

Underlining and overstrikes show the changes from the existing model. Comments are being requested on this draft. Comments should be sent by email only to Jolie Matthews at [jmatthew@naic.org](mailto:jmatthew@naic.org).

## SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION

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### Section 1. Purpose

- A. The purpose of this regulation is to require insurers to establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers that result in a transaction involving annuity products so that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed.
- B. Nothing herein shall be construed to create or imply a private cause of action for a violation of this regulation.

**Drafting Note:** The language of ~~S~~subsection B comes from the NAIC Unfair Trade Practices Act. If a ~~s~~State has adopted different language, it should be substituted for ~~S~~subsection B.

### Section 2. Scope

This regulation shall apply to any recommendation to purchase, ~~or~~ exchange or replace an annuity made to a consumer by an insurance producer, or an insurer where no producer is involved, that results in the purchase, ~~or~~ exchange or replacement recommended.

### Section 3. Authority

This regulation is issued under the authority of [insert reference to enabling legislation].

**Drafting Note:** States may wish to use the Unfair Trade Practices Act as enabling legislation or may pass a law with specific authority to adopt this regulation.

### Section 4. Exemptions

Unless otherwise specifically included, this regulation shall not apply to recommendations involving:

- A. Direct response solicitations by insurers where there is no recommendation based on information collected from the consumer pursuant to this regulation;
- B. Contracts used to fund:

- (1) Any of the following, unless there is a recommendation to an individual plan participant regarding an annuity, in which case this regulation does apply with respect to the recommendation:

**NOTE: THIS CONDITION TO EXEMPTION FOR EMPLOYER-SPONSORED PLANS PARALLELS FINRA RULE 2821(a)(1).**

- ~~(A)~~(a) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);
- ~~(B)~~(b) A plan described by ~~S~~sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer;
- ~~(C)~~(c) A government or church plan defined in ~~S~~section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under ~~S~~section 457 of the IRC; or
- ~~(D)~~(d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;
- ~~(5)~~(2) Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or
- ~~(6)~~(3) Formal prepaid funeral contracts.

## Section 5. Definitions

- A. “Annuity” means ~~a fixed~~an annuity ~~that is an insurance product or variable annuity under State law~~ that is individually solicited, whether the product is classified as an individual or group annuity.
- ~~B.~~ “Continuing education credit” or “CE credit” means one continuing education credit as defined in [insert reference in State law or regulations governing producer continuing education course approval].
- ~~C.~~ “Continuing education provider” or “CE provider” means an individual or entity that is approved to offer continuing education courses pursuant to [insert reference in State law or regulations governing producer continuing education course approval].
- ~~D.~~ “FINRA” means the Financial Industry Regulatory Authority or a succeeding agency.
- ~~B~~E. “Insurer” means a company required to be licensed under the laws of this state to provide insurance products, including annuities.
- ~~C~~F. “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.
- ~~D~~G. “Recommendation” means advice provided by an insurance producer, or an insurer where no producer is involved, to an individual consumer that results in a purchase, ~~or~~exchange or replacement of an annuity in accordance with that advice.
- ~~H.~~ “Suitability information” means information that is reasonably appropriate to determine the suitability of a recommendation, including the following:
- (1) Age;
- (2) Annual income;
- (3) Financial situation and needs, including the financial resources used for the funding of the annuity;
- (4) Financial experience;

- (5) Financial objectives;
- (6) Intended use of the annuity;
- (7) Financial time horizon;
- (8) Existing assets, including investment and life insurance holdings;
- (9) Liquidity needs;
- (10) Liquid net worth;
- (11) Risk tolerance; and
- (12) Tax status.

**Section 6. Duties of Insurers and of Insurance Producers**

A. In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the insurance producer, or the insurer where no producer is involved, shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to his or her investments and other insurance products and as to his or her financial situation and needs, including the consumer's suitability information, and that there is a reasonable basis to believe all of the following:

- (1) The consumer has been informed, in general terms, of various features of the annuity, such as the potential surrender period and surrender charge, potential tax penalty if the consumer sells, exchanges, surrenders or annuitizes the annuity, mortality and expense fees, investment advisory fees, potential charges for and features of riders, insurance and investment components and market risk;
- (2) The consumer would benefit from certain features of the annuity, such as tax-deferred growth, annuitization or death or living benefit;
- (3) The particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of purchase or exchange of the annuity, and riders and similar product enhancements, if any, are suitable (and in the case of an exchange or replacement, the transaction as a whole is suitable) for the particular consumer based on his or her suitability information; and
- (4) In the case of an exchange or replacement of an annuity, the exchange or replacement is suitable including taking into consideration whether:
  - (a) The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living or other contractual benefits), or be subject to increased fees, investment advisory fees or charges for riders and similar product enhancements;
  - (b) The consumer would benefit from product enhancements and improvements; and
  - (c) The consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 36 months.

B. Prior to the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain the consumer's suitability information ~~concerning:~~

- (1) ~~The consumer's financial status;~~

- ~~(2) The consumer's tax status;~~
  - ~~(3) The consumer's investment objectives; and~~
  - ~~(4) Such other information used or considered to be reasonable by the insurance producer, or the insurer where no producer is involved, in making recommendations to the consumer.~~
- ~~C. An insurer is ultimately responsible for compliance with this regulation. If a violation occurs, either because of the action or inaction of the insurer or its insurance producer, the insurer is responsible for taking appropriate corrective action, including, but not limited to, canceling a transaction that is not suitable, and is subject to sanctions and penalties, subject to section 8 of this regulation.~~
- ~~D. Except as permitted under subsection E, an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information. The penalty for a violation of this subsection is subject to section 8C of this regulation.~~
- ~~E.~~ (1) Except as provided under ~~P~~paragraph (2) of this subsection, neither an insurance producer, nor an insurer where no producer is involved, shall have any obligation to a consumer under ~~S~~subsection A ~~or D~~ related to any ~~recommendation~~annuity transaction if a consumer:
- ~~(a) Refuses to provide relevant information requested by the insurer or insurance producer, or decides to enter into an annuity transaction that is not based on a recommendation of the insurer or insurance producer, but there is a reasonable basis to believe the annuity transaction is suitable; or~~
  - ~~(b) Decides to enter into an insurance transaction that is not based on a recommendation of the insurer or insurance producer; or~~
  - ~~(e)(b)~~ Fails to provide complete or accurate information.
- (2) An insurer or insurance producer's recommendation subject to ~~P~~paragraph (1) shall be reasonable under all the circumstances actually known to the insurer or insurance producer at the time of the recommendation.
- ~~F. An insurance producer or, where no insurance producer is involved, the responsible insurer representative, shall at the time of sale:~~
- ~~(1) Make a record of any recommendation subject to section 6A of this regulation;~~
  - ~~(2) Obtain a customer signed statement documenting a customer's refusal to provide suitability information, if any; and~~
  - ~~(3) Obtain a customer signed statement acknowledging that an annuity transaction is not recommended if a customer decides to enter into an annuity transaction that is not based on the insurer producer's or insurer's recommendation.~~
- ~~DG.~~ (1) An insurer ~~either shall assure that~~establish a supervision system to supervise recommendations that is reasonably designed to achieve the insurer's and its insurance producers compliance with this regulation ~~is established and maintained by complying with Paragraphs (3) to (5) of this subsection, or shall establish and maintain such a system, including, but not limited to, the following:~~
- ~~(a) Maintaining written procedures; and~~
  - ~~(b) Conducting periodic reviews of its records that are reasonably designed to assist in detecting and preventing violations of this regulation.~~

- (a) The insurer shall maintain reasonable procedures to inform its insurance producers of the requirements of this regulation and shall incorporate the requirements of this regulation into relevant insurance producer training manuals;
  - (b) The insurer shall establish standards for insurance producer product training and shall maintain reasonable procedures to require its insurance producers to comply with the requirements of section 7 of this regulation;
  - (c) The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its insurance producers;
  - (d) The insurer shall maintain reasonable procedures to confirm consumer suitability information that supports a recommendation to the extent reasonably appropriate to identify, and to deter, insurance producer submission of inaccurate information;
  - (e) (i) The insurer shall maintain reasonable procedures for review of each recommendation, including each insurance producer recommendation, that are reasonably designed to ensure that there is a reasonable basis to determine that a recommendation is suitable. An insurer's procedures under this paragraph may be accomplished electronically applying a system of selection criteria to identify selected recommendations for review that is reasonably designed to ensure that there is a reasonable basis to determine that recommendations are suitable. Such an electronic system may be designed to require staff review only of those transactions identified for staff review by the selection criteria.
    - (ii) Nothing in this subparagraph:
      - (I) Restricts the FINRA member broker-dealer safe harbor provided under paragraph (2); or
      - (II) Prevents an insurer from contracting as provided under paragraph (3) for performance of the procedures required under this subparagraph;
  - (f) The insurer shall maintain reasonable procedures to detect recommendations that are not suitable. This may include, but is not limited to, systematic customer surveys, interviews, confirmation letters and programs of internal monitoring;
  - (g) The insurer shall maintain reasonable procedures for examination of its insurance producers and their affiliated insurance agencies at reasonable periodic intervals. The examination shall be reasonably designed to assist in detecting and preventing violations of this regulation. Nothing in this paragraph prohibits an insurer from accepting an examination conducted, and report certified, by an independent qualified firm or contracting under paragraph (3) for performance of the examination. Any such examination shall comply with the requirements of this subparagraph; and
  - (h) The insurer shall annually provide a report to senior management, including to the senior manager responsible for audit functions, which details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.
- (2) (a) A FINRA member broker-dealer supervision system that complies with FINRA suitability rules shall satisfy the insurer's supervision requirements under this subsection G.

**Drafting Note:** This paragraph is intended to grant a safe harbor to an insurer for the supervision system requirement under this subsection for annuity sales that are subject to the FINRA member broker-dealer required supervision system. The safe harbor applies to FINRA broker-dealer sales of fixed annuities as well as variable annuities.

- (b) An insurer shall:
- (i) Monitor the FINRA member broker-dealer, using information collected in the normal course of the insurer's business; and
  - (ii) Provide to the FINRA member broker-dealer information and reports that are reasonably appropriate to assist the FINRA member broker-dealer to maintain its supervision system.
- ~~(2) A general agent independent agency either shall adopt a system established by an insurer to supervise recommendations of its insurance producers that is reasonably designed to achieve compliance with this regulation, or shall establish and maintain such a system, including, but not limited to:~~
- ~~(a) Maintaining written procedures; and~~
  - ~~(b) Conducting periodic reviews of records that are reasonably designed to assist in detecting and preventing violations of this regulation.~~
- (3) (a) Nothing in this subsection restricts An an insurer may contract with a third party, including a general agent or independent agency, to establish and maintain a system of supervision as required by Paragraph (1) with respect to insurance producers under contract with or employed by the third party from contracting for performance of a function required under this subsection. An insurer is subject to, and is required to comply with this subsection G regardless of whether the insurer contracts for performance of a function and regardless of the insurer's compliance with subparagraph (b) of this paragraph.
- (b) An insurer's supervision system under paragraph (1) shall include supervision of contractual performance under this subsection. This includes, but is not limited to, the following:
- (i) Monitoring and, as appropriate, audits to assure that e contracted function is properly performed; and
  - (ii) Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the manager has a reasonable basis to represent, and does represent, that the function is properly performed.
- ~~(4) An insurer shall make reasonable inquiry to assure that the third party contracting under Paragraph (3) of this subsection is performing the functions required under Paragraph (1) of this subsection and shall take such action as is reasonable under the circumstances to enforce the contractual obligation to perform the functions. An insurer may comply with its obligation to make reasonable inquiry by doing all of the following:~~
- ~~(a) The insurer annually obtains a certification from a third party senior manager who has responsibility for the delegated functions that the manager has a reasonable basis to represent, and does represent, that the third party is performing the required functions; and~~
  - ~~(b) The insurer, based on reasonable selection criteria, periodically selects third parties contracting under Paragraph (3) of this subsection for a review to determine whether the third parties are performing the required functions. The insurer shall perform those procedures to conduct the review that are reasonable under the circumstances.~~
- ~~(5) An insurer that contracts with a third party pursuant to Paragraph (3) of this subsection and that complies with the requirements to supervise in Paragraph (4) of this subsection shall have fulfilled its responsibilities under Paragraph (1) of this subsection.~~

~~(6)(4) An insurer, general agent or independent agency is not required to by Paragraph (1) or (2) of this subsection to:~~

~~(a) Review, or provide for review of, all insurance producer solicited transactions; or~~

~~(b) Include include in its system of supervision an insurance producer's recommendations to consumers of products other than the annuities offered by the insurer, general agent or independent agency.~~

~~(7) A general agent or independent agency contracting with an insurer pursuant to Paragraph (3) of this subsection shall promptly, when requested by the insurer pursuant to Paragraph (4) of this subsection, give a certification as described in Paragraph (4) of this subsection or give a clear statement that it is unable to meet the certification criteria.~~

~~(8) No person may provide a certification under Paragraph (4)(a) of this subsection unless:~~

~~(a) The person is a senior manager with responsibility for the delegated functions; and~~

~~(b) The person has a reasonable basis for making the certification.~~

~~H. An insurance producer shall not dissuade, or attempt to dissuade, a consumer from:~~

~~(1) Truthfully responding to an insurer's request for confirmation of suitability information;~~

~~(2) Filing a complaint; or~~

~~(3) Cooperating with the investigation of a complaint.~~

~~EI. A registered representative recommendation of an annuity that is a security that Compliance complies with the National Association of Securities Dealers Conduct FINRA Rules pertaining to suitability shall satisfy the requirements under this section for the recommendation of variable annuities. However, nothing in this subsection shall limit the insurance commissioner's ability to enforce the provisions of this regulation.~~

**Drafting Note:** This subsection is intended to grant a safe harbor when ~~the NASD has reviewed a transaction and found that~~ the security representative recommendation of an annuity that is a security complies with the ~~NASD Conduct Rules~~ FINRA rules pertaining to suitability. ~~This safe harbor applies regardless of whether the annuity/security is required to be registered a security.~~

## Section 7. Insurance Producer Training

~~A. An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has adequate knowledge of the product to recommend the annuity and the insurance producer is in compliance with the insurer's standards for product training. An insurance producer may rely on insurer-provided product-specific training standards and materials to comply with this subsection.~~

~~B. (1) An insurance producer who engages in the sale of annuity products shall complete a one-time four (4) credit training course approved by the department of insurance and provided by the department of insurance-approved education provider.~~

~~(2) The minimum length of the training required under this subsection shall be sufficient to qualify for at least four (4) CE credits, but may be longer.~~

~~(3) The training required under this subsection shall include information on the following topics:~~

~~(a) The types of annuities and various classifications of annuities;~~

~~(b) Identification of the parties to an annuity;~~

- (c) How fixed, variable and indexed annuity contract provisions affect consumers;
  - (d) The application of income taxation of qualified and non-qualified annuities;
  - (e) The primary uses of annuities; and
  - (f) Appropriate sales practices, replacement and disclosure requirements.
- (4) Providers of courses intended to comply with this subsection shall cover all topics listed in the prescribed outline and shall not present any marketing information or provide training on sales techniques or provide specific information about a particular insurer's products. Additional topics may be offered in conjunction with and in addition to the required outline.
  - (5) A provider of an annuity training course intended to comply with this subsection shall register as a CE provider in this State and comply with the rules and guidelines applicable to insurance producer continuing education courses as set forth in [insert reference to State law or regulations governing producer continuing education course approval].
  - (6) Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with [insert reference to State law or regulations governing producer continuing education course approval].
  - (7) Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with [insert reference to State law or regulations governing to producer continuing education course approval].
  - (8) The satisfaction of the training requirements of another State that are substantially similar to the provisions of this subsection shall be deemed to satisfy the training requirements of this subsection in this State.
  - (9) Insurance producers who hold a life insurance line of authority on the effective date of this regulation shall complete the requirements of this subsection within six (6) months after the effective date of this regulation. Individuals who obtain a life insurance line of authority on or after the effective date of this regulation may not engage in the sale of annuities until the annuity training course required under this subsection has been completed.
  - (10) An insurer shall verify that an insurance producer has completed the annuity training course required under this subsection before allowing the producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this subsection by obtaining certificates of completion of the training course or obtaining reports provided by commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

**Section 78. Mitigation of Responsibility**

A. The commissioner may order:

- (1) An insurer to take reasonably appropriate corrective action for any consumer harmed by the insurer's, or by its insurance producer's, violation of this regulation;

~~Drafting Note: Section 7A(1) is not intended to apply to violations by an insurance producer who, under a state's laws, is not an insurer's agent. A state may wish to review this issue and, if necessary, clarify that the paragraph does not apply to brokers who are agents of the consumer, not the insurer.~~

- (2) An insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this regulation; and

- (3) A general agency or independent agency that employs or contracts with an insurance producer to sell, or solicit the sale, of annuities to consumers, to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this regulation.

~~Drafting Note: A consumer may have a right to seek relief through NASD arbitration for sale of a variable annuity in violation of the NASD Conduct Rules pertaining to suitability. State insurance departments may wish to consider this right when determining whether to bring an action requiring corrective action under Subsection A.~~

- B. Any applicable penalty under [insert statutory citation] for a violation of ~~S~~section 6A, B, ~~E~~ or ~~C(2)F~~ of this regulation may be reduced or eliminated [, according to a schedule adopted by the commissioner,] if corrective action for the consumer was taken promptly after a violation was discovered.

- ~~C. Any applicable penalty under [insert statutory citation] for an insurer's violation of section 6D of this regulation may be reduced or eliminated [, according to a schedule adopted by the commissioner,] if:~~

~~(1) Corrective action for the consumer is taken promptly after a violation is discovered; and~~

~~(2) The insurer reviewed the recommendation and approved issuance of the annuity after consideration of the customer's suitability information as required under section 6G(1)(e) of this regulation. The review and approval may be made applying selection criteria as permitted under section 6G(1)(e) of this regulation.~~

**Drafting Note:** A ~~s~~State that has authority to adopt a schedule of penalties may wish to include the words in brackets. In that case, "shall" should be substituted for "may" in the same sentence.

#### **Section ~~89~~. [Optional] Recordkeeping**

- A. Insurers, general agents, independent agencies and insurance producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer and other information used in making the recommendations that were the basis for insurance transactions for [insert number] years after the insurance transaction is completed by the insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

**Drafting Note:** States should review their current record retention laws and specify a time period that is consistent with those laws. For some ~~s~~States this time period may be five (5) years.

- B. Records required to be maintained by this regulation may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

**Drafting Note:** This section may be unnecessary in ~~s~~States that have a comprehensive recordkeeping law or regulation.

#### **Section 10. Effective Date**

The amendments to this regulation shall take effect six (6) months after the date the regulation is adopted or on January 1, 2011, whichever is later.

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