

State of Rhode Island and Providence Plantations
DEPARTMENT OF BUSINESS REGULATION
Division of Insurance
1511 Pontiac Avenue, Bldg. 69-2
Cranston, Rhode Island 02920

Public Notice of Proposed Rule-Making

Pursuant to the provisions of R.I. Gen. Laws § 42-14-16, and in accordance with the Administrative Procedures Act Chapter 42-35 of the General Laws, the Department of Business Regulation hereby gives notice of its intent to amend Insurance Regulation 12 – Suitability in Annuity Transactions.

The purpose of these amendments are to update the regulation to the current version of the National Association of Insurance Commissioners model regulation and strengthen protections for consumers of annuity products.

The proposed regulation and concise summary of non-technical amendments are available for public inspection at www.dbr.ri.gov, in person at Department of Business Regulation, 1511 Pontiac Avenue, Cranston, Rhode Island 02920, or requested by email edwyer@dbr.ri.gov or by calling Elizabeth Kelleher Dwyer at (401) 462 9520.

In the development of the proposed amendment consideration was given to: (1) alternative approaches; (2) overlap or duplication with other statutory and regulatory provisions; and (3) significant economic impact on small business. No alternative approach, duplication, or overlap was identified based upon available information.

All interested parties are invited to submit written or oral comments concerning the proposed regulations by December 16, 2010 to Elizabeth Kelleher Dwyer, Department of Business Regulation, 1511 Pontiac Avenue, Cranston, Rhode Island 02920, edwyer@dbr.ri.gov. A public hearing to consider the proposed amendment shall be held on December 16, 2010 at 10:00 am at 1511 Pontiac Avenue, Cranston, Rhode Island 02920 at which time and place all persons interested therein will be heard. The room is accessible to the disabled and interpreter services for the hearing impaired will be provided if requested 48 hours prior to the hearing. Requests for this service can be made in writing or by calling (401) 462 9520 or TDD 711.

A. Michael Marques
Director, Department of Business Regulation

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Concise Summary of Proposed Non-technical Amendments
to
Insurance Regulation Number 12

In accordance with the Administrative Procedures Act, Section 42-35-3(a)(1) of the General Laws of Rhode Island, following is a concise summary of proposed non-technical amendments:

1. Section 2(a) is amended to clarify insurers obligations with regard to suitability.
2. Section 3 is amended to clarify the concurrent regulatory authority in cases where both insurance and securities laws are applicable.
3. Section 4 substitutes the word "transactions" for the word "recommendations."
4. Section 5(A) clarifies the definition of "annuity."
5. Sections 5(B), (C), (D), (H) and (I) were added to add definitions of continuing education credit, continuing education provider, FINRA, replacement, suitability information
6. Section 5(G) was amended to add replacement to the definition of recommendation.
7. Section 6 is amended to provide specific consumer disclosures and specific inquiries necessary for a proper consideration of suitability in the sale of life insurance and annuities products. The regulation also clarifies the obligations of insurers and insurance producers with regard to suitability requirements. The words "or contestability" have been added to the NAIC Model language in section 6(A)(4)(a).
8. Section 7 is added to provide specifics with regard to new insurance producer training required before a producer can sell insurance products to which suitability requirements apply.
9. Section 8 is amended to clarify the responsibilities of insurers with regard to suitability and the fact that the regulator may assess penalties for violations of the regulation.
10. Section 10 is amended to clarify the effective date of the proposed amendments.

State of Rhode Island and Providence Plantations
DEPARTMENT OF BUSINESS REGULATION
Division of Insurance

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INSURANCE REGULATION 12

SUITABILITY IN ANNUITY TRANSACTIONS

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Section 1. Authority

This regulation is promulgated in accordance with R.I. ~~Gen. Laws: §§ 27-29-1 et seq. and 42-14-17.~~

Section 2. Purpose

- A. The purpose of this regulation 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 ~~a~~ 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.

Section 3. Scope

This regulation shall apply to any recommendation to purchase, ~~or~~ 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, ~~or~~ exchange or replacement recommended. If a recommendation is subject both to this regulation and to R.I. ~~Gen. Laws: §§ 7-11-101 et seq., the authority established under R.I. Gen. Laws: § 7-11-101 et seq. shall be the primary regulatory~~

~~authority under which~~ the State of Rhode Island ~~shall may~~ investigate and, where appropriate, seek sanctions with regard to such recommendation under both R.I. Gen. Laws §§ 7-11-101 et seq. and this Regulation. ~~The laws are complementary and application of one does not prohibit enforcement of the other prior to, concurrent with or subsequent to any action taken by the appropriate enforcement authority.~~

Section 4. Exemptions

Unless otherwise specifically included, this regulation shall not apply to ~~recommendations transactions~~ 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 Income Security Act (ERISA) [US Pub. Law 93-406, as amended];
 - (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 ~~fixed~~-annuity ~~that is an insurance product or variable annuity 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 R.I. Gen. Laws § 27-3.2-1 et seq. and Insurance Regulation 40.

- C. “Continuing education provider” or “CE provider” means an individual or entity that is approved to offer continuing education courses pursuant to R.I. Gen. Laws § 27-3.2-1 *et seq.* and Insurance Regulation 40.
- D. “FINRA” means the Financial Industry Regulatory Authority or a succeeding agency.
- BE. “Insurer” means a company required to be licensed under the laws of this state to provide insurance products, including annuities.
- CE. “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.
- DG. “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 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.
- 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 (the requirements of this section are intended to supplement and not replace the disclosure requirements of Insurance Regulation 41-Annuity Disclosure);
 - (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 or contestability 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, ~~or 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 ~~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 there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information.

ED. (1) Except as provided under Paragraph (2) of this subsection, neither an insurance producer, nor an insurer ~~where no producer is involved~~, shall have any obligation to a consumer under Subsection A related to any ~~recommendation-annuity transaction~~ if a consumer:

(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;

~~(ac)~~ A consumer Refuses to provide relevant suitability information requested by the insurer or insurance producer and the annuity transaction is not recommended; or;

~~(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.

~~(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 or insurance producer's recommendation~~issuance of an annuity 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~~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 6(A) of this regulation;

(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.

~~DE.~~ (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 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~~, including, but not limited to, the following:

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

(b) ~~Conducting periodic reviews of its records that are reasonably designed to assist in detecting and preventing violations of this regulation.~~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;

- (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 general agent and independent agency either shall adopt a system established by an insurer to supervise recommendations of its insurance producers that is reasonably designed to achieve compliance with this regulation, or shall establish and maintain such a system, including, but not limited to:~~

~~(a) Maintaining written procedures; and~~

~~(b) Conducting periodic reviews of records that are reasonably designed to assist in detecting and preventing violations of this regulation.~~

- (32) (a) Nothing in this subsection restricts 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 (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 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.

~~(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.~~

(63) An insurer, general agent or independent agency is not required by Paragraph (1) or (2) of this subsection to:

- ~~(a) Review, or provide for review of, all insurance producer solicited transactions; or~~
- ~~(b) Include in its system of supervision an insurance producer's recommendations to consumers of products other than the annuities offered by the insurer, general agent or independent agency.~~
- ~~(7) A general agent or independent agency contracting with an insurer pursuant to Paragraph (3) of this subsection shall promptly, when requested by the insurer pursuant to Paragraph (4) of this subsection, give a certification as described in Paragraph (4) of this subsection or give a clear statement that it is unable to meet the certification criteria.~~
 - ~~(8) No person may provide a certification under Paragraph (4)(a) of this subsection unless:
 - ~~(a) The person is a senior manager with responsibility for the delegated functions; and~~
 - ~~(b) The person has a reasonable basis for making the certification.~~~~

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.

EH. (1) Sales made in compliance with the National Association of Securities Dealers Conduct Rules-FINRA requirements pertaining to suitability and supervision of annuity transactions shall satisfy the requirements under this section for the recommendation of variable annuities regulation. 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.

(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 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.
- (2) The minimum length of the 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 Insurance Regulation 40.
- (6) Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with Insurance Regulation 40
- (7) Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with Insurance Regulation 40.
- (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 78. Compliance, Mitigation of Responsibility; Penalties

- A. An insurer is responsible for compliance with this regulation. 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;
 - (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; and
 - (3) Appropriate penalties and sanctions. ~~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 R.I. Gen. Laws: §§ 27-29-6 and 42-14-16 for a violation of ~~Section 6A, B, or C (2) of~~ this regulation may be reduced or

eliminated 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.

Section 8. 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 (5) 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.
- 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.

Section 9 Severability

If any provision of this regulation or the application thereof to any person or circumstances is held invalid or unconstitutional, the invalidity or unconstitutionality shall not affect other provisions or applications of this Regulation which can be given effect without the invalid or unconstitutional provision or application, and to this end the provisions of this Regulation are severable.

Section 10 Effective Date

This Regulation and the amendments thereto shall be effective as indicated below. The September 2006 amendments to the regulation shall be applicable to all recommendations made on and after January 1, 2007. The January 2011 amendments to this regulation shall take effect on June 1, 2011.

EFFECTIVE DATE: February 1, 2006
AMENDED: September 18, 2006
AMENDED: January , 2011