

DISCUSSION DRAFT

Draft: 5/26/09
Revisions to Model 275

Underlining and overstrikes show the changes from the existing model. Comments are being requested on this draft. Comments should be sent on or before June 8, 2009 to Jolie Matthews at jmatthew@naic.org.

SUITABILITY IN ANNUITY TRANSACTIONS
MODEL REGULATION

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Section 1. Purpose

- A. The purpose of this regulation is to set forth standards and procedures for recommendations to consumers that result in a transaction involving annuity products so that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed.
- B. Nothing herein shall be construed to create or imply a private cause of action for a violation of this regulation.

Drafting Note: The language of subsection B comes from the NAIC Unfair Trade Practices Act. If a State has adopted different language, it should be substituted for subsection B.

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Section 2. Scope

This regulation shall apply to any recommendation to purchase or exchange an annuity made to a consumer by an insurance producer, or an insurer where no producer is involved, that results in the purchase or exchange recommended.

Section 3. Authority

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

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

Section 4. Exemptions

Unless otherwise specifically included, this regulation shall not apply to recommendations or transactions involving:

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- A. Direct response solicitations where there is no recommendation based on information collected from the consumer pursuant to this regulation;
- B. Contracts used to fund:
 - (1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);
 - (2) A plan described by Sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer;
 - (3) A government or church plan defined in Section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the IRC;
 - (4) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;
 - (5) Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or
 - (6) Formal prepaid funeral contracts.

Section 5. Definitions

- A. "Annuity" means a fixed annuity or variable annuity that is individually solicited, whether the product is classified as an individual or group annuity.
- B. "FINRA" means the Financial Industry Regulatory Authority or a succeeding agency.
- C. "Includes," "include" or "including" mean including, but not limited to.
- D. (1) "Insurance agency" means a person or entity, other than an officer or employee of an insurer, that receives compensation, directly or indirectly, for managing the sales of an insurer's annuities by insurance producers.
(2) "Insurance agency" includes field marketing organizations and independent marketing organizations.
- E. "Insurance producer" means an individual required to be licensed under the laws of this State to sell, solicit or negotiate insurance, including annuities.
- F. "Insurer" means a company required to be licensed under the laws of this State to provide insurance products, including annuities.
- G. "NAIC Life Insurance Committee" means the committee or body of the National Association of Insurance Commissioners designated to develop and publish guidance related to this regulation.
- H. "Qualified reviewer" means a firm or person who conducts an audit or inspection required under this regulation.

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Deleted: C. "Insurance producer" means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.¶

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NOTE: THIS DEFINITION IS REVISED TO MAKE CLEAR THAT THE COMMITTEE PROVIDING GUIDANCE WILL BE A NAIC COMMITTEE OR BODY.

N. "Supervision system" means a supervision system that complies with sections 7, 8 and 9 of this regulation.

O. "Transaction monitoring elements" means those indicators with respect to individual proposed transactions that are reasonably appropriate to collect, analyze and report to identify situations that raise a materially higher risk of a violation of the suitability requirement, including suitability information.

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

A. **SUITABLE RECOMMENDATION REQUIRED.** A recommendation to a consumer to purchase an annuity, or to exchange an annuity that results in another insurance transaction or series of insurance transactions, by a insurance producer, or the insurer where no producer is involved, shall be suitable for the consumer based on a reasonable assessment 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.

B. **RECOMMENDATION MUST BE BASED ON CLIENT'S SUITABILITY INFORMATION.** Prior to the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall obtain the suitability information.

C. **INSURER DUTY TO MAKE SUITABILITY DETERMINATION.** No insurer may issue an annuity recommended to a consumer unless the annuity is suitable based on the suitability of information provided by the consumer at the time of sale. Any penalty for violation of this subsection is subject to section 17 of this regulation.

D. **INACCURATE OR INCOMPLETE SUITABILITY INFORMATION.**

(1) 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 if a consumer:

(a) Decides to enter into an insurance transaction that is not based on a recommendation of the insurer or insurance producer; or

(b) Fails to provide accurate information, and the failure is unknown to the insurer or insurance producer.

(2) No insurer may issue recommended annuity, and no insurance producer may recommend an annuity if the consumer fails to provide complete suitability information unless:

(a) The consumer provides information relating to each element of suitability information that is sufficient to allow the insurer or insurance producer to reasonably determine the annuity is suitable; and

(b) The insurer or insurance producer's recommendation is reasonable under all the circumstances actually known to the insurer or insurance producer at the time of the recommendation.

E. **RECOMMENDATIONS TO BE INCLUDED IN SUPERVISION SYSTEM.** An insurer or insurance agency is not required by section 7, 8 or 9 of this regulation to include in its supervision system recommendations to consumers of products other than the annuities offered by the insurer or insurance agency.

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F. COORDINATION WITH FINRA RULES. Compliance with the FINRA Conduct Rules pertaining to suitability shall satisfy the requirements under this section for the recommendation of annuities that are securities. However, nothing in this subsection shall limit the insurance commissioner’s ability to enforce the provisions of this regulation.

Drafting Note: This subsection is intended to grant a safe harbor under this section when the suitability of recommendation of an annuity is regulated by, and complies with, the FINRA Conduct Rules pertaining to suitability.

Section 7. Insurer Supervision System

A. SUPERVISION SYSTEMS AND PROCEDURES. An insurer that sells annuities shall establish and maintain systems and procedures that are reasonably designed to prevent, detect and remedy violations of the suitability requirement.

B. REVIEW OF COMPLAINTS AND ENFORCEMENT ACTIONS. An insurer shall include the following in its supervision system:

(1) Systems and procedures for complete and documented investigation and disposition of any State insurance department, State security regulator or FINRA enforcement action against an insurance producer or insurance agency involving the sale of the insurer’s annuity, including [after June 30, 2011 or six (6) months after the effective date of this regulation, whichever is later] all of the following:

- (a) Appropriate and documented action, including termination, suspension, supervision, warning or training, for any misconduct by an insurance producer or insurance agency;
- (b) Review of each enforcement action to determine whether the enforcement action reasonably suggests the insurance producer or insurance agency may have engaged in a pattern of misconduct with respect to the suitability requirement that materially harmed customers other than those whose transactions were the subject of the action;
- (c) Reasonable measures to identify all consumers materially harmed by a pattern of misconduct identified under subparagraph (b) of this paragraph; and
- (d) Reasonable measures to provide appropriate corrective action for consumers materially harmed by a pattern of misconduct identified under subparagraph (b) of this paragraph, regardless of whether the consumer’s transaction is a subject of the enforcement action; and

(2) Systems and procedures for investigation of consumer complaints, including documented consumer and insurance producer interviews to the extent reasonably appropriate to investigate consumer complaints.

C. INSURER SUPERVISION SYSTEM MONITORING OF INSURANCE AGENCIES, FINRA MEMBER-BROKER-DEALERS AND INSURANCE PRODUCERS. An insurer shall include in its supervision system procedures to require the insurer’s insurance agencies, FINRA member broker-dealers and insurance producers to comply with the supervision system, including after [June 30, 2011 or six (6) months after the effective date of this regulation, whichever is later] all of the following:

(1) The insurer, prior to contracting with an insurance agency, conducts a reasonable review to determine, and reasonably concludes, that the insurance agency has established, has the capacity to maintain, and will implement those elements of the supervision system that are applicable to the insurance agency;

(2) The insurer:

Deleted: (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.

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- (a) Contractually requires the insurance agency to comply with, and implement, the elements of the supervisory system that are applicable to insurance agency;
 - (b) Includes substantial contractual penalties for failure to comply with, and implement, the required elements of the supervision system;
 - (c) Imposes, as is reasonably appropriate, supervision, suspension or termination of the insurance agency, and its insurance producers, for failure to comply with, or implement, the supervisory system; and Formatted: Indent: Left: 0 pt, Hanging: 144 pt, Tabs: 108 pt, Left + 144 pt, Left
 - (d) Enforces the contractual penalties where appropriate. Formatted: Indent: Left: 72 pt, First line: 36 pt, Tabs: Not at 216 pt
 - (3) The insurer monitors its insurance producers, insurance agencies and FINRA member-broker dealers through measures reasonably designed to identify violations of the suitability requirement and failure to comply with the insurer's supervision system, including collection, analysis and reports concerning all of the following: Formatted: Indent: Left: 72 pt, Hanging: 36 pt
 - (a) Consumer interviews and surveys; Formatted: Indent: Left: 108 pt
 - (b) Consumer complaints and inquiries; Formatted: Indent: Left: 108 pt
 - (c) Replacement, surrender, withdrawal, free-look cancellations, declinations, and lapse information; Formatted: Indent: Left: 108 pt, Hanging: 36 pt
 - (d) Insurer insurance producer disciplinary information; Formatted: Indent: Left: 108 pt
 - (e) Regulatory insurance producer disciplinary information; Formatted: Indent: Left: 108 pt
 - (f) Proposed transactions identified for review by suitability review standards; Formatted: Indent: Left: 108 pt
 - (g) The insurer's suitability review of transactions; and Formatted: Indent: Left: 108 pt
 - (h) Inspection reports required under this regulation. Formatted: Indent: Left: 108 pt
 - (4) (a) The insurer maintains procedures to verify that its insurance producers complete the training competency and ongoing education required by section 14A(1) and (2) of this regulation. Formatted: Indent: Left: 72 pt, Hanging: 72 pt, Tabs: 144 pt, Left
 - (b) The procedures may include obtaining and recording certificates of completion of the ongoing education 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. Formatted: Tabs: 144 pt, Left
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 - (5) The insurer monitors its insurance agencies, FINRA member broker-dealers and insurance producers for, and contractually enforces, compliance with the firm training program and firm element training required under section 14A(3) and D of this regulation. Formatted: Tabs: 144 pt, Left
 - (6) The insurer requires practices, training, procedures or controls as reasonably appropriate to address compliance risk associated with product design, marketing practices and producer sales patterns.
 - (7) The insurer conducts targeted audits and investigations of the insurer's insurance agencies, FINRA member broker-dealers and insurance producers to the extent prudent based on the results of its monitoring. Formatted: Indent: Hanging: 36 pt, Tabs: 108 pt, Left
- D. INSURER PLANNING PROCESS. Formatted: Indent: Left: 0 pt, First line: 36 pt

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(1) After [June 30, 2011 or six (6) months after the effective date of this regulation, whichever is later], the insurer shall develop and maintain its supervision system through a process of collection of relevant data and information, analysis of the data and information, and evaluation of the effectiveness of implemented supervision systems and procedures. Nothing in this paragraph restricts integration of the process with business planning processes.

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(2) An insurer shall include in the process all of the following:

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(a) Consideration of the NAIC Life Insurance Committee adopted and published guidance. The insurer shall retain a record documenting its consideration of the guidance; and

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(b) A compliance risk assessment of product design, marketing practices and insurance producer sales patterns.

E. INSURER SUPERVISION ORGANIZATION AND ORGANIZATIONAL REPORTING. On or after [June 30, 2011 or six (6) months after the effective date of this regulation, whichever is later], an insurer shall maintain a supervision organization, and organizational reporting, that includes:

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(1) An officer whose primary function is to manage the supervision and monitoring functions required under subsection D and sections 8 and 9 of this regulation who has substantial qualifications for that function and who is not responsible for, or subordinate to managers who are responsible for, sales or marketing functions, other than the chief executive officer;

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(2) Sufficient qualified supervision personnel to adequately address each supervision function required under this section and sections 8 and 9 of this regulation;

(3) Audit and special investigation units;

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(4) Provisions ensuring that supervision personnel, vendors and functions performing the functions required under subsections B through D and sections 8 and 9 of this regulation are independent from, and not subject to the direction, control or influence by, the insurer's sales or marketing divisions or functions;

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(5) Provisions ensuring that insurer functions required under subsections B through D and sections 8 and 9 of this regulation are performed by insurer vendors only if the vendors are professional service providers for the function and are not subject to direction, control or influence by a person or entity that performs, or is affiliated with a person or entity that performs, sales or marketing functions;

(6) An annual report to senior management, including to the senior officer 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; and

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(7) (a) A report, at least every five (5) years, conducted and certified by a qualified reviewer, to senior management, including to the senior officer responsible for audit functions, which details a review that includes those procedures and tests that are generally accepted, and reasonably necessary, to provide reasonable assurance that the insurer has established, and is maintaining, an effective supervision system, the exceptions found, and recommended corrective actions, if any; and

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(b) The qualified reviewer certification shall be in the form adopted and published by the NAIC Life Insurance Committee unless the insurer requests approval for, and the commissioner approves, a different form.

Section 8. Insurer Supervision System for Non-Security Broker-Dealer Distribution

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An insurer's supervision system for supervision of annuity sales, other than annuity sales by a FINRA licensed broker-dealer subject to section 9 of this regulation, shall include on and after [January 1, 2012 or six (6) months after the effective date of this regulation, whichever is later], all of the following:

A. INSURER COMPLIANCE VERIFICATION PROCEDURES.

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(1) Forms and processes reasonably designed to assure all information necessary to analyze and determine suitability of an annuity transaction for an individual consumer is obtained and documented by the insurance producer at the point of sale and reported to the insurer, including suitability information and transaction monitoring elements, except as permitted under section 6 of this regulation;

(2) Measures reasonably designed to ensure that suitability information and transaction monitoring elements are accurately reported by insurance producers and that insurance producers make appropriate disclosures, including all of the following:

(a) (i) Mailing by the insurer to each customer a statement clearly describing the customer's suitability information and transaction monitoring information submitted with the customer's application, a request and form to respond identifying any information that is incorrect and postage paid response envelope;

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(ii) The insurer shall mail the statement and material directly to the customer not later than fourteen (14) days after the effective date of each annuity sale;

(iii) The insurer shall prohibit insurance producers from contacting customers regarding the statement or regarding the customer's response;

(iv) An insurer shall not use the lack of response to the statement, in any proceeding as evidence of the accuracy of the suitability information; and

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(b) Supervision system staff or, subject to supervision staff supervision, qualified vendor, conducted consumer interviews by sampling to the extent sufficient to provide a reasonable degree of assurance of the following:

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(i) Insurance producers collect and accurately report information in connection with annuity sales transactions, including suitability information and transaction monitoring elements; and

(ii) Insurance producers provide customers an accurate and adequate explanation of the material features of the product;

(c) Supervision system staff reasonable attempts, prior to acceptance of an application from any customer age 70 or older, to interview the customer to verify the customer's liquidity related suitability information and the customer's understanding of the liquidity related to features of the annuity; and

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(d) Supervision system staff reasonable attempts, prior to issuing the annuity, to interview any purchaser of an annuity when the consumer refuses to provide sufficient suitability information to justify a determination the transaction is suitable, and maintain a record of the interview, to establish:

(i) The transaction was not recommended; and

(ii) The consumer's refusal to provide suitability information;

(3) Disapproval of any annuity sale if the suitability information does not comply with section 6 of this regulation;

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- (4) Procedures requiring insurance producers to take measures reasonably designed to encourage consumers to accurately respond to supervision system interviews and surveys;
- (5) Recording of supervision system consumer interviews; and
- (6) Retention of recordings and records of the communications required under this paragraph and responses, or record of a failure to respond, for not less than six (6) years.

B. INSURER SUITABILITY REVIEW. Supervision system staff documented review and approval as suitable, or disapproval as unsuitable, of each sale of an annuity identified in accordance with suitability review standards, including:

- (1) Collection of suitability information and transaction monitoring elements for each annuity sales transaction, except as otherwise permitted under section 6 of this regulation;
- (2) Development and application of suitability review standards to proposed transactions;
- (3) Supervision system staff reasonable attempts to interview the customer for each proposed transaction identified for review by a suitability review standard if the proposed transaction reasonably suggests that verification of the suitability information, or the customer's understanding of significant product features, is appropriate; and
- (4) Enhanced measures for monitoring of transaction monitoring elements, and suitability review standards determined to address compliance risks associated with product design, marketing practices and producer sales patterns.

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C. INSURER AGENCY INSPECTION REPORTS. Procedures to require each of the insurer's insurance agencies to submit to the insurer, at least every three (3) years, a certified report of an inspection of the insurance agency, as required under section 10A(4) of this regulation.

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D. INSURER SUPERVISION SYSTEM INSURANCE AGENCY RESPONSIBILITIES. Documented communication to insurance producers and insurance agencies describing the elements of the insurer's supervision system standards and procedures that are the responsibility of the insurance producer and insurance agency, including required suitability information submission procedures and required producer training and verification procedures.

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Section 9 Insurer Supervision System For Security Broker-Dealer Supervised Distribution

A. FINRA MEMBER BROKER-DEALER SUPERVISION. An insurer's systems and procedures under section 7 of this regulation to supervise sales by a FINRA member broker-dealer registered security representatives subject to this section shall include:

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- (1) On and after [January 1, 2012 or six (6) months after the effective date of this regulation, whichever is later] all of the following:

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- (a) The insurer conducts a reasonable review to determine, and concludes, that the FINRA member security broker-dealer has established, has the capacity to maintain, and will implement, application of a system of supervision as to the sale of annuities, including non-security annuity products if non-security products are offered, that conforms to all appropriate provisions of the supervision requirements of FINRA, that are applicable to sales of securities, including FINRA Rule 3010, and FINRA requirements for principal review, product training, training verification and inspection; and

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- (b) The insurer contractually requires the security broker-dealer to establish and maintain the system of supervision described under subparagraph (a) of this paragraph and includes and imposes contractual remedies, as reasonably appropriate, including termination of the contract, for failure to maintain, or comply with, such a system of supervision.

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(2) (a) Application of the systems and procedures required under section 7 of this regulation to monitor, supervise and enforce the FINRA member broker-dealer's obligation under this subsection and section 11 of this regulation, including the broker-dealer's responsibility to provide and verify training. The insurer is not required to verify insurance producer training compliance under section 14 of this regulation to the extent the broker-dealer undertakes and performs that function under paragraph (1).

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(b) An insurer shall provide to each contracting FINRA member broker-dealer information and reports maintained under section 7 of this regulation that are reasonably appropriate to assist the broker-dealer to effectively carry out its supervision responsibilities under the contract.

B. FINRA MEMBER SUPERVISION LIMITED TO SECURITY REPRESENTATIVES. This section applies only to sales of annuities, and supervision of sales of annuities, solicited by a registered security representative of a FINRA member broker-dealer that contractually agrees to subject the sale to supervision under subsection A.

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Section 10. Supervision by Responsible Insurance Agency

A. RESPONSIBLE INSURANCE AGENCY. Except as provided under subsection B and section 11 of this regulation, an insurer on and after [January 1, 2012 or six (6) months after the effective date of this regulation, whichever is later] may not contract or continue a contract with an insurance agency, and an insurance agency may not enter into a contract or continue a contract, to sell, or solicit the sale of, the insurer's annuities, unless the insurance agency complies with all of the following:

(1) The insurance agency is a licensed insurance agency;

(2) The insurance agency has reasonable capacity to comply with this regulation, cause its insurance producers to comply with this regulation, including section 14 of this regulation, and to establish, implement and maintain those elements of the insurer's supervision system that are applicable to the insurance agency and its insurance agency and insurance producers;

(3) (a) A senior manager of the insurance agency certifies to the insurer at least annually that the senior manager has a reasonable basis to represent, and does represent, that each element of the insurer's supervisory system applicable to the responsible insurance agency and its insurance agency and insurance producers was properly performed in the previous annual period except as specifically disclosed in the certification; and

(b) The certification is in the form adopted and published by the NAIC Life Insurance Committee unless the insurer requests approval for, and the commissioner approves, a different form; and

(4) (a) The responsible insurance agency at least every three (3) years causes a qualified reviewer to prepare a report which is submitted to each insurer represented by the responsible insurance agency which details the results of the qualified reviewer's review that includes those procedures and tests that are generally accepted, and reasonably necessary, to provide reasonable assurance that the responsible insurance agency, including its supervised insurance producers, are in compliance with each insurer's supervision system and the suitability requirement.

(b) The report shall describe any identified material failure to comply with the insurer's supervision system or the suitability requirement, and make recommendations for corrective actions, if any; and

(c) The qualified reviewer certification shall be in the form adopted and published by the NAIC Life Insurance Committee unless the insurer requests approval for, and the commissioner approves, a different form.

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Drafting Note: States that do not license, and do not permit licensing of, insurance agencies should substitute for this provision a requirement that the person who controls the responsible insurance agency or who is the manager of the responsible insurance agency must be a licensed insurance producer and is subject to discipline if the responsible insurance agency fails to perform the required regulatory and contractual duties under this subsection.

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B. EXEMPTION FOR SUB-INSURANCE AGENCIES. Subsection A does not apply to an insurance agency if its insurance producers are supervised by a responsible insurance agency.

Section 11. FINRA Member Broker-Dealer Distribution and Supervision.

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A. FINRA MEMBER BROKER-DEALER SECURITY REPRESENTATIVE DISTRIBUTION. On and after [January 1, 2012 or six months after the effective date of this regulation, whichever is later], an insurer may not contract or continue a contract with an insurance agency that is also a FINRA member broker-dealer, or enter into or continue a joint marketing agreement with an insurance agency and a FINRA member broker-dealer for the FINRA member broker-dealer's security representatives to sell, or solicit the sale of, the insurer's annuities unless the insurance agency is a responsible insurance agency under section 10A of this regulation or the insurer complies with all of the following:

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- (1) The insurance agency is a licensed insurance agency;
- (2) The FINRA member broker-dealer has reasonable capacity to cause its security registered representatives and insurance producers to comply with this regulation, and to apply a system of supervision as to sales of annuities that conforms to all appropriate provisions of the supervision requirements of FINRA that are applicable to sale of securities, including FINRA rule 3010, and FINRA requirements for principal review, firm element training, product training, training verification and inspection that are applicable to the sale of securities;
- (3) The FINRA member broker-dealer enters into a contract required under section 9A of this regulation with respect to all sales subject to supervision under section 9 of this regulation; and
- (4) (a) A senior manager of the FINRA member broker-dealer certifies to the insurer at least annually that the senior manager has a reasonable basis to represent, and represents, that the FINRA member broker-dealer properly performed its supervision function in the previous annual period, including with respect to its sub-agents and insurance producers, except as specifically disclosed in the certification;
(b) The certification is in the form the NAIC Life Insurance Committee adopts and publishes unless the insurer requests approval for, and the commissioner approves, a different form.

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B. EXEMPTION FOR SUB-INSURANCE AGENCIES. Subsection A does not apply to an insurance agency if its insurance producers are security representatives who are supervised by a FINRA member broker-dealer under subsection A.

Section 12. Insurance Agency and Insurance Producer Duties

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A. INSURANCE AGENCY DUTIES. In addition to other penalties that may apply, the license of an insurance agency may be revoked or suspended for any of the following:

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- (1) A violation of this regulation;
- (2) A failure to comply with a material element of an insurer's supervision system applicable to the insurance agency;
- (3) A failure to comply with a material element of a FINRA supervision requirement that is applicable to the sale of annuity products under this regulation or that a FINRA member broker-dealer contractually agrees to apply under section 11 of this regulation; or
- (4) A material misrepresentation in a certification required under this regulation.

B. INSURANCE PRODUCER DUTIES.

- (1) An insurance producer may contract to sell, or solicit the sale of, an annuity in this State only if the insurance producer is:
 - (a) An insurance producer for a responsible insurance agency;
 - (b) Contractually subject to supervision by a responsible insurance agency; or
 - (c) A licensed security representative contractually subject to supervision by a FINRA member broker-dealer contracting under section 11A of this regulation.
- (2) In addition to other penalties that may apply, the license of an insurance producer may be revoked or suspended for any of the following:
 - (a) A violation of this regulation;
 - (b) A failure to comply with a material element of either an insurer's supervision system or FINRA supervision requirement applicable to, or applied by a FINRA member broker-dealer to, the insurance producer.

Section 13. Insurance Producer Product Comparison; Reverse Mortgage Funding Prohibited; Unsolicited Sale-Commissioner Limit

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An insurer [on and after January 1, 2012 or six (6) months after the effective date of this regulation, whichever is later] shall:

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- A. PRODUCT COMPARISON. Enforce standards requiring insurance producers to disclose at the time of solicitation to the customer applying for an annuity a comparison of the significant differences between the features of the annuity offered for sale and any financial product, other than a security that is not an annuity that is replaced or is the source of funds for the solicited sale;
- B. REVERSE MORTGAGE FUNDING. Enforce standards that prohibit the sale of an annuity if the source of the funding of the annuity, directly or indirectly, is a reverse mortgage; and

NOTE: THE PROVISIONS IN SUBSECTIONS A AND B WERE INCLUDED IN THE MARCH 12, 2009 DRAFT, BUT HAVE BEEN RELOCATED TO THIS SECTION. SOME INTERESTED PARTIES HAVE EXPRESSED THE VIEW THAT SOME REVERSE MORTGAGE FUNDED SALES ARE SUITABLE.

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- C. LIMIT ON PRODUCER COMPENSATION FOR UNSOLICITED SALE. Compensate an insurance agency or insurance producer for the sale of an annuity that is not recommended no more than an amount equal to 50% of the compensation paid for a recommended annuity sale.

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Drafting Note: Each state should review its statutory authority to determine whether this provision may be adopted by regulation.]

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Section 14. Responsible Insurance Agency and Insurance Producer Training Duties

- A. PRODUCER COMPETENCY TRAINING, ONGOING TRAINING AND PRODUCT TRAINING. On and after [January 1, 2012 or six (6) months after the effective date of this regulation, whichever is later], an insurance producer may sell, solicit or negotiate an annuity only if:
 - (1) COMPETENCY TRAINING COURSE.
 - (a) The insurance producer, prior to selling, soliciting or negotiating the annuity, successfully completes a one-time competency training course approved by the commissioner for the applicable annuity category and proved by a department-approved education provider.

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- (b) The categories for required competency training courses shall be the two categories of fixed annuities and indexed annuities, unless the commissioner determines that other categories of competency training are warranted.
- (c) The competency training course must include a requirement for successful passing of an examination to establish completion of the course.
- (d) Unless the commissioner determines that a substantial public interest requires otherwise, the commissioner shall approve a competency training course, including the examination and the annuity category covered, according to the standards recommended by the NAIC Life Committee.
- (e) An insurance producer who is licensed as a security representative to sell a category of annuities is not required to complete a competency training course for that category.

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(2) ONGOING TRAINING. The insurance producer receives training in the areas of annuity suitability, replacement, disclosure and ethics of not less than four (4) hours every 24 months. The training must be approved by the commissioner and provided by a department-approved education provider. The commissioner shall consider the recommendation of the NAIC Life Committee in approving training courses as meeting the requirements of this paragraph.

(3) PRODUCT TRAINING.

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- (a) The insurance producer complies with the firm training plan required under subsection D or the security broker-dealer firm element training program, if under section 11A of this regulation, the firm element training program is applied to insurance producer-sold annuity products.
- (b) An insurance producer may sell, solicit or negotiate an annuity for a period of three (3) months prior to successfully completing the product training required under a firm training plan, if any. During this period the insurance producer's recommendation must be overseen by an insurance producer who has successfully completed the product training.

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B. RECIPROCAL RECOGNITION OF STATE-APPROVED TRAINING. The satisfaction of the training requirements of another State that are substantially similar to subsection A(1) or (2) shall be deemed to satisfy the training requirements of subsection A(1) or (2) in this State.

C. CONTINUING EDUCATION CREDIT PERMITTED NOT REQUIRED. An insurance producer may, but is not required to, include credit for commissioner-approved continuing education courses that meet the training requirements of subsection A among continuing education credits submitted for the purpose of complying with the continuing education requirements under [insert reference to applicable State law or regulation governing continuing education].

D. FIRM TRAINING PROGRAM.

(1) Except as provided under paragraph (5), on and after [January 1, 2012 or six (6) months after the effective date of this regulation whichever is later], a responsible insurance agency or insurer shall maintain a continuing and current training program for its insurance producers, and supervisors of its insurance producers, to reasonably ensure each insurance producer has adequate knowledge to competently recommend the annuity products offered by the insurance producer. At a minimum, the responsible insurance agency or insurer shall annually evaluate and prioritize training needs and develop and implement a written firm training plan.

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(2) The firm training plan must include:

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- (a) Consideration of elements recommended by published NAIC Life Committee guidance;
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(b) Required insurance producer product training to the extent reasonably necessary to ensure each insurance producer has adequate knowledge of the material features of annuity products the insurance producer offers.

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(3) Nothing in this subsection requires training of an insurance producer if the responsible insurance agency or insurer reasonably expects the insurance producer has adequate knowledge of the material features of an annuity product based on prior training, including competency and ongoing training required under subsection A.

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(4) The responsible insurance agency or insurer shall monitor and enforce insurance producer compliance with the firm training plan.

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(5) This subsection does not apply to FINRA member broker-dealer, or an insurance agency and a FINRA member broker-dealer, subject to section 11A of this regulation.

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(6) For the purpose of this subsection, "responsible insurance agency or insurer" means the licensed insurance agency that an insurer contracts with under section 10A of this regulation or the insurer, if the insurer agrees in its contracts with a responsible insurance agency to perform the functions required by this subsection.

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E. INSURER PRODUCT TRAINING. An insurer shall make available product training for firm training programs and FINRA member broker-dealer firm element training programs.

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Section 15. Standards for Qualified Reviewer

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A. QUALIFICATIONS. An insurer or insurance agency may not obtain or accept an audit or inspection by a qualified reviewer required under this regulation unless the insurer or insurance agency, after reasonable inquiry, determines the firm or person meets all of the following standards:

(1) The management and staff of the firm are, or the person is, trustworthy, competent, trained, educated and experienced in the management and performance of the required functions;

(2) The firm or person maintains and implements procedures to properly document and record a required audit or inspection;

(3) The firm or person, and the individual who conducts a required audit or inspection, are independent from the insurer, insurance agency, and insurance agency insurance producers and not subject to direction, control or influence by, the insurer's insurance agency, insurance producers, or insurer's management that is responsible for sales or marketing functions; and

(4) (i) The firm or person is accredited by an accrediting organization the NAIC Life Insurance Committee approves, unless the insurer requests approval of, and the commissioner approves, a firm or person to perform the function.

(ii) This paragraph applies only after the effective date of the NAIC Life Insurance Committee approval of an accrediting organization.

B. DISQUALIFICATION. The commissioner may disqualify a firm or person from acting as a qualified reviewer.

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Section 16. NAIC Life Insurance Committee Guidance

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NAIC Life Insurance Committee adopted and published guidance is admissible in evidence and shall be considered, in any department proceeding alleging a violation of this regulation, including guidance regarding any of the following:

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A. Practices, training, procedures and controls to address compliance risk associated with product design, marketing practices and producer sales patterns;

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B. Transaction monitoring elements;

C. Suitability review standards;

D. Suitability information;

E. Forms or formats for collection of information, including suitability information;

F. Measures related to verification of transaction monitoring elements and suitability information;

G. Measures relating to verification of effectiveness of disclosures;

H. Form or format for disclosures, including comparison of annuity product features with financial products that are the source of funding for the annuity;

I. Audit guidance with respect to required audits and inspections; or

J. Training.

Section 17. Mitigation of Responsibility

A. The commissioner may order:

- (1) An insurer to take reasonably appropriate corrective action for any consumer harmed by the insurer's, or by its insurance producer's, violation of this regulation;

Drafting Note: Section 17A(1) is not intended to apply to violations by an insurance producer who, under a state's laws, is not an insurer's agent. A State may wish to review this issue and, if necessary, clarify that the paragraph does not apply to brokers who are agents of the consumer, not the insurer.

- (2) An insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this regulation; and
- (3) A general agency or independent agency that employs or contracts with an insurance producer to sell, or solicit the sale, of annuities to consumers, to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this regulation.

Drafting Note: A consumer may have a right to seek relief through FINRA arbitration for sale of a variable annuity in violation of the FINRA Conduct Rules pertaining to suitability. State insurance departments may wish to consider this right when determining whether to bring an action requiring corrective action under Subsection A.

B. Any applicable penalty under [insert statutory citation] for a violation of section 6A, B or C of this regulation may be reduced or eliminated [, according to a schedule adopted by the commissioner,] if corrective action for the consumer was taken promptly after a violation was discovered.

Drafting Note: A state that has authority to adopt a schedule of penalties may wish to include the words in brackets. In that case, "shall" should be substituted for "may" in the same sentence.

Section 18. [Optional] Recordkeeping

A. Insurers, general agents, independent agencies and insurance producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer and other information used in making the recommendations that were the basis for insurance transactions for [insert number] years after the insurance transaction is completed by the insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

Drafting Note: States should review their current record retention laws and specify a time period that is consistent with those laws. For some states this time period may be five (5) years.

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- B. Records required to be maintained by this regulation may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

| **Drafting Note:** This section may be unnecessary in States that have a comprehensive recordkeeping law or regulation.

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reasonable grounds for believing that the recommendation is		
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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		
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Except as provided under Paragraph (2) of this subsection, neither		
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(a) Refuses to provide relevant information requested by the insurer or insurance producer;		
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subject to Paragraph (1) shall be		
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- D. (1) An insurer either shall assure that a system to supervise recommendations that is reasonably designed to achieve 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:

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

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- (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:

Maintaining written procedures; and

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

- (3) 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.

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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:

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

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.

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Paragraph (1) or (2) of this subsection

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Review, or provide for review of, all insurance producer solicited transactions; or
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