2025 Investment Adviser Compliance Conference, Keith Cassidy, acting director of the SEC's examinations division, and Corey Schuster, co-chief of the SEC enforcement division's asset management unit, indicated that agency staff is working closely with the new administration to implement the rule requiring that investment advisers comply with the AML compliance provisions of the BSA by January 1, 2026. For more information on that rule, see "Deadline Approaches for RIAs to Adopt AML Programs: CIP Requirements Remain in Limbo," *Expect Focus – Life, Annuity, and Retirement Solutions* (January 2025).

Among other considerations, FinCEN has delegated to the SEC examination authority over investment adviser compliance with the new rule. Thus, the SEC is building onto its existing framework for overseeing AML compliance programs, including by ensuring that programs properly detect and deter cross-border money laundering activity. These SEC requirements will complement the administration's efforts, through executive orders and presidential memoranda, to combat foreign actors believed to threaten American institutions, such as by sanctioning international drug trafficking organizations, as well as imposing new tariffs against China.

Accordingly, it is more important than ever for SEC-regulated institutions to adopt effective and legally compliant AML programs in advance of any routine examinations.

NAIC Life and Annuity Illustration Subgroup and Suitability Working Group Construct More Guidance

BY ANN BLACK

At the NAIC Spring National Meeting, the Illustration Subgroup and the Suitability Working Group reported that they are building out the following additions:

- The **Illustration Subgroup** laid out its plans for proposed additions to Section 7 of Actuarial Guideline 49-A (AG 49-A).
- The **Suitability Working Group** is proposing to construct a new suitability/best interest training course for regulators and a centralized database of state interpretations of the Suitability in Annuity Transactions Model Regulation (#275). Still pending is the working group's Safe Harbor Guidance Document, which remains under review by a small drafting group.

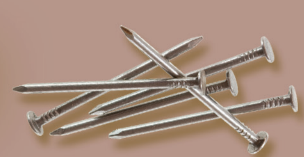
On April 2, the Illustration Subgroup exposed its proposed additions to Section 7. These additions followed illustration building code inspections by 13 life insurers offering whole life, universal life, and indexed universal life (IUL) products. These inspectors were reportedly "pleasantly surprised" to find that the illustrations checked all the boxes of the NAIC Life Insurance Illustrations Model Regulation (#582) and the AG 49-A checklist.

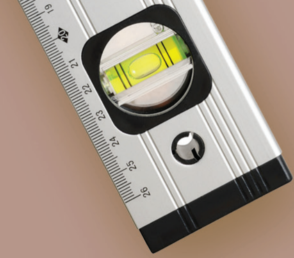
However, regulators found one unexpected item on their inspection punch list: the use of back-casted historical data for certain newly created indices. They concluded that 10-, 15-, or 20-year back-casted data in IUL illustrations — when the indices themselves had not existed for that long — should not be included. So, the regulators believed that the IUL illustration building code still needed "a little more guidance" to focus such illustrations on actual historical data.

As proposed, the code additions to Section 7:

- Limit the table showing the minimum and maximum geometric average annual credited rates to the benchmark index account only, preventing any side-by-side comparisons with other indices. (Section 7.A.ii).
- Limit the actual historical index changes and the corresponding hypothetical annual rate of index credits to the actual period that the index has been in existence, preventing the use of back-casted performance. The proposed changes make clear that the period must not include the period the underlying components of an index have been in existence if the index itself was not in existence. (Section 7.A.iii).
- Prohibit the basic illustration or any supplemental illustration from including material that is not expressly allowed by revised Section 7.A.ii and iii.
- Prohibit comparisons, or side-by-side presentations, of historical returns and maximum illustrated rates.

The proposed amendment has been exposed for public comment, with the period ending on June 30, 2025.





FINRA Adds On to Its Annual Oversight Report
Building in RILA Sales Guidance for First Time

BY ANN FURMAN

In a section titled “Annuities Securities Products,” FINRA’s 2025 Annual Regulatory Oversight Report, issued on January 28, 2025, addresses regulatory obligations related to the sales of variable annuities (VAs) and registered index-linked annuities (RILAs).

FINRA’s report includes RILAs as a topic for the first time, presumably due to the significant growth of the product in recent years. RILA sales in 2024 reached $65.2 billion, a 37% increase from 2023 sales of $47.4 billion. The report describes RILAs as “complex financial products” and summarizes their key features. For a discussion of other key areas of the report, see “FINRA Issues 2025 Annual Regulatory Oversight Report.”

The report identifies SEC Regulation Best Interest (Reg BI) obligations as a key part of the applicable regulatory framework when a broker-dealer or registered representative recommends a RILA or VA to a retail customer. Reg BI’s overarching principle, of course, is that a broker-dealer and its registered representatives must not put their financial or other interests ahead of the customer’s interests.

Additionally, the report emphasizes obligations under FINRA Rule 2330 (“Members’ Responsibilities Regarding Deferred Variable Annuities"). Although Rule 2330 does not apply to RILAs, FINRA notes that it would be “an effective practice” for firms to incorporate elements of Rule 2330 into their RILA compliance procedures.

Rule 2330 requires firms to establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the rule’s various requirements relating to VA sales. This includes surveillance procedures to determine whether any registered representative is effecting VA exchanges at a rate high enough to suggest “switching” conduct inconsistent with applicable FINRA rules or federal securities laws.

Nevertheless, regardless of how much it might like to do so, FINRA cannot allege that conduct in a RILA context violates Rule 2330, as the rule does not currently apply to RILAs. Moreover, FINRA might be unable to identify another rule or statutory provision that would prohibit such conduct and serve as the basis for an enforcement action. As it stands, Rule 2330 is merely a suggested blueprint, rather than a mandatory building code, for constructing firms’ RILA compliance policies and procedures.

In any event, FINRA’s report contains a large number of other findings from its recent reviews, market examinations, surveillance, investigations, and enforcement activities — findings that firms should carefully consider, particularly in relation to their involvement with RILAs.

Finally, almost before the concrete on FINRA’s report had completely hardened, FINRA announced (on March 12, 2025) that it has begun a rule modernization review, calling for public comments by May 12, 2025. FINRA’s report may well provide insight into some rule revisions that FINRA ultimately will put on the table. In particular, it would not be surprising if FINRA proposed amendments to Rule 2330 or introduced a similar new rule specifically covering RILA sales.

States Build the Next Mile of Artificial Intelligence Regulation

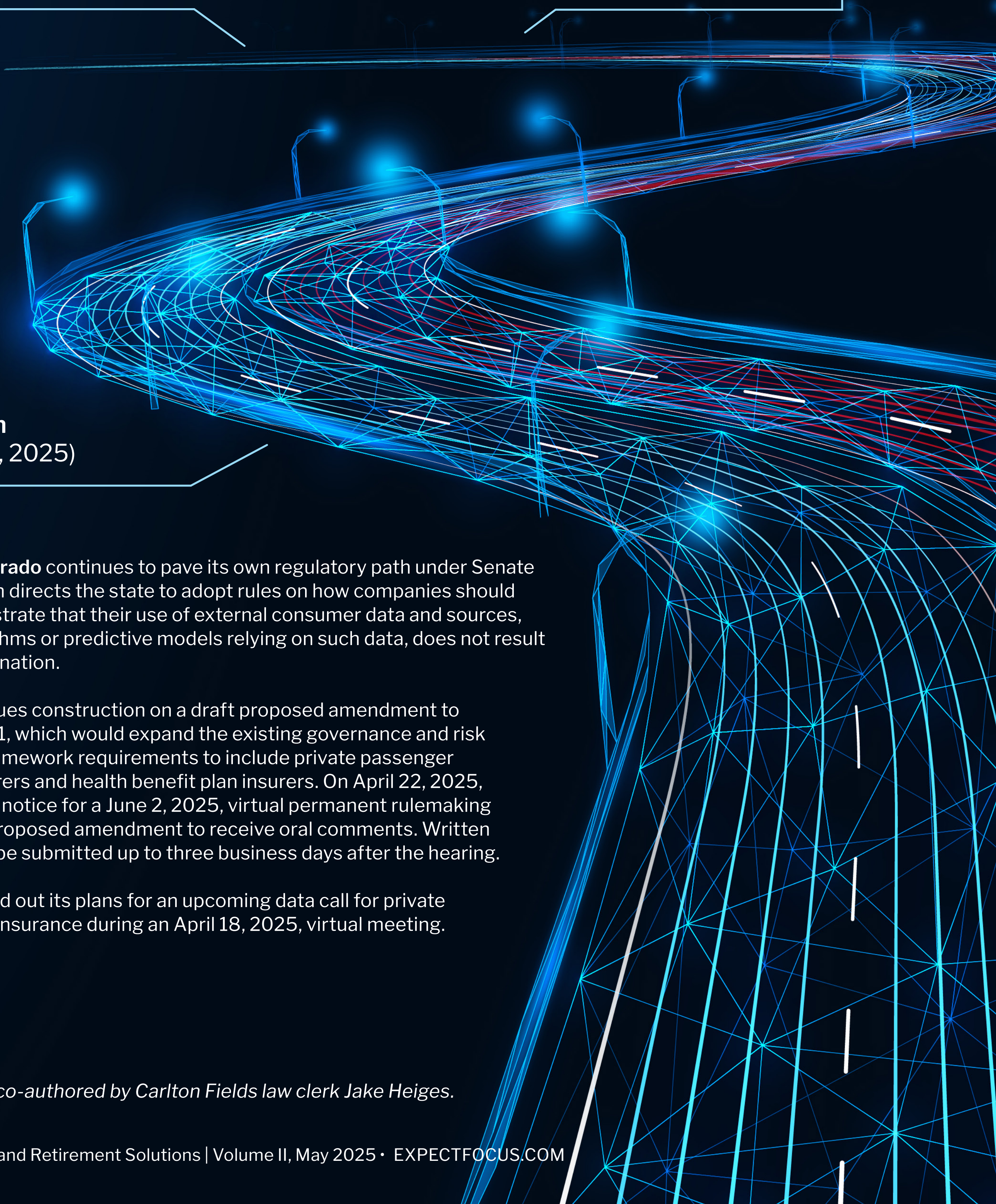
BY ANN BLACK

Since the start of 2025, the following states have added to the roadwork on artificial intelligence regulation in insurance by implementing the NAIC's model bulletin on the use of AI systems by insurers:

Delaware
(February 5, 2025)

New Jersey
(February 11, 2025)

Wisconsin
(March 18, 2025)

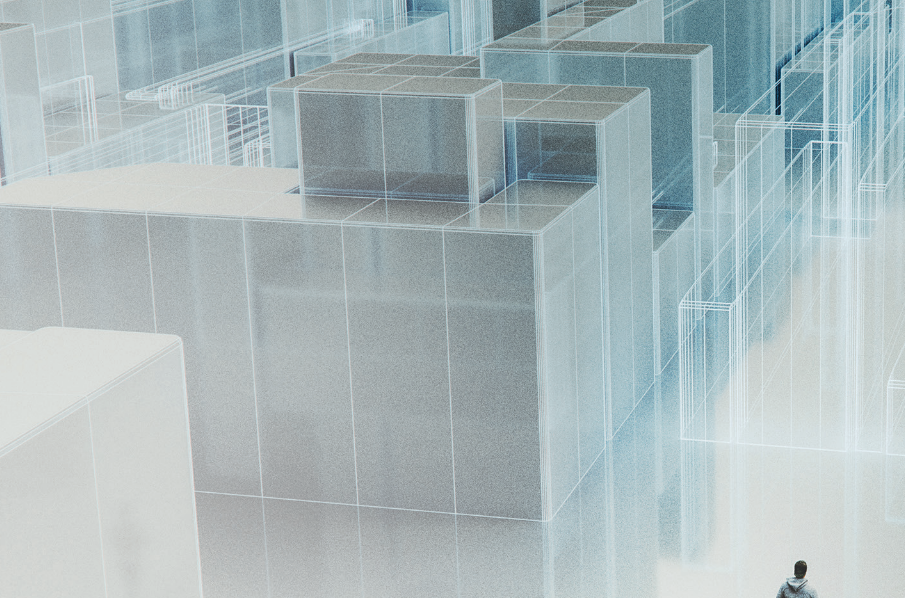


Meanwhile, **Colorado** continues to pave its own regulatory path under Senate Bill 21-169, which directs the state to adopt rules on how companies should test and demonstrate that their use of external consumer data and sources, as well as algorithms or predictive models relying on such data, does not result in unfair discrimination.

Colorado continues construction on a draft proposed amendment to Regulation 10-1-1, which would expand the existing governance and risk management framework requirements to include private passenger automobile insurers and health benefit plan insurers. On April 22, 2025, Colorado issued notice for a June 2, 2025, virtual permanent rulemaking hearing on the proposed amendment to receive oral comments. Written comments may be submitted up to three business days after the hearing.

Colorado also laid out its plans for an upcoming data call for private passenger auto insurance during an April 18, 2025, virtual meeting.

This article was co-authored by Carlton Fields law clerk Jake Heiges.



FINRA's Blueprint for the Metaverse

BY CLIFFORD PEREZ

In October 2024, FINRA released its blueprint for the securities industry's use of the metaverse — the metaverse report. The metaverse, often framed as "the next evolution of today's internet," is a loosely defined term used to refer to several different immersive digital technologies such as virtual and augmented reality. Its global revenue opportunity has been forecast in the hundreds of billions, with some expecting it to contribute more than $3 trillion to global gross domestic product by 2031.

With younger generations driving the adoption of the metaverse, financial institutions are exploring ways to use it to reach a new generation of investors. Firms can engage and educate these young investors by meeting them in virtual spaces. For example, firms could use digital currencies, which many metaverse users already use, to provide the building blocks for financial concepts such as earning and investing. Firms can then use these interactions to build brand awareness with these potential future customers.

FINRA's blueprint highlighted some other ways firms are considering using the metaverse, for example by creating virtual spaces for customers to access financial services or by enhancing data visualization tools to help investors better understand complex financial topics. The blueprint also identifies challenges firms may face when using the metaverse, such as high adoption costs and concerns with data privacy.

With the metaverse's impact on the securities industry being relatively unknown, FINRA's blueprint contained few instructions. But FINRA's main instruction seems to echo what it, and other financial regulators, are saying about artificial intelligence: FINRA's rules, and the securities laws, are technology-neutral and continue to form part of the building code for securities-related metaverse operations.

New Shareholders Join Carlton Fields' Securities, Financial Services, Life Insurance, and Business Transactions Practices

Carlton Fields is pleased to announce the addition of Dean Conway, Carol McClarnon, Stephen Jorden, and Brian Soares as shareholders, further strengthening our Securities Litigation and Enforcement, Financial Services Regulatory, Life, Annuity, and Retirement Litigation, and Business Transactions practices.

Dean Conway, formerly assistant chief litigation counsel at the SEC, brings more than two decades of experience in securities enforcement, litigation, and regulatory compliance. He brings a wealth of experience and practical insights to our securities practice.

A leading authority in ERISA compliance and tax qualification, **Carol McClarnon** reinforces our capabilities in retirement plan regulation and fiduciary rulemaking. Her comprehensive understanding of both ERISA and tax qualification allows her to deliver effective strategies that help clients navigate complex regulatory requirements and optimize their retirement plan solutions and businesses.

Stephen Jorden returns to our Life, Annuity, and Retirement Litigation practice, bringing more than 30 years of experience in defending life insurers and financial institutions in complex litigation and regulatory matters, including class actions and issues related to sales practices and nonguaranteed benefits.

Drawing on his experience across multiple roles within the U.S. Securities and Exchange Commission's Division of Corporation Finance, **Brian Soares** serves as primary outside corporate and securities counsel to numerous public companies. Brian counsels public companies and their boards with respect to federal securities laws, corporate governance, and capital raisings.

Litigation Under Construction: Recent Life Insurance and Long-Term Care Developments

BY STEPHANIE FICHERA AND ANNICK RUNYON

Long-Term Care Insurance

In *Potovsky v. Lincoln Benefit Life Co.*, the Ninth Circuit Court of Appeals affirmed the dismissal of the insureds' complaint for failure to sufficiently allege damages regarding the denial of a long-term care claim.

After the insured wife was diagnosed with dementia, her husband filed a claim because he intended to hire a caregiver. The policy covered "actual expenses incurred" for qualified long-term care should one of the insureds become "chronically ill." The policy defined "chronically ill" as requiring "substantial supervision to protect [insureds] from threats to health and safety due to severe cognitive impairment." It did not cover long-term care provided by spouses or children.

The insurer denied the claim, reasoning that the wife's condition did not satisfy the policy's "chronically ill" definition. The husband did not want to pay out of pocket for a caregiver and did not hire one. The insureds then filed suit, arguing they were entitled to the cost of health care services that the wife would have received or the cost of the care that the husband provided instead. The Ninth Circuit concluded that the insureds' request for alleged damages in the form of health care services the wife *would have* received was too speculative, and the cost of the care provided by the husband was not covered by the policy. The court explained: "Their complaint seeks only damages which they never incurred." Accordingly, the court affirmed the district court's dismissal of the insureds' breach of contract claim. Because their other claims for bad faith and elder abuse were predicated on the breach of contract claim, those claims were also properly dismissed.

Agent Misrepresentations

The Eleventh Circuit Court of Appeals affirmed summary judgment for an insurer in *Gonzalez v. The Independent Order of Foresters*, where the insured alleged material misrepresentations were made by agents.

The insured claimed he relied on material misrepresentations by two independent agents affiliated with the insurer when he purchased two life insurance policies. According to the insured, the agents represented that an accelerated death benefits rider would pay between 90% and 100% of the policies' face value if the insured satisfied the terms for chronic illness. After submitting chronic illness claims, the insurer offered substantially less; the insured rejected the offers, claiming they were inconsistent with the agents' representations.

The district court concluded, *inter alia*, that the agents had no authority to bind the insurer and that the insured's reliance on the agents' representations was not justified, and it granted summary judgment to the insurer. The Eleventh Circuit affirmed. The insured's breach of contract claim failed because he was put on notice by language in the policies' applications that agents had no authority to bind the insurer to terms not in the contracts. In addition, since the insured reviewed the policies and disclosures and further inquired about contradictory terms with the agents, the court found that the insured investigated the alleged misrepresentations and that a reasonable jury could not return a verdict against the insurer for fraudulent inducement.

Illinois Genetic Information Privacy Act

The U.S. District Court for the Southern District of Illinois dismissed a putative class action against a life insurer under the Illinois Genetic Information Privacy Act (GIPA) in *Thompson v. Prudential Insurance Co. of America*.

GIPA, among other things, prohibits insurers from seeking "information derived from genetic testing for use in connection with a policy of accident and health insurance." The plaintiff claimed the life insurer violated her right to privacy regarding genetic information when it asked questions about her family medical history, including family members' inheritable diseases and disorders, during the life insurance application and medical examination process. The plaintiff sought to represent a class of individuals who applied for insurance coverage in Illinois and who provided genetic information to a health care provider used by the insurer for underwriting purposes.

The court dismissed the case with prejudice, holding that GIPA "does not apply to the underwriting practices concerning life insurance policies" and noting there was no indication that the Illinois legislature intended to apply GIPA to life insurance underwriting.

Contingent Deferred Annuities: Time for Renewal?

BY HARRY EISENSTEIN

Contingent deferred annuities (CDAs) represent an interesting approach to securing lifetime income but have struggled for recognition in the marketplace since their introduction more than a decade ago. Recent developments, however, offer the product a chance for new life and offer advisers an opportunity to build out their toolkits for assisting investors who want a more secure investment program.

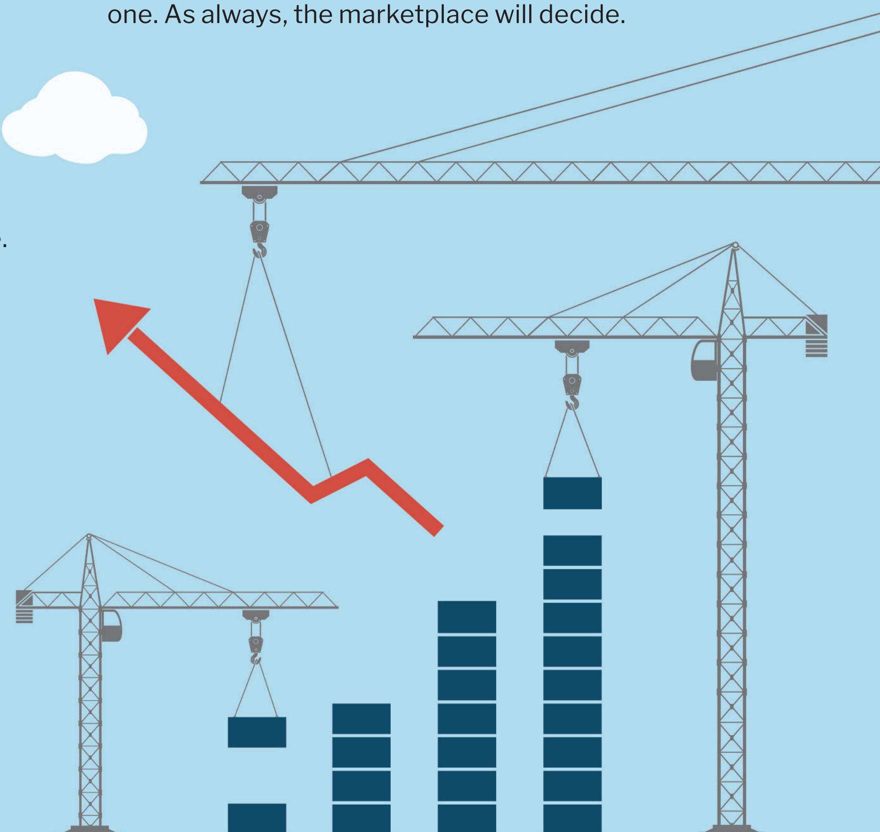
CDAs act very much like a guaranteed lifetime withdrawal benefit (GLWB) under a variable annuity contract, in that an investor can receive lifetime income payments, even if the investor's assets covered by the CDA have been depleted; and the amount of these continuing payments is guaranteed so long as the investor's withdrawals have not exceeded specified amounts. Unlike GLWBs, however, the assets covered by a CDA don't have to be held by an insurer as part of an insurance contract. Instead, CDAs, though issued by an insurance company, can be used as a "wrapper" around, for example, mutual fund shares or other investments owned by the investor and managed by the investor's adviser.

Moreover, unlike GLWBs, which carry fees that generally must be paid until asset depletion or contract surrender, CDAs can be purchased that cover a more limited period of time. For example, a CDA might be purchased to cover the period immediately preceding and following retirement that is often referred to as the "fragile decade," because of its importance to the protection of retirement savings. Specifically, adverse returns on retirement assets during this period can be especially devastating for retirees, and CDAs can provide more efficient protection against this or other "sequence of returns" risks.

That said, several impediments may at least partially explain the difficulty CDAs have had in the marketplace. One is that, as of now, the Interstate Insurance Product Regulation Commission, also known as the Insurance Compact, has not adopted a uniform standard for this product. So prospective issuers have had to file their CDA contracts for separate approval by each member state of the Compact, instead of making just a single filing that would satisfy all of those member states. Earlier this year, however, the American Council of Life Insurers (ACLI) requested the Compact to adopt such a common standard. The ACLI noted that "the market would benefit from the clarity and consistency the [Compact] would bring to the CDA market."

A perhaps more serious impediment has been that CDAs have been offered by only a relatively small number of brokerage firms, limiting their availability. Certain technology vendors, however, are now developing online platforms that would allow advisers to assess and offer annuity products from multiple carriers. These platforms could be used by any carrier willing to standardize a CDA offering in a way that would allow the platform to facilitate comparisons with the offerings of other carriers.

To be sure, these developments do not assure future growth in the use of CDAs. Advisers may be uncomfortable with portfolio allocation restrictions that CDAs (like GLWBs) necessarily entail. While the potential development of online platforms to facilitate the offering of these products is encouraging, it remains to be seen whether enough underlying funds will be willing to engage with carriers on the administrative infrastructure needed to develop viable products. And, while CDAs offer one alternative to conventional annuities for securing retirement assets, it is by no means the only one. As always, the marketplace will decide.



Stay Ahead With EO Watch:

Timely Insights on Executive Orders Impacting Your Industry

Presidential actions in the new administration are playing a crucial role in shaping U.S. policy. It is important for businesses to stay informed about the potential impact of recent executive orders, memoranda, and proclamations.

To support our clients in navigating this evolving landscape, Carlton Fields is proud to present EO Watch — our dedicated online hub for analyzing select executive orders. EO Watch provides clear, actionable insights to help businesses understand and address the implications of these executive actions on operations, compliance, and strategy.

Here are some of the latest EO Watch articles of interest to the financial services, life insurance, and securities industries:

- **New SEC Management Boldly Charts New Course**
  The SEC is prioritizing longer comment periods, more stakeholder engagement, and revisiting recent rules, especially around crypto. Stakeholders should engage proactively due to potential staffing changes.
- **SEC's Newly Established Crypto Task Force: An Ambitious Agenda to Fill in the Gaps**
  The SEC, under EO 14178, has formed a Crypto Task Force led by Commissioner Hester Peirce to develop clear regulations for digital assets, focusing on security status, disclosure, and custody.
- **SEC Deep-Sixes Its Expanded "Dealer" Definition**
  The SEC reversed the expansion of its dealer definition to cover certain persons formerly regarded merely as securities "traders."
- **Executive Order Making "So-Called Independent Agencies" Directly Responsive to the President Is Another Nail in the Coffin of the "Headless Fourth Branch of Government"**
  Executive Order 14215 challenges agency independence by requiring presidential approval for rulemaking and legal positions, sparking a constitutional showdown over executive power.
- **DOJ Withdraws Defense of SEC ALJs' Constitutionality as Trump Issues Executive Order on Agency Accountability**
  EO 14215 challenges SEC in-house courts, questioning ALJ constitutionality. The DOJ's shift could end ALJ tenure protections, moving SEC enforcement to federal courts.
- **President Issues Regulatory Freeze: Will the DOL Fiduciary Rule Saga Continue?**
  President Trump's regulatory freeze and new appointments signal a likely end to the fiduciary rule, with potential for deregulation in the employee benefits sector under a new administration.
- **Presidential Freeze May Put SEC Final Climate Rule on Ice**
  Under leadership of then-acting Chair Mark Uyeda, the SEC — over the dissent of Commissioner Caroline Crenshaw — decided no longer to defend against a pending court challenge to its climate disclosure rule, leaving that rule hanging by a thread.
- **President Trump Issues Executive Order Pausing Enforcement of FCPA: A Sea Change Moment for DOJ and SEC**
  EO 14209 pauses FCPA enforcement for up to a year, shifting DOJ focus to cartel-related bribery. Companies should stay compliant and prepare for future risks as the regulatory environment evolves.
- **Immediate Practical Consequences of SEC-Related EOs**
  Executive actions under President Trump are reshaping SEC operations, creating new opportunities for companies to influence regulatory shifts, while posing risks of staffing disruptions and delays.
- **10-for-1 Rule: EO Mandates Agencies Repeal 10 Regulations for Every New One, Signaling Supercharged Deregulatory Philosophy**
  This executive order demands a 10-for-1 repeal-to-rule ratio, marking a bold push to slash regulations and reshape federal policymaking.

Access our full collection of EO insights at https://www.carltonfields.com/services/executive-order-watch.

News and Notes

Thomson Reuters has named 11 Carlton Fields attorneys to its 2025 "Stand-Out Lawyers" list, including **Ann Black**, **Richard Choi**, and **Ann Furman**. Lawyers on this list were recognized by clients for their ability to offer proactive, business-savvy advice; deliver exceptional client service; and integrate well within the client's legal team.

JD Supra has named **Ann Black** as a **top author for insurance** in its 2025 Readers' Choice Awards, placing her among a select group of 344 thought leaders chosen from more than 70,000 authors whose work was read by C-suite executives, in-house counsel, media, and other professionals across the *JD Supra* platform over the last year.

We are pleased to announce the release of the *2025 Carlton Fields Class Action Survey*, which summarizes recent developments in class action filings and details best practices in class action management. Highlights of this year's survey include details on which alternative fee models work best for class actions, trend data for class action waivers, and in-house counsel's concerns about claims arising from the use of generative artificial intelligence.

Carlton Fields was recognized as a **class action powerhouse** in BTI Consulting Group's *Litigation Outlook 2025* report. This is the only law firm litigation ranking based solely on unprompted, objective feedback from corporate counsel.

Carlton Fields has been named the **Litigation Department of the Year** in the insurance category by the *Daily Business Review* for the 2025 Florida Legal Awards. Our insurance group was recognized for its work in securing favorable outcomes in high-stakes matters across every sector of the insurance industry, including life, financial lines, property and casualty, title, and reinsurance.

Carlton Fields was recognized in BTI Consulting Group's **Most Recommended Law Firms 2025** report. The report recognizes firms that earn recommendations from outside counsel for superior client service. The firm was named among the most recommended in the insurance industry.

Carlton Fields sponsored the **SIFMA C&L Annual Seminar** on March 23–26 in Austin, Texas.

The firm sponsored the **IRI Annual Conference** on March 26–28 in Tampa, Florida. **Gina Alsdorf** spoke on the topic of "Maximizing Lifetime Income Opportunities in the New Administration," and **Richard Choi**, **Justin Chretien**, **Tom Conner**, **Dean Conway**, and **Harry Eisenstein** presented on the program, "The New SEC Regulatory and Enforcement Landscape."

Carlton Fields sponsored the **DRI 2025 Life, Health, Disability, and ERISA Seminar** on April 9–11 in Denver, Colorado.

The firm was pleased to support the **2025 Global Insurance Symposium** on April 15–16 in Des Moines, Iowa, as a sponsor.

The firm will sponsor the **ACLI Compliance & Legal Conference** on July 14–16 in New Orleans, Louisiana. **Trish Carreiro** will speak on the topic of "Navigating Third-Party Management: A Legal Perspective."

Carlton Fields welcomes the following attorneys to the firm: shareholders **Cassady Brewer** (business transactions, Atlanta), **Dean Conway** (securities litigation and enforcement, Washington, D.C.), **Stephen Jorden** (life, annuity, and retirement litigation, Hartford), **Carol McClarnon** (financial services regulatory, Washington, D.C.), **Brian Soares** (business transactions, Tampa), and **Catherine Liyun Zhang** (health care, Tampa); of counsel **Frederick Ou** (health care, Tampa); and associates **Arielle Canepa** (business litigation, Los Angeles), **Stefano Cavallaro** (business litigation, Tampa), **Ian Finley** (business litigation, West Palm Beach), **Clark Girges** (construction, Miami), **Dylan Magruder** (property and casualty insurance, Atlanta), **Melissa Murrin** (construction, Tampa), **Tyler Takvor** (property and casualty insurance, New York), and **Graciana Zevallos** (property and casualty insurance, Miami).

Carlton Fields Expands CF Compliance Consulting Group

Carlton Fields is proud to announce the expansion of its CF Compliance Consulting Group (CFCCG), welcoming **Larry Nakamura** as chief compliance leader. With more than 30 years of experience navigating regulatory frameworks such as FINRA, SEC, OCC, CFTC, and NFA, Larry will play a pivotal role in helping clients proactively identify and address compliance gaps. Under the continued leadership of **Erin VanSickle**, CFCCG is primed to meet the evolving needs of financial services and insurance sectors. We're ready to strengthen your compliance operations, ensure regulatory readiness, and mitigate risks before they emerge.

Carlton Fields serves business clients in key industries across the country and around the globe. Through our core practices, we help our clients grow their businesses and protect their vital interests. The firm serves clients in eight key industries:

- Life, Annuity, and Retirement Solutions
- Banking, Commercial, and Consumer Finance
- Construction
- Health Care
- Property and Casualty Insurance
- Real Estate
- Securities and Investment Companies
- Technology and Telecommunications

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For more information, visit our website at www.carltonfields.com.

Carlton Fields, P.A. practices law in California through Carlton Fields, LLP.