

# **NAIC Suitability in Annuity Transactions Model Regulation**

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# **NAIC Annuity Suitability Model**

- Adopted in 2003 and revised in 2006 and 2010.
- 2006 revisions expanded scope to apply to consumers of all ages.

# **The 2003 NAIC Annuity Suitability Model**

In order to ensure the insurance needs and financial objectives of consumers were appropriately being addressed at the time an annuity sale or replacement took place, in 2003, the NAIC adopted the suitability model, which set forth standards and procedures for recommendations to consumers that result in a transaction involving an annuity product.

# The 2003 NAIC Annuity Suitability Model

- In recommending the purchase or exchange of an annuity, insurer or insurance producer had to have reasonable grounds for believing the recommendation was suitable based on the facts disclosed by the consumer and consumer's financial situation and needs.

# The 2003 NAIC Annuity Suitability Model

- Required insurer or insurance producer to make reasonable efforts to obtain information on:
  - The consumer's financial status;
  - The consumer's tax status;
  - The consumer's investment objectives; and
  - Such other information used or considered reasonable by the insurer or producer.
- No definition of "suitability information."

# The 2003 NAIC Annuity Suitability Model

- Required insurers to set up a system of supervision that is reasonably designed to ensure suitable sales.
- Permitted insurers to contract with a 3<sup>rd</sup> party to establish and maintain that system of supervision.

# The 2003 NAIC Annuity Suitability Model

- Required insurers to make reasonable inquiry to assure that the 3<sup>rd</sup> party with which it has contracted is performing the contracted functions.
- The reasonable inquiry obligation could be complied with by:
  - Annually obtaining a certification from a 3<sup>rd</sup> party senior manager who has responsibility for the delegated functions that the 3<sup>rd</sup> party is performing the delegated functions; and
  - Periodically, the insurer selects 3<sup>rd</sup> party contractors for a review to determine compliance.

# The 2003 NAIC Annuity Suitability Model

- Provided that if the insurer contracts with a 3<sup>rd</sup> party to establish and maintain a system of supervision for recommendations and the insurer fulfills its responsibility related to making reasonable inquiry as to the 3<sup>rd</sup> party's performance of the contracted functions, the insurer shall have fulfilled its responsibilities as to having a system to supervise recommendations reasonably designed to achieve compliance with the model requirements.



# NAIC Annuity Suitability Model 2010 Revisions

- Clarifies that the insurer is responsible for compliance with the model even if the insurer contracts out functions to a 3<sup>rd</sup> party.
- The insurer shall maintain procedures for reviewing each recommendation prior to the issuance of an annuity.

# **NAIC Annuity Suitability Model 2010 Revisions**

- Insurance producers required to complete general annuity product training prior to soliciting the sale of an annuity product.
- Insurers required to provide product-specific training and training materials that explain all material features of their annuity products to its insurance producers.

# NAIC Annuity Suitability Model 2010 Revisions

- Similar to the 2003 version, the insurer or insurance producer shall have reasonable grounds for believing that the recommendation to purchase an annuity or exchange an annuity is suitable for the consumer based on the facts disclosed by the consumer as to his or her investments and other insurance products and financial situation and needs, including the consumer's suitability information.

# **NAIC Annuity Suitability Model 2010 Revisions**

- When assessing suitability, insurers or producers must have a reasonable basis to believe all of the following:
  - The consumer would benefit from certain features of the annuity.
  - The annuity as a whole, and the underlying subaccounts, are suitable for the consumer.

# **NAIC Annuity Suitability Model 2010 Revisions**

- Insurers required to maintain procedures to detect recommendations that are not suitable.
- Insurers required to annually provide a report to senior management, which details a review, with appropriate testing that was designed to determine the effectiveness of the system.

# NAIC Annuity Suitability Model 2010 Revisions

- Insurers may contract with a 3<sup>rd</sup> party for performance of a function.
- However, the insurer is responsible for taking appropriate action and may be subject to sanctions and penalties regardless of whether the insurer contracts for performance of a function and regardless of the insurer's compliance with the model's requirement to supervise contractual performance.

# **NAIC Annuity Suitability Model 2010 Revisions**

In addition to requiring insurers to establish a system to supervise recommendations made in the marketing and sale of annuities, the model was further amended in order to ensure NAIC annuity suitability standards were consistent with those standards imposed by the Financial Industry Regulatory Authority (FINRA).

# **NAIC Annuity Suitability Model 2010 Revisions**

- As such, a safe harbor provision was added to the model.
- The safe harbor provision states that sales made in compliance with FINRA requirements will satisfy the requirements outlined in the model.



# NAIC Annuity Suitability Model

## 2010 Revisions

- Age
- Annual Income
- Financial Situation & Needs
- Financial Resources for the Funding of the Annuity
- Financial Experience
- Financial Objectives
- Intended Use of the Annuity
- Financial Time Horizon
- Existing Assets
- Liquidity Needs
- Liquid Net Worth
- Risk Tolerance
- Tax Status

# Exemptions To The Annuity Suitability Model

- Direct response solicitations where there is no recommendation based on information collected from the consumer.
- Contracts used to fund:
  - Employee pension or welfare benefit plans that are covered by ERISA.
  - Plans described by sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the IRC if established or maintained by an employer.

# Exemptions To The Annuity Suitability Model

- 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.
- A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

# Exemptions To The Annuity Suitability Model

- Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process.
- Formal prepaid funeral contracts.

# Questions

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