LIFE, ANNUITY, AND RETIREMENT SOLUTIONS INDUSTRY

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Funds Not Caged by SEC Names Rule Amendments: Roaming Room Remains

BY THOMAS LAUERMAN

The SEC recently adopted amendments to its investment company “names” rule that apply to most SEC-registered funds, including underlying funds in which registered insurance company separate accounts invest.

While the amendments, and the SEC’s interpretive guidance in its adopting release, are quite extensive, some of the key effects are to:

- Revise the analysis of what words, if included in a fund’s name, will require the fund generally to follow a policy of investing at least 80% of the fund’s net assets in industries, investment types, or geographical areas suggested by the fund’s name. For example, unlike the rule previously in force, the amendments add names referring to “value” or “growth” or mentioning “ESG” factors to the many other names that generally require an 80% policy.
- Add new requirements that, if a fund is required to adopt an 80% policy, (a) the fund’s prospectus (as well as periodic reports the fund files with the SEC on Form N-PORT) must include disclosures defining the terms used in its name, including the specific criteria, if any, that the fund uses to select investments described by those terms, and (b) those definitions must be reasonable and consistent with the terms’ “plain English” meanings or established industry use. Most of this new prospectus information must be tagged using Inline XBRL.
- Require such a fund to (a) monitor compliance with its 80% policy at least quarterly (as well as, under normal circumstances, at the time of any investment); (b) restore compliance within 90 days after any noncompliance is identified (including noncompliance resulting from changes in the value or characteristics of the fund’s existing portfolio investments or any decision by a fund to deviate from the 80% policy due to non-normal circumstances); and (c) on a quarterly basis report to the SEC on Form N-PORT the then percentage of the fund’s net assets that it classifies as qualifying for the 80% basket and, as to each portfolio investment, whether that investment is so classified.
- Call for a “meaningful nexus” to exist between the fund’s name and each portfolio investment that the fund assigns to its 80% basket, as the SEC adopting release prescribes and explains in some detail.
- Add new requirements for how derivative positions held by a fund must be treated for purposes of the 80% test.
- Prescribe extensive additional record-keeping requirements for funds that must follow an 80% policy, although other funds are relieved of a previous requirement to maintain certain records documenting their decision that they do not require an 80% policy.

These and other consequences of the amendments raise a number of potentially important questions and decisions for funds, at least some of which may require or merit considerable analysis. For example:

- For a fund that does not currently follow an 80% policy, (a) do the amendments require the fund to adopt such a policy, and (b) if so, should the fund modify its investment program or name to escape any such requirement?
- For a fund that currently follows an 80% policy, (a) do the amendments permit the fund to terminate that policy without making any change in its investment program or name, and (b) should the fund terminate its 80% policy, even if it must change its investment program or name to do so?
- For a fund that decides to follow an 80% policy in compliance with the amended rule, can and should the fund make any changes in its investment program or the administration thereof to reduce the burdens or costs of such compliance? In most cases, some cost-savings can be achieved.

Fortunately, the amendments leave the door open for funds to take actions that in many cases will enable them to escape or mitigate the costs and burdens of being subject to an 80% policy requirement. This is especially important, because the changes outlined above will substantially increase those costs and burdens.

IRS Gives Equal Billing to an Adviser Life Insurance Contract

Treats Adviser's Fee the Same as Under Adviser Annuities

BY STEPHEN KRAUS

The IRS recently published a private letter ruling (No. 202341002) dealing with the tax treatment of advisory fees paid to an adviser from an "adviser life insurance contract." Specifically, the letter ruling addressed whether the payment of such fees directly from a life insurance contract will be treated as a distribution from the life insurance contract.

The letter ruling is substantially identical to 19 others issued by the IRS in connection with "adviser annuities." Consistent with those, the recent letter ruling held that the fees were an integral part of the operation of the life insurance contract and, as such, were not treated as "amounts received" under section 72 of the Internal Revenue Code, i.e., not a distribution from the life insurance contract.

The letter ruling contained the same representations as 17 of the "adviser annuity" rulings:

- The life insurance contract owner will authorize payment of the investment advisory fees from the life insurance contract's cash value.
- The fees will compensate the adviser only for investment advice with respect to the life insurance contract and not for any other service.
- The life insurance contract will be solely liable for paying the entire fee, which will be paid directly to the adviser and not the life insurance contract owner.
- The adviser will not be paid a commission for the sale of the life insurance contract.
- The advisory fees received will not exceed an annual amount of 1.5% of the life insurance contract's cash value.

Despite this favorable development, letter rulings can be relied on only by the taxpayers who receive them. The rulings do, however, reflect the IRS' thinking on how advisory fees from either annuities or life insurance contracts, under the facts of the rulings, should be treated. Taxpayers must assess the risks before relying on the rulings, rather than obtaining their own letter ruling.

Juggling Act: SEC Fines Three Employers for Potentially Discouraging Whistleblowers

BY NATALIE NAPIERALA AND NADER AMER

The SEC has continued its enforcement against employers — including privately held companies — that have provisions in their agreements or policies that could potentially discourage whistleblowing or communications with regulators.

Rule 21F-17 under the Securities Exchange Act of 1934 provides that "[n]o person may take an action to impede an individual from communicating directly with the [SEC] about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement ... with respect to such communications." Three September 2023 cease-and-desist orders exemplify the prominence the SEC continues to place on this rule:

- A $225,000 civil penalty against a privately held company that had included a provision in separation agreements stating generally that its separating employees retained the right to file charges and complaints with governmental agencies and participate in investigations, but waived their right to recover an award from such agencies. Notably, the SEC imposed the penalty even though the company cooperated with the SEC, had revised the separation agreements to state that employees were not waiving such awards, had notified all employees who signed the agreements that they were not waiving such awards, and had never taken any steps to enforce the provision.
- A $375,000 civil monetary penalty against a real estate services and investment firm because it included an attestation in its separation and release agreements that separating employees had not filed complaints against the firm with any federal agency. The SEC stated that the attestation, which is a common provision in separation agreements, was a condition to severance compensation and therefore a prohibited impediment to whistleblowers. The SEC reached this conclusion despite the agreements stating that "nothing in the agreement shall be construed to prohibit [employees] from filing a charge with or participating in any investigation or proceeding conducted by" a regulator.
- A $10 million civil penalty against a financial institution that had included an employee attestation in its separation agreements similar to the one above, as well as a provision in its employment agreements that prohibited employees from disclosing confidential information to any person outside of the company, unless authorized or required by law. The agreements did not provide an exception for employees' communications with regulators. Additionally, the SEC alleged that at least one former employee was discouraged from communicating with SEC staff because of this provision.

As we have previously warned, the National Labor Relations Board also has increased its focus on confidentiality and non-disparagement provisions that could impede employee communications with regulators. *See* "NLRB Stacks Deck in Favor of Employees: Employers Must Play Cards Defensively or Go Bust," *Expect Focus – Life, Annuity, and Retirement Solutions* (September 2023). Especially because of these continuing developments, employers should review their employment, separation, and confidentiality agreements, as well as employee handbooks and compliance policies, to confirm that such documents do not include any provisions that regulators could view as impeding whistleblower communications.

NASAA Report on BD Compliance With Reg BI

Finds Progress, but Specifies Work To Be Done

BY GARY COHEN

A September report of the North American Securities Administrators Association (NASAA) on broker-dealer compliance with the SEC's Regulation Best Interest (Reg BI) finds:

- There's "helpful and steady implementation progress."
- But "firms are still relying heavily on suitability policies and strategies that pre-dated Reg BI."
- And "[e]fforts to address the standard of care concepts established by Reg BI remain perfunctory."

These findings result from NASAA's examination of FINRA firms in years two and three of Reg BI. The examination focused on four product types characterized as "complex, costly, risky products" (CCRs): leveraged and inverse exchange-traded funds, non-traded real estate investment trusts, private placements, and variable annuities.

Most of the findings, summarized below, relate to all four of the CCRs, but some findings relate to only variable annuities. The report characterizes variable annuities as being "complex and costly, routinely paying commissions of 6% or more." It singles out that variable annuities "require long-term holding to fully maximize benefits like favorable tax deferral and certain guarantees." There was no mention of registered indexed-linked annuities known as RILAs.

Care Obligation Findings

The report notes that the "care obligation" under Reg BI "requires firms to exercise due care in matching the right customer to the right product."

The first step is for a firm to have a clear understanding of each customer. Although the report finds that "[f]irms have been updating their investor profile forms," NASAA also observed firms' "[f]ailure to include customers' education level on investor profile forms as relevant to the customers' financial sophistication and ability to understand complex terms."

The second step is to develop policies and procedures governing the matching of product to investor. The report finds that, generally speaking, "[f]irms recommending CCR products are imposing product-specific restrictions based on [customers'] age, net income/worth, and risk profiles and are using exception reports to monitor compliance with those restrictions." However, the report observes that "some firms failed to investigate the activity that generated an exception report."

The third step is to develop processes to consider available alternatives to CCRs to help avoid conflicts of interest. The report seems to find the most shortcomings in this area, to the extent that some firms:

- Are "using helpful cost-comparison tools to better consider reasonably available alternatives, but are still ignoring common lower-cost and lower-risk products when recommending CCRs."
- Exhibit a "[f]ailure to educate or otherwise provide guidance to associated persons on the firm's process for consideration of reasonably available alternatives."
- Use "[c]heckbox-style attestations with a naked claim that other investment options were discussed with the client or that the associated person considered unidentified reasonably available alternatives."
- Have "[p]olicies that require consideration of lower-cost, lower-risk alternatives without documentation or explanation of which, if any, alternatives were actually considered in a recommendation."

Additional report findings (mentioning only variable annuities):

On the positive side, "[g]enerally, firms did

have restrictions in place, such as [annuity] product concentration as a percentage of [customer] net worth, and certain firms used variable annuity specific forms to document these considerations and provide specific disclosures." On the negative side, however, "multiple firms had no restrictions tied to key features of a variable annuity, like limiting sales to customers with a documented need for a death benefit and/or lifetime income payments," features that the SEC's release adopting Reg BI deemed important in making a best-interest determination.

Furthermore, "[w]hile firm supervisory procedures and compliance manuals typically included provisions to address variable annuity recommendations and related sales practice concerns, certain firms failed to include or implement procedures to identify perhaps the biggest sales practice risk of variable annuities: a customer incurring substantial surrender charges as variable annuities are repeatedly replaced."

NASAA notes that some firms offering variable annuities "simply did not specifically require agents to consider lower-cost, or lower-risk products."

Disclosure Obligation Findings

NASAA noted that Reg BI's "disclosure obligation" requires that "a broker-dealer, prior to or at the time of [a] recommendation, must provide to [a] retail customer, in writing, full and fair disclosure of all material facts related to the scope and terms of the relationship with the retail customer."

NASAA's overall compliance assessment is mixed in that "[f]irms have not enhanced point-of-sale disclosure, but they have devoted significant time, energy, and effort to compliance with Reg BI's Disclosure Obligation by crafting the Form CRS and detailed supplemental Reg BI disclosures, along with disclosure information available via link to the firm's website."

At the same time, the report notes a "[f]ailure to disclose the anticipated amount of the up-front sales commission or the material risks associated with a product at the time of the recommendation, outside of the Form CRS and product prospectus." The report also notes a "[f]ailure to document or require documentation ensuring the delivery of the primary disclosure document or Form CRS to customers."

The report finds deficiencies in disclosure language. These include the "[u]se of the term 'advisor' or 'adviser' by dually-registered firms, even for associated persons that are not dually registered as an investment adviser representative and broker-dealer agent" and the "[u]se of confusing boilerplate and complex financial jargon regarding fees and costs that reasonable retail customers would likely have difficulty deciphering."

Conflict of Interest Obligation Findings

Finally, the report notes that Reg BI's "conflict of interest obligation" requires a firm to (i) "establish written policies and procedures to identify and at a minimum disclose, pursuant to the Disclosure Obligation, or eliminate all conflicts of interest associated with [a] recommendation" and (ii) "establish policies and procedures … reasonably designed to mitigate or eliminate certain identified conflicts of interest."

The report finds a low level of compliance with this obligation, observing that "[f]irms are still relying on financial incentives to sell CCR products and there is little uniformity in implementing effective firm mitigation strategies." Indeed, according to NASAA, "[t]he only mitigation step in place for a vast majority of firms was limiting the types of customers to whom a product may be recommended."

More specific shortcomings include that certain firms had procedures that "did not contain information on how the firm identifies conflicts, nor did the firm have a list of conflicts, such as a conflict register or matrix," and other firms "had no procedures to mitigate conflicts of interest of an associated person potentially recommending a higher commission product and placing their own interest ahead of the customer's interest."

Looking Ahead

The report warns that, "as states begin adopting their own regulations that incorporate Reg BI principles, more will be issuing deficiency letters with specific citations to these regulations and, potentially, bringing regulatory enforcement actions." Moreover, securities and insurance administrators in some states have been adopting such regulations that impose duties that in various respects are significantly more rigorous than those in Reg BI. *See* "Mass. High Court Plays Wild Card, Upholds Broad Fiduciary Duty for Broker-Dealers," *Expect Focus – Life, Annuity, and Retirement Solutions* (September 2023). State regulators, therefore, appear poised to play an increasing role in policing firms' conduct in the sale of many types of securities.

Market Pushes Back on SEC Short Sale Reporting Rule

BY EDMUND ZAHAREWICZ

On October 13, the SEC adopted a new Securities Exchange Act rule that will require ‘‘institutional investment managers,’’ such as insurance companies, banks, brokers and dealers, investment advisers, and pension funds, that meet specified reporting thresholds to report, on a monthly basis, certain short position and activity data for equity securities. The SEC intends to aggregate the resulting data by security on an anonymized basis and publicly disseminate the aggregated data on a delayed basis. New Rule 13f-2 has a compliance date of January 2, 2025, giving managers roughly a year to update their compliance policies and procedures.

The term ‘‘institutional investment manager’’ is defined broadly to include “any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person.” As such, the term applies to managers irrespective of the amount of securities they manage. In contrast, only managers that exercise investment discretion over $100 million or more in section 13(f) securities must file Form 13F. Accordingly, many money managers that are unaccustomed to filing securities position reports are being dragged from the bleachers and suited up for the SEC’s reporting act.

Affected managers must file a report on Form SHO with the SEC within 14 calendar days after the end of each calendar month with respect to short positions in each equity security over which the manager has investment discretion where the manager has (a) with regard to positions in SEC-reporting company securities, an average gross short position for the month of at least $10 million or 2.5% of shares outstanding and (b) with regard to positions in non-reporting company securities, a gross short position of at least $500,000 on any settlement date during the month.

The new rule has attracted the ire of several private fund trade associations that have petitioned the Fifth Circuit to overturn the rulemaking, along with a “closely related” rulemaking that was adopted by the SEC on the same day as Rule 13f-2 relating to securities lending transactions. The petition alleges that both rules impose extensive new requirements for the reporting and public disclosure of information pertaining to short sales of securities, yet adopt fundamentally contradictory approaches to the new disclosure requirements in violation of the Administrative Procedure Act.

This is but the latest of several recent industry challenges to the current SEC’s aggressive rulemaking agenda.

In the Big Top Spotlight: NAIC Model Bulletin on the Use of Artificial Intelligence Systems by Insurers

BY ANN BLACK AND ERIN VANSICKLE

The Innovation, Cybersecurity, and Technology (H) Committee of the National Association of Insurance Commissioners has been in the big top spotlight the past year as it has been developing its model bulletin on the use of artificial intelligence systems by insurers. As swift as trapeze artists, the committee quickly drafted and exposed for comment three versions of the model bulletin before the NAIC's 2023 Fall National Meeting. Drafting of the model bulletin brought together various performers from 15 states who collaboratively sought to set forth the industry regulatory expectations for the responsible use of AI by insurance companies.

During the H Committee's portion of the meeting, there was only a minor sideshow as to comments on the third version of the model bulletin. The use of the term "bias" in the model bulletin was juggled about:

- North Dakota Commissioner Jon Godfread suggested the references to "bias" be replaced with the phrase "unfair discrimination."
- Iowa Commissioner Doug Ommen expressed concerns about the replacement of "bias," and bantered about questions as to whether the term "unfair discrimination" would be uniformly understood among regulators or the industry.
- Colorado Commissioner Michael Conway took a stab and proposed "statistical bias" as an alternative.
- Rhode Island Superintendent Elizabeth Dwyer pointed out the varying uses of the term "bias" throughout the model bulletin.

In the end, there was no change to the use of the term bias, and the only adopted proposed change was to clarify that audits on third parties would only be performed to the extent that there were contractual rights to do so. In the big ring, on December 4, the NAIC Executive Committee and Plenary adopted the model bulletin with no commotion.

The model bulletin, now a traveling act, is set to tour each state for possible adoption and use. It serves as a guiding document, with the intent of fostering uniformity among state insurance regulators regarding expectations for insurance carriers deploying AI. Indeed, H Committee Chair Kathleen Birrane reminded stakeholders that the model bulletin is an interpretive bulletin, not a regulation or model law, and individual states would need to consider it for adoption.

Now that the circus has left town, insurers would be wise to review their own use of AI and consider how such use is consistent with the regulatory expectations set forth in the model bulletin. In particular, insurers should use AI in a manner that mitigates the risk of "adverse consumer outcomes," which is defined as adversely impacting consumers in a manner that violates insurance regulatory standards. To do so, the model bulletin recognizes that robust governance, risk management controls, and internal audit functions play a core role in mitigating the risk of adverse consumer outcomes. The model bulletin sets forth:

- General guidelines for an insurer's written program for the responsible use of AI.
- Considerations for an insurer as it develops its governance framework.
- Items that should be addressed in an insurer's risk management and internal controls for each stage of the AI life cycle.
- The considerations for the acquisition, use, or reliance on third parties concerning the insurer's use of AI.
- The inquiries and document requests that an insurer should expect to receive from regulators.

Insurance companies should consider doing a dress rehearsal to align their practices with regulators' evolving expectations ... before the circus comes to town again.

New DOL Fiduciary Rule Proposal: Still the Same Old Act…

BY JUSTIN CHRETIEN

On November 3, 2023, the Department of Labor proposed yet another fiduciary rule, the latest in more than a decade of DOL efforts to ensure that every financial professional who sells an investment product to a retirement investor is held to a fiduciary standard of care. This proposal, should it become law, will significantly impact insurance agents, independent marketing organizations, and insurance providers.

After ERISA was enacted in 1974, the DOL enacted implementing regulations in 1975 that defined "an investment advice fiduciary" for purposes of ERISA. Under a conjunctive five-part test, an investment advice fiduciary is a person who (1) "renders advice … or makes recommendation[s] as to the advisability of investing in, purchasing, or selling securities or other property"; (2) "on a regular basis"; (3) "pursuant to a mutual agreement … between such person and the plan"; and the advice (4) "serve[s] as a primary basis for investment decisions with respect to plan assets"; and (5) is "individualized … based on the particular needs of the plan."

ERISA fiduciaries were generally prohibited from receiving compensation for such investment advice from third parties dealing with a plan, absent a specific exemption. Also, DOL guidance issued in 2005 established that recommendations to take a distribution from a plan and roll over to an IRA were not investment advice for purposes of ERISA.

DOL Enters the Center Ring …

In 2016, the DOL enacted a new fiduciary rule revising the 1975 five-part test, most notably dispensing with the "regular basis" and "primary basis" criteria used for 40 years. The new rule encompassed virtually all financial and insurance professionals who did business with ERISA plans and IRA holders, including stockbrokers and insurance agents engaged in single transactions. They were barred, if they did not qualify for an exemption, from being paid whatever transaction-based commissions and brokerage fees were standard in their industries because those types of compensation were deemed a conflict of interest.

In 2018, the Fifth Circuit Court of Appeals vacated the new rule in *Chamber of Commerce v. Department of Labor* and upheld the 1975 five-part test, stating that the "1975 regulation captured the essence of a fiduciary relationship known to the common law as a special relationship of trust and confidence between the fiduciary and his client." The court explained: "For the past forty years, DOL has considered the hallmarks of an 'investment advice' fiduciary's business to be its 'regular' work on behalf of a client and the client's reliance on that advice as the 'primary basis' for her investment decisions." Under the new rule, however, a single transaction recommended by a stockbroker or insurance agent would be sufficient to trigger fiduciary status. The Fifth Circuit held that the language of ERISA did not support such an expansion of DOL authority and vacated the rule. Shortly thereafter, the DOL re-implemented the 1975 five-part test.

Donning some new costumes in December 2020, the DOL adopted a revised prohibited transaction exemption for fiduciary investment advice (PTE 2020-02). While the operative text provided broad exemptive relief, the preamble to the exemption provided a new interpretation of the reinstated 1975 five-part test and withdrew the 2005 guidance regarding rollover advice.

Essentially, the preamble indicated that a single instance of rollover advice could now mark the beginning of an ongoing fiduciary relationship that would subject any financial or insurance professional to fiduciary status for a single transaction. This, again, was contrary to the language of the 1975 five-part test requiring a "regular basis" to hold someone accountable as an ERISA fiduciary.

Litigation ensued. In February 2023, in *American Securities Association v. Department of Labor*, the district court vacated the DOL policy holding that advice to roll over from a plan may be part of an ongoing advice relationship that satisfies the regular basis prong. Another federal lawsuit, *Federation of Americans for Consumer Choice Inc. v. Department of Labor*, remains pending.

... Still the Old Act

The DOL did not appeal *American Securities Association.* Instead, in November 2023, the department proposed another fiduciary rule that would expand investment advice fiduciary status. Most notably, the proposal again attempts to nullify the "regular basis" prong of the five-part test, this time by revising it from persons who provide investment advice *to a particular client on a regular basis* to persons who provide investment advice *'on a regular basis as part of their business,"* which is quite different. This change alone would make one-time advice, such as rollover advice, subject to the ERISA fiduciary standard provided the financial or insurance professional provides such advice regularly to others. Other changes in the proposal to the "mutual agreement" and "primary basis" prongs would serve to expand fiduciary status to any recommendation, notwithstanding the absence of an agreement or a primary basis, where "the recommendation is based on the particular needs or individual circumstances of the retirement investor and may be relied upon by the retirement investor as a basis for investment decisions that are in the retirement investor's best interest."

The proposal also includes significant restrictions to another exemption, PTE 84-24. For example, investment advice fiduciaries *who are not independent producers* would not be able to rely on the exemption for relief. Thus, insurance agents who have relied on PTE 84-24, and its predecessor PTE 77-9, in order to receive commissions in connection with any of the covered transactions, but who are not independent producers, would have to rely on PTE 2020-02 to do so. Further, PTE 84-24 would be available only for investment advice that is provided by independent producers who work with two or more unrelated insurers to sell fixed annuities or other insurance products not regulated by the SEC (investment advice regarding any other investment products would require compliance with PTE 2020-02). An independent producer is defined as a person or entity licensed under the laws of a state to sell, solicit, or negotiate insurance contracts, including annuities, and who sells to retirement investors products of multiple unaffiliated insurance companies, but who is not an employee of an insurance company (including a statutory employee under Internal Revenue Code section 3121). Finally, PTE 84–24 would provide relief from the prohibited transaction rules only for the receipt of fully disclosed commissions or fees in connection with annuity recommendations or other insurance products not regulated by the SEC.

Overall, the pending DOL rule proposal would have a profound impact on financial and insurance professionals who may provide a single instance of advice regarding a fixed annuity to an investor only to find themselves subject to the ERISA fiduciary standard. In particular, insurance agents would then need policies, procedures, and training to ensure compliance with the ERISA fiduciary standard, which burden will likely fall on insurance companies or independent marketing organizations. And most errors and omissions insurance policies held by agents won't cover claims for breach of fiduciary duty. In short, this proposal would have a huge impact on the insurance industry and independent producers.

But even if the newly proposed rule is finally adopted, it will be challenged in the courts, notwithstanding its revised script, new cast, and makeup. And for largely the same reasons that the courts vacated the DOL's 2016 rule and partially vacated PTE 2020-02, it appears likely that the new rule will be vacated as well. After all, "the touchstone of common law fiduciary status" is "the parties' underlying relationship of trust and confidence." Such a relationship is not likely to arise in a single transaction, no matter how much a government agency wants it so.

NAIC H Committee Continues as Ringmaster Coordinating Numerous Initiatives

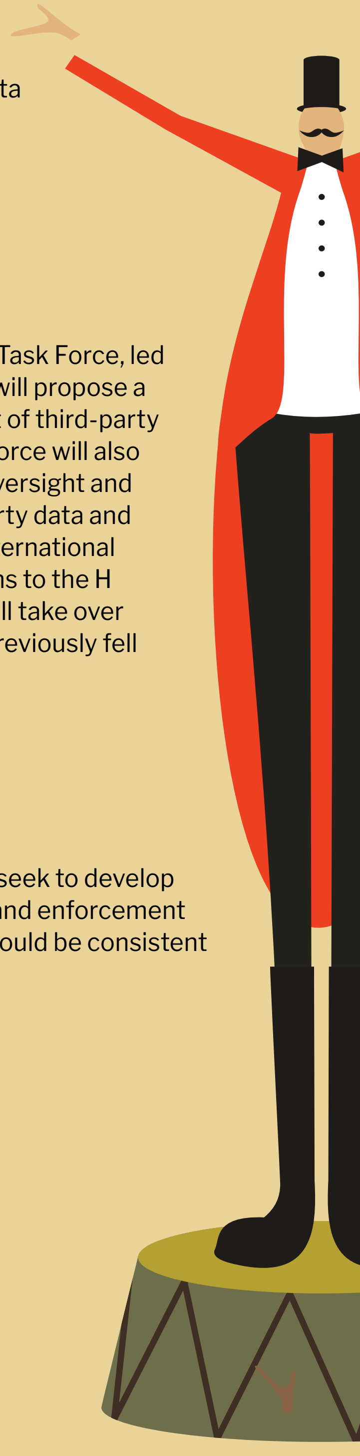
BY ANN BLACK AND ERIN VANSICKLE

Under the leadership of Maryland Insurance Commissioner Kathleen Birrane, in 2023 the Innovation, Cybersecurity, and Technology (H) Committee of the National Association of Insurance Commissioners completed two main performances and, in 2024, will continue to orchestrate a number of high-flying acts.

As reported above in "In the Big Top Spotlight: NAIC Model Bulletin on the Use of Artificial Intelligence Systems by Insurers," the H Committee completed work on a model bulletin on the use of AI systems by insurers, which was adopted by the NAIC at the 2023 Fall National Meeting. In addition, the Big Data and Artificial Intelligence (H) Working Group completed its AI and machine learning survey and presented its findings at the 2023 Fall National Meeting. In the other rings, work will continue in 2024 by the following (H) working groups: Cybersecurity, E-Commerce, Innovation in Technology and Regulation, and Privacy Protections.

Birrane also announced the following initiatives that are further summarized below:

- A new Third-Party Data and Models (H) Task Force.
- A new enforcement collaboration forum.
- A new open source technology collaboration forum.
- Revised workstreams for the Big Data AI WG.
- Changes in charges for the other H Committee working groups.



Third-Party Data and Models (H) Task Force

During the Big Data AI WG presentation, Commissioner Kevin Gaffney reported that third parties develop more than half of the AI and machine learning models used by life insurers. He also reiterated that insurers' reliance on third parties was also found in the home AI and machine learning survey and the private passenger auto AI and machine learning survey.

Given the reliance on third parties, a new task force will be dedicated exclusively to this spectacle. Birrane reiterated that, while the committee believes insurers ultimately bear the responsibility for the third-party vendors they use, there is a need for a sharper focus on third-party data, models, and systems.

The new Third-Party Data and Models Task Force, led by Iowa Commissioner Doug Ommen, will propose a framework for the regulatory oversight of third-party data and predictive models. This task force will also monitor and report on governmental oversight and regulation activities related to third-party data and model vendors at state, federal, and international levels, and will deliver recommendations to the H Committee. This new working group will take over the third-party oversight charge that previously fell under the Big Data AI WG.

Enforcement Collaboration Forum

With the work complete on the model AI bulletin, the H Committee in 2024 will spotlight enforcement. It will rely on the principles laid out in the model AI bulletin, which sets forth regulators' expectations as to how insurers use AI. The new Enforcement Collaboration Forum will seek to develop efficient and best practices oversight and enforcement tools. Birrane noted that these tools should be consistent based upon product lines.

Open Source Technology Collaboration Forum

Another collaboration forum, to be chaired by North Dakota Commissioner Jon Godfread, will focus on the use of open-source technology to facilitate and respond to data calls and the development of data standards. This work will likely follow the pilot conducted by North Dakota to use blockchain methodology for data calls. Godfread reported on this pilot during the H Committee's Spring National Meeting in March.

Revised Big Data Workstreams

The Big Data AI WG, operating with multiple rings, will continue to carry out its charges through the use of workstreams.

- Workstream 1 will continue to research the use of big data, AI, and machine learning through the use of surveys, presenting recommendations to the H Committee.
- Workstream 2 will continue to monitor activities related to AI at the state, federal, and international levels, addressing potential impacts on existing state insurance laws or regulations and making recommendations regarding gaps in regulation. Workstream 2 will also focus on consumer protection and the risks of bias and unfair discrimination in insurance.
- The efforts of the Collaboration Forum on Algorithmic Bias will fold under Workstream 3. Workstream 3 will explore the creation of independent synthetic data sets to support the testing of predictive models for unfair discrimination. It will also support the adoption of the model AI bulletin and maintain a glossary/lexicon to guide regulators as they engage in AI and technology-related discussions.
- Workstream 4 will continue to provide foundational education for regulators as it relates to AI and big data.

Charges of Other H Committee Working Groups

- The E-Commerce Working Group has been challenged with crafting an e-commerce modernization guide.
- The Cybersecurity Working Group has received new charges, including monitoring the availability and affordability/pricing of cyber insurance; disclosures, limits, and sub-limits in policies; policy language and trends in requirements; underwriting practices; and the role of reinsurance in the cyber insurance market. This working group, coordinating with NAIC working groups like the Casualty Actuarial and Statistical (C) Task Force, will also monitor federal and international activities related to cyber insurance and financing mechanisms for cyber risk insurance.
- The Technology, Innovation, and InsurTech Working Group, previously known as the Innovation in Technology and Regulation Working Group, is ready to perform its grand act, developing opportunities for startups and insurtech companies to step into the circus ring and present to, as well as receive feedback from, state insurance regulators.
- After engaging in discussions with industry stakeholders, the H Committee determined that the Privacy Protections Working Group could consider amending or revising NAIC model acts such as #670 and #672. The charge, initially involving the development of a new Privacy Protections Model Act, now allows for more flexibility, permitting the amendment of current models without necessitating their replacement. At the Fall National Meeting, the committee accepted the Privacy Protections Working Group's request to extend its model law completion deadline to December 31, 2024. This decision transforms 2024 into a year brimming with drafts, revisions, public commentary, and other developments — both within and beyond the circus ring.

With a number of spectacular acts performing in 2024, the H Committee will be busy with working group workstream, collaboration forum, and task force stage management.

Second Circuit Clarifies Limitations of Fraud on Market Theory

BY JOHN CLABBY AND NADER AMER

In a three-ring circus — where the *first* is the motion to dismiss, the *second* is class certification, and the *third* is summary judgment — the Second Circuit Court of Appeals has introduced a new act in the second ring for audience enjoyment: a tightrope for defendants and plaintiffs alike to navigate. More specifically, the Second Circuit's August 2023 decision in *Arkansas Teacher Retirement System v. Goldman Sachs Group Inc.* has clarified, in the context of class certification, the limitations of the "fraud on the market" theory that the U.S. Supreme Court first developed in its 1988 *Basic Inc. v. Levinson* decision.

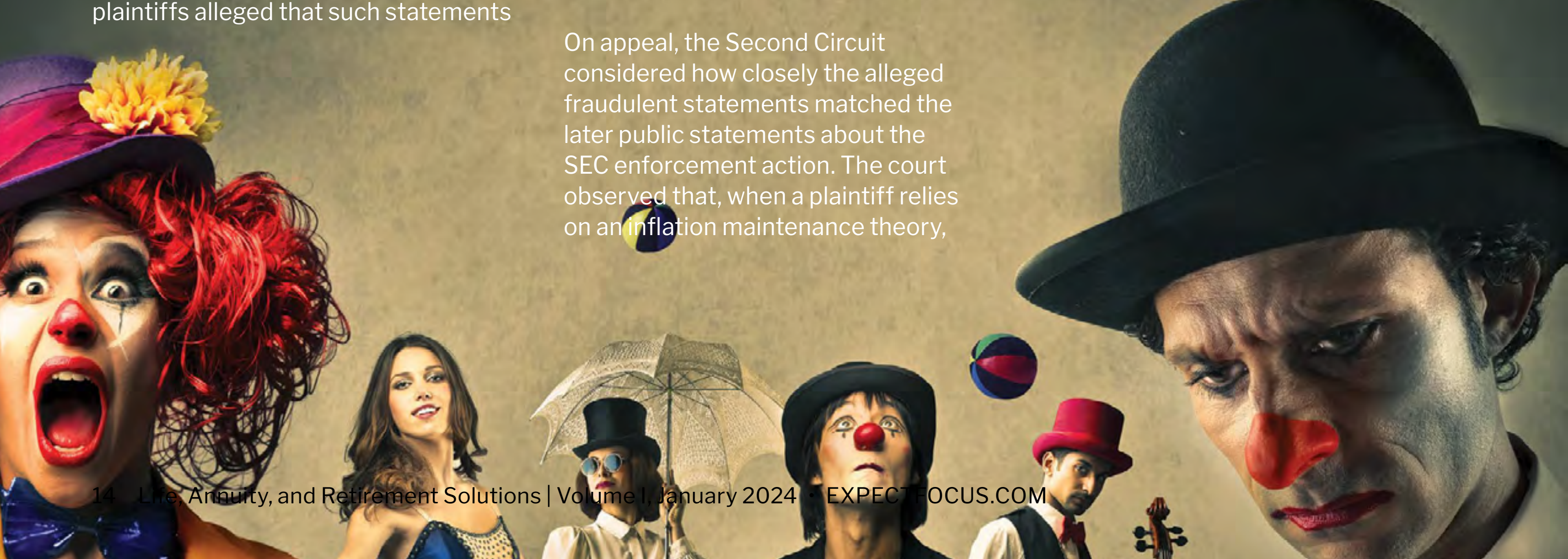
Basic held that investors seeking to recover losses under section 10(b) of the Securities Exchange Act of 1934 are entitled to a rebuttable presumption that they relied on an alleged public material misrepresentation about a security that is traded in an efficient market, such as a stock exchange. The Second Circuit's decision in *Arkansas Teacher*, however, lays out a path for defendants to rebut the presumption of reliance and any class certification based thereon.

As alleged in *Arkansas Teacher*, the SEC announced an enforcement action against Goldman Sachs for improperly marketing investments in a cross-collateralized debt-obligation vehicle, without disclosing that a hedge fund that selected the assets for that vehicle was shorting those very same assets. Thereupon, Goldman Sachs' stock price fell and investors brought suit claiming they had relied on previous generic statements by Goldman Sachs such as: "clients' interests always come first" and "[the company has] extensive procedures and controls that are designed to identify and address conflicts of interest." The plaintiffs alleged that such statements (a) were materially misleading because they omitted that Goldman Sachs was mismanaging conflicts and (b) prevented the company's stock price from dropping, thus maintaining an artificially inflated value until the date of the corrective disclosure (referred to as an "inflation maintenance theory").

At class certification, however, Goldman Sachs presented expert evidence showing that (1) 36 times prior to the corrective disclosure from the SEC about Goldman Sachs' conflicts procedures, news outlets criticized Goldman Sachs' conflicts procedures, (2) from the time Goldman Sachs first issued the allegedly misleading statements to the date of the corrective disclosure, none of the 880 analyst reports about Goldman Sachs discussed the company's conflicts systems, and (3) Goldman Sachs' generic statements, therefore, played no role in supporting its stock price. Despite this evidence, the district court cut the defendant's tightrope short by granting the plaintiff's motion for class certification. Rather than falling to the ground, however, Goldman Sachs appealed the district court's ruling.

On appeal, the Second Circuit considered how closely the alleged fraudulent statements matched the later public statements about the SEC enforcement action. The court observed that, when a plaintiff relies on an inflation maintenance theory, it cannot simply "identify a specific back-end, price-dropping event" and match it to "a front-end disclosure bearing on the same subject," unless "the front-end disclosure is sufficiently detailed in the first place." Rather, there must be a sufficient link between the corrective disclosure and the alleged misstatements. The Second Circuit concluded that, in light of the evidence presented, it was more likely than not that the alleged misrepresentations did not inflate Goldman Sachs' stock price. Accordingly, the Second Circuit overturned the district court's finding to the contrary and remanded with instructions to decertify the class for failure to demonstrate reliance.

Arkansas Teacher shows that defendants may have a meaningful opportunity at the class certification stage to rebut the presumption of reliance by using expert evidence, particularly in inflation maintenance cases where the challenged disclosure is generic. Accordingly, litigants may feel as if they are performing a high-wire act until their judge comes down with the answer to such rebuttal arguments.



Preparing for 2024: Encore to 2023's Cyber and Privacy Extravaganza

BY PATRICIA CARREIRO

Step right up as we discuss some of 2023's most notable cybersecurity and privacy regulatory and litigation developments and tips for keeping your program flying high.

Regulatory Activity

New regulatory requirements now in the center ring:

- *Amendments to the New York State Department of Financial Services' Part 500 cybersecurity requirements.* The amendments create an entirely new class of entity, enhance cybersecurity responsibilities for senior management and boards, and impose more prescriptive cybersecurity program requirements, annual compliance certifications, and enhanced cybersecurity event reporting requirements.
- *Continued state adoption of the National Association of Insurance Commissioners' Insurance Data Security Model Law (Model Law 668).* Almost half of U.S. states (most recently Pennsylvania and Illinois) have now adopted Model Law 668, which includes data security program management, cyber event investigation and response, annual reporting of cybersecurity events, and cybersecurity event notification obligations.

Upcoming Acts:

- *New and proposed rules from the SEC* bringing new public company cybersecurity event reporting requirements and teasing climactic new acts via the SEC's reengagement with proposed cybersecurity risk management rules for investment advisers, registered investment companies, and business development companies and proposed amendments to Regulation S-P (*see* "SEC Stirs Its Pot of Cybersecurity Preparedness and Response Proposals," *Expect Focus – Life, Annuity, and Retirement Solutions* (May 2023)).
- *Continuing efforts at the NAIC,* including new drafts of both a cybersecurity event response plan for use by departments of insurance responding to licensees' cybersecurity events and a potential new privacy model, Insurance Consumer Privacy Protection Model Law (Model Law 674) (*see* "NAIC Privacy Working Group Goes All-in on New Draft Privacy Model," *Expect Focus – Life, Annuity, and Retirement Solutions* (September 2023)).

Class Action Litigation

Like clowns from a car, privacy and cybersecurity class actions poured out of plaintiffs' firms, including data breach class actions and privacy claims related to everything from voice signatures to session replay technology and pixels, chatbots to digital advertising (both for targeting advertisements to consumers, as well as *not* targeting advertisements to protected classes of consumers). Claims spanned everything from violations of the Video Privacy Protection Act to wiretapping, discrimination, and invasion of privacy torts. A recent batch of cases has even challenged life insurers' ability to use family history to underwrite their policies. See our sideshow below on GIPA, "Lawsuits Alleging Violations of Illinois' GIPA Are Piling Into Court Like Clowns Out of a Circus Car."

Five Key Steps to Keep Your Program Flying High

With this funhouse of acts, here are a few recommendations for keeping your privacy and cybersecurity program flying high in 2024:

- *Build* internal awareness of privacy and cybersecurity developments to ensure your organization is keeping pace with the band.
- *Ensure* data maps and risk assessments are up to date and terms of use are using the latest in class action waivers and arbitration provisions.
- *Inventory* the data you hold and understand the legal obligations regarding such data (current and potential).
- *Assess* how current obligations are being met, and make adjustments as necessary (either due to new or impending legal changes or changed business practices).
- *Harmonize* state and regulatory requirements:
    - For privacy, evaluate consumer notices, opt-out rights, data disposal, limiting sharing with non-affiliates, and record-keeping obligations.
    - For cybersecurity, start with risk assessments, information security policies, annual cybersecurity program reviews, board involvement in, and oversight of, the cybersecurity program, an incident response plan, annual reporting to the regulator, and record-keeping.
- *Revise* your incident response plan to address new requirements and prepare for proposed changes.

The SEC's Compulsory Practice of Restraining Free Speech: "You Signed It, So Live With It!"

BY THOMAS SJOBLOM

Since 1972, the SEC has prohibited defendants who settle civil enforcement actions with the SEC without admitting or denying wrongdoing from later publicly "denying the allegations in the complaint" filed against them. The SEC codified this policy in 17 C.F.R. § 202.5(e), after determining that it was "important to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur." Therefore, "[i]n compliance with this policy, [a] defendant agrees not to take any action or to make or permit to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis."

This "policy" forecloses the defendant's ability to question not only the staff's "interpretation" of the facts, even if other witnesses or evidence proves them wrong, but also the tactics used by the staff to threaten the defendant with enormous sanctions to force a settlement. But the SEC generally would not be entitled to such a "gag order" as part of its case on the merits, nor be able to point to a compelling need for such an order to carry out its mission of protecting investors and promoting fair and orderly securities markets. Rather, the gag order's main effect is to throw a protective bubble over the SEC staff's often overly aggressive strategies for extracting settlements.

In *SEC v. Novinger* (July 2022), Judge Edith Jones of the Fifth Circuit Court of Appeals disagreed with her colleagues who upheld one of these gag orders:

> I write to note that nothing in the opinion (or in the district court opinion, for that matter) approves of or acquiesces in the SEC's longstanding policy that conditions settlement of any enforcement action on parties' giving up First Amendment rights. If you want to settle, SEC's policy says, 'Hold your tongue, and don't say anything truthful — ever'— or get bankrupted by having to continue litigating with the SEC. A more effective prior restraint is hard to imagine.

In *SEC v. Moraes* (October 2022), Judge Ronnie Abrams of the Southern District of New York, daughter of First Amendment lawyer and scholar Floyd Abrams, issued her own scathing opinion of this policy:

> Truth is no defense. No matter how weak, or strong, the allegations in the [SEC] complaint may be — indeed, even if the testimony of key witnesses proves to be false — if defendants ever consider publicly defending themselves, the [settlement gag provision] prevents them from doing so.
>
> . . .
>
> Perhaps most concerning, the federal judiciary is made complicit in this practice — normalizing lifetime gag orders in the process. Courts are called upon to turn a blind eye to First Amendment rights being used as a bargaining chip; to endorse consent decrees, giving No-Admit-No-Deny Provisions the imprimatur of judicial sanction; and to enforce them should defendants ever step out of line.

Judge Abrams found that the SEC's practice "raises the specter of violating the unconstitutional conditions doctrine," by which the government "conditions" receipt of a particular benefit on giving up certain rights (including the right to criticize the government). She also stated that the SEC's practice has "all the hallmarks of a prior restraint on speech." Nevertheless, Judge Abrams reluctantly felt compelled under *SEC v. Romeril* to approve the settlement; but she refused to "do so silently."

In its 2021 *Romeril* opinion, the Second Circuit Court of Appeals held that the defendant waived any First Amendment right when he signed an SEC settlement agreement containing a gag order. The Second Circuit remarked that "*even assuming that Romeril is correct that the no-deny provision violates his First Amendment rights*," he failed to satisfy either of the prerequisites for voiding a judgment pursuant to Federal Rule of Civil Procedure 60(b)(4): lack of jurisdiction, which the district court had, or lack of due process (notice and opportunity), which Romeril had received. Relying on cases that permit waiver of *procedural* rights in a criminal case, and also relying on cases involving private (not governmental) parties, the Second Circuit boldly jumped to the conclusion that the *fundamental* constitutional right of the First Amendment is "no exception." The opinion seems wrongly decided.

The U.S. Supreme Court has yet to provide a definitive analysis. A string of Supreme Court cases upholds the waiver of certain criminal *procedural* rights — such as the right to trial, the right to confront witnesses, and appellate review —

when the waiver is "knowingly, voluntarily, and intelligently" made. But none of those cases deal with the waiver of a *fundamental* right like those protected by the First Amendment.

Snepp v. United States is the only case in which the U.S. Supreme Court has *implied* that a defendant may waive First Amendment rights in a contract with the government. In 1968, Snepp signed an employment agreement with the Central Intelligence Agency under which he agreed not to publish any information relating to his employment without agency approval. When Snepp published a book about CIA activities in Vietnam, the CIA sued to enforce the employment agreement. Snepp lost in the district court. On appeal, the Fourth Circuit Court of Appeals stated that the purpose of such an agreement was not to give the CIA the power to censor its employees' critical speech but rather to ensure that classified, nonpublic information is not disclosed without the agency's permission. Indeed, the Fourth Circuit stated that Snepp had a First Amendment right to publish unclassified information.

The Supreme Court held that Snepp's violation of his agreement impaired the CIA's ability to perform its statutory duties and potentially jeopardized the safety of current foreign government operatives. The court thus enforced his employment agreement as a *matter of national security* but did not address First Amendment issues other than signaling in a footnote that a claim of "execution under duress" could render any waiver of First Amendment rights unenforceable.

However, the dissenting justices in *Snepp* stated that under a rule of reason analysis of the government's interest and the employee's interest in protecting his First Amendment rights, the "covenant imposes a serious prior restraint on Snepp's ability to speak freely and is of indefinite duration and scope — factors that would make most similar covenants unenforceable." Nor can the SEC point to a compelling interest for gag orders unlimited in duration and scope, which the SEC as much as acknowledged before Judge Abrams in *Moraes*.

Judge Jones' and Judge Abrams' apt analyses — as well as *Snepp*, properly understood in its entirety — should embolden defense counsel to challenge the SEC over gag orders. But such efforts should commence at the time of settlement talks, and a record should be made to preserve the defendant's right to raise First Amendment issues, including any facts suggesting that the gag order was agreed to under duress and for an impermissible duration and scope. First Amendment issues could then be raised with the district court after the SEC approves the settlement and the staff presents it to the district court for approval. In an administrative proceeding context, a respondent who signs the settlement should preserve the First Amendment issue and challenge the final order in court under the Administrative Procedure Act as arbitrary, capricious, and an abuse of discretion as well as contrary to a constitutional right.

The time may well be at hand when such challenges to sweeping SEC gag orders may find more success than historically they have.

Lawsuits Alleging Violations of Illinois' GIPA Are Piling Into Court Like Clowns Out of a Circus Car

BY ANN BLACK, PATRICIA CARREIRO, AND MICHAEL BAILEY

A string of putative class actions has been filed against life insurance companies for allegedly violating section 20(b) of Illinois' Genetic Information Privacy Act (GIPA) by using applicants' family medical history in underwriting. In general, these actions allege that life insurers violated section 20(b)'s prohibition by requiring applicants to answer questions concerning the applicants' family medical history for underwriting purposes.

The complaints are colorful and seek to distract the audience from seeing the "false bottom" in the clown car. Although there are many missteps in the plaintiffs' claims, one of the most basic is the laughable assertion that section 20(b) applies to life insurers at all. GIPA's very text demonstrates that the relevant provisions are limited to accident and health insurers and health plans and the coverages they issue; it does not include life insurers. Adding to the pileup is extensive legislative history reflecting that GIPA, as currently adopted, generally excludes life insurers and was not intended to change insurers' then-current practices, including asking questions about family medical history. Finally, if life insurance was intended to be part of GIPA's section 20(b) act, then the Illinois legislature would not have recently introduced HB 4142 to extend GIPA to the life insurance industry.

Perhaps once the plaintiffs' bar recognizes the deficiency in the GIPA complaints, the clowns will pile back into the car and drive away. Until then, it appears that the show must, unfortunately, go on.

SEC Wants More Securities Traders Under Its Dealer Big Top

Would Require Exchange Act Registration by More Regular Traders

BY ANN FURMAN

Recent SEC actions relating to the definition of "dealer" under the Securities Exchange Act of 1934 may enable the SEC to start cracking the whip over more persons who actively trade securities for their own account "as part of a regular business." This potentially could include insurance companies, among others.

Specifically, despite long-standing SEC staff interpretive positions addressing the distinction between "traders" and "dealers," the SEC under Chair Gary Gensler has (a) brought several federal court actions alleging unregistered dealer status against persons involved in active trading activity and (b) proposed rules that would define what it means to be dealing "as part of a regular business" in a way that would require more individuals and entities claiming trader status to register under the Exchange Act as dealers.

Statutory Definition. The Exchange Act defines "dealer" to mean "any person engaged in the business of buying and selling securities ... for such person's own account through a broker or otherwise." The statutory definition excludes "a person that buys or sells securities ... for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business." The SEC's *Guide to Broker-Dealer Registration* states that, under this definition, "[i]ndividuals who buy and sell securities for themselves generally are considered traders and not dealers."

Similarly, in a series of SEC staff no-action letters, dating from 197 to 2001, the SEC staff agreed, subject to conditions, not to recommend enforcement against traders if traders did not register as dealers. The letters set forth a variety of factors to consider in a facts and circumstances analysis of whether a trader or investor is required to register as a dealer.

SEC Enforcement Actions

Notwithstanding SEC staff guidance on the dealer/trader distinction, since 2019 the SEC has filed actions in New Jersey (*SEC v. Fierro*), Florida (*SEC v. Keener; SEC v. Almagarby*), and Minnesota (*SEC v. Carebourn Capital*). In each action, the SEC alleged that defendants were unregistered dealers involved in dealing in securities "as part of a regular business." In each case, the SEC prevailed on summary judgment against the unregistered dealers.

SEC Proposed Rulemaking

Following the commencement of the enforcement actions, the SEC in March 2022 proposed new Rules 3a5-4 and 3a44-2 under the Exchange Act to define the phrase "as a part of a regular business" as used in the statutory definitions of "dealer" and "government securities dealer." The proposing release identifies advancements in technology, changes in the U.S. Treasury market, and unregistered market participants who provide liquidity as some of the reasons why the new rules are needed.

The proposed rules would not apply to persons who have or control less than $50 million in total assets or to registered investment companies but would apply to other persons or entities, including private funds and registered investment advisers.

If adopted, the proposed rules would provide that buying and selling securities for a person's own account is "a part of a regular business" if such person:

> [E]ngages in a routine pattern of buying and selling securities that has the effect of providing liquidity to other market participants by:
>
> - Routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day; or
> - Routinely expressing trading interests that are at or near the best available prices on both sides of the market and that are communicated and represented in a way that makes them accessible to other market participants; or
> - Earning revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interests.

Although the SEC has not yet taken final action on the proposed rules, its continuing recent enforcement activity in this area may cause some persons who have been considering themselves mere "traders" to reevaluate whether they should now purchase a ticket to get inside the SEC's dealer tent or should take other action to reduce the possibility of the SEC telling them that such a ticket is required.

Ringmaster's Review: Fall 2023 Litigation on Parade

BY STEPHANIE FICHERA

Annuities

In *Ross v. Venerable Insurance & Annuity Co.*, a Missouri appellate court reversed judgment in favor of the named beneficiary of a flexible premium deferred annuity contract. Following the annuitant's death, the beneficiary sued for breach of contract, claiming that she was entitled to all payments that the annuitant would have received under the contract had he lived. The appellate court disagreed, concluding that the company had no further obligation to pay proceeds under the contract's plain language.

Prior to the annuitant's death, the contract had matured, and the annuitant had received 121 monthly annuity payments. He did not, however, elect one of the payment plans set out in the contract specifying how the annuity's proceeds would be paid at the time of his death. As a result, the contract's "automatic option" for payment of the proceeds governed.

The "automatic option" provided that "monthly income for a minimum of 120 months and as long thereafter as the Annuitant lives will be applied to the Accumulation Value." The court concluded that the company's obligation to pay under the "automatic option" ceased at the time of the annuitant's death, given the company's payment of more than the minimum 120 payments. The court rejected the beneficiary's request for continued payment of whatever the annuitant would have been paid had he lived, explaining that the contract contained "no provision permitting a judgment for [the beneficiary] for payment of some unknown dollar amount for some unknown time period assuming [the annuitant] had lived."

Disability Insurance

In *Perez v. Unum Life Insurance Company of America*, the Ninth Circuit Court of Appeals affirmed the district court's judgment that an insurer did not violate ERISA when it concluded the insured was no longer "totally disabled" because he could do sedentary work and terminated his long-term disability benefits.

The court rejected the insured's argument that the district court had adopted new rationales presented for the first time during litigation, finding that the challenged rationales reflected reasoning stated in the insurer's denial letters and were direct responses to the insured's litigation arguments.

The court also declined to interpret the long-term disability policy's consideration of the insured's "station in life" to require that alternative occupations pay at least 80% of his pre-disability earnings, noting that doing so would require the court to add a contract term to the policy.

Finally, the court rejected the insured's argument that the policy barred consideration of alternative occupations that required minimal on-the-job training. The policy defined alternative occupations as those the insured "could reasonably be expected to perform satisfactorily." This provision was not limited, as the insured advocated, to jobs he "can do now." Rather, the court found it was "reasonable to expect an insured who has the overall qualifications and skills to perform a job to undergo the typical on-the-job training for any new hire."

ERISA

In *Steigleman v. Symetra Life Insurance Co.*, the U.S. District Court for the District of Arizona resolved a dispute as to whether the plaintiff's long-term disability policy was part of an employee welfare benefit plan under ERISA. Jill Steigleman, an insurance agent who owned and operated her own insurance agency, obtained a variety of insurance benefits for herself and her employees through the Agents Association, a nonprofit organization of agents.

The court applied what it characterized as a "relatively simple test" that the Ninth Circuit uses to determine whether benefits are being provided pursuant to an employee welfare benefit plan, focusing largely on whether the benefits package implicates an ongoing administrative scheme and whether the employer exercises discretionary decision-making in operating the scheme.

After a bench trial, the court found that Steigleman had decided her agency needed to offer a benefits package to recruit and retain staff. In doing so, she "assessed the quality" of the coverages offered by the association and determined which would be paid by the agency and which would be the responsibility of the employees. For the coverages paid by the agency, she decided that the agency would pay only for employees and not their families and that the premiums would be paid out of her commission checks and not recouped from her employees. The benefits would end if the employees left the agency. The court found that both Steigleman and the agency's employees considered the coverages to be employee benefits.

In light of these findings, the court concluded that the agency had an "ongoing administrative scheme regarding employee benefits that required the exercise of discretionary decision-making" and "ongoing monitoring by Steigleman," which went beyond "the simple purchase of insurance on behalf of its employees." As such, ERISA applied to the long-term disability policy at issue. The agency's involvement in the provision of benefits also raised the possibility of abuse (such as failure to pay premiums leading to loss of expected coverage), further warranting the application of ERISA. The agency's failure to comply with ERISA's administrative and reporting requirements did not prevent an ERISA-governed plan from existing.

Life Insurance

In *American General Life Insurance Co. v. O.H.M.*, the Eleventh Circuit Court of Appeals resolved a beneficiary dispute over proceeds of a life insurance policy. Following a divorce and remarriage, the decedent submitted a beneficiary change request. The insurer advised the decedent, however, that it was unable to complete this request because, among other things, entirely different parties needed to be assigned as primary and contingent beneficiaries. The insurer enclosed a beneficiary change form with instructions, but the decedent never responded.

After the decedent passed years later, the insurer received competing claim submissions and filed a complaint for interpleader relief. The Eleventh Circuit affirmed the district court's entry of judgment in the original beneficiary's favor.

Applying Florida law, the court noted that insureds must strictly comply with the terms of the insurance policy to effectuate a change in beneficiary. The policy at issue provided:

> While this policy is in force the owner may change the beneficiary or ownership by written notice to us. When we record the change, it will take effect as of the date the owner signed the notice, subject to any payment we make or other action we take before recording.

The court rejected an argument that this language was ambiguous. According to the court, Florida law required it to read the "other action" phrase of the policy "as creating some objectively reasonable standard." Strict compliance with such a standard "may require the insured to respond appropriately in curing any defects."

The court concluded that the insurer acted objectively reasonably after receiving the decedent's defective beneficiary change request by responding with written notice explaining the defect and how to cure it, and by providing the decedent with necessary change forms and instructions. Because the decedent neither responded nor took any action with respect to the notice of defect in the years that followed, he did not strictly comply with the policy's terms. So the beneficiary change never went into effect, and the originally designated beneficiary was entitled to the policy's proceeds.

Long-Term Care Insurance

In *Clark v. SILAC Insurance Co.*, the Ninth Circuit Court of Appeals affirmed the district court's grant of summary judgment to the insurer on claims that the insurer had denied benefits due to the plaintiffs under a long-term care insurance policy and a home-care recovery policy.

With respect to the long-term care policy, the appeal centered on the plaintiffs' argument that the policy's "home again benefit" contained a prior institutionalization requirement that was prohibited by Montana law. Montana's insurance code, section 33-22-1115(3), prohibits an insurance company from including a prior institutionalization requirement in a long-term care policy when the policy contains a benefit that is "advertised, marketed, or offered as a home health care benefit." "Home health care" is defined under Montana law as "services provided by a licensed home health agency to an insured in the insured's place of residence that is prescribed by the insured's attending physician as part of a written plan of care."

The court distinguished the home again benefit provided by the long-term care policy at issue from the home health care benefits envisioned by the insurance code, explaining that the policy offered "a broader array of services in a narrower set of circumstances: i.e., when coming home again after a long-term care stay." Unlike the statutory definition of home health care, which is limited to "services provided by a licensed home health agency," the home again benefit would "be paid regardless of who provides for [the insured's] care, including family members, friends, and home health agencies." As a result, the court concluded that the policy's prior institutionalization requirement was not prohibited by Montana law.

One judge dissented from the court's conclusion on this point, describing it as "puzzling." The judge argued that the long-term care policy showed "a clear violation" of the statute prohibiting prior institutionalization requirements because it contained a statutorily defined "home health care" benefit. The fact that the policy also provided other benefits did not, in the judge's view, render the statute inapplicable.

The majority of the court also held that the policy's failure to disclose the prior institutionalization requirement in a separate, titled paragraph as required by the insurance code was only a "technical violation," which did not invalidate the provision because it was otherwise "unambiguously and prominently disclosed."

Finally, with respect to the home-care recovery policy, the court rejected the plaintiffs' argument that they were entitled to unlimited home-care benefits, noting that the first page of the policy stated that it was a "limited benefit policy" and that the second page explained that benefits would be received only under limited circumstances.

Federal Rule Amendment Clarifies Requirements for Admitting Expert Testimony

BY CLIFTON GRUHN

On December 1, 2023, Federal Rule of Evidence 702 was amended to "clarify and emphasize" that, before expert witness testimony can be admitted, the proponent must satisfy all the rule's requirements by a preponderance of the evidence. After receiving more than 500 comments regarding proposed changes, the rule was amended as follows:

> A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if the proponent demonstrates to the court that it is more likely than not that:
>
> a. the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
>
> b. the testimony is based on sufficient facts or data;
>
> c. the testimony is the product of reliable principles and methods; and
>
> d. the ~~expert has reliably applied~~ expert's opinion reflects a reliable application of the principles and methods to the facts of the case.

Although the preponderance standard, represented by the addition of the "more likely than not" language, applies to most admissibility issues, "many courts" had misapplied the requirement by ruling that "critical questions of the sufficiency of an expert's basis, and the application of the expert's methodology," were issues of weight to be addressed during examination. The advisory committee notes clarify that such rulings "are an incorrect application" of the rule. In the same vein, section (d) was amended to "emphasize" that all expert opinions must "stay within the bounds of what can be concluded from a reliable application of the expert's basis and methodology."

The amendment is intended to ensure that courts do not misinterpret the rules in ways that allow juries to hear inadmissible and potentially misleading expert testimony that they may not be qualified to evaluate. Although the amendment does not implement new requirements, even before it became effective, courts throughout the county have been noting the proposal's importance in analyzing the admissibility of proposed expert testimony.

• ADMIT ONE •

NEWS AND NOTES

Carlton Fields is a **sponsor** of the SIFMA C&L Annual Seminar on March 17–20, 2024, in Orlando, Florida. **Justin Chretien** will speak on digital engagement practices and their compliance and legal challenges.

Carlton Fields was pleased to participate in the American Bar Association's 40th Annual National Institute on Criminal Tax Fraud and the 13th Annual National Institute on Tax Controversy on December 7–9, 2023, in Las Vegas. **Tino Lisella** served as a speaker on a panel addressing what the government must do to prove a case using a deposits method, and how to defend these cases.

Responding to businesses facing an intensified focus on international transactions, evolving regulations, and enhanced enforcement by government agencies, **Carlton Fields has launched a Global Anti-Corruption Practice**. The group is led by **Thomas Sjoblom** and **Thomas Morante**.

Carlton Fields was recognized by corporate counsel as a "**litigation leader**" in *BTI Litigation Outlook 2024: Navigating Litigation Spending in the New Unpredictable World*. BTI's annual survey identifies top law firms to which corporate counsel will turn for their most pressing litigation needs.

Senior SEC Official Joins Carlton Fields

Carlton Fields is pleased to announce that **Harry Eisenstein** has joined the Financial Services Regulatory Practice as a shareholder in Washington, D.C. Prior to joining the firm, he served as senior special counsel in the SEC's Division of Investment Management.

In his 25-year career with the SEC, Harry has been at the forefront of disclosure and regulatory issues for both traditional and innovative investment products. This includes training SEC staff on reviewing registered index-linked annuities and registered index-linked life insurance, as well as other non-variable insurance products. His wealth of professional experience includes serving with the Chief Counsel's Office of the Division of Investment Management at the SEC, where he addressed a wide variety of regulatory issues arising under the securities laws concerning variable insurance products and investment companies generally.

In addition to a law degree from the University of Pennsylvania Law School, where he served as an editor of the *University of Pennsylvania Law Review*, Harry holds a bachelor's degree in finance and accounting from Penn's Wharton school of business, and an MBA from the University of Chicago. Throughout his career, Harry's background and interest in finance, economics, and other quantitative matters have enabled him to make especially valuable contributions to resolving many difficult and cutting-edge problems that he has been called upon to address. We, and Harry, now look forward to applying his broad experience and skills for the benefit of our clients.

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