

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
AT RICHMOND, NOVEMBER 18, 2016

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COMMONWEALTH OF VIRGINIA, *ex rel.*

STATE CORPORATION COMMISSION

CASE NO. INS-2016-00267

Ex Parte: In the matter of
Amending the Rules Governing
Suitability in Annuity Transactions

ORDER TO TAKE NOTICE

Section 12.1-13 of the Code of Virginia ("Code") provides that the State Corporation Commission ("Commission") shall have the power to promulgate rules and regulations in the enforcement and administration of all laws within its jurisdiction, and § 38.2-223 of the Code provides that the Commission may issue any rules and regulations necessary or appropriate for the administration and enforcement of Title 38.2 of the Code.

The rules and regulations issued by the Commission pursuant to § 38.2-223 of the Code are set forth in Title 14 of the Virginia Administrative Code. A copy may also be found at the Commission's website: <http://www.scc.virginia.gov/case>.

The Bureau of Insurance ("Bureau") has submitted to the Commission proposed amendments to rules set forth in Chapter 45 of Title 14 of the Virginia Administrative Code, entitled Rules Governing Suitability in Annuity Transactions ("Rules"), which amend the Rules set out at 14 VAC 5-45-10 through 14 VAC 5-45-40, and add new Rules at 14 VAC 5-45-45 and 14 VAC 5-45-47.

The proposed amendments to Chapter 45 are necessary to incorporate provisions contained in the National Association of Insurance Commissioners' Suitability in Annuity Transactions Model Regulation. These provisions include a new definition for suitability

information, additional requirements for providing information to consumers regarding the annuity, a requirement that agents complete a one-time four-credit continuing education course on annuity products, and a five-year recordkeeping retention requirement.

NOW THE COMMISSION is of the opinion that the proposed amendments submitted by the Bureau to amend the Rules set out at 14 VAC 5-45-10 through 14 VAC 5-45-40, and add new Rules at 14 VAC 5-45-45 and 14 VAC 5-45-47, should be considered for adoption with a proposed effective date of April 1, 2017.

Accordingly, IT IS ORDERED THAT:

(1) The proposed amendments to the Rules Governing Suitability in Annuity Transactions, which amend the Rules set out at 14 VAC 5-45-10 through 14 VAC 5-45-40, and add new Rules at 14 VAC 5-45-45 and 14 VAC 5-45-47, are attached hereto and made a part hereof.

(2) All interested persons who desire to comment in support of or in opposition to, or request a hearing to consider the proposed amendments to the Rules, shall file such comments or hearing request on or before January 23, 2017, with Joel H. Peck, Clerk, State Corporation Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Interested persons desiring to submit comments electronically may do so by following the instructions at the Commission's website: <http://www.scc.virginia.gov/case>. All comments shall refer to Case No. INS-2016-00267.

(3) If no written request for a hearing on the proposal to amend the Rules as outlined in this Order is received on or before January 23, 2017, the Commission, upon consideration of any comments submitted in support of or in opposition to the proposal, may adopt the Rules as submitted by the Bureau.

(4) The Bureau forthwith shall provide notice to all companies, agencies, and agents licensed by the Commission to sell annuities or variable annuities in Virginia and to all interested persons.

(5) The Commission's Division of Information Resources forthwith shall cause a copy of this Order, together with the proposal to amend the Rules, to be forwarded to the Virginia Registrar of Regulations for appropriate publication in the *Virginia Register of Regulations*.

(6) The Commission's Division of Information Resources shall make available this Order and the attached proposed amendments to the Rules on the Commission's website: <http://www.scc.virginia.gov/case>.

(7) The Bureau shall file with the Clerk of the Commission an affidavit of compliance with the notice requirements of Ordering Paragraph (4) above.

(8) This matter is continued.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to: Kiva B. Pierce, Assistant Attorney General, Division of Consumer Counsel, Office of the Attorney General, 900 East Main Street, Second Floor, Richmond, Virginia 23219; and a copy hereof shall be delivered to the Commission's Office of General Counsel and the Bureau of Insurance in care of Deputy Commissioner Althelia P. Battle.

STATE CORPORATION COMMISSION, BUREAU OF INSURANCE

Rules Governing Suitability in Annuity Transactions

14VAC5-45-10. Purpose and scope.

The purpose of this chapter is to set forth rules 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. This chapter shall apply to any recommendation to purchase or exchange or replace an annuity made to a consumer by an agent, or insurer where no agent is involved, that results in the purchase or exchange or replacement recommended.

14VAC5-45-20. Definitions.

The following words and terms when used in this chapter shall have the following meaning, unless the context clearly indicates otherwise:

"Agent" or "insurance agent" means an individual or business entity that sells, solicits, or negotiates contracts of insurance or annuity in this Commonwealth.

"Annuity" means a fixed, variable or modified guaranteed annuity that is individually solicited, whether the product is classified as an individual annuity or group annuity.

"Commission" means the State Corporation Commission.

"Continuing education credit" or "CE credit" means one continuing education credit as defined in § 38.2-1867 of the Code of Virginia.

"Continuing education provider" or "CE provider" means an individual or entity that is approved to offer continuing education courses pursuant to § 38.2-1867 of the Code of Virginia.

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

"Insurer" means an insurance company required to be licensed under the laws of this Commonwealth to provide insurance products, including annuities.

"Recommendation" means advice provided by an agent, or an insurer where no agent is involved, to an individual consumer that results in a purchase or exchange or replacement of an annuity in accordance with that advice.

"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 agent, or to the proposing insurer if there is no agent, 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 non-forfeiture 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.

"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.

14VAC5-45-30. Exemptions.

Unless otherwise specifically included, this chapter shall not apply to ~~recommendations~~ transactions involving:

1. Direct response solicitations where there is no recommendation based on information collected from the consumer pursuant to this chapter;
2. Contracts used to fund:
 - a. An employee pension or welfare benefit plan that is covered by the Employee Retirement Income Security Act of 1974 (29 USC § 1001 et seq.);
 - b. A plan described by 26 USC §§ 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code, if established or maintained by an employer;
 - c. A government or church plan defined in 26 USC § 414 of the Internal Revenue Code, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under 26 USC § 457 of the Internal Revenue Code;

- d. A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;
- e. Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or
- f. Preneed funeral contracts as defined in § 54.1-2800 of the Code of Virginia.

14VAC5-45-40. Duties of insurers and agents.

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 agent, or the insurer where no agent 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 investments and other insurance products and as to his 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;

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 the consumer's suitability information; and

4. In the case of an exchange or replacement of an annuity, the exchange or replacement is suitable including taking into consideration whether:

a. The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living or other contractual benefits), or be subject to increased fees, investment advisory fees or charges for riders and similar product enhancements;

b. The consumer would benefit from product enhancements and improvements;
and

c. The consumer has had another annuity exchange or replacement, and, in particular, an exchange or replacement within the preceding 36 months.

B. Prior to the execution of a purchase or exchange or replacement of an annuity resulting from a recommendation, an agent, or insurer where no agent 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. Other information used or considered to be reasonable by the agent, or the insurer where no agent is involved, in making recommendations to the consumer.~~

C. Except as permitted under subsection D of this section, an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information.

D.1. Except as provided in subdivision 2 of this subsection, neither an agent, nor an insurer where no agent is involved, shall have any obligation to a consumer under ~~subsection~~ subsections A or C of this section related to any ~~recommendation~~ annuity transaction if a consumer:

a. ~~Refuses~~ 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 suitability information requested by the insurer or agent and the annuity transaction is not recommended;

~~b. Decides~~ d. A consumer decides to enter into an insurance annuity transaction that is not based on a recommendation of the insurer or agent; or

~~e. Fails~~ e. A consumer fails to provide complete or accurate information.

2. An insurer or agent's recommendation subject to subdivision 1 of this subsection shall be reasonable under all the circumstances actually known to the insurer or agent at the time of the recommendation.

E. An agent or, where no agent is involved, the responsible insurer representative, shall at the time of sale:

1. Make a record of any recommendation subject to subsection A of this section;

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 agent's or insurer's recommendation.

D. F.1. An insurer either shall assure that a system to supervise recommendations that is reasonably designed to achieve compliance with this chapter is established and maintained by complying with subdivisions 3 and 4 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 agents of the requirements of this chapter and shall incorporate the requirements of this chapter into relevant agent training manuals;

b. ~~Conducting periodic reviews of its records that are reasonably designed to assist in detecting and preventing violations of this chapter.~~ The insurer shall establish standards for agent product training and shall maintain reasonable procedures to require its agents to comply with the requirements of 14 VAC 5-45-45;

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

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 procedures 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 subdivision prevents an insurer from complying with this

subdivision 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. An agent and independent agency either shall adopt a system established by an insurer to supervise recommendations of its agents that is reasonably designed to achieve compliance with this chapter, 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 chapter.

3. An insurer may contract with a third party, including an agent or independent agency, to establish and maintain a system of supervision as required by subdivision 1 of this subsection with respect to agents under contract with or employed by the third party.

4. An insurer shall make reasonable inquiry to assure that the third party contracting under subdivision 3 of this subsection is performing the functions required under subdivision 1 of this subsection and shall take action that 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 subdivision 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 subdivision 3 of this subsection and that complies with the requirements to supervise in subdivision 4 of this subsection shall have fulfilled its responsibilities under subdivision 1 of this subsection.

6. An insurer, agent or independent agency is not required by subdivisions 1 or 2 of this subsection to:

a. Review, or provide for review of, all agent-solicited transactions; or

b. Include in its system of supervision an agent's recommendations to consumers of products other than the annuities offered by the insurer, agent or independent agency.

7. An agent or independent agency contracting with an insurer pursuant to subdivision 3 of this subsection, when requested by the insurer pursuant to subdivision 4 of this subsection, shall promptly give a certification as described in subdivision 4 or give a clear statement that it is unable to meet the certification criteria.

8. No person may provide a certification under subdivision 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 agent shall not dissuade, or attempt to dissuade, a consumer from:

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

H. An agent shall comply with the following FINRA requirements:

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

2. For subdivision 1 of this subsection 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.

~~E. I. Compliance with the National Association of Securities Dealers Conduct Rules (http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466)~~

~~FINRA Rule 2111~~

~~(http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859)~~

pertaining to suitability shall satisfy the requirements under this section for the recommendation of variable annuities. However, nothing in this subsection shall limit the commission's ability to enforce the provisions of this chapter.

14VAC5-45-45. Agent training.

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

B. Training requirements are as follows:

1. An agent who engages in the sale of annuity products shall complete a one-time four credit training course approved as continuing education by the Insurance Continuing Education Board in accordance with § 38.2-1867 of the Code of Virginia, and provided by the Insurance Continuing Education Board approved education provider.

2. Agents who hold a life insurance line of authority and who desire to sell annuities shall complete the requirements of this subsection by January 1, 2018. Individuals who obtain a life insurance line of authority on or after January 1, 2018, may not engage in the sale of annuities until the annuity training course required under this subsection has been completed.

3. The minimum length of the training required under this subsection shall be sufficient to qualify for at least four CE credits, but may be longer.

4. 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 product specific annuity contract features 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.

5. 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.

6. A provider of an annuity training course intended to comply with this subsection shall register as a CE provider in this Commonwealth and comply with the rules and guidelines applicable to agent continuing education courses as set forth in § 38.2-1867 of the Code of Virginia.

7. Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with § 38.2-1867 of the Code of Virginia.

8. Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with § 38.2-1867 of the Code of Virginia.

9. 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 Commonwealth.

10. An insurer shall verify that an agent has completed the annuity training course required under this subsection before allowing the agent 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 commission-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

14VAC5-45-47. Recordkeeping.

A. Insurers, agencies and agents shall maintain or be able to make available to the commission 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 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 agent.

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