

## How the NAIC Model Regulation Is Changing the Way Annuities Are Sold and Supervised

The NAIC Suitability in Annuity Transactions Model Regulation is gaining wide adoption, and is changing the way all annuities — fixed and variable — are designed, distributed, and supervised. The Regulation removes some of the protections previously in place for issuers where responsibility for the suitability and supervision of the sales transactions could be delegated through selling agreements to the selling firm, producer, or other intermediaries. When adopted in its model form, the Regulation places new obligations squarely on the insurance company issuing the contract to implement new procedures, controls, exception reporting, training, and pre- and post-issue review processes surrounding annuity sales and replacement sales. How will this impact the companies that issue annuities? The reality is that very few departments — from product development to new policy issue — will escape having to make changes in the way they conduct business. This article outlines some of the changes that specific departments inside issuing and selling firms should consider as the Regulation becomes law over the coming months.

### *Product Development*

As new annuity products and features are developed and introduced the product design team must weigh how these products or features meet specific client needs, and under what circumstances they might not be suitable for other clients. This means that the product development team must work closely with training, new policy issue, and compliance to make sure everyone who either trains producers, produces sales materials, or reviews new applications understands exactly for which clients the new product or feature is suitable, and why.

The Regulation also presents a significant hurdle for new product rollout in that it specifically requires all producers, regardless of distribution channel, to be trained on how the consumer would benefit from certain features of the annuity, and how the particular annuity and riders of each company are suitable for the particular consumer based on his or her circumstances. In other words, no producer can solicit or sell your new product until the annuity carrier certifies that the producer has been trained on the specific features and benefits of the new product. Previously, once a new policy form was approved by the state, wholesalers

needed only to provide new sales materials and product descriptions to producers, who could then immediately begin to sell it. Now, producer training content, delivery, and certification must precede any sales of a new product or feature.

As a result, selling firms will be looking to the insurance carriers to make product-specific training available to principals, representatives, and producers in order to carry out their training and suitability review obligations. While manufacturers are permitted the “safe harbor” of considering that sales made by FINRA firms and their representatives are in compliance with the Regulation, they can only do so if they provide those firms with the necessary tools to effectively monitor and carry out their supervisory obligations. Manufacturers are still required to have records on product training delivered to producers.

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## ***Product Training and Marketing***

Insurance carrier producer training departments and marketing departments will need to quickly adjust to the new requirements. Training departments at career firms likely will be heavily involved in producer training. Marketing departments will need to redraft marketing materials to include which product features are suitable or not, and for which prospects and why. Just calling the existing product marketing materials “training” will not be acceptable. Those training materials will need to be modified and enhanced. Any marketing approaches, sales concepts, or techniques will need to be removed — and new content will need to address how the consumer would benefit from certain features of the annuity, based on his or her suitability information.

This also puts a new twist on training materials. In the past, sales and training materials could describe the product’s features and benefits and outline possible sales approaches and concepts. As long as this was done in a balanced manner, equally presenting the risks and the benefits, the requirement was met. The Regulation now introduces two new concepts in its language. First, that training should address how the specific product and features of the annuity will benefit a specific consumer; and second, that the transaction, including replacements, “as a whole” is suitable for that consumer, in light of their facts and circumstances. These new concepts make a case for training producers not just on when and where the product, its particular features, or the whole transaction might be suitable; but also on when they might *not* be suitable. This type of training would also be valuable for home office and distribution partner reviewers or principals.

Training staff could also sit in on the product development process, to learn early on about the product’s features so that training can be ready on “day one.” This would also provide them with an opportunity to provide input to the product development team on any particular training challenges that a complex product feature or rider might present.

Training delivery and certification are perhaps the biggest challenges that the Regulation presents. As with many new state risk-based education requirements such as training on sales to elderly consumers, sales are not permitted with a simple licensed producer appointment any longer. Many states require (and the Regulation is no different) that specific additional “CE” producer training be certified as delivered before a policy can be solicited or issued. The Regulation requires two specific training requirements. First is the basic training by a state-approved vendor or other provider, on annuity suitability as defined under the Regulation. Second — and perhaps more challenging — is the requirement that

each carrier certify that their producers have been trained on the specific features and benefits of the products. This requirement effectively joins product development and producer training “at the hip” going forward. Every new product innovation now must be preceded by a training module, and manufacturers must be able to certify delivery to the producers before the first sale.

## ***Compliance and Audit***

It is expected that future state market conduct examinations will review all aspects of an annuity company’s compliance with the Regulation, as they may already do where the Regulation is currently effective. The compliance and audit teams have several new areas to test, and some will be areas in which they had little previous involvement. As noted earlier, FINRA selling firms can be relied upon to carry out the suitability review under the Regulation, and those sales will be deemed to be in compliance with the Regulation as it closely mirrors the requirements of 2821 (now 2330). However, in order for an annuity company to rely on that they must:

1. Monitor the FINRA member broker-dealer, using information collected in the normal course of an insurer’s business; and
2. Provide the FINRA member broker-dealer with information and reports that are reasonably appropriate, to assist the FINRA member broker-dealer to maintain its supervision system.

This then directly obligates the annuity carrier to monitor and produce exception reports to a distributor. Reports should test and detect transactions outside the expected norms, using information collected in the ordinary course of reviewing new applications, and other data such as customer surveys. In addition, the information in those reports should be provided to the selling firm. Selling firms may also request that the issuing carrier give them the additional information they feel they need to effectively carry out their duties, and may request that the carrier conduct post-issue customer surveys and report unusual responses or transactions such as excessive or undisclosed replacements. These reports can help firms compare their sales activities with those of other firms or the market as a whole.

Compliance testing should be done on how the firm is meeting the training requirement, testing the new issue licensing and training cross check. Does training adequately inform the suitability choices? Is the suitability review process in new issue adequate to the regulation? Who is doing the review? Are they trained and qualified? How are questionable cases escalated for added review? What issue systems reports showing suitability data are produced? Could they show, for

example, how many clients over a certain age are buying annuities with a certain rider? Who is looking at these reports? Are there reports that show trending, or how many replacements are being handled? What about undisclosed replacements? Have any selling firms requested any special reports? Would it make sense to provide similar reports to all selling firms? Training tests should cover both the basic and the product-specific components: whether training on new product features and riders were properly delivered before new product sales; how well the product-specific training addresses whether or not the new feature or rider is suitable for certain clients; and if the internal review staff are appropriately trained on how to review applications for the new feature or benefit.

### ***Complaints and Customer Service Areas***

The Regulation also raises new questions about customer service. What is being done differently in how the firm handles complaints? Are changes to complaint handling being considered in response to the Regulation? Has the method for reviewing and settling complaints been modified to conform to the expectations of suitability under the Regulation? Are complaints that were previously sent to selling firms now reviewed in house? Who is tracking trends on those complaints?

### ***Insurer's New Policy Issue Department***

Most new issue systems have a cross-check limiting policy issue unless the producer is properly licensed. The Regulation adds another layer to the producer license check, as systems will need to check for completed training prior to issue, similar to AML. Most firms have a basic license check, but just being life and annuity licensed is not sufficient. Producers must show that they have both

the basic annuity training and the carrier's product-specific training on the features and benefits and the suitability of each, or policy issue should not proceed. Product-specific cross checks will need to be added to compare the product applied for and all its riders to the training the producer has completed. Any system doing the training verification must be able to certify to each policy form and rider.

Although the Regulation does not impose any specific license or training requirement on firm new business review staff, this is implied in the obligations placed on the insurance company. Reviewers should be trained on all of the same content as the producers, plus be well informed of all the various features of the annuities sold by the firm and how to spot "red flags" such as the imposition of new surrender period within a few years of a similar surrender; indications the consumer may not be aware of the new surrender charge; or potential tax penalties, higher mortality and expense fees, or loss of any death or living benefit. Reviewers should be able to discern that the particular annuity as a whole, the underlying sub-accounts 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 how to escalate questionable case to supervisors for added review.

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## **How LIMRA Can Help**

LIMRA has the expertise and the resources available to help your firm achieve full compliance with the NAIC Model Regulation. Contact Meggan Tufveson today at [usclientservices@limra.com](mailto:usclientservices@limra.com) or 860-285-7859 to schedule a demonstration of our AnnuityXT training solution. It is available now and being installed by clients to meet the *Suitability in Annuity Transactions Model Regulation*. Regardless of the type of distribution, or limitations on product by distribution channel, or at what stage in the appointment process your producers are, this training can be taken by producers on demand before they sell your products. You pay only for those producers who actually enroll, and you control who sees what product training. Robust real-time reporting is available online at any time.

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