

2009 Fall National Meeting
Washington, DC
**SUITABILITY OF ANNUITY SALES WORKING GROUP
OF THE
LIFE INSURANCE AND ANNUITIES (A) COMMITTEE**

Monday, September 21, 2009

11:30 a.m. – 1:00 p.m.

Gaylord Convention Center—National Harbor 4-5—National Harbor Level

Kim Shaul, Chair	Wisconsin
Steve Ostlund	Alabama
Katie Campbell	Alaska
Joe Musgrove	Arkansas
Jodi Lerner	California
Mary Ellen Breault	Connecticut
Mary Beth Senkewicz	Florida
Jim Mumford	Iowa
Marlyn Burch	Kansas
Paul Hanson	Minnesota
Mary Kempker/Tamara Kopp	Missouri
Anne Marie Narcini	New Jersey
Gail Keren/Martin Schwartzman	New York
Michelle Brugh	Ohio
Mike Lydon	Oregon
John Morris	Tennessee
Christopher Bean	Texas
Betsy Jerome	Utah
Herb Olson	Vermont

AGENDA

- 1. Roll Call**
- 2. Discussion of Subgroup Proposal of Revisions to Suitability in Annuity Transactions Model Regulation**
- 3. Working Group Discussion of Next Steps**
- 4. Any Other Matters Brought Before the Working Group**
- 5. Adjournment**

ISSUES RAISED IN COMMENT LETTERS RECEIVED ON JULY 2, 2009 DRAFT REVISIONS TO SUITABILITY MODEL

List of Comments: Ohio Department of Insurance (**OHDOI**)
Northwestern Mutual/Thrivent Financial for Lutherans (**NM/Thrivent**)
Prudential Financial, Inc. (**Prudential**)
National Association of Insurance and Financial Advisors (**NAIFA**)
National Association for Fixed Annuities (**NAFA**)
American Council of Life Insurers (**ACLI**)
Metropolitan Life Insurance Company (**MetLife**)

GENERAL CONCERNS

Current model does not need to be revised at this time. Focus should be to get states to adopt current model and developing uniform enforcement procedures for the current model. (**OHDOI**)

Significant concerns with much of the exposure draft. Support the work of IMSA and ACLI regarding proposed alternative model language. The Working Group should avoid an inflexible framework. Insurers need to have discretion to develop and implement solutions to take into consideration their customers' needs, the company's unique product mix, the organizational structure, marketplace and distribution process. (**NM/Thrivent**)

Current model is quite adequate in setting forth requirements and enforcement procedures to assure that insurers and producers sell annuities in a suitable fashion. Proposed revisions unworkable or move the regulation in the wrong direction or both. Suggests interpretative guidance to clarify situations where the insurer delegates its supervisory authority to a third party. Also supports, other areas of interpretive guidance as proposed by ACLI, IMSA and IRI. (**Prudential**)

Does not believe the existing framework has failed, but current model can be enhanced in areas to address regulator concerns. These enhancements can be achieved by retaining the current model and issuing interpretive guidance. (**NAIFA**)

Believes current model sets forth requirements and enforcement procedures to assure that annuities are being sold according to suitability standards and the existing model can be enhanced and to provide insurers with uniform guidance in developing agent training, supervision and monitoring standards in order to protect consumers from unsuitable sales and abusive sales and marketing practices. Proposed revisions will create non-uniform suitability regulation. Industry and NAIC resources best used to promote adoption of the current model. Draft is overly prescriptive and burdensome. (**NAFA**)

Current model provides sufficient suitability standards. Regulator concerns about interpretation or implementation can be addressed through the issuance of uniform guidance. The wholesale revision of the current model is not necessary or desirable. Revisions are overly prescriptive and providing specific comments makes little sense because the draft is not salvageable or necessary, but still providing specific comments. (**ACLI**)

Believes proposed amendments would impose obligations significantly more prescriptive than the requirements of the current model and FINRA Rule 2821. The proposed amendments are not workable as written. The current model's standards are commensurate with FINRA standards. Proposed amendments would require a wholesale restructuring of annuity marketing and compliance structures

with no resulting benefit to consumers. See potential downsides in proposed amendments in that consumer access to annuities will be limited and the cost of annuities to consumers will increase. Expresses support for alternatives, such as interpretive guidelines.

SPECIFIC CONCERNS

SECTION 4 EXEMPTIONS

Introductory phrase “[u]nless otherwise specifically included” too subjective. **(ACLI)**

SECTION 5 DEFINITIONS

“*Insurance agency*” and “*insurance producer*” definitions are too narrow. Conflict with each other to some degree and also may conflict with existing statute and case law. **(NM/Thrivent)**

“*Qualified reviewer*” definition and related standards are vague and highly subjective; it is also unclear how the NAIC Life Insurance Committee accreditation process would function for such individuals or firms. **(NM/Thrivent)**

“*Qualified reviewer*” does not state that the reviewer must be independent, as required in Section 14. Requiring review by an independent entity is unnecessarily costly and burdensome. **(ACLI)**

“*Suitability information*” definition not focused on consumer’s liquidity; focused on investment objectives. **(NM/Thrivent/NAFA)**

“*Suitability information*” definition should be consistent with the types of information required by FINRA Rule 2821. **(NAIFA/NAFA)**

“*Suitability information*” definition includes information that is confusing and unnecessary. **(ACLI/NAFA)**

SECTION 6 DUTIES OF INSURERS AND INSURANCE PRODUCERS TO RECOMMEND SUITABLE PRODUCTS

○ 6A SUITABLE RECOMMENDATION REQUIRED

Imposes strict liability on insurer to ensure each sale is suitable. Imposing strict liability goes beyond current model and FINRA standards which state that sales *shall not be unsuitable*. **(ACLI)**

○ 6C INSURER DUTY TO MAKE SUITABLE SALES

Requirement to conduct reviews of all transactions would needlessly absorb compliance resources and would be prohibitively expensive. **(NM/Thrivent)**

Provision makes insurers strictly liable in the event of an unsuitable sale. As such, an insurer would have to review each sale to ensure suitability, which would be unsustainable. **(Prudential)**

Provision is confusing in that it suggests that the insurer is always the one making the suitability determination. Provision fails to recognize a common insurer business model under which the insurer contracts with a third party to make the suitability determination. (ACLI/MetLife)

- **COMPENSATION**

There should be no restrictions on or prohibitions of commissions when a consumer proceeds with an annuity purchase not recommended by the producer. (NAIFA/NAFA/ACLI)

- **6D INACCURATE OR INCOMPLETE SUITABILITY INFORMATION**

Finds confusing in that 6D(2) appears to preclude sales without recommendation, which is permitted under 6D(1). (ACLI)

- **6F COORDINATION WITH FINRA RULES**

Provision limits applicability to annuities that are securities when in fact some annuities are subject to FINRA rules even though they are exempt from registration. Suggests alternative wording. (ACLI)

SECTION 7 INSURER SUPERVISION SYSTEM

This section is quite rigid and would require insurers to implement specific and detailed controls for a single product line. Forcing companies to change entire organizational structures to accommodate one product line is not the optimal way to achieve goals. (NM/Thrivent)

- **7B REVIEW OF COMPLAINTS AND ENFORCEMENT ACTIONS**

Agrees that a deeper review of a producer's business may be warranted following certain types of enforcement actions, but should not be based on a single regulatory complaint. (NM/Thrivent)

Consumer complaints are subject to a separate NAIC regulation and, therefore, should not be included. With respect to enforcement actions, only those involving the suitability of a sale should be referenced. (ACLI)

- **7C INSURER SUPERVISION SYSTEM MONITORING OF INSURANCE AGENCIES, FINRA MEMBER BROKER-DEALERS AND INSURANCE PRODUCERS**

Finds 7C(1) confusing in that it references only insurance agencies. Objects to language in 7C(2) that requires "continuous" monitoring, which undefined and vague. For 7C(4), the third party providing the training, not the insurer, should be required to ensure producer compliance. (ACLI)

- **7E INSURER SUPERVISION ORGANIZATION AND ORGANIZATIONAL REPORTING**

This section is problematic because it dictates how an insurer may organize its supervision organization and it requires insurers to engage the services of a qualified review every 5 years, which is expensive and unnecessary. (NM/Thrivent)

7E(3)(a)'s provision for an annual report to senior management, as well as ongoing market conduct analysis and examination is sufficient. To require additional, comprehensive 5 year reviews by a qualified reviewer is overly burdensome and impose unnecessary expense. (ACLI)

o **7F INSURER CONTRACTING FOR SUPERVISION FUNCTIONS**

Ignores the broker-dealer and general agent distribution models. Requiring an insurer to contract with an independent vendor for supervision functions adds unnecessary expense and is unworkable in the third party broker/dealer world. (ACLI)

SECTION 8 INSURER SUPERVISION SYSTEM FOR NON-FINRA MEMBER BROKER-DEALER DISTRIBUTION

o **8A SUITABILITY REVIEW**

Same concerns as expressed for Sec. 6. (NM/Thrivent)

Questions the use of the term "non-FINRA member broker-dealer". Says this provision appears to require insurers to perform a secondary review of each annuity recommendation, which is duplicative and unworkable under a third party distribution system. (ACLI)

o **SOURCE OF FUNDS**

Does not support including any provisions in model related to source of funds. (NAIFA/NAFA/ACLI)

o **8B INSURER COMPLIANCE VERIFICATION PROCEDURES**

Costs associated with requiring mailings to each consumer are significant without a reasonable expectation of benefit. The technology needs associated with requiring same consumer interviews with mandated recording and a set retention period would result in expensive investments that companies could use to benefit consumers in other ways. (NM/Thrivent)

Finds these provisions to be overly prescriptive, burdensome, unnecessary and duplicative. (ACLI)

SECTION 9 INSURER SUPERVISION SYSTEM FOR SECURITY BROKER-DEALER SUPERVISED DISTRIBUTION

The provisions of this section are inappropriate and unnecessary. FINRA rules mandate that broker-dealers have their own system of supervision and monitoring. Insurers should not be expected to impose additional requirements. Suggests that it is more appropriate to grant a safe harbor under the model for the sale of annuities by FINRA broker-dealers made in compliance with FINRA Rule 2821. (ACLI)

SECTION 10 SUPERVISION BY RESPONSIBLE INSURANCE AGENCY

Believes this section with its certification, reporting and qualified reviewer requirements would impose additional company costs with little benefit to consumers. (NM/Thrivent)

Section 10A's requirements that an insurer to obtain certification that a third party has properly performed each element of the insurer's supervision system conflicts with the third party delegation provisions of the model. The standard should be that the insurance agency has processes that are designed to achieve compliance with the supervisory requirements, which would be consistent with FINRA Rule 2821. Also finds the requirements of a comprehensive 5-year review by an independent reviewer to be overkill and imposes an unnecessary expense. **(ACLI)**

SECTION 11 FINRA MEMBER BROKER-DEALER DISTRIBUTION AND SUPERVISION

This section is inappropriate and unnecessary. FINRA mandates that broker-dealers have their own systems of supervision and monitoring and conducts multiple examinations for compliance. Insurers should not be expected to impose additional requirements. It is more appropriate to provide a safe harbor under the model for the sale of annuities by FINRA broker-dealers made in compliance with FINRA Rule 2821. **(ACLI)**

SECTION 12 INSURANCE AGENCY AND INSURANCE PRODUCER DUTIES

Suggests adding a provision to 12B(1) stating: "Knowledgeable enough to competently recommend annuity products offered by the insurance producer." **(NAIFA)**

12B(1)(a) fails to recognize direct insurer supervision of a captive sales force. Also, producers may sell under a general agency agreement where they contact with the general agency rather than the insurance agency. **(ACLI)**

SECTION 13 RESPONSIBLE INSURANCE AGENCY AND INSURANCE PRODUCER TRAINING DUTIES

With respect to initial and ongoing training, provision should allow for the enhanced training to apply towards current requirements. Section fails to state who will track and maintain training records for 13A. Would support requiring each DOI to do this, but if insurer would be required to do this, there could be issues with costs. Suggests that it should be the responsibility of the insurer to determine content and approach for the product-specific training, not the NAIC Life Insurance Committee. **(NM/Thrivent)**

Suggests that additional annuity product education be included as part of the initial licensing process and examination; no need for additional testing obligations or testing outlined in 10A(1). **(NAIFA/NAFA)**

Supports the requirement of completion of some form of training prior to providing any advice or making a recommendation to purchase an annuity, but that it is clear that such training is part of the continuing education requirements. **(NAIFA)**

Supports provisions requiring ongoing training and product-specific training, but make clear that this training would be part of, and not in addition to, the producer's current continuing education requirements. **(NAFA)**

Suggests that provisions in this section needed to be clarified in many respects, such as the initial training be part of the state's biannual or periodic continuing education and whether producers who do not sell certain annuity products would still have to be trained on that product. Supports grandfathering (no specific language included). **(ACLI)**

SECTION 14 STANDARDS FOR QUALIFIED REVIEWERS

Requiring review by an independent firm is unnecessarily costly and burdensome. This function should be able to be performed by an area of the insurer independent from the sales and marketing functions such as internal audit, compliance or legal. **(ACLI)**

SECTION 15 NAIC LIFE INSURANCE COMMITTEE GUIDANCE

Finds the extensive role envisioned for the committee as unprecedented. Many responsibilities to be undertaken by the committee would overlap existing responsibilities of state DOIs and difficult to understand how this could work in the existing state-based regulatory system. **(NM/Thrivent)**

Concerns regarding the creation of this committee. No specifics on its composition and on its role and powers. Also concerned that the guidance is intended to be quasi-law without following established due process and that additional forms, disclosures and prescriptive processes will be mandated. **(ACLI)**

Underlining and overstrikes show the changes from the existing model. Comments are being requested on this draft. Comments should be sent by Sept. 17, 2009 to Jolie Matthews at jmatthew@naic.org.

SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION

Table of Contents

Section 1.	Purpose
Section 2.	Scope
Section 3.	Authority
Section 4.	Exemptions
Section 5.	Definitions
Section 6.	Duties of Insurers and Insurance Producers
<u>Section 7.</u>	<u>Insurance Producer Training</u>
Section 7 8.	Mitigation of Responsibility
Section 8 9.	[Optional] Recordkeeping
<u>Section 10.</u>	<u>Effective Date</u>

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 Ssubsection B comes from the NAIC Unfair Trade Practices Act. If a sState has adopted different language, it should be substituted for Ssubsection 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 ~~S~~sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer;
- (3) A government or church plan defined in ~~S~~section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under ~~S~~section 457 of the IRC;
- (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.~~ “FINRA” means the Financial Industry Regulatory Authority or a succeeding agency.

~~BC.~~ “Insurer” means a company required to be licensed under the laws of this state to provide insurance products, including annuities.

~~CD.~~ “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.

~~E.~~ “Qualified staff” means individuals who are:

(1) Qualified to perform a function required under this regulation; and

(2) Independent from insurance producers whose recommendations are the subject of the function and independent from the sales managers of the insurance producers.

NOTE: THIS DEFINITION IS BASED ON FINRA RULE 3012.

~~DE.~~ “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.

~~G.~~ “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 source of funding of the annuity;

(4) Investment experience;

(5) Investment objectives;

(6) Intended use of the annuity;

(7) Investment 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.

NOTE: THIS DEFINITION PARALLELS FINRA RULE 2821(b)(2), OTHER THAN THE ADDITION OF SPECIFIC REFERENCE TO SOURCE OF FUNDS AS INCLUDED WITHIN “FINANCIAL SITUATION AND NEEDS” IN PARAGRAPH (3).

H. “Suitability requirement” means [insert reference to this regulation and to State law or regulations that govern advertising, misrepresentation or disclosures related to sales of annuities] and, with respect to products subject to regulation by FINRA, FINRA rules governing the suitability of, or misrepresentation or disclosures in connection with, the sale of those products, including FINRA rules 2310 and 2821 or substantially similar FINRA rules.

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 or redeems 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, 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 of an annuity, the exchange 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 within the preceding 36 months.

NOTE: THIS PROVISION HAS BEEN REVISED TO PARALLEL FINRA RULE 2821(b).

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. Except as permitted under subsection D, an insurer shall not issue an annuity recommended to a consumer unless the annuity is suitable based on the consumer's suitability information. The penalty for a violation of this subsection shall be reduced or eliminated if the violation is not part of a pattern or practice.~~

~~E~~D. (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 C related to any recommendation if a consumer:

(a) Refuses to provide relevant information requested by the insurer or insurance producer, but there is a reasonable basis to believe the recommendation is suitable;

NOTE: SUBPARAGRAPH (A) PARALLELS FINRA 2821(b), WHICH REQUIRES THAT FOR ANY RECOMMENDED SALE THERE MUST BE A REASONABLE BASIS TO BELIEVE THE RECOMMENDATION IS SUITABLE.

(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 ~~P~~paragraph (1) shall be reasonable under all the circumstances actually known to the insurer or insurance producer at the time of the recommendation.

~~D~~E. (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 agency and 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 the suitability requirement,~~ including, but not limited to, the following:

NOTE: THIS PROVISION PARALLELS FINRA RULE 2821(d), WHICH ALSO INCORPORATES FINRA RULE 3110. THOSE RULES REQUIRE A BROKER-DEALER TO ESTABLISH AND MAINTAIN A SYSTEM TO SUPERVISE THE ACTIVITIES OF EACH REPRESENTATIVE.

~~(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 require its insurance producers to comply with the training requirements of section 7 of this regulation;~~

NOTE: THIS PROVISION IS SIMILAR TO FINRA RULE 1120, WHICH REQUIRES BROKER-DEALERS TO MAINTAN PROCEDURES TO REQUIRE SECURITY REPRESENTATIVES TO COMPLETE REGULATORY

AND FIRM ELEMENT TRAINING, AND FINRA RULE 2821(e), WHICH REQUIRES BROKER-DEALERS TO ENSURE REPRESENTATIVES COMPLETE PRODUCT TRAINING.

(b) The insurer shall maintain reasonable procedures to verify consumer suitability information that supports a recommendation;

NOTE: THIS PROVISION PARALLELS FINRA RULE 2821(d), WHICH INCORPORATES THE FINRA RULE 3012 REQUIREMENT THAT A BROKER-DEALER CONFIRM CONSUMER INFORMATION, AND ALSO THE SEC REQUIREMENT THAT A BROKER-DEALER VERIFY CONSUMER ACCOUNT INFORMATION, INCLUDING SUITABILITY INFORMATION, WITH THE CONSUMER WITHIN 30 DAYS AFTER THE ACCOUNT IS OPENED (AND AT LEAST EVERY THREE YEARS THEREAFTER).

(c) The insurer shall issue a recommended annuity only if qualified staff review the recommendation and approved it as suitable based on the factors delineated in this section except an insurer may limit qualified staff review and approval to selected transactions by applying a system of selection criteria that is reasonably designed to prevent unsuitable recommendations;

NOTE: THIS PROVISION PARALLELS THE FINRA RULE 2821(c) REQUIREMENT FOR LICENSED PRINCIPAL SUITABILITY REVIEW OF EACH ANNUITY TRANSACTION AND FINRA REGULATORY NOTICE 07-53 (NOTE OF ADOPTION OF FINRA RULE 2821) AUTHORIZING THE USE OF AUTOMATED SYSTEMS TO FACILITATE PRINCIPAL REVIEW.

(d) The insurer shall maintain reasonable procedures to monitor whether insurance producers have rates of effecting exchanges that raise for review whether the exchanges evidence conduct inconsistent with the suitability requirement;

NOTE: THIS PROVISION PARALLELS THE FINRA RULE 2821(d) REQUIREMENT THAT BROKER-DEALERS MONITOR EXCHANGES.

(e) The insurer shall maintain reasonable procedures for qualified staff to examine, and report on, its insurance agencies at reasonable periodic intervals. The examination shall be 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; and

NOTE: THIS PROVISION PARALLELS THE REQUIREMENT OF AN ANNUAL REVIEW AND INSPECTION, INCORPORATED INTO FINRA RULE 2821, UNDER FINRA RULES 3010 AND 3012.

(f) The insurer shall annually provide a report to senior management, including to the senior manager responsible for audit functions, which details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.

NOTE: THIS PROVISION PARALLELS THE REQUIREMENT UNDER FINRA RULE 3012, INCORPORATED INTO FINRA RULE 2821, THAT BROKER-DEALERS ANNUALLY PRODUCE A REPORT OF A REVIEW AND TESTING OF ITS SUPERVISION SYSTEM.

(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 E.

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)(3)~~ A general agent and independent agency ~~either shall adopt~~shall establish a supervision system established by an insurer to supervise recommendations of its insurance producers that is reasonably designed to achieve insurance producer compliance with the suitability requirement, including, but not limited to, reasonable procedures to require insurance producers to comply with section 7 of this regulation, 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)(4)~~ Nothing in this subsection restricts An an insurer may contract with a third party, including a general agent or independent agency, to establish and maintain a system of supervision as required by Paragraph (1) with respect to insurance producers under contract with or employed by the third party from contracting for performance of a function required under this subsection. An insurer remains responsible and liable for compliance with this subsection regardless of whether the insurer contracts for performance of a function.

~~(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)(5)~~ 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.~~

~~F. 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.~~

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

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

Section 7. Insurance Producer Training

~~A. An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has completed training on the material features of the annuity to the extent reasonably necessary to ensure the insurance producer has adequate knowledge of the product to recommend the annuity.~~

~~B. (1) An insurance producer, prior to soliciting the sale of an annuity, shall complete a one-time eight (8) credit training course approved by the department and provided by a department-approved education provider. The department shall consider any recommendations by the National Association of Insurance Commissioners for content of the required training course and shall use the following course outline:~~

~~(a) Historical development of annuity contracts;~~

~~(b) Types of annuities and various classifications of annuities;~~

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

~~(d) How fixed, variable and indexed annuity contract provisions affect consumers;~~

~~(e) The application of income taxation of qualified and non-qualified annuities;~~

~~(f) Qualified plans and annuities;~~

~~(g) The primary uses of annuities;~~

~~(h) The senior market;~~

~~(i) Appropriate sales practices;~~

~~(j) Reserving issues with annuity contracts;~~

~~(k) Consumer attitudes towards retirement; and~~

(1) Guaranty Fund role in relationship to annuities.

NOTE: THIS PROVISION, INCLUDING THE OUTLINE, IS BASED ON THE CALIFORNIA REQUIREMENT. SEE:

<http://www.insurance.ca.gov/0200-industry/0050-renew-license/0200-requirements/life-agent/questions-answers.cfm>

- (2) The satisfaction of the training requirements of another State that are substantially similar to paragraph (1) shall be deemed to satisfy the training requirements of paragraph (1) in this State.
- (3) An insurance producer may, but is not required to, include credit for courses that meet the training requirements of paragraph (1) among continuing education credits submitted for the purpose of complying with the continuing education requirements under [insert reference to applicable State law or regulation governing continuing education].
- (4) An insurer may satisfy its responsibility to require an insurance producer to comply with paragraph (1) 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, C or ~~C(2)D~~ 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 ~~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 sStates 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, 2012, whichever is later.

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COMMENTS

MEMO

TO: Jolie Matthews, NAIC Senior Health and Life Policy Advisor and Counsel

FROM: Brenda J. Cude and Karrol Kitt, NAIC Consumer Representatives

RE: Suitability in Annuity Transactions Model Regulation

DATE: September 17, 2009

We wish to begin by thanking the working group for the time and energy expended thus far on behalf of consumers. We look forward to continuing to work with the group to further consumer interests in annuity sales.

Our comments are based on the September 2, 2009 draft of the model regulation.

Section 5 G includes a list of suitability information. We have commented previously that we find the list “curious;” we believe the list should be based on the financial planning process, which is:

1. Analyze the current financial position
2. Develop financial goals/objectives
3. Identify and evaluate strategies to achieve those goals
4. Establish and implement the plan
5. Reevaluate and revise the plan as needed.

Operating from that basis, we would suggest the list in Section 5 G be:

- Current financial position, including but not limited to information about assets and liabilities, net worth, income, any anticipated disruptions in future income (e.g., retirement), expenses (including payroll deductions), and any anticipated future changes in expenses (e.g., increased health care costs)
- Financial objectives, including those to be achieved by the purchase of an annuity. Information relevant to financial objectives includes but is not limited to age, liquidity needs, investment experience, investment objectives, risk tolerance, investment time horizon, tax status, and potential impact of an annuity on eligibility for benefits
- Source(s) of funds for purchase of an annuity, including specific information about any financial product the annuity would replace
- Any other information the insurer requires the insurance producer to consider prior to making a recommendation.

However, assuming that the working group’s preference is to use the existing list in Section 5 G, we wish to specifically challenge one item – liquid net worth. We know of

no such concept in family financial planning. We're familiar with net worth and liquidity, but not liquid net worth. At a minimum if this item is to be retained, we recommend a definition be added in Section 5. We can't write one, as we don't know what it means.

Section 6A (1) indicates the consumer should be informed *in general terms* (emphasis added) about various items. We are not clear about what is meant by "in general terms." Does it mean not specific to the annuity product? Or, does it mean about the various items as they relate to the product being considered but without the details – e.g., there is a surrender charge period but not how long it is? Greater clarity on this would seem to have value.

Section 6A (1) also lists various items about which the consumer must be informed. A very obvious one seems to be missing – what an annuity is. We would suggest adding this.

Also in **Section 6A (1)** the word "redeems" is used (i.e., "if the consumer sells or redeems the annuity"). We aren't familiar with this term as it applies to annuities. Perhaps it *is* commonly used but it is a word that never appears in any of the three annuity buyers guides.

In **Section 6A (3)** we believe the first phrase is specific to variable annuities and should be amended as such – "The particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of a purchase or exchange involving a *variable* annuity..."

In **Section 6A (4) (a) and (b)**, we suggest minor revisions to complete thoughts and make the intention clearer.

- (a) The consumer will incur a surrender charge, be subject to the commencement of a new surrender charge period, lose existing benefits (such as death, living or other contractual benefits), or be subject to increased fees, ~~investment advisory fees~~ or charges, including those for riders and similar product enhancements;
- (b) The consumer would benefit from product enhancements and improvements to be gained from an exchange; and

Finally, we note that this document places great faith in a common understanding of the word "reasonable." It (or reasonably) is used no less than 12 times in Section 6 alone. We hope that faith is not misplaced.

Underlining and overstrikes show the changes from the existing model. Comments are being requested on this draft. Comments should be sent by Sept. 17, 2009 to Jolie Matthews at jmatthew@naic.org.

SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION

Table of Contents

Section 1.	Purpose
Section 2.	Scope
Section 3.	Authority
Section 4.	Exemptions
Section 5.	Definitions
Section 6.	Duties of Insurers and Insurance Producers
Section 7.	Insurance Producer Training
Section 8.	Mitigation of Responsibility
Section 9.	[Optional] Recordkeeping
Section 10.	Effective Date

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;
 - (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. “FINRA” means the Financial Industry Regulatory Authority or a succeeding agency.
- C. “Insurer” means a company required to be licensed under the laws of this state to provide insurance products, including annuities.
- D. “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.
- E. “Qualified staff” means individuals who are:
 - (1) Qualified to perform a function required under this regulation; and
 - (2) Independent from insurance producers whose recommendations are the subject of the function and independent from the sales managers of the insurance producers.

- F. “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.
- G. “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 source of funding of the annuity;
 - (4) Investment experience;
 - (5) Investment objectives;
 - (6) Intended use of the annuity;
 - (7) Investment 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.
- H. “Suitability requirement” means [insert reference to this regulation and to State law or regulations that govern advertising, misrepresentation or disclosures related to sales of annuities] and, with respect to products subject to regulation by FINRA, FINRA rules governing the suitability of, or misrepresentation or disclosures in connection with, the sale of those products, including FINRA rules 2310 and 2821 or substantially similar FINRA rules.

Comment [FaCS1]: At a minimum, must be defined.

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 or redeems 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;

Comment [FaCS2]: It’s unclear what this means.

Comment [FaCS3]: Is this the correct term?

- (3) The particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of a purchase or exchange ~~involving a variable~~the annuity, and riders and similar product enhancements, if any, are suitable (and in the case of an exchange, 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 of an annuity, the exchange is suitable including taking into consideration whether:
 - (a) The consumer will incur a surrender charge, be subject to the commencement of a new surrender charge period, lose existing benefits (such as death, living or other contractual benefits), or be subject to increased fees, ~~investment advisory fees~~ or charges, including those for riders and similar product enhancements;
 - (b) The consumer would benefit from product enhancements and improvements to be gained from an exchange; and
 - (c) The consumer has had another annuity exchange 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.
- C. Except as permitted under subsection D, an insurer shall not issue an annuity recommended to a consumer unless the annuity is suitable based on the consumer's suitability information. The penalty for a violation of this subsection shall be reduced or eliminated if the violation is not part of a pattern or practice.
- D. (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 if a consumer:
- (a) Refuses to provide relevant information requested by the insurer or insurance producer, but there is a reasonable basis to believe the recommendation is suitable;
 - (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.
- E. (1) An insurer shall establish a supervision system that is reasonably designed to achieve the insurer's and its insurance agency and insurance producers compliance with the suitability requirement, including, but not limited to, the following:

- (a) The insurer shall maintain reasonable procedures to require its insurance producers to comply with the training requirements of section 7 of this regulation;
 - (b) The insurer shall maintain reasonable procedures to verify consumer suitability information that supports a recommendation;
 - (c) The insurer shall issue a recommended annuity only if qualified staff review the recommendation and approved it as suitable based on the factors delineated in this section except an insurer may limit qualified staff review and approval to selected transactions by applying a system of selection criteria that is reasonably designed to prevent unsuitable recommendations;
 - (d) The insurer shall maintain reasonable procedures to monitor whether insurance producers have rates of effecting exchanges that raise for review whether the exchanges evidence conduct inconsistent with the suitability requirement;
 - (e) The insurer shall maintain reasonable procedures for qualified staff to examine, and report on, its insurance agencies at reasonable periodic intervals. The examination shall be 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; and
 - (f) The insurer shall annually provide a report to senior management, including to the senior manager responsible for audit functions, which details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.
- (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 E.

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.
- (3) A general agent or independent agency shall establish a supervision system that is reasonably designed to achieve insurance producer compliance with the suitability requirement, including, but not limited to, reasonable procedures to require insurance producers to comply with section 7 of this regulation.

- (4) Nothing in this subsection restricts an insurer from contracting for performance of a function required under this subsection. An insurer remains responsible and liable for compliance with this subsection regardless of whether the insurer contracts for performance of a function.
- (5) An insurer, general agent or independent agency is not required to 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.

F. 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.

G. A security representative recommendation of an annuity that is a security that complies with the FINRA rules pertaining to suitability shall satisfy the requirements under this section for the recommendation of 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 a security representative recommendation of an annuity that is a security complies with the FINRA rules pertaining to suitability. This safe harbor applies regardless of whether the annuity/security is required to be registered a security.

Section 7. Insurance Producer Training

A. An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has completed training on the material features of the annuity to the extent reasonably necessary to ensure the insurance producer has adequate knowledge of the product to recommend the annuity.

B. (1) An insurance producer, prior to soliciting the sale of an annuity, shall complete a one-time eight (8) credit training course approved by the department and provided by a department-approved education provider. The department shall consider any recommendations by the National Association of Insurance Commissioners for content of the required training course and shall use the following course outline:

- (a) Historical development of annuity contracts;
- (b) Types of annuities and various classifications of annuities;
- (c) Identification of the parties to an annuity;
- (d) How fixed, variable and indexed annuity contract provisions affect consumers;
- (e) The application of income taxation of qualified and non-qualified annuities;
- (f) Qualified plans and annuities;

- (g) The primary uses of annuities;
 - (h) The senior market;
 - (i) Appropriate sales practices;
 - (j) Reserving issues with annuity contracts;
 - (k) Consumer attitudes towards retirement; and
 - (l) Guaranty Fund role in relationship to annuities.
- (2) The satisfaction of the training requirements of another State that are substantially similar to paragraph (1) shall be deemed to satisfy the training requirements of paragraph (1) in this State.
 - (3) An insurance producer may, but is not required to, include credit for courses that meet the training requirements of paragraph (1) among continuing education credits submitted for the purpose of complying with the continuing education requirements under [insert reference to applicable State law or regulation governing continuing education].
 - (4) An insurer may satisfy its responsibility to require an insurance producer to comply with paragraph (1) 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 8. 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;
 - (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.
- B. Any applicable penalty under [insert statutory citation] for a violation of section 6A, B, C or D 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 9. [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.

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, 2012, whichever is later.

September 17, 2009

Via E-mail

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

Dear Ms Matthews:

The National Association of Independent Life Brokerage Agencies (NAILBA) appreciates the opportunity to comment on the Suitability of Annuity Sales (A) Working Group's September 4, 2009 draft of proposed revisions to the NAIC Suitability in Annuity Transactions Model Regulation. NAILBA is the primary trade association for the independent insurance distribution channel, representing 350 small businesses that account for \$4 billion in annualized premiums. Our members distribute fixed, indexed, and variable annuities through their independent producers. Each of our member agencies employ an average of 13 full-time staff members.

Our industry is committed to conduct that is ethical, professional, and honorable. While we fully understand the need for appropriate annuity sales and marketing practices, and suitable recommendations for annuity purchasers, we have very significant concerns about the proposed revisions in the current draft.

In an effort to further discussion at the NAIC, we offer the following comments to highlight these concerns:

Section 6(E)(3) Insurers have historically retained supervisory responsibilities. Imposing similar responsibilities on brokerage general agents is redundant and unnecessary as they are not well-equipped to assume these responsibilities.

Section 8(A)(3) The relationship between an independent brokerage agency and an independent agent is not that of employer/employee, but rather agency/independent contractor. Agencies cannot be held accountable for the actions of their independent contractors. Subjugating independent agencies to this type of accountability could have significant negative tax implications for both the agency and the agent.

NAILBA believes consumers are best served by a competitive marketplace and the active and consistent enforcement of the current regulatory structure. Any proposals authored by the NAIC in the spirit of consumer protection must be careful not to impede the flow of transactions in the annuities marketplace.

We strongly encourage the Working Group to consider removing the draft language identified above for the reasons explained.

Regards,

Gary S. Dworkin, CLU, RHU
Chairman
National Association of Independent Life Brokerage Agencies (NAILBA)

Comments Of The Center For Economic Justice

On September 4, 2009 Draft Revisions Of
The Suitability of Annuity Transactions Model Regulation

September 17, 2009

CEJ supports the work of the A Committee to revise the model regulation to provide better guidance to insurers, more uniformity with suitability regulation of other non-insurance annuity products and to clarify regulatory authority.

CEJ supports the approach of revising the model regulation, as opposed to providing “interpretive guidance” in a bulletin. It is clear that all stakeholders need guidance in how to comply with and enforce the current NAIC suitability model. It is also clear that greater consistency with FINRA rules will help overall compliance and enforcement. The proper place for interpretive guidance is a regulation through which the regulator utilizes her statutory authority to implement a law and provide the interpretive guidance necessary to enforce a law and to develop this guidance through an administrative process which provides the public an opportunity to comment and challenge the regulator's action. It is inappropriate to provide substantive interpretation of a statute and specific compliance guidelines through a bulletin because there is no regulatory authority associated with a bulletin.

We strongly oppose the proposed change to Section 6 D. Section 6 D states:

- (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 if a consumer:
 - (a) Refuses to provide relevant information requested by the insurer or insurance producer, but there is a reasonable basis to believe the recommendation is suitable;

This proposal is very inappropriate because the provision gives immunity to the producer or insurer for recommending and selling an unsuitable product if the consumer does not provide the relevant information – as long as there is a reasonable basis to believe the recommendation is suitable. The provision is illogical – how can a suitable recommendation be made if the relevant information to evaluate suitability is not available? There can be no reasonable basis for judging a recommendation suitable if the necessary information is not provided. Moreover, this provision would logically lead to some producers or insurers intentionally not collecting relevant information so the producer or insurer can sell a product she suspects might not meet suitability standards. And in the absence of collecting the information demonstrating the recommended product is not suitable, the insurer or producer could sell the product and claim it was reasonable given the (lack of) available information.

Model Bulletin¹
NAIC Suitability in Annuity Transactions Model Regulation

After receiving numerous inquiries from licensed insurance companies and producers regarding the provisions of [insert title and citation from state version of the NAIC Suitability in Annuity Transactions Model Regulation], this Bulletin has been issued to clarify the Department's expectations regarding key provisions of the [insert title and/or citation of state version of the NAIC Suitability in Annuity Transactions Model Regulation].

1. Section 6 B - Collection of Consumer Information.

Section 6 B of the Model Regulation requires an insurance producer, or an insurer where no producer is involved, to make reasonable efforts to obtain information concerning a consumer's financial status, tax status, investment objectives and other information used or considered to be reasonable in making a recommendation to the consumer. An insurance producer, or insurer where no producer is involved, making a recommendation to a consumer will be deemed to satisfy this requirement if it makes reasonable efforts to obtain the following information from the consumer. It is recognized that not all of the elements listed below will be applicable for every type of product recommended.

- age,
- annual income,
- financial situation and needs,
- investment or financial experience,
- investment or financial objectives,
- intended use of the annuity,
- investment or financial time horizon,
- existing assets (including investment and life insurance holdings),
- liquidity needs,
- liquid net worth,
- risk tolerance,
- tax status.

2. Section 6 A – Basis for Determining the Suitability of Recommendations.

The suitability analysis required under Section 6 A of the Model Regulation requires the insurance producer, or the insurer where no producer is involved, to have a reasonable basis 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. An insurance producer, or insurer where no producer is involved, making a recommendation to a consumer will be deemed to satisfy this requirement if it has a reasonable basis to believe that the consumer:

- Has been informed, in general terms, of the various features of an annuity, such as a potential surrender period and surrender charge; potential tax penalty if the consumer sells or redeems the annuity before reaching the age of 59 1/2; fees and expenses; potential charges for and features of riders; the insurance and/or investment components of the annuity; and

¹ This Model Bulletin shall be adopted uniformly in all jurisdictions.

An insurance producer, or insurer where no producer is involved, shall satisfy the requirements set forth in this bullet point if it provides disclosure to a consumer that complies with the provisions of the NAIC Annuity Disclosure Model Regulation.

- Would benefit from certain features of the annuity such as tax-deferred growth; annuitization or a death benefit or living benefit.

3. Section 6 D. (1) – System of Supervision.

Section 6 D. (1) of the Model Regulation requires an insurer to establish and maintain a system of supervision including, but not limited to, maintaining written procedures and conducting periodic reviews of its records reasonably designed to achieve compliance with the Model Regulation. Sections 6 D. (3) and (4) allow an insurer to contract with a third-party to establish and maintain a system of supervision provided that the insurer makes reasonable inquiry to assure that the third party is performing the functions required under Section 6 D. (1) and takes such action as is reasonable under the circumstances to enforce the contractual obligation to perform those functions.

The system of supervision should be reasonably designed to reflect the unique combination of annuity product types and distribution systems to which it applies.

An insurer will be deemed to satisfy this requirement if the system of supervision established and maintained by the insurer or a third-party with whom the insurer has contracted under Section 6 D. (3) is designed to reasonably assure that:

- Producers conduct an appropriate suitability analysis prior to making a recommendation to a consumer.
- Producers have completed all insurance licensing and continuing education training as required by [citation to State's insurance licensing or continuing education requirement] before selling the insurer's annuity products. For purposes of Section 6 D. (3), an insurer or third party, as applicable, may rely on evidence that a producer's license is in good standing to determine that the producer has completed all required training.
- The insurer develops and makes available product-specific training materials or programs reasonably designed to enable producers who recommend the insurer's annuity product to understand the product's material features.
- The insurer or third-party, as applicable, analyzes sales and other data to identify patterns among recent annuity transactions that may be indicative of conduct inconsistent with the requirements of the Model Regulation, and makes reasonable inquiry, based upon such analysis, to determine whether appropriate corrective action may be warranted. Elements of this analysis may include, depending on the specific circumstances, the appropriate combination of the following:
 - Age of the applicants or annuitants;
 - Complaints;
 - Returns during the "free look" period;
 - Withdrawals;
 - Surrenders;
 - Replacements (both incoming and outgoing);
 - Regulatory sanctions; and

- Agent terminations.

4. Section 6 D. (4) - System of Monitoring – Periodic Reviews.

Section 6 D. (4) of the Model Regulation requires an insurer to make reasonable inquiry to assure that a third-party with whom the insurer has contracted to establish and maintain a system of supervision is performing its obligation according to the terms of the contract. An insurer may comply with its obligations to make reasonable inquiry by:

- Annually obtaining a certification from a manager at the third-party who has responsibility for the delegated functions to confirm that the manager has a reasonable basis to represent, and does represent, that the third party is performing the required functions; and
- Conducting a periodic review of selected third parties based on reasonable selection criteria as a means to determine whether the third parties are performing the contractual obligations designed to comply with the requirements of Section 6 D. (1).

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

An insurer will be deemed to satisfy this requirement if the insurer establishes reasonable selection criteria to identify third-parties to be reviewed, and takes such appropriate corrective action that the insurer determines to be warranted based upon the findings of the periodic review. Reasonable selection criteria may include, but is not limited to:

- Analysis of sales data;
- Age of the applicants or annuitants;
- Product or share class;
- Optional riders;
- Complaints;
- "Red flag" programs (including telephonic or written surveys);
- Surrenders;
- Replacements (both incoming and outgoing);
- Regulatory sanctions; and
- Agent terminations.

5. FINRA Safe Harbor.

Nothing in this Bulletin shall limit the applicability of the "safe harbor" in Section 6 E. for compliance with Financial Industry Regulatory Authority (FINRA) Conduct Rules pertaining to suitability.



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September 19, 2009

The Honorable Sean Dilweg,
Commissioner and Chair, NAIC Suitability of Annuity Sales (A) Working Group
State of Wisconsin, Office of the Commissioner of Insurance
125 South Webster Street
GEF III – 2nd Floor
Madison, Wisconsin 53702

Re: Comments Regarding the Discussion Draft Containing Revisions to the Suitability in
Annuity Transactions Model Regulation dated May 26, 2009

Dear Commissioner Dilweg:

On July 20, 2009, NAVA--The Association for Insured Retirement Solutions, publicly announced its new expanded mission and the change of its name to the Insured Retirement Institute (IRI).¹ Consistent with our mission of promoting “adherence to the highest ethical standards,” as stated in previous comment letters, IRI supports the consumer protection measures contained in the current NAIC Suitability in Annuity Transactions Model Regulation (2006). We are committed to working with state legislators and regulators to achieve adoption of the Model in all states, as well as adoption of the NAIC Annuity Disclosure Model and NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities.

We have appreciated the opportunity to provide previous comment letters to the Working Group,² and we appreciate very much the time Working Group members have spent with us discussing the various issues related to suitability regulation. We are still working with our members to evaluate the September Draft

¹ IRI a not-for-profit organization dedicated to the growth and understanding of annuity and variable life insurance products. IRI represents all segments of the annuity and variable life industry with over 300 member organizations including insurance companies representing over 85% of the market, distribution firms, banks, investment management firms, and industry service providers.

² IRI, under its prior name NAVA, previously provided the Working Group comment letters dated December 3, 2008, December 4, 2008 (Joint Letter submitted by IRI, ACLI, IMSA, and NAIFA), December 19, 2008, and June 10, 2009.

and therefore are not able to offer comprehensive comments at this time. We offer the following initial comments and commit to providing further comments in the near future:

1. We continue to believe the current Suitability Model Regulation, and NAIC Annuity Disclosure Model, provide regulators with all the regulatory authority and requirements necessary to carry out their important consumer protection responsibilities. This has been demonstrated by a number of regulatory enforcement actions relating to suitability and reports from state regulators the current Model has reduced the number of consumer suitability issues.
2. While not necessary, we understand some regulators want to provide more detailed regulatory expectations relating to operational or regulatory compliance with certain requirements of the current Model.
3. We support adoption of a Model Bulletin as the best and most timely vehicle to provide more detailed regulatory expectations in the following areas:
 - (1) Information that should be obtained from the consumer to determine whether a sale is suitable;
 - (2) Information that the consumer should be provided prior to purchasing an annuity and a clear statement of the already inherent requirement that the consumer must benefit from certain features of an annuity;
 - (3) Requirements that the system of supervision required by the current Model include state required training, analysis of relevant data to identify violations of the law, investigation procedures, and corrective action procedures; and
 - (4) "Selection criteria" to identify third-parties to be reviewed for contractual compliance with fulfilling the supervisory requirements of the Model.

We ask that the Working Group review and evaluate the specific provisions of the attached Model Bulletin, which are consistent with and taken in part from FINRA Rule 2821, and consider the advantages of this approach given over forty (40) states have already adopted the current Model, the need for uniformity, and other factors.

4. We view the September Draft as a good faith effort to explore alternative approaches for consideration by the Working Group and Interested Parties. We recognize the Working Group has addressed a good number of the issues we have raised over the past year, and we appreciate very much the efforts of those who worked on this draft. For many reasons, including the issues identified in Paragraph 5, we ask that the Model Bulletin also be considered by the Working Group as another very viable alternative approach for providing regulatory expectations relating to the Model.

5. As stated, while we have started our review process, given the September Draft was released late on Friday, September 4, we will need more time to fully evaluate the provisions of the September Draft. During our limited review thus far, we have identified several provisions that raise very substantial questions and concerns, including the following fundamental items:
 - (1) The Model attempts in many instances to apply a number of FINRA rules applicable to securities broker dealers, which are distributors, to insurers, which are product manufacturers without direct customer contact. *See* Section 6.E. Along with other problems with this approach, insurer compliance with these sections is unworkable in many respects. Further, these requirements would necessitate dramatic, wide-ranging changes to current business, operational and distribution models, which would add significant burdens and costs without a demonstrable corresponding benefit. These burdens could actually create a significant disincentive for financial advisors, and insurers, to offer competitive and useful products to consumers, who have shown a growing interest in using these products as a part retirement planning.
 - (2) If we are correct about the Model's apparent intent, we believe language in a number of areas needs to be removed or revisions need to be made to make it clear it is not the intent of the September Draft to impose a requirement for the insurer to perform a suitability analysis for every transaction.

As noted, we have identified additional concerns regarding the September Draft, and look forward to discussing those with the Working Group.

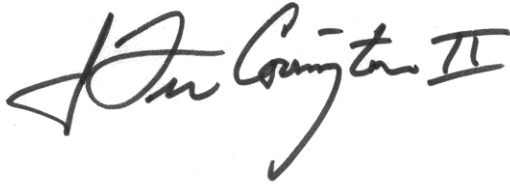
6. We believe the Model Bulletin addresses a number of the same areas the Working Group is looking to address in a revised model. Therefore, we strongly believe the Bulletin should be a part of the NAIC's discussion given it can provide uniform regulatory expectations regarding compliance with the Model, which will inure to the benefit of consumers, regulators, and industry. While the September Draft certainly moves in a positive direction, because of the substantial questions and concerns relating to a number of provisions in the September Draft, we believe the attached Model Bulletin represents a better, more viable, and more expedient approach to achieving the objectives of the Working Group.

We appreciate the opportunity to provide these initial comments regarding the September Draft and will provide further comments after additional review by our member companies. We look forward to

Letter to Commissioner Sean Dilweg
September 18, 2009
Page 4 of 4

discussing our initial comments at the Working Group's meeting during the NAIC September National Meeting.

Best regards,

A handwritten signature in black ink that reads "J. Lee Covington II". The signature is written in a cursive style with a large, sweeping initial "J" and a distinct "II" at the end.

J. Lee Covington II
Senior Vice President and General Counsel

cc: Kim Shaul, Deputy Commissioner, Wisconsin Office of the Commissioner of Insurance
All members of the Suitability of Annuity Sales Working Group
Jolie Matthews, NAIC Senior Health & Life Policy Advisor & Counsel
Other Interested Parties



September 21, 2009

September 17th, 2009

Via e-mail

The Honorable Kim Shaul
Deputy Commissioner
Office of the Commissioner of Insurance GEF 3, Second Floor
125 South Webster Street
Madison, Wisconsin 53702

NAFA, the National Association for Fixed Annuities, continues to be grateful for the ongoing opportunity to submit comments to the Working Group. As you know, NAFA is the exclusive trade association dedicated to promoting the awareness and understanding of fixed annuities and the association's members represent the overwhelming majority of independent insurance agents who write fixed indexed, declared-rate and income annuities.

NAFA continues to support the Working Group's objective to protect consumers considering annuity purchases by requiring suitable sales and producer education. And, while the latest draft is much improved over earlier drafts and wisely reflects suggestions made by this association and many of our trade partners, NAFA remains concerned with some aspects of the draft. In short, NAFA's main objections to the draft model are:

- 1). the existing model is working in some 40-plus and there has been no evidence produced to the contrary;
- 2). the implementation of a brand new model would undermine the progress made and harm consumers by creating disharmony and lack of uniformity between states; and,
- 3). the definitions, supervisory and training sections are incompatible with the fixed annuity distribution system.

But most importantly Rule 2821, while a commendable principles-based model for suitability in securities sales, does not address the unique differences of insurance and its guaranteed elements which are necessary for fixed annuity suitability review. NAFA believes it would be wise to edit or change the language to reflect the insurance application and the independent distribution.

Below are comments and suggested improvements to specific sections of the revised draft.

Section 5. Definitions

NAFA is concerned with the qualified staff definition and the requirement that the staff member must be "[i]ndependent from insurance producers whose recommendations are the subject of the function and independent from the sales managers of the insurance producers." It is important to note that FINRA does not have this requirement. NAFA recommends that this requirement is eliminated.

The current draft still reflects the consumer information list that is a replication of the FINRA 2821 list without modification to the insurance marketplace. NAFA member companies already require producers to review suitability information that follows the essence of Rule 2821's list and have incorporated into the list their suitability forms **with one major change** – they have included ***relevant and enlightening insurance information***.

NAFA member companies have spent many human and financial resources to train producers not to use the term “investment” when discussing a fixed annuity because fixed annuities are insurance products that provide guarantees to consumers and the investment community and regulators have appropriated the term for exclusive use to describe risky products (securities). To use the term investment muddies the significant differences between securities and insurance and will likely create misunderstandings and/or incorrect expectations by consumers.

Specifically, NAFA believes that asking the consumer's investment time horizon, investment objectives and investment experience does not provide the appropriate information in the suitability review when discussing a fixed annuity. Instead a suitability review for a fixed annuity should include ***financial*** objectives to uncover things like the consumers objectives for retirement income, asset protection, legacy giving to heirs or charities, etc. A question of ***financial*** experience might uncover their experience with budgeting money for emergency expenditures, loss of job, investments, insurance protection, savings, etc. Conversely, a question of ***investment objective*** might only uncover the need to obtain a 7% annual growth rate in their mutual fund. Investment objectives and experience would be limited to securities, while the term “financial” requests a much broader perspective of the customer's situation, needs, and experience or at least one which includes guaranteed products.

Furthermore, NAFA objects to the request for the source of funding for the annuity. The language appears to ignore the real problems of a licensed producer who is selling fixed annuities and may or may not be licensed to sell mutual funds, variable annuities, stocks (or for that matter long term care, health insurance, real estate, etc.) It is imperative that non-securities licensed insurance producers do not cross the line and give investment or securities advice (or health/long term care advice) without the proper license and supervision in an attempt of determining suitability of the fixed annuity. Discussion of the premium amount and the financial needs of the client, along with the remaining customer information are sufficient for a thorough suitability review. Analyzing or discussing the ***source*** of the premium could have the unintended consequences of leading a conscientious non-securities licensed agent to give investment advice when they are not educated, licensed, or authorized to do so.

Section 6. **Duties of Insurers and Insurance Producers to Recommend Suitable Sales**

NAFA questions the need for 6. A. 3. when there is an exemption for FINRA supervised sales. It appears this section is not necessary with that exemption.

NAFA objects to the imposition of a strict liability on insurers to ensure each sale is suitable. Even the FINRA standards do not apply this strict liability but rather imposes standards which state that sales *shall not be*

unsuitable. It is not possible to eliminate unsuitable sales by regulation. Some unsuitable sales will occur even when insurers follow the very letter of the Model Regulation because suitability is not an exact mathematical equation. Imposing a standard of liability on insurers that is not feasible can only result in violation of the law each time a sale is determined to be unsuitable. Additionally, the draft states that the penalty for a violation “shall only be reduced or eliminated if the violation is not a part of a pattern or practice,” which, without definition or context, is substantially vague and provides the insurer with little to no defense against a charge of violation. The insurer’s responsibility to put the consumer whole when a sale is determined to have been unsuitable is the appropriate standard, not one of strict liability.

Lastly, NAFA and its members have learned from experience that exchanges are not in and of themselves suggestive of unsuitable sales and the acceptable rates of exchange vary from individual to individual and sale to sale and cannot be hard-coded into a systemic formula. Further, the individual consumer information obtained and the reasonable grounds of the insurance producer, or insurer where no producer is involved, to believe that the recommendation is suitable under the reasonable basis conditions listed in Section 6.A. 1-4 will be the basis for determining the suitability of the exchange and not some arbitrary rate of exchange. NAFA requests removal of this paragraph.

Section 7. Insurance Producer Training

NAFA agrees that all producers need and should receive training on suitability requirements, disclosure and annuity product features. The association also believes this section is overly prescriptive and respectfully reminds the Working Group that FINRA does not have this requirement.

However, assuming the inclusion of the provision, NAFA objects specifically to the requirement that a producer “shall not sell” a fixed annuity unless the insurance producer has completed training on the material features of the annuity on the grounds that it is paradoxically overly broad and too prescriptive. It is overly broad in that the draft does not specify what it means by “training.” It is too prescriptive in that the draft language suggests that this training must occur before each and every sale of the annuity product or between lapses of time between sales. NAFA recommends the following language:

An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has adequate knowledge of the material features of the annuity to the extent reasonably necessary to make the recommendation.

Furthermore, the insurer must develop and make available product-specific training materials or programs reasonably designed to enable producers who recommend the insurer’s annuity product to understand the product’s material features.

The requirement that the insurer “satisfy its responsibility to require an insurance producer to comply with paragraph (1) by obtaining certificates of completion...” is duplicative, overly burdensome, and unnecessary. Rather, the education requirement of paragraph (1) should be made **as part of** the licensing or continuing education requirements of the states. In doing so, the insurer may satisfactorily rely on the licensing status of the producer to ensure compliance.



September 21, 2009

NAFA is unclear as to which draft the Working Group will be discussing at the meeting next week. It would be beneficial to all interested parties to be informed which draft version (9/4/2009 or the 7/2/2009) will be discussed in order to prepare appropriately for the meeting. NAFA is willing and ready to assist in working toward finalizing the Working Group's recommendation and we look forward to seeing you in Washington next week. Please contact me for any clarification and/or more information.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kim O'Brien", is written over a circular stamp or seal.

Kim O'Brien
Executive Director

Cc: All members of the Suitability of Annuity Sales (A) Working Group
All members of the Life Insurance and Annuities (A) Committee