

## SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION

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### Section 1. Purpose

- A. The purpose of this regulation is 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 Subsection B comes from the NAIC Unfair Trade Practices Act. If a state has adopted different language, it should be substituted for Subsection B.

### Section 2. Scope

This regulation shall apply to any recommendation to purchase or exchange 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 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 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;

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- (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 or variable annuity that is individually solicited, whether the product is classified as an individual or group annuity.
- B. "Insurer" means a company required to be licensed under the laws of this state to provide insurance products, including annuities.
- C. "Insurance producer" means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.
- D. "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 of an annuity in accordance with that advice.

**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.
- 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 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.
- (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 related to any recommendation if a consumer:
    - (a) Refuses to provide relevant information requested by the insurer or insurance producer;
    - (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.
  - (2) An insurer or insurance producer's recommendation 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.
- D.
- (1) An insurer either shall assure that a system to supervise recommendations that is reasonably designed to achieve 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:
    - (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.
  - (2) A general agent and 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) 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.
  - (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

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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) An insurer, general agent or independent agency is not required by Paragraph (1) or (2) of this subsection to:
- (a) Review, or provide for review of, all insurance producer solicited transactions; or
  - (b) 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.
- E. Compliance with the National Association of Securities Dealers Conduct 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 complies with the NASD Conduct Rules pertaining to suitability.

## Section 7. 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 Section 6A, B, 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.

**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.

## Section 8. [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 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 states that have a comprehensive recordkeeping law or regulation.

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*Legislative History (All references are to the Proceedings of the NAIC).*

*2003 Proc. 3<sup>rd</sup> Quarter 17-18, 24-27, 32, 213 (adopted).*

*2006 Proc. 2<sup>nd</sup> Quarter (amended).*

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The date in parentheses is the effective date of the legislation or regulation, with the latest amendments.

<b>NAIC MEMBER</b>	<b>MODEL/SIMILAR LEGIS.</b>	<b>RELATED LEGIS./REGS.</b>
Alabama	ALA. ADMIN. CODE § 482-1-137 (Effective Jan. 1, 2007).	
Alaska	NO ACTION TO DATE	
Arizona	ARIZ. REV. STAT. ANN. §§ 20-1243.03 to 1243.04 (2006) (limited to seniors).	
Arkansas	ARK. INS. RULE & REG. 82 (2004) (limited to seniors).	See Directive 2-2006.
California		CAL. INS. CODE § 10509.8 (1990/2004) (Unnecessary replacements of annuities for seniors); See Letter Oct. 5, 2005.
Colorado	COLO. ADMIN. INS. REG. 4-1-11 (2004) (proposed amendment to remove limitation to seniors, Effective Aug. 1, 2006).	
Connecticut	CONN. ADMIN. CODE tit. 38a § 819-70 to 819-76 pending (2004) (limited to seniors).	
Delaware	DEL. ADMIN. CODE tit. 18 § 1214 (effective July 1, 2006) (limited to seniors).	
District of Columbia	NO ACTION TO DATE	
Florida	FLA. STAT. § 627.4554 (2004) (limited to seniors).	
Georgia	NO ACTION TO DATE	
Guam	NO ACTION TO DATE	
Hawaii	NO ACTION TO DATE	
Idaho	IDAHO CODE § 41-1940 (2005) (Small portion of model and authority to adopt regulation); IDAHO INS. REGS. 09 [IDAPA 18.01.09] (2005/2006) (limited to seniors).	

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<b>NAIC MEMBER</b>	<b>MODEL/SIMILAR LEGIS.</b>	<b>RELATED LEGIS./REGS.</b>
Illinois	NO ACTION TO DATE	
Indiana	IND. CODE §§ 27-4-9-1 to 27-4-9-6 (2005) (Includes portion of model and authority to adopt regulation) (limited to seniors).	IND. ADMIN. Tit. 760 R. 1-72-1 to 1-72-6 (effective July 1, 2006).
Iowa		IOWA ADMIN.CODE § 191-15.8 (Life and annuity sales guidelines); § 191-33.3 (1984/1999) (variable life); §§ 191-15.68 to 191.15.73 (2006).
Kansas		KAN. ADMIN. REGS. § 40-20-2 (1974/1988) (Life and annuity recommendations); § 40-2-14a; § 40-2-14b (2005) (Recommendations for life insurance and annuities).
Kentucky	NO ACTION TO DATE	
Louisiana	LA. ADMIN. CODE 37:11701 to 37:11717 (2006).	
Maine		ME. REV. STAT. ANN. tit. 24-A § 2517 (1969/2005) (Authority to adopt regulation).
Maryland	NO ACTION TO DATE	
Massachusetts	211 CODE of MASS. REGS. 96.01 to 96.10 (2006).	See BULLETIN B-2006-8.
Michigan	MICH. ADMIN. CODE R. 500.4151 to 500.4165 (2006).	
Minnesota		MINN. STAT. § 60k.46 (2002) (Solicitation standards).
Mississippi	NO ACTION TO DATE	
Missouri		MO. ADMIN. CODE tit. 20 § 400-1.020 (198/2002); § 700-1.146.
Montana	NO ACTION TO DATE	
Nebraska	NO ACTION TO DATE	
Nevada	LCB File RO76-05 (2005) (Not limited to seniors).	



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<b>NAIC MEMBER</b>	<b>MODEL/SIMILAR LEGIS.</b>	<b>RELATED LEGIS/REGS.</b>
New Hampshire	NO ACTION TO DATE	
New Jersey		N.J. REV. STAT. § 17B:25-20 (1981/2005) (Limits maturity dates and surrender charges for annuities sold to seniors).
New Mexico	NO ACTION TO DATE	
New York	NO ACTION TO DATE	
North Carolina		N.C. ADMIN. CODE tit. 11 ch. 12 § .0420 (1976/1992) (Submit suitability form).
North Dakota		N.D. ADMIN. CODE § 45-02-02-14 (Recommendations to consumers over age 65); § 45-04-04-07 (1984).
Northern Marianas	NO ACTION TO DATE	
Ohio	NO ACTION TO DATE	
Oklahoma	OKLA. ADMIN. CODE §§ 365:25-17-1 to 365:25-17-11 (2005) (limited to seniors).	
Oregon		OR. ADMIN. R. 836-080-0090 (2004).
Pennsylvania	NO ACTION TO DATE	
Puerto Rico	NO ACTION TO DATE	
Rhode Island	R.I. REGS. R27-12-1 to 27-12-10 (2006).	
South Carolina	SB 967 pending (2006).	
South Dakota		S.D. ADMIN. R § 58-28-33 (2003).
Tennessee	NO ACTION TO DATE	
Texas	NO ACTION TO DATE	
Utah	UTAH INS. R 590-230-1 (2004/2006).	

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Vermont	NO ACTION TO DATE	
Virgin Islands	NO ACTION TO DATE	
Virginia	NO ACTION TO DATE	
Washington	NO ACTION TO DATE	
West Virginia	NO ACTION TO DATE	
Wisconsin	WIS. STAT. § 628.347 (2004).	
Wyoming		WYO. INS. REGS. ch. 27 § 11 (1968/1997) (Variable contract regulation).

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In 2000, the NAIC adopted a white paper recommending the establishment of suitability standards for life insurance and annuities. Shortly thereafter a working group was appointed to draft standards. The purpose of the model act and regulation developed by that working group was to regulate the activities of insurers and producers who made recommendations to consumers to purchase certain life insurance and annuity products to ensure that insurers and producers made suitable recommendations based on relevant information obtained from the persons who purchased life insurance and annuity products. **2003 Proc. 3<sup>rd</sup> Quarter 27.**

A model act and regulation were adopted by the working group and forwarded to the parent committee. Because of the lack of support for a wide-reaching suitability standard, and because none had existed before in most states, the parent committee recommended a narrow model that addressed the area of most concern to regulators—the sale of annuities to seniors. A new model was drafted in early 2003 and comments solicited. Associations, consumer groups and others participated. The process resulted in a new model that was adopted by the NAIC membership. **2003 Proc. 3<sup>rd</sup> Quarter 28.**

**Section 1. Purpose**

A. There was some consensus to prepare a draft that started with the National Association of Securities Dealers (NASD) standards in place for variable products. An interested party said the primary issue was whether incorporation of the NASD standards meant that regulators were also incorporating the whole supervisory structure of the NASD. **2003 Proc. 2<sup>nd</sup> Quarter 220.**

A regulator said the earlier draft prepared by the working group had a checklist of specific items to be reviewed but now that the standard was more general, he suggested removing the word “minimum” before standards so that the regulation would just say that it set forth standards and procedures. An interested party said that the wording of Section 1 could imply that insurers did not have a responsibility if they did not make recommendations and the committee agreed to reword that section to make this clearer. **2003 Proc. 2<sup>nd</sup> Quarter 217.**

To address continuing concerns on the part of interested parties that suitability might be determined based on later circumstances, the committee added the phrase “at the time of the transaction” to Subsection A. **2003 Proc. 2<sup>nd</sup> Quarter 220.**

B. An interested party asked the committee to consider adding specific language in Section 1 about a private cause of action. Regulators agreed to add a Subsection B referring to a private cause of action. Another regulator said this already appeared in the Unfair Trade Practices Act and so it was not needed in this regulation. The committee agreed to repeat the language as it was written in the Unfair Trade Practices Act in this document. The regulator suggested adding a drafting note that if a state had different language in its Unfair Trade Practices Act, it should use that instead. **2003 Proc. 2<sup>nd</sup> Quarter 217.**

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**Section 2. Scope**

Extensive discussion took place on whether the model should cover all recommendations or just recommendations that resulted in a sale. Ultimately the drafters settled on a focus on recommendations that resulted in sales. They expressed concern that all recommendations be suitable, but recognized the record-keeping burden that would be imposed by extending the model to cover all recommendations. **2003 Proc. 3<sup>rd</sup> Quarter 28.**

An interested party said the draft was so general in scope that it was confusing. The interested party said that the phrase, “transaction or a series of transactions” was too broad. If a producer who was not licensed with Company A recommended that an individual surrender his annuity and buy a Company B product, Company A had no ability to judge the suitability of that recommendation. A commissioner said that, if a person exchanged an annuity for a universal life insurance policy, the language recommended by the interested party would be clearer. Another interested party asked if this would cover a situation when a person surrendered his annuity and bought a mutual fund. The interested party said that, in that case, neither the securities nor insurance regulators would have jurisdiction when someone surrendered an annuity. **2003 Proc. 3<sup>rd</sup> Quarter 212.**

Once the model was narrowed to apply only to sales of annuities to seniors, one new issue was whether the rules should apply to all transactions involving an annuity, or just a transaction where an annuity was being purchased. The language settled on referred to a purchase or exchange of an annuity. **2003 Proc. 3<sup>rd</sup> Quarter 28-29.**

**Section 3. Authority**

There were many controversial items raised during the drafting of the initial model draft. The working group discussed whether to use the Unfair Trade Practices Act as authority for development of a regulation. Interested parties urged the working group to develop language specific to suitability of sales. This discussion also extended to whether to require a pattern of conduct, as in the Unfair Trade Practices Act, or whether a single violation was sufficient to invoke penalties. **2003 Proc. 3<sup>rd</sup> Quarter 28.**

**Section 4. Exemptions**

Once the model was narrowed to apply only to sales of annuities to seniors, many of the issues that previously had been controversial no longer applied, such as many of the exemptions included in the earlier draft. However one new issue was whether the rules should apply to all transactions involving an annuity, or just a transaction where an annuity was being purchased. The language settled on referred to a purchase or exchange of an annuity. **2003 Proc. 3<sup>rd</sup> Quarter 28-29.**

A. An interested party suggested a number of technical changes to the draft. One suggestion was to add “pursuant to this regulation” following “based on information collected from the senior consumer” in Section 4A. A regulator said that if the producer used information he already knew, it would fall outside the scope of the regulation and that was not the drafters’ intent. The interested party responded that the purpose of that language was to reflect the fact that the type of information gathered from the consumer should be relevant to determining suitability in order to fall under this regulation. Regulators decided to include the language suggested by the interested party in Section 4A. **2003 Proc. 3<sup>rd</sup> Quarter 213.**

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**Section 4A (cont.)**

The drafting group discussed how the regulation would apply to direct writers. An interested party said that a recommendation should be based on an exchange of information. Direct writers sent out information with minimal knowledge of the person receiving it. If the model applied to them, direct writers will have to change the way they did business. A regulator opined that in direct response solicitations, the advertising just described the product; it does not “advise.” Another interested party said the earlier draft prepared by the working group exempted direct response if no direct recommendation was made. An interested party said all advertising could be a recommendation. That is why the words “specific personalized” needed to be in the draft referring to recommendations. **2003 Proc. 2<sup>nd</sup> Quarter 217.**

B. The committee decided to put exemptions in this regulation similar to those that had been in the draft act considered by the earlier working group. A regulator pointed out that the draft included an exemption for variable annuities, which should be removed. The committee discussed the various types of contracts included in Subsection B and decided that they were all appropriate exemptions. A regulator asked why prepaid funeral contracts were being excluded. Another regulator responded that these were smaller face amount products, not generally in the area of abuses. The drafters considered adding an exemption for structured settlements. A regulator pointed out that this type of contract did not generally result from a recommendation by an insurer or producer but agreed that it did not hurt to have the exemption there. Another interested party requested that the committee consider an exemption for sophisticated purchasers. An interested party said the National Association of Securities Dealers (NASD) suitability standards did not have an exemption for sophisticated purchasers, for good reason. The committee declined to add it to this draft. **2003 Proc. 2<sup>nd</sup> Quarter 219.**

**Section 5. Definitions**

An interested party pointed out that the earlier draft from the working group included a definition of “suitable.” He asked if that should be added here. A regulator said using the standards from the NASD addressed that issue. **2003 Proc. 2<sup>nd</sup> Quarter 219.**

D. A commissioner said he would like to finish the recommendation definition so that the wording for Section 1 could be clearer. An interested party suggested inserting the word “specific personalized” before recommendations. The commissioner said he was not in favor of the suggestion to add “specific personalized” to recommendations to relieve direct writers from any obligation. A regulator said that “personalized” could mean that, as long as the individual’s name is not on any advice, it is not personalized. This created a loophole. Another regulator said this suggestion had been brought up to the former working group over and over again and was always rejected. An interested party said that a recommendation should be based on an exchange of information. Otherwise the model was too broad. **2003 Proc. 2<sup>nd</sup> Quarter 217.**

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**Section 5D (cont.)**

The committee spent a considerable amount of time discussing the definition of recommendation in Subsection D. Several interested parties suggested adding language to the definition of recommendation to clarify that it applied only to recommendations that resulted in a sale. A regulator asked if the NASD rules applied to all recommendations. An interested party responded that in theory they did, but in practical terms, only recommendations that resulted in a sale were acted upon because those were the transactions that caused harm. A regulator pointed out that the rulekeeping requirements applied only to recommendations that resulted in a sale. **2003 Proc. 2<sup>nd</sup> Quarter 219.**

A commissioner asked how the NASD defined recommendations. An interested party said that the NASD did not have a legal definition but gave guidance to members on various issues related to their recommendations. A regulator asked if that created any problems and the interested party responded that it gave the NASD flexibility to look at the circumstances. The regulator asked if a specific definition such as contained in the NAIC's model might cause a problem with variable products. The interested party said that was a possibility. **2003 Proc. 2<sup>nd</sup> Quarter 216.**

A regulator asked how this regulation would operate if a recommendation were made in a group situation. A commissioner said that, before any transaction took place, members of the group would have to sit down individually with the producer to complete an application. The regulator said that it might be difficult for regulators to decide if a seminar or education program was really a recommendation. The commissioner said the producer would not be relieved of his duty to get an application and information from each person who decided to purchase the product. An interested party suggested that it might be wiser to follow the lead of the NASD and not define a recommendation. Another interested party suggested including the word "individual" to avoid the question of whether advertising was a recommendation. A regulator asked if the NASD considered a group presentation to be a recommendation. An interested party responded that an analysis would be done on a case-by-case basis. Another interested party said that, after a general sales presentation to a group, an individual recommendation must be made as to a specific product and amount. A regulator said that a recommendation would not take place until that point. An interested party said adding the NASD rules addressed many of the concerns about these types of situations. **2003 Proc. 2<sup>nd</sup> Quarter 219.**

E. An industry trade association suggested raising the age when someone was a "senior consumer" to 75. A regulator said that, with people moving toward early retirement, the age should be 55. If the committee wanted to consider an adjustment, he would argue for a lower age. Another regulator said 65 was a compromise already. The scope was narrowed from covering all transactions. **2003 Proc. 2<sup>nd</sup> Quarter 217.**

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

While the model was being drafted, one of the most controversial issues was balancing the responsibilities of the insurers and the producers. The working group that first drafted a model was convinced that the proper balance was to require responsibility for both. The working group draft required the insurer to have standards for suitable recommendations in place and a system designed to make sure that producers knew and followed those standards. The producer had a responsibility to follow the standards set by the insurer. One significant addition to the draft prepared by the parent committee was to add standards for mitigation of penalties if the producer and insurer worked to right any wrongs done to a consumer. **2003 Proc. 3<sup>rd</sup> Quarter 28.**

An interested party opined that one of the fundamental issues was the duties of insurers and producers. A commissioner asked what would happen if a recommendation was made and then six months later the individual decided to make the purchase. An interested party said the presumption in the draft was that, if the purchase was the result of the recommendation, the responsibility to determine suitability would still be there. The commissioner said that seemed to him to be a good approach. The interested party said the case-by-case analysis of the NASD was an appropriate approach. Another commissioner agreed that regulators should allow themselves the latitude to consider suitability issues on a case-by-case basis without specific detail. **2003 Proc. 2<sup>nd</sup> Quarter 217.**

B. The committee agreed to insert “resulting from a recommendation” following “transaction” in subsection B. **2003 Proc. 3<sup>rd</sup> Quarter, 213.**

C. A regulator criticized the draft by saying that if a customer refused to provide information, the entire model was not applicable to that transaction. He suggested adding a new Paragraph (2) so that the insurer or producer was still charged with responsibility. If it was clear that the producer should have not gone forward, it was still not an appropriate sale. **2003 Proc. 2<sup>nd</sup> Quarter 152.**

D. A commissioner asked whether upfront review of each transaction was needed. He had not been in favor of the earlier model developed by the working group because it opened up insurers to possible litigation. He preferred a requirement that did not add lots of expense. A regulator expressed concern with the language that ultimately became a part of Subsection D. He said he did not believe that it relieved insurers of liability and he did not think it was necessary. He said the draft as it existed did not imply a case-by-case review. He expressed concern that the language was overly broad in saying that a company was relieved of all responsibility if it had sampling, testing or audit. The commissioner said this phrase described the process that an insurer used to meet its obligations and should not be interpreted any other way. The regulator asked if it was clear that the insurer was still ultimately responsible and asked why the second sentence was needed. Another regulator opined that it was there to recognize the different distribution systems. An interested party said that the drafters of this additional language did not intend to suggest that this would relieve insurers of their obligations. She opined that this type of flexibility would go a long way toward alleviating concerns within the industry about how to address suitability under different distribution systems. **2003 Proc. 2<sup>nd</sup> Quarter 218.**

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**Section 6D (cont.)**

Determining what standards to use for determining suitability resulted in extensive discussion. Insurers requested more specific guidance on how their standards should look so that they were reasonably assured that they were adequate. Regulators discussed using membership in an organization as a standard, but rejected that approach. **2003 Proc. 3<sup>rd</sup> Quarter 28.**

A commissioner opined that “assuring recommendations are supervised” was less explicit than requiring a “system to supervise.” Another commissioner said she expected a system demonstration that would assure her that recommendations were supervised, so she did not see much difference between the two wording alternatives. The chair disagreed, saying that there was a shade of difference in the meaning and that a “system” was a stronger requirement. The director said that giving the responsibility to an insurer, general agent or independent agency gave the insurer an opportunity to say it was not the responsible party. **2003 Proc. 3<sup>rd</sup> Quarter 31-32.**

An interested party asked who was ultimately responsible if an insurer contracted with a third party. A regulator responded that the company was ultimately responsible. Another regulator responded that the insurer would probably make the third party partially responsible. The interested party said this was a very important issue to him and he wanted to make sure that everyone had the same understanding. He did not want the companies to say that because they monitored, they had no responsibility. He said he believed that the first sentence in Subsection D gave the insurer a responsibility that was clear. What if in the sampling, testing or audit it was discovered that the insurer had not found what was needed? Another regulator said that in this case the company system was inadequate. **2003 Proc. 2<sup>nd</sup> Quarter 218.**

E. There was some consensus to prepare a draft that started with the National Association of Securities Dealers (NASD) standards in place for variable products. An interested party said the primary issue was whether incorporation of the NASD standards meant that regulators were also incorporating the whole supervisory structure of the NASD. **2003 Proc. 2<sup>nd</sup> Quarter 220.**

A regulator suggested a change to Section 6E. He said the draft as written may not be clear in its intent to give a safe harbor for compliance with the NASD rules. He suggested a different paragraph that requires the commissioner to apply guidance from the NASD in coming to a conclusion about compliance. **2003 Proc. 2<sup>nd</sup> Quarter 152.**

The committee considered a suggestion that would grant a safe harbor for compliance with the NASD Rules of Conduct for variable annuities. A regulator opined that it was not necessary, but an interested party said it reduced the possibility of conflict. The regulator asked whether it would remove the ability for the insurance department to take action for violations. Another regulator said that the parties wanting to take shelter in this safe harbor would still have to demonstrate that they were in compliance with those rules. Another interested party suggested adding a sentence to the effect that nothing in this section would detract from a state’s ability to enforce the regulation. Another interested party asked if a state can determine whether a person has failed to comply with NASD rules. Another regulator said most states’ securities laws include a provision that any violation of NASD or Securities Exchange Commission (SEC) rules or any other federal law will be a violation of state law. An interested party said that if the company complied with the interpretations of the NASD, they had utilized the safe harbor. **2003 Proc. 2<sup>nd</sup> Quarter 218.**



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**Section 7. Mitigation of Responsibility**

One significant addition to the draft prepared by the parent committee was to add standards for mitigation of penalties if the producer and insurer worked to right any wrongs done to a consumer. **2003 Proc. 3<sup>rd</sup> Quarter 28.**

A regulator said he had a concern about this section because it required an insurer only to take remedial action when it got caught. He suggested changing the word “remedial” to “corrective” to require the company to make a change to prevent future occurrences. An interested party said this section was ambiguous because it did not tell an insurer what type of action to take. He asked if being in compliance with a state’s “free look” provision was sufficient, for example. The regulator said it depended on the facts and circumstances of the case. Another regulator said that if the insurer did not resolve the issue, there will be a negotiation with the insurance department and the corrective action would be worked out together. The committee agreed to accept Section 7 with a reference to corrective action. **2003 Proc. 2<sup>nd</sup> Quarter 219.**

One state provided suggestions for amendments to make this section stronger. An interested party said the extensive amendments changed the concepts of corrective action. Another interested party asked what it meant to take “corrective action where appropriate.” Another interested party said that if an inappropriate sale occurred, the insurer would work to determine the nature of the situation and may need to refund the money or change some aspect of the contract. An interested party asked if an insurer would be amenable to that type of corrective action when it found out from other sources, such as a complaint filed with the insurance department. A commissioner said the action would also include termination of the producer who made an inappropriate recommendation. The commissioner said he looked at the model as a hammer to encourage companies to make the consumer whole. The interested party suggested language that would say when an insurer discovered someone had purchased an unsuitable annuity, the consumer would be put back in the right position if either the insurer or the producer did not meet his responsibility under the regulation. The commissioner said the purpose of this regulation was to encourage companies to make the consumer right. He would assume that corrective action included putting the person back in the condition he should have been. **2003 Proc. 2<sup>nd</sup> Quarter 153.**

**Section 8. [Optional] Recordkeeping**

An interested party suggested changing the section from saying that the insurer shall maintain records to say that the insurer shall make them available to the commissioner. Regulators agreed with the suggested change. **2003 Proc. 2<sup>nd</sup> Quarter 219.**

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**Chronological Summary of Actions**

September 2003: Model adopted.

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