

LIFE INSURANCE AND ANNUITIES (A) COMMITTEE

Life Insurance and Annuities (A) Committee Dec. 6, 2009, Minutes

 Annuity Disclosure (A) Working Group Dec. 5, 2009, Minutes (Attachment One)

 Suitability of Annuity Sales (A) Working Group Dec. 1, 2009, Conference Call Minutes (Attachment Two)

 Suitability of Annuity Sales (A) Working Group Nov. 24, 2009, Conference Call Minutes (Attachment Two-A)

 Draft Revisions to Suitability in Annuity Transactions Model Regulation Nov. 16, 2009 (Attachment Two-A1)

 Joint Trades Comment Letter Nov. 23, 2009 (Attachment Two-A2)

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Life Insurance and Annuities (A) Committee
San Francisco, CA
December 6, 2009

The Life Insurance and Annuities (A) Committee met in San Francisco, CA, Dec. 6, 2009. The following Committee members participated: Thomas R. Sullivan, Chair (NY); Adam Hamm, Vice Chair (ND); Jim L. Ridling represented by Steve Ostlund (AL); Steve Poizner represented by Perry Kupferman and Jodi Lerner (CA); Gennet Purcell (DC); Kevin M. McCarty (FL); Susan E. Voss and Jim Mumford (IA); James J. Donelon (LA); Glenn Wilson represented by Manny Munson-Regala (MN); Ann Frohman represented by John Rink (NE); Scott J. Kipper (NV); James J. Wrynn (NY); and Sean Dilweg and Kim Shaul (WI). Also participating was: Larry Bruning (KS).

1. Federal Legislative Update

Amanda Yanek (NAIC) provided a legislative update of federal bills of interest to the Committee. She said the Senior Investment Protection Act of 2009, introduced in the U.S. Senate by Sen. Herb Kohl (D-WI), chair of the Senate Special Committee on Aging, and in the U.S. House of Representatives by Rep. Paul Hodes (D-NH) has been incorporated into H.R. 4173, Wall Street Reform and Consumer Protection Act of 2009. Rep. Barney Frank (D-MA), chair of the House Committee on Financial Services, introduced this legislation Dec. 2. Ms. Yanek reminded the Committee that the Senior Investment Protection Act of 2009 would provide grants to the states to assist in the detection, prevention and prosecution of deceptive sales practices perpetrated on seniors. To receive funds, a state would need to adopt senior designation and suitability standards. At a minimum, a state would have to adopt the NAIC *Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities* (#278) to receive grant funds. The stated purpose of the legislation is to protect older Americans from misleading and fraudulent marketing practices, with the goal of increasing retirement security. Ms. Yanek said H.R. 4173 is scheduled to be considered by the House Committee on Rules Dec. 8 and for full debate Dec. 9.

Ms. Yanek noted that, additionally, on the Senate-side, language reflecting the provisions of the Senior Investment Protection Act of 2009 can be found in Title IX, Subtitle I, Section 989A—Senior Investor Protections—of Sen. Christopher J. Dodd’s (D-CT) Chairman’s Mark of the Restoring American Financial Stability Act of 2009.

Ms. Yanek noted that H.R. 2733, Fixed Indexed Annuities and Insurance Products Classification Act of 2009, introduced June 4 by U.S. Reps. Gregory Meeks (D-NY) and Tom Price (R-GA), continues to gain co-sponsors. To date, the bill has 58 co-sponsors. The bill would nullify the U.S. Securities and Exchange Commission (SEC) Rule 151A, Indexed Annuities and Certain Other Insurance Contracts, and clarify that indexed annuities are regulated solely at the state level. The bill has been referred to the U.S. House Financial Services Committee. The companion bill on the Senate side, introduced by Sen. Ben Nelson (D-NE) June 25, also continues to gain co-sponsors. To date, that bill, S. 1389, has nine co-sponsors. Ms. Yanek said NAIC Government Relations staff will continue to monitor the bills’ progress and will update the Committee should action be taken on either bill.

Ms. Yanek noted that, at the Fall National Meeting, the Committee received an update on H.R. 2748 and S. 1297, The Retirement Security Needs Lifetime Pay Act. H.R. 2748 provides tax incentives for workers to annuitize part of their retirement savings. Specifically, the bill amends the Internal Revenue Code to encourage workers to annuitize some of their retirement savings by providing a 50% tax exclusion for up \$10,000 of lifetime annuity payments annually. It also excludes from taxes 25% of lifetime income payments from individual retirement accounts (IRAs), qualified plans and similar employer-sponsored retirement savings plans other than defined benefit plans. The bill also excludes the value of longevity insurance from amounts subject to required minimum distributions (RMDs), and clarifies the taxation of partial annuity payments. The Senate version, S. 1297, The Retirement Security for Life Act of 2009, amends the Internal Revenue Code to allow an exclusion from gross income for 50% of the amount otherwise includible in gross income as guaranteed payments from certain annuity or life insurance contracts. The bill limits the amount of such exclusion to \$20,000 in any taxable year. It also provides for an inflation adjustment of the \$20,000 limitation beginning in 2011. She noted that no additional activity has taken place for either bill. NAIC Government Relations staff will continue to monitor the bills’ progress and will update the Committee should action be taken on either bill.

2. Consider Adoption of Working Group Reports:

a. Annuity Disclosure (A) Working Group

Mr. Mumford reported that the Annuity Disclosure (A) Working Group met Dec. 5. During the meeting, the Working Group discussed proposed revisions to the latest draft revisions of annuity illustration guidelines forwarded by the American Academy of Actuaries (AAA) and the American Council of Life Insurers (ACLI). Mr. Mumford said that, during its discussions, the Working Group identified several issues that need to be discussed further and resolved prior to finalizing the guidelines. The Working Group reviewed the latest draft buyer's guides and extended the timeline for comment on all three guides. Mr. Mumford said the Working Group plans to hold a conference call prior to the 2010 Spring National Meeting to finalize all three buyer's guides. The Working Group approved requesting a one-year extension from the Committee to complete its work revising the *Annuity Disclosure Model Regulation* (#245). Mr. Mumford said the Working Group anticipates finishing its work next year. Commissioner Voss motioned, and Commissioner Hamm seconded, to adopt the Annuity Disclosure (A) Working Group report (Attachment One). The motion passed unanimously, which included granting the Working Group's request for a one-year extension to complete its work.

b. Suitability of Annuity Sales (A) Working Group

Ms. Shaul reported that the Suitability of Annuity Sales (A) Working Group met by conference call Dec. 1 and Nov. 24. During its Dec. 1 conference call, the Working Group adopted its Nov. 24 conference call minutes. Also, during the Dec. 1 conference call, the Working Group reviewed and discussed a new draft, released Nov. 27, of proposed revisions to the *Suitability in Annuity Transactions Model Regulation* (#275). This new draft was based on the discussion and comments received on the previous Nov. 16 draft. Ms. Shaul said, at the conclusion of the Dec. 1 conference call, the Working Group adopted the proposed revisions to the *Suitability in Annuity Transactions Model Regulation* (#275). Commissioner Dilweg motioned, and Commissioner Donelon seconded, to adopt the Suitability of Annuity Sales (A) Working Group report.

Commissioner Sullivan acknowledged the hard work of the Working Group since the Fall National Meeting. He said, however, that he believed there was an opportunity to refine some of the revisions to gain more support and suggested that the Committee defer adopting the revisions to the *Suitability in Annuity Transactions Model Regulation* (#275) in order to provide for a limited extended period until Dec. 14 for regulators and interested parties to provide additional comments. Commissioner Sullivan said he anticipates the Committee holding a conference call Dec. 18 to consider adopting the revisions, which would include any additional revisions based on the comments received during the extended comment period. He asked Mr. Mumford to review all of the comments received during the extended comment period. Commissioner Sullivan said that, although all comments are welcome, the Committee would most welcome comments on language in the proposed revisions that need clean-up or changes to address any inconsistencies. Commissioner Dilweg said he would not oppose Commissioner Sullivan's suggestion to defer voting on the revisions in order to gain more support. He did believe, however, that there was already the necessary number of Committee members who would vote in favor of adopting the revisions to satisfy the NAIC model law development procedure requirements.

Herb Olson (VT) asked when a new draft of proposed revisions to the *Suitability in Annuity Transactions Model Regulation* (#275) would be available for review following the Dec. 14 deadline. Commissioner Sullivan said the draft would be available sometime prior to the Dec. 18 conference call. Birny Birnbaum (Center for Economic Justice—CEJ) asked for clarification concerning the type of comments the Committee was seeking. Commissioner Sullivan reiterated his previous comments about wanting only to receive clean-up or corrective comments, but not substantive. The spirit and intent of the Working Group's product is to be preserved. The motion to adopt the Suitability of Annuity Sales (A) Working Group report passed unanimously, which included adopting the Working Group's Dec. 1 and Nov. 24 conference call minutes (Attachment Two).

3. Life and Health Actuarial Task Force Report

Mr. Bruning reported that the Life and Health Actuarial Task Force met Dec. 3—4. During this meeting, the Task Force received a report from the Society of Actuaries (SOA)/AAA Joint Project Oversight Group regarding margins. Mr. Bruning noted that the Task Force received a report and a presentation related to VM-20, the section of the Valuation Manual for life insurance products. The AAA Life Reserves Work Group Asset Subgroup reported on the default costs on existing assets for VM-20; ACLI gave a presentation regarding an additional net premium reserve methodology for VM-20. The Task Force received a report from the SOA/AAA Joint Payout Annuity Project Oversight Group on the development of a new payout annuity mortality table. Mr. Bruning said the Task Force discussed implementation issues for *Actuarial Guideline XLIII—CARVM for Variable Annuities* (AG 43). The Task Force revised and adopted AG 43. The revisions to AG 43 add Section

IV.G to define reserves as of Jan. 1, 2009. Appendix 8 was modified to add the required date for filing the management certification, the actuarial certification and the actuarial memorandum.

Mr. Bruning said the Task Force adopted the following sections of the Valuation Manual: 1) VM-00—Valuation Manual; 2) VM-01—Definitions for Terms in Requirements; 3) VM-21—Requirements for Principle-Based Reserves for Variable Annuities; 4) VM-26—Credit Life and Disability Reserve Requirements; and 5) VM-30—Actuarial Opinion and Memorandum Requirements. However, the Task Force has not completed work on other Valuation Manual sections that will become part of the Valuation Manual through the NAIC revision process. These sections are VM-20—Requirements for Principle-Based Reserves for Life Insurance Products and VM-25—Health Insurance Reserves Minimum Reserve Requirements. Mr. Bruning pointed out a letter the Task Force had sent to the Committee seeking direction from the Committee as a consequence of VM-20 and VM-25 not being completed (Attachment Three). Mr. Bruning said that if it is the desire of the Committee to wait until VM-20 and VM-25 are complete, prior to sending the amendments to the *Standard Valuation Law* (#820) and Valuation Manual to state legislatures, the Task Force requests that the date of completion of the Valuation Manual be extended to no later than the August 2010 NAIC national meeting.

Commissioner Dilweg said he found it troubling that the Task Force is asking for an extension and asked for clarification on how the Valuation Manual could be considered complete if essential sections of the Valuation Manual have not been completed. Mr. Bruning said the amendments to the *Standard Valuation Law* (#820) establish a new framework for implementing a principle-based reserving regulatory system for future new lines of business. After this framework is established, then new products can be added through the Valuation Manual. The question is what new products should first be included in this new framework. Mr. Bruning said VM-21—Requirements for Principle-Based Reserves for Variable Annuities and VM-26—Credit Life and Disability Reserve Requirements, which the Task Force completed and adopted, are the first products for which principle-based reserving are to be applied. The Task Force would also like to include life insurance products, but VM-20 is not complete. While VM-20 currently contains a minimum reserve floor, the Task Force is working with ACLI on a net premium reserve that will serve as a formulaic floor in VM-20. Mr. Bruning noted that this floor will also serve as the reserve for federal income tax purposes and allow insurers with low risk insurance guarantees to avoid the extensive calculations of principle-based valuation, provided certain exclusion tests are met. To date, the Task Force has reviewed some concepts, but the details of the proposal are still being developed by ACLI. Mr. Bruning said ACLI has said they will present those details to the Task Force by the end of the year. Given this, the Task Force is requesting an extension from the Committee until August 2010 to complete the Valuation Manual in order to complete work on VM-20 and VM-25. Commissioner Sullivan noted that even if all of the Valuation Manual sections had been completed, some states would have had implementation issues in 2010, particularly those states whose legislatures do not meet in 2010.

Paul Graham (ACLI) expressed support for giving the Task Force until the August 2010 NAIC National Meeting to complete VM-20. He said it seemed premature to adopt the Valuation Manual without VM-20. Mr. Graham also said that ACLI is committed to presenting the details of the net premium reserve to the Task Force by the end of the year. Norm Hill (National Alliance of Life Companies—NALC) expressed support for Mr. Graham's comments. Mr. Rink motioned, and Commissioner Donelon seconded, to give the Task Force until the August 2010 NAIC National Meeting to complete VM-20 and VM-25 in order to complete the Valuation Manual. Mr. Rink motioned, and Commissioner Hamm seconded, to adopt the Life and Health Actuarial Task Force report, which included adopting the revisions to *Actuarial Guideline XLIII—CARVM for Variable Annuities* (AG 43).

Having no further business, the Life Insurance and Annuities (A) Committee adjourned.

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Annuity Disclosure (A) Working Group
San Francisco, CA
December 5, 2009

The Annuity Disclosure (A) Working Group of the Life Insurance and Annuities (A) Committee met in San Francisco, CA, Dec. 5, 2009. The following Working Group members participated: Jim Mumford, Chair (IA); Steve Ostlund (AL); Joe Musgrove (AR); Peg Brown (CO); Richard Marcks (CT); Mary Beth Senkewicz (FL); Ted Clark (KS); Pam Gergen (MN); Jim Mealer (MO); Jack Chaskey (NY); Michelle Brugh (OH); Tomasz Serbinowski (UT); and Fred Nepple (WI). Also participating were: Perry Kupferman and Jodi Lerner (CA); Bill McAndrew (IL); John Kissling (IN); Ana Smith-Daley (TX); and Jim Young (VA).

1. Request for Extension of Time

The Working Group approved requesting a one-year extension from the Life Insurance and Annuities (A) Committee to complete its work revising the *Annuity Disclosure Model Regulation* (#245). Mr. Mumford said the Working Group anticipates finishing its work next year.

2. Annuity Illustration Guidelines

The Working Group discussed the American Council of Life Insurers (ACLI) Dec. 2 comment letter and proposed revisions to the American Academy of Actuaries (AAA) revisions to the ACLI Proposed Annuity Illustration Guidelines. The ACLI and AAA have worked together to resolve the differences between their two proposals; Kelly Ireland (ACLI) reviewed key points outlined in the ACLI comment letter.

a. When to Include an Illustration

The AAA had suggested that if a company chooses to market a product with an illustration, then an illustration must be used in all sales of that product; i.e., if an illustration was a good disclosure for one consumer, it follows that it would be good for another. Ms. Ireland said that an annuity illustration is not a mandatory disclosure; it is a sales tool and, as such, it should be up to the company and the producer (who is often closest to the consumer) to determine when an annuity illustration should be used in a proposal for a sale of a particular annuity. Mr. Ostlund said he was concerned that the optional use of illustrations could be subject to abuse. He suggested that guidelines for when an illustration should be used might be helpful. Mr. Mealer mentioned that there might be issues with using the same illustration for the same product, because sometimes a product can be sold with a rider that would change the illustration. Mr. Serbinowski said that whether an illustration is required might depend on the complexity of the product. The Working Group identified this as an issue that needs to be discussed further and resolved.

b. What Annuitization Rate to Use in Illustration

The AAA had suggested language stating that “illustrated annuitization rates shall not be higher than current annuitization rates.” Ms. Ireland explained that some companies update their annuitization rates frequently, while others might set them annually. To require “current annuitization rates” as a cap would mean constant updating of this factor for a company that frequently updates its annuitization rates. The illustration is intended to show possible future scenarios; therefore, ACLI suggested stating that “illustrated annuitization rates shall not be higher than the annuitization rate in effect on the last business day of the previous year.” Mr. Musgrove expressed concern that it would be possible to “game” the illustration by using this method. The Working Group identified this as an issue that needs to be discussed further and resolved.

c. How Timing of Use of Illustration Relates to Content of Illustration

The AAA had removed the requirement that the legal name of the annuity must include the basic type of annuity (e.g., “single premium deferred annuity,” “modified single premium deferred annuity,” “fixed premium deferred annuity” or “flexible premium deferred annuity”) in an effort to keep the illustration simple. ACLI wants to keep this requirement because they understand it to be of importance to regulators, as indicated in the “Report on Iowa Project to Review Annuity Illustrations.” The Working Group observed that whether this information should be included in the illustration might depend on when the consumer gets the illustration.

Mr. Ostlund said this issue is related to avoiding duplication between required disclosures and the illustration. The illustration should work with the disclosure — and, if there is needless duplication of information, then there is the risk of information overload, which is counter-productive. Mr. Ostlund said he did not want the illustration to be a stand-alone document. ACLI agreed that there needs to be a balance between providing too much, and not enough, information. ACLI tried to address this concern by including a statement in a drafting note to the guidelines. However, ACLI also said that the illustration is a sales tool that should be able to be given to a consumer prior to the application and the required disclosures. In this situation, it would be a stand-alone document, but ACLI suggested that by requiring that the illustration refer consumers to the required disclosure documents and buyer's guide for more detailed information, this concern could be addressed. The Working Group identified this as another issue that needs to be discussed further and resolved.

d. Illustration Guidelines or Template

Ms. Ireland expressed concern that, after reviewing some of the comments, there was a desire to create an illustration template. ACLI does not support the creation of a template. The illustration guidelines are intended to describe the information that should be included in an illustration and might direct that certain information be prominently displayed. The inclusion of the sample illustrations were for explanatory purposes only and not to suggest that a particular format needed to be followed. Mr. Mumford said that, at this point, guidelines are better. He allowed that there might be best practices that emerge in the future that would make the development of a template desirable. The Working Group identified this as an issue that needs to be discussed further and resolved.

e. How to Incorporate Illustration into the *Annuity Disclosure Model Regulation* (#245)

Ms. Ireland asked how the illustration guidelines were going to be incorporated into the *Annuity Disclosure Model Regulation*. ACLI suggested making the illustration guidelines Appendix B and combining the three buyer's guides into Appendix A. If the illustration guidelines are made into Appendix B, an effective date for their use would need to be included. Mr. Musgrove suggested that the effective date should be included in the model, rather than in Appendix B.

Mr. Mumford asked about how the AAA's efforts to explain market value adjustments (MVAs) were going. Barbara Lautzenheiser (Lautzenheiser and Associates) said that the AAA is working on it. Mr. Ostlund said it was difficult to explain MVAs in the buyer's guides, but that it needs to be explained because it can be counter-intuitive. Mr. Mumford said that maybe something will have to be included in the disclosure. Mr. Musgrove suggested developing an Appendix C addressing MVA disclosure guidelines.

2. Annuity Buyer's Guides

Funded consumer representatives Brenda Cude (University of Georgia) and Karrol Kitt (University of Texas) were largely responsible for the three draft consumer guides and proposed revisions to those draft guides. All of the guides and proposed revisions are posted on the NAIC Web site. Mr. Mumford extended the comment period for all three annuity buyer's guides until Jan. 4, 2010.

Having no further business, the Annuity Disclosure (A) Working Group adjourned.

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Suitability of Annuity Sales (A) Working Group
Conference Call
December 1, 2009

The Suitability of Annuity Sales (A) Working Group of the Life Insurance and Annuities (A) Committee met via conference call, Dec. 1, 2009. The following Working Group members participated: Kim Shaul, Chair (WI); Linda Brunette (AK); Steve Ostlund (AL); Joe Musgrove and Amanda Rose (AR); Jodi Lerner and Perry Kupferman (CA); Tom Sullivan, Mark Franklin and Richard Marcks (CT); Mary Beth Senkewicz and Eric Lingswiler (FL); Jim Mumford, Rosanne Mead and Lee Sellmeyer (IA); Cindy Colonius (IL); Paul Hanson (MN); Tamara Kopp and Jim Mealer (MO); Keith E. Nyhan (NH); Anne Marie Narcini (NJ); Gail Keren and Matt Gaul (NY); Michelle Brugh and Lynette Baker (OH); Mike Lydon (OR); Andy MacLaurin (TX); Betsy Jerome (UT); and Herb Olson (VT). Also participating were: Luther Ellis (DC); Michael Fix (ND); and Fred Nepple and Mike Honeck (WI).

1. Adoption of Nov. 24 Conference Call Minutes

Mr. Mumford motioned, and Mr. Ostlund seconded, to adopt the Nov. 24 conference call minutes (Attachment Two-A). The motion passed unanimously.

2. Review of Subgroup Revisions

Ms. Shaul said the Working Group has been working on developing revisions to the *Suitability in Annuity Transactions Model Regulation* (#275) for over a year to codify insurer responsibility for suitable sales and fill in gaps in the current model regarding insurer supervision and insurance producer training requirements. Ms. Shaul said the Nov. 27 draft of proposed revisions to the *Suitability in Annuity Transactions Model Regulation* (#275) (Attachment Two-B) achieves these goals.

Mr. Mumford provided a detailed review of the subgroup revisions in the Nov. 27 draft. He said the subgroup of the Working Group—composed of Ms. Shaul, Ms. Mead, Mr. Nepple and himself—reviewed and discussed all of the comments received on the previous draft when developing these revisions. He said the Nov. 27 draft clarifies provisions in the previous draft that some of those who commented said were confusing. Mr. Mumford said the subgroup kept in mind the Working Group’s charge, which was to improve the regulation of annuity sales and to provide insurers uniform guidance in developing agent training, supervision and monitoring standards in order to better protect annuity consumers from unsuitable sales and abusive sales and marketing practices.

Mr. Mumford said the words “by insurer” in Section 4A—a revision made in response to subgroup discussions with U.S. Securities and Exchange Commission (SEC) representatives—was deleted because the subgroup did not want to introduce new concepts at this stage in the process. Mr. Mumford said the subgroup also felt that the revision was not necessary because of the specific language in the provision, which provides that the exemption for direct solicitation applied in the situation where there is no recommendation made based on information collected from the consumer pursuant to the regulation. Mr. Mumford said the subgroup decided to delete the suggested revisions to Section 4B—made in response to comments received from the Vermont Insurance Division—which were intended to clarify the scope of the exemption for ERISA plans because the subgroup found that this provision was standard language in other NAIC models and, as such, did not want to change it and raise additional issues.

For Section 5—Definitions, Mr. Mumford said a new definition for “replacement” in Section 5H was added because this term was used throughout the model. He said the definition was derived from the definition of “replacement” in the *Life Insurance and Annuities Replacement Model Regulation* (#613). Mr. Mumford said the additional revisions to Section 6—Duties of Insurers and Insurance Producers—were made in response to some of the comments received on this section in order to further clarify some of the language. He said the subgroup again struggled with the revisions to Section 6D to address situations where the consumer refuses to provide relevant information or a recommendation is made based on erroneous information. Mr. Mumford explained that the additional revisions to Section 6F were made to clarify the type of review necessary to meet the requirements of this provision. He said this language reflects the subgroup’s intent to provide the necessary flexibility for insurers to comply with its requirements based on what works best for the insurer. Mr. Mumford said the subgroup revised Section 6H—Financial Industry Regulatory Authority (FINRA) Safe Harbor Provision—to clarify its application.

Ms. Mead outlined the changes to Section 7—Insurance Producer Training. She said the changes clarify that an insurance producer who has no desire to sell annuities would not be required to satisfy the training requirements. Ms. Mead reiterated that this section reflects Iowa’s training requirements for indexed annuities and other states’ training requirements for long-term care insurance partnership plans. She also noted that this section places the burden on insurance producers to have adequate training before selling an annuity product and places responsibility on insurers to make sure their insurance producers have the training. Ms. Mead said the section is not linked to insurance producer license renewal requirements. It has been designed to operate independently.

Mr. Mumford said the revisions to Section 8—Mitigation of Responsibility change the title of the section to more appropriately reflect its provisions in light of the additional changes to the section. He said the provisions in Section 6C were moved to new Section 8A in order to consolidate the penalty provisions.

3. Discussion of Nov. 27 Draft Revisions

Mr. Olson expressed concerns about the deletion of the language in Section 4B concerning the exemption for ERISA plans. Ms. Shaul said the Working Group’s basis for developing the revisions to the model was due to problems some states had experienced with unsuitable sales involving annuities sold on an individual basis, not on a group basis to employer groups. As such, the focus of the revisions was on the individual market. She also noted that if a group annuity is converted to an individual annuity, then the model’s provisions would apply. Mr. Olson motioned, and Ms. Lerner seconded, to restore the stricken language. The motion failed, with Alabama, Connecticut, Florida, Iowa, Minnesota, Missouri, New Jersey, New York, Oregon and Texas voting against the motion; Alaska, California, New Hampshire, Utah and Vermont voted in favor of the motion.

Mr. Olson reiterated his concerns about the safe-harbor language in Section 6H leaving a regulatory gap. Mr. Mumford pointed out the last sentence in Section 6H, which states that nothing in this subsection limits the commissioner’s ability to enforce the model’s provisions. After additional discussion, Mr. Mumford agreed to draft additional clarifying language for the drafting note for this provision to address Mr. Olson’s concerns.

Mr. Olson motioned, and Mr. Gaul seconded, to delete the definition of “recommendation” in Section 5G. Mr. Olson said the definition was too narrow. He also said that FINRA does not have an equivalent definition in its suitability rules. Ms. Shaul pointed out that this definition was an existing definition in the underlying model. Mr. Hanson expressed support for Ms. Shaul’s comments. The motion failed, with Alabama, Alaska, Connecticut, Florida, Minnesota, Missouri, New Hampshire, New Jersey, New York, Ohio, Oregon, Texas and Utah voting against the motion; Vermont voted in favor of the motion.

Mr. Hanson motioned, and Mr. Ostlund seconded, to adopt the Nov. 27 draft.

Ms. Lerner outlined her concerns with the draft, particularly Section 6D, which would allow an insurer to issue an annuity when no recommendation is made. Mr. Mumford explained the reasoning for permitting the issuance of an annuity under those circumstances. Ms. Lerner outlined her concerns with the removal of the word “reasonable” in Section 6F(e), which establishes the requirements for insurer review of recommendations. She suggested that the word “reasonable” be added back into this provision. After discussion, the Working Group rejected her suggestion.

Birny Birnbaum (Center for Economic Justice—CEJ) said the changes to Section 6D were an improvement from the previous draft, but he still had concerns. He said he believed that the current language provides a loophole, particularly the language permitting an insurer to issue an annuity in the absence of the consumer providing necessary information if the insurer or the insurance producer has a reasonable basis to do so. Mr. Birnbaum suggested that an insurer should not be permitted to issue an annuity if the consumer refused to provide the necessary information to determine suitability. He also suggested that the insurer or insurance producer would not have any obligation to the consumer related to a recommendation if the consumer provides “materially” inaccurate information. Ms. Shaul and Mr. Mumford pointed out provisions in the draft that might alleviate some of his concerns.

Ms. Brugh expressed concerns with voting to adopt the Nov. 27 draft at this time. She said that, given the discussion, regulators and interested parties still have questions and concerns with the Nov. 27 draft. Ms. Brugh suggested that the Working Group wait to adopt the revisions in order to have more time to address those concerns. Mr. Nyhan expressed support for Ms. Brugh’s comments. Mr. Olson said he was comfortable with the Working Group voting on whether to adopt the Nov. 27 draft, but only if Vermont would have the necessary flexibility to differentiate from the revisions as it feels is necessary. Eric DuPont (MetLife) expressed concern with Mr. Olson’s comments about making changes to any adopted draft. He said MetLife operates in all 50 states. As such, any changes made among the states make it difficult for his company from

a compliance stand point. Kelly Ireland (American Council of Life Insurers—ACLI) acknowledged the subgroup's efforts to address regulator and interested party concerns; however, ACLI still has concerns. Some of those concerns include: 1) the review requirements in Section 6F; 2) the lack of clarity in the FINRA compliance safe harbor language in Section 6H; and 3) the insurer liability and mitigation provisions in Section 8. Ms. Ireland said that, given these concerns, ACLI opposes the Nov. 27 draft. Ron Panneton (National Association of Insurance and Financial Advisors—NAIFA) expressed support for Ms. Ireland's comments. Lee Covington (Insured Retirement Institute—IRI) outlined his concerns. He said Section 6C creates strict liability for insurers for a single violation of the model. This is problematic, he said, because this is a model regulation with its statutory authority derived from the NAIC *Unfair Trade Practices Act* (#880). The *Unfair Trade Practices Act* does not trigger a violation based on a single act; as such, if states adopted this draft with this provision, then the state would be violating its own law. Mr. Covington suggested that Section 6C be deleted. Ms. Senkewicz expressed disagreement with Mr. Covington's reasoning. Mr. Olson also disagreed with Mr. Covington.

The motion to adopt the Nov. 27 draft passed, with Alaska, Arkansas, Connecticut, Florida, Iowa, Minnesota, Missouri, New Jersey, New York, Oregon, Texas, Utah, Vermont and Wisconsin voting in favor of the motion; California and Ohio voted against the motion, and New Hampshire abstained. Vermont voted in favor of the motion with the caveat that voting to adopt the draft meant that it would still have the flexibility to make changes it feels are necessary for state adoption. California voted against the motion and New Hampshire abstained, stating that more time was needed to address concerns with the draft.

Having no further business, the Suitability of Annuity Sales (A) Working Group adjourned.

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Draft: 11/30/09

Suitability of Annuity Sales (A) Working Group
Conference Call
November 24, 2009

The Suitability of Annuity Sales (A) Working Group of the Life Insurance and Annuities (A) Committee met via conference call, Nov. 24, 2009. The following Working Group members participated: Kim Shaul, Chair (WI); Linda Brunette (AK); Steve Ostlund (AL); Joe Musgrove (AR); Jodi Lerner and Perry Kupferman (CA); Peg Brown (CO); Mark Franklin (CT); Mary Beth Senkewicz and Eric Lingswiler (FL); Jim Mumford and Rosanne Mead (IA); Cindy Colonius (IL); Paul Hanson (MN); Angela Nelson, Molly White, Mary Kempker and Tamara Kopp (MO); Keith E. Nyhan and Barbara Richardson (NH); Gail Keren and Matt Gaul (NY); Lynette Baker (OH); Mike Lydon (OR); Andy MacLaurin (TX); Betsy Jerome (UT); and Herb Olson (VT). Also participating were: Norm Stevens (ME); Bruce Ramge and John Rink (NE); and Fred Nepple, Jennifer Stegall and Mike Honeck (WI).

1. Opening Remarks

Ms. Shaul provided a timeline of the Working Group's work to revise the *Suitability in Annuity Transactions Model Regulation* (#275). She said the Working Group has had six meetings since May 31, 2008, and held three conference calls between May 2008 and September 2009. Ms. Shaul said the Sept. 4 draft (See Attachment Six-B of the Life Insurance and Annuities (A) Committee, 3rd Quarter 2009 *Proceedings*) was a product of much regulator, industry and consumer discussion over the past 18 months. She said the Working Group requested comments on the Sept. 4 draft prior to and after the Fall National Meeting. Ms. Shaul noted that since the Fall National Meeting, the subgroup of the Working Group—composed of Mr. Mumford, Ms. Mead, Mr. Nepple and herself—has reached out to get the views of a widespread number of stakeholders, including industry and consumers. The subgroup also held an all-day meeting with industry trade associations earlier this month. Ms. Shaul said the subgroup released the current draft of proposed revisions to the *Suitability in Annuity Transactions Model Regulation* (#275) Nov. 16 (Attachment Two-A1). This draft clarifies provisions in the Sept. 4 draft and is based on the comments received on that draft and the additional stakeholder discussions. Ms. Shaul said the purpose of this conference call is to review the subgroup revisions. Specifically, this draft clarifies: 1) insurer and producer responsibility for training; 2) the information that should be collected to determine suitability; 3) the supervision system that an insurer is required to establish and maintain; and 4) an insurer's responsibility for an annuity sale that is not recommended.

2. Review of Subgroup Revisions

Mr. Mumford provided a detailed review of the subgroup revisions in the Nov. 16 draft. He noted that when the subgroup met with the trade associations, it became clear that there was some miscommunication regarding the intent of some of the provisions. As such, the subgroup's revisions aim to clarify those provisions. He said throughout the draft the word "replacement" was added to more appropriately reflect insurance terminology. Adding the word "insurer" in Section 4A—a revision made in response to subgroup discussions with Securities and Exchange Commission (SEC) representatives was intended to clarify what type of direct response solicitation would be exempt from the model's provisions. He said the subgroup may revisit this revision based on some comments received on the draft. Mr. Mumford also noted that the suggested revisions to Section 4B—made in response to comments received from the Vermont Department of Insurance—are intended to clarify the scope of the exemption for ERISA plans. He noted that the subgroup also may revisit this revision based on comments received on this provision.

For Section 5—Definitions, Mr. Mumford said new definitions for "continuing education credit" and "continuing education provider" in Section 5B and C, respectively, were added because these terms were used in Section 7—Insurance Producer Training. The definition of "qualified staff" was deleted because the subgroup addressed the issues requiring this definition in a different manner in Section 6—Duties of Insurers and Insurance Producers such that the term was no longer necessary. Mr. Mumford said the former definition of "suitability requirement" in Section 5H was deleted for the same reason. He said the revisions to the definition of "suitability information" in Section 5H were made to more appropriately reflect that buying an annuity is a financial planning decision, not necessarily an investment decision. Mr. Mumford said the revisions to Section 6—Duties of Insurers and Insurance Producers were made to clarify the core concepts in the model. The revisions to Section 6C are intended to make clear that an insurer is responsible for the suitable sale of its products and is responsible for ensuring that the model's requirements are followed by its producers and any third-party contractors. Mr. Mumford noted that the subgroup struggled with the revisions to Section 6E to address the situation when the consumer refuses to provide relevant information or decides to enter into an annuity transaction that is not recommended. He said the subgroup may have to revisit the language in light of some of the comments received on this provision. Mr. Mumford said the recordkeeping requirements

in Section 6F were new and were added to provide guidance to insurers on what type of information must be retained related to recommendations for any future market conduct examinations. The revisions to Section 6G are intended to make clear the specific responsibilities for insurers and insurance producers under the model for satisfying the training requirements and ensuring suitable sales.

Ms. Mead outlined the revisions to Section 7—Insurance Producer Training. She said the subgroup revised this section to reflect Iowa’s training requirements for indexed annuities and other states’ training requirements for long-term care insurance partnership policies. She said she also worked with the National Association of Insurance and Financial Advisors (NAIFA) and noted that this section makes the insurer responsible making sure their producers have the required training. She also noted that this section places the burden on insurance producers to have adequate training before selling an annuity product.

Mr. Mumford said the revisions to Section 8—Mitigation of Responsibility add a new subsection to giving the commissioner discretion to assess appropriate penalties for violations of Section 6D, which prohibits an insurer from not issuing an annuity to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer’s suitability information. With respect to the revisions to Section 10—Effective Date, Mr. Mumford said that instead of setting a specific date for the effective date of the revisions to the model, the subgroup will review this language and, perhaps, set an effective date for six months after the date the revisions are adopted by a state given that states will adopt the revisions at different times.

3. Discussion of Nov. 16 Draft Revisions

Mr. Olson asked about the Working Group’s plan for moving forward. He noted that although this draft is a better version than the previous draft, in his opinion, some provisions still needed to be clarified. Ms. Shaul said she believed the draft was a good product, but understood Mr. Olson’s opinion. Mr. Olson said it appeared the Nov. 16 draft took into account some of the comments received on the Sept. 4 draft, but not all of them. He believed some of those comments would have made the draft better. Mr. Olson said that if these comments were not included, he wanted the Working Group to know he may raise them at some other time as part of his state’s legislative process. Ms. Shaul said she believed this draft would enable uniform adoption in the states with respect to its core provisions. Ms. Senkewicz said she would like the Working Group to complete its work as soon as possible in order to be able to introduce legislation reflecting the model’s revisions during Florida’s legislative session, which begins in March 2010. Mr. Olson said he still had concerns about the language in Section 4 regarding the ERISA plan exemption. He also had concerns that the safe-harbor language for broker-dealers regulated by the Financial Industry Regulatory Authority (FINRA) would leave a regulatory gap. Mr. Mumford suggested that Mr. Olson detail his concerns in writing for the subgroup’s consideration.

Ms. Lerner outlined her concerns with the draft, as noted in the changes to the draft she had recently submitted. She said she agreed with some of Mr. Olson’s comments. She also noted that the draft does not include language that clearly describes the model’s purpose to set forth standards and procedures for recommendations that would help ensure that unsuitable sales are deterred. Section 1—Purpose should include such language. Ms. Shaul acknowledged Ms. Lerner’s comments. She noted that the draft is stronger than the current model and holds the insurer responsible for unsuitable sales.

Kelly Ireland (American Council of Life Insurers—ACLI) said her organization submitted a joint industry comment letter with Insured Retirement Institute (IRI) and NAIFA (Attachment Two-A2). She said industry shares the Working Group’s goal to prevent unsuitable sales. She acknowledged that, from industry’s perspective, this draft was better than previous versions. However, industry still has concerns. Some of those concerns include: 1) the removal of the “pattern or practice” standard as the standard to be applied on insurers for violations of the model; 2) the removal of the unconditional exemption for employer-sponsored plans and the exemption for all direct response solicitations; 3) the lack of clarity in the FINRA compliance safe harbor language; and 4) the requirement that all insurance agencies be examined periodically. Ms. Ireland expressed concern that there would not be sufficient time prior to the Working Group’s Nov. 30 conference call to review any subsequent draft to see if industry’s concerns were addressed. Eric DuPont (MetLife) expressed support for Ms. Ireland’s comments about the Working Group’s plan for moving forward. Ms. Ireland asked for clarification of Ms. Shaul’s comment regarding the uniform adoption of the model. Ms. Shaul said the goal is to reach uniformity in state adoption of the model. However, she said that all should understand there could be some minor changes because that is the reality of the legislative process. With respect to Ms. Ireland’s concern about not having sufficient time to review any subsequent draft prior to the Nov. 30 conference call, Ms. Shaul said the issues are not new. As such, she was not concerned with holding the Nov. 30 conference call. Kim O’Brien (National Association for Fixed Annuities—NAFA) asked when the next draft would be released for comment. Ms. Shaul said it would be released Nov. 25 or 27. Birny Birnbaum (Center for Economic Justice—CEJ) also expressed concern that there would not be enough time to review a new draft prior to the Nov. 30 conference call. He also said the revised language in Section 6E made that provision more confusing than what was in the previous draft. Mr.

Musgrove indicated that if there is not sufficient time to review any subsequent draft prior to the Nov. 30 conference call, he would not be prepared to vote on whether to adopt the revisions.

Having no further business, the Suitability of Annuity Sales (A) Working Group adjourned.

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Draft: 11/16/09
Subgroup Revisions to Model 275

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.

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).

- ~~(1)~~(a) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);
- ~~(2)~~(b) A plan described by ~~§~~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;
- ~~(3)~~(c) A government or church plan defined in ~~§~~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 ~~§~~section 457 of the IRC; or
- ~~(4)~~(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 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~~
 - ~~(c)~~(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.~~
- ~~D~~G. (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 Anan 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)Includeinclude 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 Compliancecomplies with the National Association of Securities Dealers ConductFINRA 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~~ it a security representative recommendation of an annuity that is a security complies with the NASD Conduct RulesFINRA 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.



November 23, 2009

Ms. Kim Shaul
Chair, NAIC Suitability of Annuity Sales (A) Working Group
Deputy Commissioner
Wisconsin Office of Insurance Commissioner
125 S Webster St
Madison, WI 53703

Ms. Jolie Matthews
Senior Health and Life Policy Advisor & Counsel
NAIC
Government Relations Office
444 N. Capitol Street, N.W. Suite 701
Washington, DC 20001-1509

Dear Ms. Shaul and Ms. Matthews:

These comments on the Suitability of Annuity Sales (A) Working Group's November 16th Draft of Revisions to the Suitability in Annuity Transactions Model Regulation are being submitted on behalf of the undersigned organizations. We appreciate this opportunity to provide comment prior to the Working Group's November 24th call to discuss the draft revisions.

We and our members share a common goal with you and all Suitability of Annuity Sales Working Group members – we do not want to see any consumer suffer the effects of an unsuitable annuity sale. Nor, given the importance of annuities to consumers' retirement planning, do we want to see the reputation of these important products eroded by unsuitable sales. We strongly support a regulatory system that requires comprehensible consumer disclosures, and suitable sales recommendations by properly credentialed individuals. We believe that uniform state adoption of the NAIC's Model Regulations governing annuity disclosure, suitability, and the use of senior-specific designations is an enormous regulatory step forward in providing strong consumer protections and preserving the integrity of the annuity sales process.

We understand there is some pressure to adopt amendments to the Suitability Model by year end. We believe, however, that changes are needed in the draft revisions before we can move toward consensus which would help to accomplish that goal. While we will briefly outline some of the more problematic areas of the draft below, we have also attached a list of these and other issues, which we hope will be helpful in understanding our concerns.

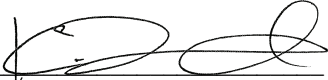
Though we acknowledge improvements in the November 16th draft such as the Insurance Producer Training provisions which will strengthen consumer protection and producer understanding in the marketplace, there are still a number of fundamental concerns we continue to maintain relative to the new draft. Foremost among these concerns is the setting of a standard of insurer strict liability for producer recommendations which could subject insurers to sanctions and penalties for a single violation, even though the violation may be that of a third party. The draft's inclusion of certain FINRA Rules, which are designed to regulate broker-dealer distribution of annuities and are not applicable to insurers as issuers of annuities, is another area of key concern. This attempt to simply replicate securities regulatory supervisory concepts in insurance regulation does not reflect accurately the important distinctions between the singular broker-dealer distribution model and the multiple insurer distribution systems operating within the life insurance industry today. It is our view that some of these provisions would need to be modified or deleted in order to achieve a workable result.

In addition to these concerns, which we have raised previously on a number of occasions, the November 16th draft introduces new concepts that heretofore have not been identified or discussed as problems that need to be addressed in revisions to the Model, including the potential elimination of exemptions currently afforded to direct response solicitations and employer-sponsored plans. Introducing new language in the draft at this stage complicates efforts to achieve the stated goal of

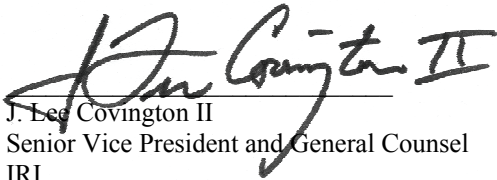
developing a workable version of the Model Regulation by year-end. Moreover, many of the provisions in the new draft must be read together to understand their meaning and we feel that this interrelation makes it difficult to achieve clarity and will ultimately lead to differing interpretations by regulators.

Thank you for your consideration of the issues we have raised. If the goal of revising the current Model Regulation is to provide uniform guidance in developing agent training, supervision and monitoring standards in order to better protect annuity consumers from unsuitable sales, we urge you to work together with industry to develop revisions that will achieve clarity and protect both consumers and the vibrant annuity marketplace that has developed under the current NAIC Suitability Model and FINRA Rules.

Very truly yours,



Kelly Ireland
Counsel
ACLI



J. Lee Covington II
Senior Vice President and General Counsel
IRI



Roland L. Panneton
Senior Counsel
NAIFA

Cc: Members of the Suitability of Annuity Sales (A) Working Group
Attachment: Key Issues Presented by the November 16th Draft

Key Issues Presented by the November 16th Draft

The November 16 draft introduced for the first time a number of new issues that raise concerns, removes some important provisions and concepts contained in the September 4 Working Group draft, and continues to contain provisions that are unclear or unworkable. These include the following:

- 1. Insurer Strict Liability for Producers' Actions Even When A Reasonable Supervision System Is In Place/Removal of the "Pattern or Practice" Standard :** Several provisions read together, as well as the absence of the pattern or practice standard, could be interpreted to impose a strict liability standard on insurers for all violations of the regulation. The enabling legislation for this regulation in most states is the Unfair Trade Practices Act. Therefore, as a matter of law, this Model cannot create liability where the NAIC Model Unfair Trade Practices Act would not. And, the "pattern or practice" standard is the appropriate standard to be applied. It has long been recognized that regulatory sanctions and penalties should not be imposed for isolated instances of non-compliance with regulatory requirements where these violations have not occurred with such frequency as to constitute a pattern or practice.
- 2. Removal of the Unconditional Exemption for Employer Sponsored Plans and the Exemption for all Direct Response Solicitations:** Amending these exemption provisions has never been raised or discussed by the Working Group or any of its members. As previously recognized in the current Model and earlier drafts, applicability of a suitability standard is simply not necessary for employer sponsored plans or direct response solicitations as part of a group marketing effort because no recommendation is made to an individual during the product selection process.
- 3. Lack of Clarity in FINRA Compliance Safe Harbor:** As currently drafted, the FINRA safe harbor is unclear as to the intended scope and applicability. In order to be workable, there should be one clear FINRA safe harbor stating that "Compliance with FINRA rules pertaining to suitability, supervision and training shall satisfy the requirements under this Model Regulation. However, nothing in this subsection shall limit the insurance commissioner's ability to enforce the provisions of this regulation." The accompanying drafting note would be revised to read: "This safe harbor applies to FINRA broker-dealer sales of fixed annuities as well as variable annuities."
- 4. Effective Imposition of a Transaction-by-Transaction Review Requirement on Insurers/Inability to Contract With Distributors to Perform Supervisory Functions .** The cumulative impact of several provisions will effectively require insurers to review every recommendation for suitability, regardless of the level of risk of an unsuitable transaction. Other provisions appear to allow insurers to use reasonable selection criteria to determine transactions to be reviewed, which is our understanding of the drafters' intent. However, this needs to be clarified.
- 5. Requirement to Confirm Suitability Information Provided by a Producer.** This requirement is based on FINRA rules requiring verification of a client's information (e.g. new account opening information), which are designed to require broker-dealers to keep client information up to date, not to achieve the objective of verifying information to support a particular transaction. If the latter is the intent, this is achieved through the supervisory requirements for reviewing and monitoring designed to reasonably assure recommendations are suitable and detect those that are not.
- 6. Requirement That All Insurance Agencies be Examined Periodically.** The examination of all producers and insurance agencies on a scheduled and routine basis is extreme and unprecedented. Examinations of these entities by each insurer they do business with would require some insurers to perform thousands of examinations, and subject most insurance agencies to a non-stop cycle of examinations by different insurers. Other more targeted and reasonable alternatives exist and are already contained in the November 16 Draft (e.g., insurers support the requirement that they must take appropriate corrective action when warranted based upon the findings of "red flag" agency monitoring systems, which would include the possible need to conduct further investigation or examination of an agency's practices).

- 7. New Unnecessary Requirements When Customer Refuses to Provide Suitability Information.** For certain types of transactions, such as products that are purchased as alternatives to Bank CDs, many consumers do not want to provide the required financial information. In other instances, consumers have other reasons for not wanting to provide suitability information, including their view that financial information is highly personal in nature. In these instances, the producer and insurer should not be liable for the customer's purchase decision. The Draft already contains a provision requiring producers to make reasonable efforts to obtain the suitability information. Further, insurer monitoring would detect any pattern or practice that may be indicative of failure to comply with this requirement
- 8. Necessary Clarity Regarding Third Party Monitoring Requirement.** The Draft should be clear about the requirements for an insurer's supervision of contractual performance where supervisory functions are being performed by its distributors. It should be clear that this supervision may be achieved by monitoring, auditing as appropriate, and obtaining a certification of compliance. As written now, the provision could be interpreted as requiring more than explicit requirements, and it is unclear what additional procedures would be required.
- 9. New Training Requirements That Are Unclear.** We support the intent of including a new section concerning Insurance Producer Training, and feel that the requirements that producers complete a four (4) hour initial training program, that the producer has adequate knowledge of the product to explain the material features of the product to a consumer, and that the insurer make available materials explaining the material features of the products, meet the regulatory objective. It is unclear, however, whether additional responsibility for producer training is being imposed on insurers and we want to ensure that an insurer or its third party distributor has flexibility to determine when other training is necessary, and how insurer product education is accomplished.

Draft: 11/27/09
Subgroup Revisions to Model 275

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.

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~~ transactions involving:

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

- (1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);
- (2) A plan described by ~~§~~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;
- (3) A government or church plan defined in ~~§~~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 ~~§~~section 457 of the IRC;
- (4) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;
- (5) Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or
- (6) Formal prepaid funeral contracts.

Section 5. Definitions

- A. “Annuity” means a fixed 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. “Replacement” means a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be:
- (1) Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;
 - (2) Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;
 - (3) Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid;
 - (4) Reissued with any reduction in cash value; or

- (5) Used in a financed purchase.

Drafting Note: The definition of “replacement” above is derived from the NAIC Life Insurance and Annuities Replacement Model Regulation. If a State has a different definition for “replacement,” the State should either insert the text of that definition in place of the definition above or modify the definition above to provide a cross-reference to the definition of “replacement” that is in State law or regulation.

- I. “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 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;

Drafting Note: If a State has adopted the NAIC Annuity Disclosure Model Regulation, the State should insert an additional phrase in paragraph (1) above to explain that the requirements of this section are intended to supplement and not replace the disclosure requirements of the NAIC Annuity Disclosure Model Regulation.

- (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 or replacement~~ 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. Except as permitted under subsection D, 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.
- ~~ED.~~ (1) Except as provided under 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 Subsection A or C related to any recommendation annuity transaction if a consumer:
- (a) No recommendation is made;
 - (b) A recommendation was made and was later found to have prepared based on inaccurate information provided by the consumer;
 - (a)(c) A consumer ~~Refuses~~refuses to provide relevant suitability information requested by the ~~insurer or insurance producer~~ and the annuity transaction is not recommended; or
 - (b) ~~Decides to enter into an insurance transaction that is not based on a recommendation of the insurer or insurance producer; or~~
 - (c) ~~Fails to provide complete or accurate information~~
 - (d) A consumer decides to enter into an annuity transaction that is not based on a recommendation of the insurer or the insurance producer.

- (2) ~~An insurer's or insurance producer's recommendation issuance of an annuity subject to Paragraph (1) shall be reasonable under all the circumstances actually known to the insurer or insurance producer at the time of the recommendation the annuity is issued.~~
- E. 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.
- ~~D.F.~~ (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 to the extent reasonably appropriate to identify, and to deter, insurance producer submission of inaccurate information. Nothing in this subparagraph prevents an insurer from complying with this subsection by applying sampling procedures or by confirming suitability information after issuance or delivery of the annuity, or both;
 - (e) 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. An insurer's procedures may apply a system of selection criteria for the purpose of identifying selected transactions for additional review. An insurer's procedures 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;
 - (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; and

- ~~(g)~~ 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 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)(2)~~ (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 F. An insurer is subject to, and is required to comply with this subsection F 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 the contracted function is properly performed;
- ~~(ii)~~ Examination of a function under paragraph (1)(e); and
- ~~(iii)~~ 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)(3)~~ 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.~~

G. 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.

EH. (1) Compliance with the National Association of Securities Dealers Conduct ~~FINRA R~~ rules pertaining to suitability and supervision of annuity transactions shall satisfy the requirements under this section for the recommendation of variable annuities regulation. 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 it complies with the NASD Conduct Rules pertaining to suitability. This safe harbor applies to FINRA broker-dealer sales of fixed annuities as well as variable annuities if the suitability and supervision is similar to the standards applied to variable annuity transactions.

(2) An insurer shall:

(a) Monitor the FINRA member broker-dealer using information collected in the normal course of an insurer's business; and

(b) 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.

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) (a) 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.

- (b) Insurance producers who hold a life insurance line of authority on the effective date of this regulation and who desire to sell annuities 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.
- (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) 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. Compliance Mitigation-of Responsibility; Penalties

- A. 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.

AB. 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; and

~~**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.~~

BC. Any applicable penalty under [insert statutory citation] for a violation of ~~Section 6A, B, D or E~~ or C(2) 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 and the violation was not part of a pattern or practice.

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

- (1) Corrective action for the affected consumer(s) 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 6F(1)(e) of this regulation. The review and approval may be made applying selection criteria as permitted under section 6F(1)(e) of this regulation.

~~**Drafting Note:** A 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. States should consider inserting a reference to the NAIC Unfair Trade Practices Act or the State's statute that authorizes the commissioner to impose penalties and fines.~~

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 [insert date], whichever is later.

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TO: Thomas Sullivan (CT), Chair, Life Insurance and Annuities (A) Committee
FROM: Larry Bruning (KS), Chair, Life and Health Actuarial Task Force
DATE: December 3, 2009
RE: Valuation Manual

The amendments to the Standard Valuation Law that authorize a principle-based valuation approach for life insurance, annuities, and accident and health insurance was adopted by the Life Insurance and Annuities (A) Committee on a September 9 conference call with two conditions: 1) the valuation manual be completed by the end of 2009; and 2) the valuation manual include minimum formulaic reserves. The amendments were then adopted by the NAIC at the 2009 Fall National Meeting.

These amendments also authorize the use of a valuation manual which will contain the minimum valuation standards for all newly issued policies. For the initial version of the valuation manual, these standards will be identical to those in the Accounting Practices and Procedures Manual except for products specifically identified in the valuation manual to use principle-based reserving.

The valuation manual will not be operational until the amendments to the Standard Valuation Law are adopted by 42 of the 55 jurisdictions of the NAIC and the manual itself is adopted by a vote of 75% of the NAIC holding 75% of the total direct premium written. Plenary has expressed a need for presenting to the legislatures as they consider the Standard Valuation Law amendments a copy of the valuation manual. Because the valuation framework is dynamic, there will continue to be modifications to the valuation manual.

On Friday, LHATF adopted a valuation manual that is composed of the following sections: VM-0, VM-1, VM-21, VM-26 and VM-30. VM-21 defines the principle-based approach to valuation for variable annuities. This section is a rewrite of Actuarial Guideline XLIII, CARVM for variable annuities which becomes effective on December 31, 2009. VM-26 provides for a uniform valuation basis for credit life and disability insurance.

The valuation manual adopted by LHATF contains minimum formulaic reserves. VM-21 has the standard scenario reserve that is a seriatim reserve that cannot be less than the cash surrender value. VM-26 which provides for a uniform valuation basis for credit life and disability insurance is a formulaic reserve.

Work is nearing completion on other valuation manual sections that will become part of the valuation manual through the NAIC revision process. These sections are VM-20 and VM-25. VM-20 is the principle-based valuation approach for Life Insurance Products and VM-25 provides for a uniform valuation basis for health insurance.

While VM-20 currently contains a minimum reserve floor, work is being done by the American Council of Life Insurers on a net premium reserve which will serve as a formulaic floor in VM-20. This floor would also serve as the reserve for federal income tax purposes and allow insurers with low risk insurance guarantees to avoid the extensive calculations of a principle-based valuation provided certain exclusion tests are met. To date, the Task Force has reviewed some concepts, but the details

EXECUTIVE OFFICE	444 N. Capitol Street, NW, Suite 701	Washington, DC 20001-1509	p 202 471 3990	f 816 460 7493
CENTRAL OFFICE	2301 McGee Street, Suite 800	Kansas City, MO 64108-2662	p 816 842 3600	f 816 783 8175
SECURITIES VALUATION OFFICE	48 Wall Street, 6th Floor	New York, NY 10005-2906	p 212 398 9000	f 212 382 4207

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of the proposal are still being developed by the ACLI. The American Council of Life Insurers has indicated they would present those details by January 1, 2010.

If it is the desire of the A-Committee to wait until VM-20 and VM-25 are complete, prior to sending the amendments to the Standard Valuation Law and valuation manual to State Legislatures, then the Task Force requests that the date for completion of the valuation manual be extended to no later than the August, 2010 National Meeting.

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