1-Hour Best Interest Requirement

United Insurance Educators, Inc.
PO Box 1030
Eatonville, WA 98328
(253) 846-1155

1-Hour Best Interest Requirement

Table of Contents

United Insurance Educators, Inc.
PO Box 1030
Eatonville, Washington 98328
(253) 846-1155

Email: mail@uiece.com

Website: www.uiece.com

1-Hour Best Interest Requirement

Changing Times

The NAIC enacted its best interest standard in February 2020 as a revision to its regulation 275. In their statement, the NAIC states:

“The revisions clarify that all recommendations by insurance producers and insurers must be in the best interest of the consumer and that insurance producers and carriers may not place their financial interest ahead of the consumer’s interest in making the recommendation. The model now requires insurance producers and carriers to act with “reasonable diligence, care, and skill” in making recommendations.”

"These changes underscore the commitment of U.S. insurance regulators to protecting consumers purchasing annuities," said Ray Farmer, NAIC President, and South Carolina Insurance Director. "Nearly every state has adopted the model, which has been protecting consumers for 15 years. I encourage my colleagues to work with their state legislatures to pass these updates to provide even stronger protection."

“The revisions incorporate a “best interest” standard into the model revisions that require producers and insurers to satisfy requirements outlined in a care obligation, a disclosure obligation, a conflict of interest obligation, and a documentation obligation. The model revisions also include enhancements to the current model’s supervision system to assist in compliance.

This course follows the **Suitability in Annuity Transactions Model Regulations** outline developed by the National Association of Insurance Commissions (NAIC). The model regulations require insurers to become responsible for ensuring that annuity sales are suitable based on specified criteria. It requires insurance producers to be trained on annuities in general and certainly on the specific products they sell. Where feasible and logical, suitability standards for annuities are consistent with the suitability standards imposed by the Financial Industry Regulatory Authority, known as FINRA.

This course provides annuity product training regarding traditional fixed-rate annuities; equity-indexed fixed annuities, and variable annuities. Variable annuities are required to meet FINRA suitability rules; sales in compliance with FINRA rules would comply with the NAIC suitability regulations.

This course provides information that is reasonably appropriate to determine the suitability of a producer’s annuity recommendation, such as age, tax position, income, individual financial situation, time horizon, and objectives. Furthermore, it covers the duties of insurers and insurance producers. Prior to recommending an annuity product, of any kind, producers and insurers are required to make reasonable efforts to obtain the consumer’s suitability information. This course covers all the steps in doing so. Since annuities are often intended to provide income during the consumers retirement years, it is important that insurance producers understand their ethical and professional duties when recommending these products.

1-Hour Best Interest Requirement

Under the NAIC Model training it states:
Section 7. Producer Training

A. A producer shall not solicit the sale of an annuity product unless the producer has adequate knowledge of the product to recommend the annuity and the producer is in compliance with the insurer's standards for product training. A producer may rely on insurer-provided product-specific training standards and materials to comply with this subsection.

B. (1) (a) A 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) Producers who hold a life insurance line of authority on the effective date of this regulation and who desire to sell annuities shall complete the requirements of this subsection within six (6) months after the effective date of this regulation. Individuals who obtain a life insurance line of authority on or after the effective date of this regulation may not engage in the sale of annuities until the annuity training course required under this subsection has been completed.

(6) A producer who has completed an annuity training course approved by the department of insurance prior to *[insert effective date of amended regulation – this date will be different for each state.]* shall, within six (6) months after *[insert effective date of amended regulation – this date will be different for each state.]*, complete either:

(a) A new four (4) credit training course approved by the department of insurance after *[insert effective date of amended regulation – this date will be different for each state.]*; or

(b) An additional one-time one (1) credit training course approved by the department of insurance and provided by the department of insurance-approved education provider on appropriate sales practices, replacement and disclosure requirements under this amended regulation.

As the states adopt these updated NAIC Model codes, some of the rules regarding annuities will be amended and how insurance producers sell them. The purpose of these rules is to require producers to act in the best interest of consumers when making recommendations of an annuity product. It requires insurance companies to establish and maintain a system to supervise recommendations made by their insurance producers to provide oversight.

For example, traditionally insurance producers and others in the insurance industry have referred to "suitability" determination. Now there will be a shift from suitability standards to "best interest" standards under NAIC Model code. This is not actually a change in how annuities should be sold, but rather a change in how the process is described. Whether we talk about "suitability" or "best interest" however, the end result is the same: insurance producers must make sure the product fits the needs of the consumer.

1-Hour Best Interest Requirement

A Brief Suitability Legislation History

In 2000, the NAIC adopted what is called a white paper (a government or other authoritative report giving information or proposals on a particular issue) recommending the establishment of what was referred to as "suitability" standards for life insurance and annuity products. Soon thereafter a working group of people was appointed to draft the suitability standards. They developed the standards for the model act and regulations regarding them.

These newly created suitability standards had the goal of protecting consumers by regulating the activities of insurance companies and the products they sold to the public. These requirements, while regulating insurance companies, insurance producers, and the products recommended, were not intended to prevent the sale of insurance, but rather it was hoped products would be better matched to the consumers. Thus, the term "suitability" in the new regulations.

A model act and regulation were adopted by the working group and forwarded to the parent committee. Due to the lack of support for far-reaching suitability standards, and especially since no such standards had previously existed, the parent committee recommended a narrow model that addressed certain areas of the most concerning issues to regulators. That included the sale of annuities to seniors. A new model was drafted in early 2003, which was discussed at the beginning of this course.

Because of the new regulations, insurance companies became involved in the process. They developed criteria for their insurance producers and others involved in the review of standards to ensure all requirements were followed.

Although there may be some variance between insurers, most follow similar patterns of operation regarding suitability or best interest regulations. For example, the funds used to buy annuities plus the total value of all other existing annuities, whether placed with the insurer being considered or elsewhere, may not be more than 50 percent of the consumers' household net worth. This is just an example, of course, and actual insurers may state it differently.

Insurers look at the consumer's disposable income too, wanting to prevent putting the consumer in a situation where there is not enough money or income to cover routine household expenses. There may be limitations placed, such as the insurer may refuse to issue an annuity contract if the consumer has less than $500 of disposable monthly income.

NAIC Section 5. Definitions

In any law, there are always definitions. Because law must be clearly understood, definitions allow the readers to recognize what is meant by the law. Definitions, in other words, give clarity to the law.

Annuity means an annuity that is an insurance product under state law, individual solicited, whether the product is classified as an individual or group annuity.

Cash compensation means any discount, concession, fee, service fee, commission, sales charge, loan, override, or cash benefit received by a producer in connection with the recommendation or sale of an annuity from an insurer, intermediary, or directly from the consumer.

Consumer profile information means information that is reasonably appropriate to determine whether a recommendation addresses the consumer's financial situation, insurance needs, and financial objectives, including, at a minimum, the following:

(1) Age;

Editor's Note: Annuities were created with retirement in mind, so regardless of whether it happens to be an equity-indexed annuity or a traditional fixed annuity, early withdrawal penalties apply. Most annuity contracts allow for free withdrawals even during surrender periods, but that does not apply to age and the IRS penalties. Anyone who might need a portion of their money prior to age 59½ should not buy annuities.

(2) Annual income;

Editor's Note: A consumer's current income requirements need to be established as well as any long-term total returns. With the advances of modern medical technology, our life spans are increasing. Therefore, we need to be prepared to support ourselves for 20 to 30 years in retirement. Obviously, this means saving and investing sufficiently.

(3) Financial situation and needs, including debts and other obligations;

Editor's Note: There are ways to ease people's negative emotional reaction to their financial situation when there is market volatility, including diversification, proper income planning, and a "buckets of money" strategy. Essentially "bucket planning" requires educating consumers on having at least four different buckets of money - one for immediate income and three others that grow and provide income down the road.

(4) Financial experience;

Editor's Note: If any particular past investment yielded badly (lost money) it is likely that the consumer will not want to try that investment again. Even if it was an isolated situation, it is unlikely that he or she will have any confidence. The reverse could also be true. If the consumer did very well in any particular type of investment, he or she may want to put all their eggs in one basket. Of course, it is usually best to have a varied portfolio.

(5) Insurance needs;

Editor's Note: Every family needs to have an emergency fund. This is true before buying life insurance to protect one's family and also after death when insurance has paid out proceeds. If an emergency fund does not currently exist, the consumer may want to add the amount to his or her projected insurance needs.

(6) Financial objectives;

Editor's Note: The objectives of consumers are basically the same: financial growth (more money). It really doesn't matter whether the objective is retirement income, a larger home, or college for the kids; it all comes down to having more money than the consumer started with.

(7) Intended use of the annuity;

Editor's Note: Life insurance insures the premature death of a stated individual while an annuity is intended to fund the insured's retirement years. Annuities may be purchased for other reasons, but they are intended to fund a long-term event, such as retirement. The younger a consumer is when he or she begins to save, the longer their time horizon is for accumulating wealth. Interest earnings will take away the need to systematically save larger amounts. As a result, the consumer can tolerate the up-and-down market cycles to a greater degree than someone without time on their side. The closer a person is to retirement, the greater the risk involved in a poor decision. He or she does not have the luxury of time to recover from a bad choice, so they must be more conservative in their investing, avoiding excessive risk when possible.

(8) Financial time horizon;

Editor's Note: The time horizon for deferred account funds is an integral part of the decision process. If the funds are to be used in short term time frames, tax deferral probably does not give many advantages. Since annuities are long-term vehicles, they are more likely to benefit from tax deferral than many other types. If the consumer takes into account his or her current tax liability then the actual net gain can be established. Also, tax deferral allows for the growth of funds that would normally need to be set aside for taxes.

(9) Existing assets or financial products, including investment, annuity, and insurance holdings;

Editor's Note: It is unlikely that any one type of financial vehicle would be sufficient to comprise a fully adequate financial plan. Annuities must be part of a portfolio that considers all types of investment vehicles so that the consumer's goals and aspirations are fully satisfied. Assets must be logically divided among several types of financial vehicles so that the consumer's full needs are met. An insurance producer or financial planner that merely divides the consumer's assets among an array of annuities, even if diversified among several indexes and annuity types, is probably not doing an adequate job of protecting his or her clients.

(10) Liquidity needs;

Editor's Note: The availability of assets is a major concern for consumers. Annuities are not typically considered a liquid account since it is subject to certain distribution restrictions and penalties for early withdrawals or surrender. Consumers who are looking for liquidity would not want to invest in annuities in most cases.

(11) Liquid net worth;

Editor's Note: The more wealth a consumer has (called their net worth) the more he or she can potentially tolerate risk, but in all cases, their sensitivity to risk must be considered. Just because the consumer could conceivably tolerate a higher degree of risk does not mean he or she wants to.

(12) Risk tolerance, including but not limited to, willingness to accept non-guaranteed elements in the annuity;

Editor's Note: There are several elements that determine whether a product is suitable, including the consumer's risk tolerance, financial needs, cash reserves, and personal or financial goals. In some cases, it is obvious that an annuity is not suitable or perhaps that *some types of annuities* are not suitable. As we know (or should know by now), there is no product that is always right for every consumer. It is misleading to compare one annuity product to another if the features each offer is vastly different. We often hear this stated as "comparing apples to oranges." Each is a fruit, but the differences are great enough that they cannot be adequately compared. The same is true for some types of annuities.

(13) Financial resources used to fund the annuity; and

Editor's Note: Annuity funding for tax-qualified plans must be nontransferable. The owner is not allowed to sell, assign, discount or pledge as collateral for a loan, as security for the performance of an obligation or for any other purpose, his interest in the contract to any person other than the issuer. Additionally, the annuity contract must specifically contain provisions making the contract nontransferable.

Other than the non-transferability of the contract, there are no other special requirements required for an annuity that funds a tax-qualified plan. There are numerous regulations and requirements for the plan itself but since the annuity funding the plan usually does not have the qualifications for the applicable plan, the same thing is accomplished by separate plan documentation kept by the employer.

(14) Tax status.

Editor's Note: Annuitization works the same whether the annuitant or contract owner will owe taxes on the earnings or not. What will be different between a non-qualified annuity and a tax-qualified annuity is the taxation. If the annuity is not a qualified annuity taxes will be due as the growth is paid out. Under current tax status, the first money withdrawn is considered to be growth, with the last money withdrawn being principal. In a non-qualified annuity, the principal was taxed prior to deposit.

Continuing education credit or **CE credit** means one continuing education credit as defined by each state's regulations.

Continuing education provider or **CE provider** means an individual or entity that is approved to offer continuing education courses pursuant to each state's regulations.

FINRA means the Financial Industry Regulatory Authority or a succeeding agency.

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

Intermediary means an entity contracted directly with an insurer or with another entity contracted with an insurer to facilitate the sale of the insurer's annuities by producers.

(1) **Material conflict of interest** means a financial interest of the producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation.

(2) **Material conflict of interest** does not include cash compensation or non-cash compensation.

Non-cash compensation means any form of compensation that is not cash compensation, including, but not limited to, health insurance, office rent, office support, and retirement benefits.

Non-guaranteed elements mean the premiums, credited interest rates (including any bonus), benefits, values, dividends, non-interest based credits, charges, or elements of formulas used to determine any of these that are subject to company discretion and are not guaranteed at issue. An element is considered nonguaranteed if any of the underlying non-guaranteed elements are used in its calculation.

Producer means a person or entity required to be licensed under the laws of this state to sell, solicit, or negotiate insurance, including annuities. For purposes of this regulation, “producer” includes an insurer where no producer is involved.

(1) **Recommendation** means advice provided by a producer to an individual consumer that was intended to result or does result in a purchase, an exchange, or a replacement of an annuity in accordance with that advice.

(2) **Recommendation** does not include general communication to the public, generalized customer services assistance or administrative support, general educational information and tools, prospectuses, or other product and sales material.

Replacement means a transaction in which a new annuity is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer whether or not a producer is involved, that by reason of the transaction, an existing annuity or other insurance policy has been or is to be any of the following:

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.

SEC means the United States Securities and Exchange Commission.

1-Hour Best Interest Requirement

Sales Practices

Insurance producers know they are required by every state to be honest in the course of practicing their profession, but appropriate sales practices go beyond that. Insurance producers could adopt the medical profession's code of "do no harm." The first step in any financial transaction is acknowledging that wrong choices could financially affect the buyer. Unfortunately, the buyer is often unaware that he or she has been adversely affected until years later when they reach retirement or some other pre-planned goal.

In an effort to mandate ethical behavior many states now require a certain number of "ethic" hours, but there is concern that mandating education does not necessarily translate into ethical behavior. It is a difficult situation for lawmakers and others who have the burden of protecting America's consumers. On the plus side, when producers have taken courses on ethical behavior, they cannot use the *"I didn't know"* excuse for their behavior.

Sales practices include everything from the first contact to the final delivery of the policy. As it relates to annuity products, establishing product suitability and ethical practices are closely related. An ethical insurance producer would not place a product that is not suitable for the buyer.

Appropriate sales practices would dictate that each item be given adequate consideration prior to placing the annuity product. There must be reasonable grounds to believe the annuity is suitable for the consumers' needs and goals.

Insurance producers must know the customer's financial situation; understand the available options and communicate the basis of the recommendations. Section 6 of the NAIC's Model Act reads:

Section 6. Duties of Insurers and Producers

A. Best Interest Obligations. A producer, when making a recommendation of an annuity, shall act in the best interest of the consumer under the circumstances known at the time the recommendation is made, without placing the producer's or the insurer's financial interest ahead of the consumer's interest. A producer has acted in the best interest of the consumer if they have satisfied the following obligations regarding care, disclosure, conflict of interest, and documentation:

(1) (a) **Care Obligation**. The producer, in making a recommendation shall exercise reasonable diligence, care, and skill to:

i. Know the consumer's financial situation, insurance needs, and financial objectives;

ii. Understand the available recommendation options after making a reasonable inquiry into options available to the producer;

iii. Have a reasonable basis to believe the recommended option effectively addresses the consumer's financial situation, insurance needs, and financial objectives over the life of the product, as evaluated in light of the consumer profile information; and

iv. Communicate the basis or bases of the recommendation.

(b) The requirements under Subparagraph (a) of this paragraph include making reasonable efforts to obtain consumer profile information from the consumer prior to the recommendation of an annuity.

(c) The requirements under Subparagraph (a) of this paragraph require a producer to consider the types of products the producer is authorized and licensed to recommend or sell that address the consumer's financial situation, insurance needs, and financial objectives. This does not require analysis or consideration of any products outside the authority and license of the producer or other possible alternative products or strategies available in the market at the time of the recommendation. Producers shall be held to standards applicable to producers with similar authority and licensure.

(d) The requirements under this subsection do not create a fiduciary obligation or relationship and only create a regulatory obligation as established in this regulation.

(e) The consumer profile information, characteristics of the insurer, and product costs, rates, benefits, and features are those factors generally relevant in making a determination whether an annuity effectively addresses the consumer's financial situation, insurance needs, and financial objectives, but the level of importance of each factor under the care obligation of this paragraph may vary depending on the facts and circumstances of a particular case. However, each factor may not be considered in isolation.

(f) The requirements under Subparagraph (a) of this paragraph include having a reasonable basis to believe the consumer would benefit from certain features of the annuity, such as annuitization, death or living benefit, or other insurance-related features.

(g) The requirements under Subparagraph (a) of this paragraph apply to the particular annuity as a whole and the underlying subaccounts to which funds are allocated at the time of purchase or exchange of an annuity, and riders and similar producer enhancements, if any.

(h) The requirements under Subparagraph (a) of this paragraph do not mean the annuity with the lowest one-time or multiple occurrence compensation structure shall necessarily be recommended.

(i) The requirements under Subparagraph (a) of this paragraph do not mean the producer has ongoing monitoring obligations under the care obligation under this paragraph, although such an obligation may be separately owed under the terms of a fiduciary, consulting, investment advising, or financial planning agreement between the consumer and the producer.

1-Hour Best Interest Requirement

Product Replacement with Best Interest in Mind

There are situations that call for replacing one existing product with a newer insurance product, but this is not true in every case. Insurance producers should never replace an existing product with another product unless there are specific reasons for doing so and those reasons are sensible, meaning the client's best interest has been considered. Especially when an annuity is the investment tool involved, there are times when a replacement might be unwise. This would especially be true if the annuity owner's contract were past the surrender period. Putting the client into a new annuity with a new surrender period should not be done without serious thought.

Obviously, insurance producers must observe all state-mandated replacement procedures. Most states have specific replacement procedures, which must be followed.

What does this mean? It all comes down to one question: *does the consumer benefit from the product replacement?* It could also be asked another way: *would the insurance producer make the same replacement if the product in question belonged to him or her instead of someone else?* Would the insurance producer make the same product choice for themselves that they are advising others to make?

Here is how the NAIC Model Act recommends product replacement.

> (j) In the case of an exchange or replacement of an annuity, the producer shall consider the whole transaction, which includes taking into consideration whether:
>
> i. 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;
>
> ii. The replacing product would substantially benefit the consumer in comparison to the replaced product over the life of the product; and
>
> iii. The consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 60 months.
>
> (k) Nothing in this regulation should be construed to require a producer to obtain any license other than a producer license with the appropriate line of authority to sell, solicit or negotiate insurance in this state, including but not limited to any securities license, in order to fulfill the duties and obligations contained in this regulation; provided the producer does not give advice or provide services that are otherwise subject to securities laws or engage in any other activity requiring other professional licenses.

Full Disclosure

As we know some products are more complex than others. A criticism of equity-indexed annuities, for example, is their complexity, even many insurance producers avoid presenting them purely due to lack of product understanding. Only when the insurance producer understands the product will he or she be able to adequately communicate all aspects of the investment to their clients.

It is important to fully disclose all product characteristics, including product limitations. Consumers will make better decisions when they understand the various products and are able to make an informed decision. More importantly for the insurance producer's commission is the fact that consumers will *keep the product* when they are satisfied that an informed decision was made.

When recommending an annuity, we know that suitability hinges on information. If the insurance producer does not request adequate information, he or she cannot make an adequate recommendation.

Insurance Producer Compensation Disclosure Forms

Insurance producers have not traditionally had to disclose how they are paid or the amount of compensation that will be received. Like so many things that develop, the need to disclose compensation emerged as legal issues became apparent.

The National Association of Insurance Commissions has developed Appendix A which is and insurance producer disclosure for annuities. There is a section for the producer's information and a section for the consumer (called customer on the form) information. There is also a section titled: *How I'm Paid for My Work*. This section outlines three options: commissions, fees, and other. Under "other" the producer would fill in how he or she received compensation. This disclosure form may vary by state, but the intent is to alert consumers to the difference in being paid by the insurer through commissions or other insurer compensation and being paid an hourly rate by the consumer. Typically, a person who charges an hourly rate never sells a commissioned product.

APPENDIX A
INSURANCE AGENT (PRODUCER) DISCLOSURE FOR ANNUITIES
Do Not Sign Unless You Have Read and Understand the Information in this Form

Date: ________________________
INSURANCE AGENT (PRODUCER) INFORMATION ("Me", "I", "My")
First Name: _________________________ Last Name: ______________________________
Business\Agency Name: ____
Website: ____
Business Mailing Address:____
Business Telephone Number: ____
Email Address:____
National Producer Number in [state]:____

CUSTOMER INFORMATION ("You", "Your")
First Name: _________________________Last Name: ______________________________

1-Hour Best Interest Requirement

What Types of Products Can I Sell You?
I am licensed to sell annuities to You in accordance with state law. <u>If I recommend that You buy an annuity, it means I believe that it effectively meets Your financial situation, insurance needs, and financial objectives. Other financial products, such as life insurance or stocks, bonds and mutual funds, also may meet Your needs.</u>

I offer the following products:
□ Fixed or Fixed Indexed Annuities
□ Variable Annuities
□ Life Insurance

I need a separate license to provide advice about or to sell non-insurance financial products. I have checked below any non-insurance financial products that I am licensed and authorized to provide advice about or to sell.

□ Mutual Funds
□ Stocks/Bonds
□ Certificates of Deposit

Whose Annuities Can I Sell to You?
I am authorized to sell:

□ Annuities from Only One (1) Insurer
□ Annuities from Two or More Insurers
□ Annuities from Two or More Insurers although I primarily sell annuities from:
____

How I'm Paid for My Work:
It's important for You to understand how I'm paid for my work. Depending on the particular annuity You purchase, I may be paid a commission or a fee. Commissions are generally paid to Me by the insurance company while fees are generally paid to Me by the consumer. If You have questions about how I'm paid, please ask Me.

<u>Depending on the particular annuity You buy, I will or may be paid cash compensation as follows:</u>

□ <u>Commission, which is usually paid by the insurance company or other sources. If other sources, describe: ____.</u>

□ <u>Fees (such as a fixed amount, an hourly rate, or a percentage of your payment), which are usually paid directly by the customer.</u>

☐ Other
(Describe): ____
________.

If You have questions about the above compensation I will be paid for this transaction, please ask me.

I may also receive other indirect compensation resulting from this transaction (sometimes called "non-cash" compensation), such as health or retirement benefits, office rent and support, or other incentives from the insurance company or other sources.

By signing below, You acknowledge that You have read and understand the information provided to You in this document.

____
Customer Signature

____
Date

____
Agent (Producer) Signature

____
Date

Section 6. Duties of Insurers and Producers

(2) **Disclosure obligation.**

(a) *Prior to the recommendation or sale of an annuity*, the producer shall prominently disclose to the consumer on a form substantially similar to Appendix A:

(i) A description of the scope and terms of the relationship with the consumer and the role of the producer in the transaction;

(ii) An affirmative statement on whether the producer is licensed and authorized to sell the following products:

(I) Fixed annuities;

(II) Fixed indexed annuities;

(III) Variable annuities;

(IV) Life insurance;

(V) Mutual funds;

(VI) Stocks and bonds; and

(VII) Certificates of deposit;

(iii) An affirmative statement describing the insurers the producer is authorized, contracted (or appointed), or otherwise able to sell insurance products for, using the following descriptions:

(I) From one insurer;

(II) From two or more insurers; or

(III) From two or more insurers although primarily contracted with one insurer.

(iv) A description of the sources and types of cash compensation and non-cash compensation to be received by the producer, including whether the producer is to be compensated for the sale of a recommended annuity by commission as part of premium or other remuneration received from the insurer, intermediary or other producer or by fee as a result of a contract for advice or consulting services; and

(v) A notice of the consumer's right to request additional information regarding cash compensation described in Subparagraph (b) of this paragraph;

(b) Upon request of the consumer or the consumer's designated representative, the producer shall disclose:

(i) A reasonable estimate of the amount of cash compensation to be received by the producer, which may be stated as a range of amounts or percentages; and

(ii) Whether the cash compensation is a one-time or multiple occurrence amount, and if a multiple occurrence amount, the frequency and amount of the occurrence, which may be stated as a range of amounts or percentages; and

(c) Prior to or at the time of the recommendation or sale of an annuity, the producer shall have a reasonable basis to believe the consumer has been 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, any annual fees, potential charges for and features of riders or other options of the annuity, limitations on interest returns, potential changes in non-guaranteed elements of the annuity, insurance and investment components and market risk.

(3) **Conflict of interest obligation**. A producer shall identify and avoid or reasonably manage and disclose material conflicts of interest, including material conflicts of interest related to an ownership interest.

(4) **Documentation obligation.** A producer shall at the time of recommendation or sale:

(a) Make a written record of any recommendation and the basis for the recommendation subject to this regulation;

(b) Obtain a consumer signed statement on a form substantially similar to Appendix B documenting:

(i) A customer's refusal to provide the consumer profile information, if any; and

(ii) A customer's understanding of the ramifications of not providing his or her consumer profile information or providing insufficient consumer profile information; and

(c) Obtain a consumer signed statement on a form substantially similar to Appendix C acknowledging the annuity transaction is not recommended if a customer decides to enter into an annuity transaction that is not based on the producer's recommendation.

(5) Application of the best interest obligation. Any requirement applicable to a producer under this subsection shall apply to every producer who has exercised material control or influence in the making of a recommendation and has received direct compensation as a result of the recommendation or sale, regardless of whether the producer has had any direct contact with the consumer. Activities such as providing or delivering marketing or educational materials, product wholesaling or other back office product support, and general supervision of a producer do not, in and of themselves, constitute material control or influence.

B. Transactions <u>not</u> based on a recommendation.

(1) Except as provided under Paragraph (2), a producer shall have no obligation to a consumer under Subsection A(1) 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 materially inaccurate information provided by the consumer;

(c) A consumer refuses to provide relevant consumer profile 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 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.

C. Supervision system.

(1) Except as permitted under Subsection B, an insurer may not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity would effectively address the particular consumer's financial situation, insurance needs and financial objectives based on the consumer's consumer profile information.

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

(a) The insurer shall establish and maintain reasonable procedures to inform its producers of the requirements of this regulation and shall incorporate the requirements of this regulation into relevant producer training manuals;

(b) The insurer shall establish and maintain standards for producer product training and shall establish and maintain reasonable procedures to require its producers to comply with the requirements of Section 7 of this regulation;

(c) The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its producers;

(d) The insurer shall establish and maintain procedures for the review of each recommendation prior to issuance of an annuity that are designed to ensure there is a reasonable basis to determine that the recommended annuity would effectively address the particular consumer's financial situation, insurance needs and financial objectives. 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 establish and maintain reasonable procedures to detect recommendations that are not in compliance with Subsections A, B, D and E. This may include, but is not limited to, confirmation of the consumer's consumer profile information, systematic customer surveys, producer and consumer interviews, confirmation letters, producer statements or attestations and programs of internal monitoring. Nothing in this subparagraph prevents an insurer from complying with this subparagraph by applying sampling procedures, or by confirming the consumer profile information or other required information under this section after issuance or delivery of the annuity;

(f) The insurer shall establish and maintain reasonable procedures to assess, prior to or upon issuance or delivery of an annuity, whether a producer has provided to the consumer the information required to be provided under this section;

(g) The insurer shall establish and maintain reasonable procedures to identify and address suspicious consumer refusals to provide consumer profile information;

(h) The insurer shall establish and maintain reasonable procedures to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific annuities within a limited period of time. The requirements of this subparagraph are not intended to prohibit the receipt of health insurance, office rent, office support, retirement benefits or other employee benefits by employees as long as those benefits are not based upon the volume of sales of a specific annuity within a limited period of time; and

(i) The insurer shall annually provide a written 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.

(3) (a) Nothing in this subsection restricts an insurer from contracting for performance of a function (including maintenance of procedures) required under this subsection. An insurer is responsible for taking appropriate corrective action and may be subject to sanctions and penalties pursuant to Section 8 of this regulation 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 this subsection 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.

(4) An insurer is not required to include in its system of supervision:

(a) A producer's recommendations to consumers of products other than the annuities offered by the insurer; or

(b) Consideration of or comparison to options available to the producer or compensation relating to those options other than annuities or other products offered by the insurer.

D. Prohibited Practices. Neither a producer nor an insurer shall dissuade, or attempt to dissuade, a consumer from:

(1) Truthfully responding to an insurer's request for confirmation of the consumer profile information;

(2) Filing a complaint; or

(3) Cooperating with the investigation of a complaint.

Deceptive Sales Practices Forbidden

Some insurance producer practices are considered deceptive. These would include high-pressure sales, quick-change tactics, or anything that is less than an honest presentation of the product facts. Just as insurance producers must correctly and honestly present their own products, they must also correctly and honestly present other products, such as the policy the insurance producer is attempting to replace.

All of us have been exposed to a salesperson that puts pressure on us to "buy now." As insurance producers, we would probably like all consumers to buy the first time around, but when decisions can greatly affect an individual's financial future, they must be made wisely. Pressuring an individual to "buy now" is not only unwise but if it is determined to be high-pressure sales tactics, it may have legal consequences.

Quick-change tactics involve discussing one type of product with the client but placing something else. The consumer may not realize that the old-fashioned fixed-rate annuity he thought he was buying is actually an equity-indexed annuity, for example. While the equity-indexed annuity is a fixed rate product, it is not the fixed-rate product that most consumers are familiar with.

Every state has specific forbidden practices but having a state or federal law should never be the reason an insurance producer is honest.

Most laws develop due to need. Annuity suitability and best interest laws are no exception. The need developed as multiple forms of annuities were developed by insurers. Not only could consumers become confused about some of the aspects of these new products, but insurance producers could also be confused. Even very honest insurance producers were making errors that could potentially harm their clients. Unfortunately, consumers are harmed when mistakes are made, whether the mistake is due to insurance producer greed or insurance producer error, either way, it is the consumer that suffers financially. Therefore, annuity suitability laws initiated procedures to hopefully prevent buying errors. Both the selling insurance producers and the issuing insurers now have responsibilities to the consumers.

As insurance producers are required to jump through more hoops, they could believe that the new suitability requirements are a hindrance to them. Nothing could be farther from the truth. Suitability standards not only protect the consumer; they also protect the insurance producers selling annuities. They protect the insurance producer from making serious mistakes that could cause a lawsuit when consumers or their families discover the insurance producer's mistake in judgment. When insurance producers follow the annuity suitability or best interest laws faithfully they may not always make a sale, but they will have a solid basis upon which their recommendations have been made.

Recordkeeping is important for many reasons, recommendations for annuity purchases should be kept as protection in case an insurance producer's judgment is called into question in the future. We cannot predict the performance of many products, keeping records is both a requirement and protection against future lawsuits.

E. Safe harbor.

(1) Recommendations and sales of annuities made in compliance with comparable standards shall satisfy the requirements under this regulation. This subsection applies to all recommendations and sales of annuities made by financial professionals in compliance with business rules, controls and procedures that satisfy a comparable standard even if such standard would not otherwise apply to the product or recommendation at issue. However, nothing in this subsection shall limit the insurance commissioner's ability to investigate and enforce the provisions of this regulation.

(2) Nothing in Paragraph (1) shall limit the insurer's obligation to comply with Section 6C(1) of this regulation, although the insurer may base its analysis on information received from either the financial professional or the entity supervising the financial professional.

(3) For paragraph (1) to apply, an insurer shall:

(a) Monitor the relevant conduct of the financial professional seeking to rely on Paragraph (1) or the entity responsible for supervising the financial professional, such as the financial professional's broker-dealer or an investment adviser registered under federal [or state] securities laws using information collected in the normal course of an insurer's business; and

(b) Provide to the entity responsible for supervising the financial professional seeking to rely on Paragraph (1), such as the financial professional's broker-dealer or investment adviser registered under federal [or state] securities laws, information and reports that are reasonably appropriate to assist such entity to maintain its supervision system.

(4) For purposes of this subsection, "**financial professional**" means a producer that is regulated and acting as:

(a) A broker-dealer registered under federal [or state] securities laws or a registered representative of a broker-dealer;

(b) An investment adviser registered under federal [or state] securities laws or an investment adviser representative associated with the federal [or state] registered investment adviser; or

(c) A plan fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974 (ERISA) or fiduciary under Section 4975(e)(3) of the Internal Revenue Code (IRC) or any amendments or successor statutes thereto.

(5) For purposes of this subsection, "**comparable standards**" means:

(a) With respect to broker-dealers and registered representatives of broker-dealers, applicable SEC and FINRA rules pertaining to best interest obligations and supervision of annuity recommendations and sales, including, but not limited to, Regulation Best Interest and any amendments or successor regulations thereto;

(b) With respect to investment advisers registered under federal [or state] securities laws or investment adviser representatives, the fiduciary duties and all other requirements imposed on such investment advisers or investment adviser representatives by contract or under the Investment Advisers Act of 1940 [or applicable state securities law], including but not limited to, the Form ADV and interpretations; and

(c) With respect to plan fiduciaries or fiduciaries, means the duties, obligations, prohibitions and all other requirements attendant to such status under ERISA or the IRC and any amendments or successor statutes thereto.

Editor's Note: Some best interest (formerly suitability) requirements may apply under FINRA, which would apply to variable annuities. The so-called "safe harbor" is intended to prevent duplicative suitability standards.

Section 9. Recordkeeping

A. Insurers, general agents, independent agencies and producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer, disclosures made to the consumer, including summaries of oral disclosures, 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 a producer.

The law quoted in this course is not the complete law. We encourage readers to look up the full law and become acquainted with it. https://content.naic.org/sites/default/files/inline-files/MDL-275.pdf