

SEC Staff Clarifies Status of Insurance Networking Arrangements

BUSINESS TRANSACTIONS | SECURITIES AND DERIVATIVE LITIGATION | APRIL 29, 2013



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April 29, 2013 – On April 23, 2013, the Staff of the Securities and Exchange Commission ("SEC") issued a No-Action Letter to three trade groups addressing the broker-dealer status of insurance agencies under insurance networking arrangements ("April 23 Letter"). In particular, the Staff determined that it would not recommend enforcement action to the Commission under Section 15(a) of the Securities Exchange Act of 1934 ("Exchange Act") against insurance agencies if, subject to certain conditions, insurance agencies:

- enter into arrangements with registered broker-dealers, commonly referred to as "insurance networking arrangements," for the offer and sale of variable annuity contracts, variable life insurance policies, and other life insurance policies or annuity contracts that are also securities or otherwise registered as securities ("variable products"); and
- make certain transaction-based payments without the insurance agencies registering as broker-dealers under Section 15(b) of the Exchange Act.

Insurance Networking Arrangements

In the typical insurance networking arrangement, a licensed insurance agency contracts with a registered broker-dealer to sell variable products. Licensed insurance agents affiliated with the insurance agency who are also registered representatives of the broker-dealer ("dual representatives") sell the products. The issuer pays compensation to the insurance agency or the broker-dealer, which then pays commissions to the dual representatives.

Conditions and Representations

The April 23 Letter resolves uncertainty about the regulatory status and viability of insurance networking arrangements following the SEC Staff's May 8, 2006 revocation of two No-Action Letters issued to M Financial on October 2, 1987 and June 14, 1988. It confirms that commissions resulting from variable product transactions may be paid by the insurance company to a registered broker-dealer or an insurance agency and, in turn, an insurance agency may make transaction-based payments to dual representatives. The April 23 Letter imposes conditions on registered broker-dealers, dual representatives, insurance agencies, and unregistered employees involved in insurance networking arrangements, as follows:

Registered Broker-Dealers –

- supervise and monitor the activities of dual representatives;
- provide conduct manuals and/or written policies and procedures to insurance agencies and to unregistered employees of insurance agencies specifying limitations on activities with respect to variable products;
- train, supervise, control, and assume responsibility for all of the securities activities of the dual representatives;
- approve and assume responsibility for all variable product advertisements and promotional materials;
- maintain all required books and records related to variable product transactions;
- handle customer funds and securities in accordance with applicable net capital and consumer protection rules;
- test and verify policies and procedures relating to insurance networking arrangements in accordance with NASD Conduct Rule 3012, and the chief executive officers make FINRA Rule 3130 certifications; and
- make readily accessible to the SEC staff, FINRA, or other relevant federal and state authorities, books and records relating to variable product transactions.

Dual Representatives --

- are registered representatives of a broker-dealer, registered and qualified with FINRA, and licensed by appropriate state regulators as insurance agents in those states in which they do business;
- if barred or suspended from association with an insurance agency or broker-dealer, will be terminated or suspended from all variable product sales activities;
- adhere to terms of broker-dealer conduct manuals and/or written policies and procedures; and
- receive or handle customer funds routed through the registered broker-dealer and the insurance agencies.

Insurance Agencies –

- are associated persons of the networking broker-dealers;
- terminate or suspend any suspended or barred dual representatives from all variable product sales activities;
- ensure that only dual representatives receive or handle customer funds routed through the registered broker-dealer and the insurance agency;
- monitor the activities of their unregistered employees;
- ensure that issuing insurance company is the payee of any customer funds intended for the purchase of a variable product (and that the insurance agency or any associated person is not the payee).

Unregistered Employees –

- only have clerical or ministerial involvement in variable product transactions and do not engage in any securities activities that are not clerical or ministerial;
- do not receive compensation based on variable product transactions or the provision of advice with respect to variable products;
- do not handle or maintain customer funds or securities; and
- do not recommend any variable products or give investment advice respecting variable products.

Payment of Commissions by Insurance Agencies -- Conditions

The Letter also provides assurance that insurance agencies may make transaction-based payments to registered representatives for the sale of variable products. Thus, subject to the several conditions, insurance agencies that are parties to insurance networking arrangements with registered broker-dealers may make transaction-based payments to dual representatives without the insurance agencies registering as broker-dealers. Any transaction-based payments related to variable product transactions are subject to the following conditions:

- payments will be made on a purely ministerial basis pursuant to instructions from the broker-dealer, and the insurance agency will not exercise any discretion over the amount of payments;
- payments will be made only to persons registered with and under the supervision and control of the broker-dealer;
- payments will be made "on behalf of" the broker-dealer; and
- the broker-dealer will assume full responsibility for the securities activities of persons in connection with the sale of variable products.

Conclusion

Following the 2006 revocation of the M Financial letters, the April 23 Letter is welcome news for insurance agencies and issuers of variable products. Variable product distributors and insurance agencies now have an updated framework for analysis when structuring insurance networking arrangements.