

***POLICY AND PROCEDURE
REGARDING
SUITABILITY IN ANNUITY
TRANSACTIONS***

***Prepared by
The Kansas Insurance Department***

November 29, 2012

**Policy and Procedure Regarding Suitability in Annuity Transactions
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This policy and procedure is an adaptation of the National Association of Insurance Commissioners' Model Regulation Regarding Suitability in Annuity Transactions. Deletions in the model have been stricken through and additions have been underlined.

SUITABILITY IN ANNUITY TRANSACTIONS

MODEL REGULATION POLICY AND PROCEDURE

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Section 1. Purpose

- A. The purpose of this ~~regulation~~ Policy and Procedure adopted by the Kansas commissioner of insurance ("commissioner") is to require insurers to establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers that result in transactions 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~~ Policy and Procedure.

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

~~**Section 3. Authority**~~

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

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

Section 4. Exemptions

Unless otherwise specifically included, this ~~regulation~~ Policy and Procedure shall not apply to transactions involving:

- A. Direct response solicitations where there is no recommendation based on information collected from the consumer pursuant to this ~~regulation~~ Policy and Procedure;
- 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 an annuity that is an insurance product under State law that is individually solicited, whether the product is classified as an individual or group annuity.
- B. “Continuing education credit” or “CE credit” means one continuing education credit as defined in K.S.A. 40-4902 ~~[insert reference in State law or regulations governing producer continuing education course approval]~~.
- C. “Continuing education provider” or “CE provider” means an individual or entity that is approved to offer continuing education courses pursuant to K.S.A. 40-4903 ~~[insert reference in State law or regulations governing producer continuing education course approval]~~.
- D. “FINRA” means the Financial Industry Regulatory Authority or a succeeding agency.
- E. “Insurer” means a company, including a fraternal benefit society, required to be licensed under the laws of this state to provide insurance products, including annuities.
- F. “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities. Insurance producer also includes the terms “insurance agent” or “agent.”
- G. “Recommendation” means advice provided by an insurance producer, or an insurer where no producer is involved, to an individual consumer that results in a purchase, exchange or replacement of an annuity in accordance with that advice.
- H. “Replacement” means a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be:
 - (1) Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;
 - (2) Converted to reduced paid-up insurance, continued as extended term

insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;

- (3) Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid;
- (4) Reissued with any reduction in cash value; or
- (5) Used in a financed purchase.

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

I. “Suitability information” means information that is reasonably appropriate to determine the suitability of a recommendation, including the following:

- (1) Age;
- (2) Annual income;
- (3) Financial situation and needs, including the financial resources used for the funding of the annuity;
- (4) Financial experience;
- (5) Financial objectives;
- (6) Intended use of the annuity;
- (7) Financial time horizon;
- (8) Existing assets, including investment and life insurance holdings;
- (9) Liquidity needs;
- (10) Liquid net worth;
- (11) Risk tolerance; and
- (12) Tax status.

Section 6. Duties of Insurers and of Insurance Producers

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

- (1) The consumer has been reasonably informed of various features of the annuity, such as the potential surrender period and surrender charge, potential tax penalty if the consumer sells, exchanges, surrenders or annuitizes the annuity, mortality and expense fees, investment advisory fees, potential charges for and features of riders, limitations on interest returns, insurance and investment components and market risk;

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

- (2) The consumer would benefit from certain features of the annuity, such as tax-deferred growth, annuitization or death or living benefit;
 - (3) The particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of purchase or exchange of the annuity, and riders and similar product enhancements, if any, are suitable (and in the case of an exchange or replacement, the transaction as a whole is suitable) for the particular consumer based on his or her suitability information; and
 - (4) In the case of an exchange or replacement of an annuity, the exchange or replacement is suitable including taking into consideration whether:
 - (a) The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living or other contractual benefits), or be subject to increased fees, investment advisory fees or charges for riders and similar product enhancements;
 - (b) The consumer would benefit from product enhancements and improvements; and
 - (c) The consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 36 months.
- B. Prior to the execution of a purchase, exchange or replacement of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain the consumer's suitability information
- C. Except as permitted under subsection D, an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information.
- D. (1) Except as provided under paragraph (2) of this subsection, neither an insurance producer nor an insurer, shall have any obligation to a consumer under subsection A or C related to any annuity transaction if:
- (a) No recommendation is made;
 - (b) A recommendation was made and was later found to have been prepared based on inaccurate material information provided by the consumer;
 - (c) A consumer refuses to provide relevant suitability information and

the annuity transaction is not recommended; or

- (d) A consumer decides to enter into an annuity transaction that is not based on a recommendation of the insurer or the insurance producer.
 - (2) An insurer's issuance of an annuity subject to paragraph (1) shall be reasonable under all the circumstances actually known to the insurer at the time the annuity is issued.
- E. An insurance producer or, where no insurance producer is involved, the responsible insurer representative, shall at the time of sale:
 - (1) Make a record of any recommendation subject to section 6A of this ~~regulation~~ Policy and Procedure;
 - (2) Obtain a customer signed statement documenting a customer's refusal to provide suitability information, if any; and
 - (3) Obtain a customer signed statement acknowledging that an annuity transaction is not recommended if a customer decides to enter into an annuity transaction that is not based on the insurance producer's or insurer's recommendation.
- F.
 - (1) An insurer shall establish a supervision system that is reasonably designed to achieve the insurer's and its insurance producers' compliance with this ~~regulation~~ Policy and Procedure, including, but not limited to, the following:
 - (a) The insurer shall maintain reasonable procedures to inform its insurance producers of the requirements of this ~~regulation~~ Policy and Procedure and shall incorporate the requirements of this ~~regulation~~ Policy and Procedure into relevant insurance producer training manuals;
 - (b) The insurer shall establish standards for insurance producer product training and shall maintain reasonable procedures to require its insurance producers to comply with the requirements of section 7 of this ~~regulation~~ Policy and Procedure;
 - (c) The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its insurance producers;
 - (d) The insurer shall maintain procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable. Such review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means including, but not limited to, physical review. Such an electronic or other system may be designed to require additional review only of those transactions identified for additional review by the selection criteria;
 - (e) The insurer shall maintain reasonable procedure to detect recommendations that are not suitable. This may include, but is not

limited to, confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters and programs of internal monitoring. Nothing in this subparagraph prevents an insurer from complying with this subparagraph by applying sampling procedures, or by confirming suitability information after issuance or delivery of the annuity; and

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

- (2) (a) Nothing in this subsection restricts an insurer from contracting for performance of a function (including maintenance of procedures) required under paragraph (1). An insurer is responsible for taking appropriate corrective action and may be subject to sanctions and penalties pursuant to section 8 of this ~~regulation~~ Policy and Procedure regardless of whether the insurer contracts for performance of a function and regardless of the insurer's compliance with subparagraph (b) of this paragraph.

- (b) An insurer's supervision system under paragraph (1) shall include supervision of contractual performance under this subsection. This includes, but is not limited to, the following:

- (i) Monitoring and, as appropriate, conducting audits to assure that the contracted function is properly performed; and
- (ii) Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the manager has a reasonable basis to represent, and does represent, that the function is properly performed.

- (3) An insurer 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.

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

- (1) Truthfully responding to an insurer's request for confirmation of suitability information;
- (2) Filing a complaint; or
- (3) Cooperating with the investigation of a complaint.

H. (1) Sales made in compliance with FINRA requirements pertaining to suitability and supervision of annuity transactions shall satisfy the requirements under this ~~regulation~~ Policy and Procedure. This subsection applies to FINRA broker-dealer sales of variable annuities and fixed annuities if the suitability and supervision is similar to those applied to variable annuity sales. However, nothing in this subsection shall limit the insurance commissioner's ability to enforce (including investigate) the provisions of this ~~regulation~~ Policy and Procedure.

Drafting Note: Non-compliance with FINRA requirements means that the broker-dealer transaction is subject to compliance with the suitability requirements of this regulation.

- (2) For paragraph (1) to apply, an insurer shall:
 - (a) Monitor the FINRA member broker-dealer using information collected in the normal course of an insurer's business; and
 - (b) Provide to the FINRA member broker-dealer information and reports that are reasonably appropriate to assist the FINRA member broker-dealer to maintain its supervision system.

Section 7. Insurance Producer Training

- A. An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has adequate knowledge of the product to recommend the annuity and the insurance producer is in compliance with the insurer's standards for product training. An insurance producer may rely on insurer-provided product-specific training standards and materials to comply with this subsection.
- B.
 - (1)
 - (a) An insurance producer who engages in the sale of annuity products shall complete a one-time four (4) credit training course approved by the department of insurance and provided by the department of insurance-approved education provider.
 - (b) Insurance producers who hold a life insurance line of authority on the effective date of this ~~regulation~~ Policy and Procedure and who desire to sell annuities shall complete the requirements of this subsection within six (6) months after the effective date of this ~~regulation~~ Policy and Procedure. Individuals who obtain a life insurance line of authority on or after the effective date of this ~~regulation~~ Policy and Procedure may not engage in the sale of annuities until the annuity training course required under this subsection has been completed.
 - (2) The ~~minimum length of the one-time~~ training required under this subsection shall be sufficient to qualify for at least four (4) CE credits, ~~but may be longer~~.
 - (3) The training required under this subsection shall include information on the following topics:
 - (a) The types of annuities and various classifications of annuities;
 - (b) Identification of the parties to an annuity;
 - (c) How fixed, variable and indexed annuity contract provisions affect consumers;
 - (d) The application of income taxation of qualified and non-qualified annuities;
 - (e) The primary uses of annuities; and
 - (f) Appropriate sales practices, replacement and disclosure

requirements.

- (4) Providers of courses intended to comply with this subsection shall cover all topics listed in the prescribed outline and shall not present any marketing information or provide training on sales techniques or provide specific information about a particular insurer's products. Additional topics may be offered in conjunction with and in addition to the required outline.
- (5) A provider of an annuity training course intended to comply with this subsection shall register as a CE provider in this State and comply with the rules and guidelines applicable to insurance producer continuing education courses as set forth in K.S.A. 49-4903 ~~[insert reference to State law or regulations governing producer continuing education course approval]~~.
- (5) Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with K.S.A. 49-4903 ~~[insert reference to State law or regulations governing producer continuing education course approval]~~.
- (7) Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with K.S.A. 49-4903 ~~[insert reference to State law or regulations governing to producer continuing education course approval]~~.
- (8) The satisfaction of the training requirements of another State that are substantially similar to the provisions of this subsection shall be deemed to satisfy the training requirements of this subsection in this State.
- (9) An insurer shall verify that an insurance producer has completed the annuity training course required under this subsection before allowing the producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this subsection by obtaining certificates of completion of the training course or obtaining reports provided by commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

Section 8. Compliance Mitigation; Penalties

- A. An insurer is responsible for compliance with this ~~regulation~~ Policy and Procedure. If a violation occurs, either because of the action or inaction of the insurer or its insurance producer, 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~~ Policy and Procedure;
 - (2) A general agency, independent agency or the insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this ~~regulation~~ Policy and Procedure; and
 - (3) Appropriate penalties and sanctions.
- B. Any applicable penalty under K.S.A. 40-2407 ~~[insert statutory citation]~~ for a violation of this ~~regulation~~ Policy and Procedure 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 or the violation was not part of a pattern or practice.~~

Drafting Note: Subsection B above is intended to be consistent with the commissioner's discretionary authority to determine the appropriate penalty for a violation of this regulation. The language of subsection B is not intended to require that a commissioner impose a penalty on an insurer for a single violation of this regulation if the commissioner has determined that such a penalty is not appropriate.

Drafting Note: A State that has authority to adopt a schedule of penalties may wish to include the words in brackets. In that case, "shall" should be substituted for "may" in the same sentence. States should consider inserting a reference to the NAIC Unfair Trade Practices Act or the State's statute that authorizes the commissioner to impose penalties and fines.

Section 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 five ~~{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~~ Policy and Procedure may be maintained in paper, photographic, micro-process, 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 This Policy and Procedure ~~amendments to this regulation~~ shall take effect on June 1, 2013 ~~six (6) months after the date the regulation is adopted or on [insert date], whichever is later.~~

Chronological Summary of Action (All references are to the Proceedings of the NAIC).

~~2003 Proc. 3rd Quarter 17 18, 24 27, 32, 213 (adopted).~~

~~2006 Proc. 2nd Quarter 40, 90 (amended).~~

~~2010 Proc. 1st Quarter (amended)~~