

REVISED

SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION

Executive Summary

Commissioners Thomas R. Sullivan (CT) and Adam Hamm (ND) chair and vice chair of the Life Insurance and Annuities (A) Committee, have developed the following Executive Summary to assist in uniform enforcement of the above referenced Model Regulation. This Executive Summary is intended to specifically address those questions which are likely to arise after the model regulation has been adopted. No provision of this Executive Summary is intended to supersede the language of the above referenced regulation.

This document is not an official pronouncement of the NAIC, but rather an unofficial statement of the chair and vice chair of the Life Insurance and Annuities (A) Committee that is offered as assistance to any state that chooses to use it. This document has no legal authority, and it is not intended to expand the content of the Model Regulation, but provides guidance regarding certain aspects of its provisions.

Why did the NAIC adopt the 2010 Suitability in Annuity Transactions Model Regulation?

This Model Regulation was adopted to set standards and procedures for suitable annuity recommendations and to require insurers to establish a system to supervise recommendations so that the insurance needs and financial objectives of consumers are appropriately addressed.

Specifically, this Model Regulation was adopted to:

1. Establish a regulatory framework that holds insurers responsible for ensuring that that annuity transactions are suitable (based on the criteria in Sec. 5I), whether or not the insurer contracts with a third party to supervise or monitor the recommendations made in the marketing and sale of annuities;
2. Require that producers be trained on the provisions of annuities in general, and the specific products they are selling.
3. Where feasible and rational, to make these suitability standards consistent with the suitability standards imposed by the Financial Industry Regulatory Authority (FINRA).

What are the obligations of insurance producers and insurers to determine suitability under this regulation?

Section 6A and B establish the duties of insurers and insurance producers with respect to compliance with this regulation. In general terms, prior to recommending a particular annuity to a consumer, an insurer or producer must make “reasonable efforts” to obtain the consumer’s “suitability information” as defined in Sec. 5I¹.

Based on the suitability information gathered in the transaction, the producer, or insurer if no producer is involved, must have reasonable grounds to believe the transaction being recommended to the consumer is suitable.

In addition to an analysis of a consumer's suitability information, there must be a reasonable basis to believe that all of the elements of Sec. 6A are satisfied.²

Sec. 6G(1) prohibits producers from dissuading or attempting to dissuade a consumer from responding truthfully to requests for, or confirmation of, suitability information or from filing a complaint with the insurer or appropriate regulatory authority .

Are there any limitations on the obligations of insurers or producers to determine suitability pursuant to this Model Regulation?

Yes. Sec. 6D states that neither a producer nor an insurer has any obligation to a consumer under the provisions of this regulation if: (1) no recommendation is made; (2) the consumer provided materially inaccurate information which led to an unsuitable recommendation; (3) a consumer fails to provide relevant suitability information and the transaction is not recommended; or (4) a consumer enters into an annuity transaction that is not based on the recommendation of an insurer or a producer. However, an insurer's issuance of an annuity is to be reasonable under all circumstances actually known to the insurer, even if the situations listed above apply.

What system of supervision is required by producers and insurers?

Sections 6E and 6F establish the parameters for supervisory systems.

A producer or insurer shall record any recommendation made subject to and in accordance with Sec. 6A; or obtain a customer signed statement documenting his or her refusal to provide suitability information; or a consumer signed statement acknowledging that an annuity transaction is not recommended and that it is not based on the producer's or insurer's recommendation.

In accordance with Sec. 6F, insurers are required to develop a system of supervision designed to achieve compliance with this regulation. Sec. 6F details the elements of the supervisory system.³

Section 6F(1)(d) requires that, prior to the issuance of an annuity contract, a recommendation must be reviewed to ensure that there is a reasonable basis to believe that the transaction being recommended is suitable. An insurer or a third party with whom the insurer has contracted under Sec. 6F(2) may conduct the review.

The reviewer must review all of the information the producer used to establish the reasonable basis for the recommendation, based on the factors delineated in Sec. 5I. The reviewer may require additional information if necessary to confirm the reasonable basis of a recommendation.

Pursuant to Sec. 6F(2), insurers are permitted to contract with third parties to establish systems of supervision, provided the insurer's supervision system includes supervising the contractual performance of the third party. Those supervisory responsibilities, set forth in Sec. 6F(2)(b), include monitoring and, as appropriate, conducting audits, to ensure that the contracted functions are properly performed. The insurer must also annually obtain a certificate from a senior manager with responsibility for the contracted function that states the manager has a reasonable basis to represent, and in fact does represent, that the function is being properly performed.

The insurer's system of monitoring should be reasonably designed to reflect the insurer's unique combination of annuity product types and distribution systems.

What are the producer training requirements under the Model Regulation?

Section 7A requires the producer to have adequate product specific training, including compliance with the insurer's standards for product training, prior to soliciting an annuity product. In addition, Section 7B requires a one time, minimum four credit hour general annuity training course offered by an insurance-department approved education provider and approved by an insurance department in accordance with applicable insurance education training laws or regulations. For this mandated course, the provider may not train in sales or marketing techniques or product specific information.

Section 7B(3) outlines the minimum required topics for this program of instruction, which can be offered in the classroom or via an insurance department approved self study method. If a producer is licensed with a life insurance line of authority prior to the effective date of the regulation, there is a six month grace period to comply with the training requirements; producers who obtain the life authority on or after the effective date of the regulation must complete the training prior to the sale of an annuity product.

If a producer receives substantially similar training in another jurisdiction, it would satisfy an insurance department's training requirements. Prior to allowing a producer to sell its annuity products, insurers shall verify the producer has completed the mandated training.

Because the amendments clearly require insurers to verify completion of training prior to the producer selling annuities on behalf of the insurer, the amendments should not be interpreted to affect producer licensing reciprocity or non-resident producer licensing processes.

What are the remedies and penalties for violating this Model Regulation?

Insurers are responsible for complying with the regulation and a violation – regardless of whether it is due to the action or inaction of the insurer or the producer and regardless of whether the insurer contracts with a third party to supervise or monitor the recommendations made – may result in an insurer, general agency, independent agency or insurance producers being ordered to take reasonably appropriate corrective action for any consumer harmed by the violation pursuant to Section 8A.

In addition, insurance commissioners may impose any other appropriate sanction or penalty within the power of the regulator to impose. While appropriate remedies on behalf of consumers will be expected even if there is a single violation, this regulation is not intended to require punitive penalties and sanctions when the commissioner has determined that a penalty is not appropriate under state insurance law. Each commissioner should consider inserting a reference to his or her state's version of the NAIC Unfair Practices Act or other statutes that authorize the commissioner to impose penalties and fines.

Sec. 6H (the so-called "safe harbor") is intended to prevent duplicative suitability standards being applied to sales of annuities through FINRA broker-dealers. Sales of insurance products which are securities under federal law, such as variable annuities, are required to meet FINRA suitability rules; and sales in compliance with FINRA rules would comply with the NAIC suitability regulation. Broker-Dealers may subject fixed annuity sales to FINRA suitability and supervision rules; and sales made in compliance with such rules would also qualify as complying with the NAIC suitability regulation. However, since FINRA does not have authority to enforce its rules on the sale of fixed annuities, broker-dealers supervising fixed annuity sales may be subject to more intensive insurance examination than for sale of security insurance products. Representatives of a broker-dealer, who are not required by the broker-dealer to comply with the FINRA requirements on the sale of fixed annuities, will have to comply with the insurance suitability regulation adopted by the state. In any case, insurers are responsible for any unsuitable annuity transactions no matter what suitability regulation or rule is applied by a broker-dealer.

¹ 5I. "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.

² **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 reasonably informed 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, limitations on interest returns, 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;
 - (c) The consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 36 months.

and

³ 6F(1) An insurer shall establish a supervision system that is reasonably designed to achieve the insurer's and its insurance producers' compliance with this regulation, including, but not limited to, the following:

- (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;

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- (d) The insurer shall maintain procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable. Such review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means including, but not limited to, physical review. Such an electronic or other system may be designed to require additional review only of those transactions identified for additional review by the selection criteria;
 - (e) The insurer shall maintain reasonable procedures to detect recommendations that are not suitable. This may include, but is not limited to, confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters and programs of internal monitoring. Nothing in this subparagraph prevents an insurer from complying with this subparagraph by applying sampling procedures, or by confirming suitability information after issuance or delivery of the annuity; and
 - (f) 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.