

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, California 94105**

TEXT OF REGULATION

Date: March 11, 2011

REG-2011-00002

Add new Article 1.4: SUITABILITY IN ANNUITY TRANSACTIONS
to Subchapter 7.5 of Chapter 5 of Title 10 of the California Code of Regulations

Adopt Section 2695.185. Purpose.

(a) The purpose of this article 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 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 article.

NOTE: Authority cited: Sections 781, 783, 783.5, 789.6, 790.10, 1668, 1668.5, 1736, 1738, 1739, 1749.7, 10508, 10509.8, 10509.9, 12921, 12926, Insurance Code; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989); *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 781, 783, 783.5, 785, 789.3, 790.03, 790.035, 1668, 1668.5, 1736, 1738, 1739, 1749.8, 10508, 10509.8, 10509.9, Insurance Code.

Adopt Section 2695.186. Scope.

This article shall apply to any recommendation to purchase, exchange or replace an annuity made to a consumer aged 65 or older by an insurance producer, or an insurer where no producer is involved, that results in the purchase, exchange or replacement recommended.

NOTE: Authority cited: Sections 781, 783, 783.5, 789.6, 790.10, 1668, 1668.5, 1736, 1738, 1739, 1749.7, 10508, 10509.8, 10509.9, 12921, 12926, Insurance Code; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989); *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 781, 783, 783.5, 785, 789.3, 790.03, 790.035, 1668, 1668.5, 1736, 1738, 1739, 1749.8, 10508, 10509.8, 10509.9, Insurance Code.

Adopt Section 2695.187. Exemptions.

Unless otherwise specifically included, this article shall not apply to transactions involving:

(a) Direct response solicitations where there is no recommendation based on information collected from the consumer pursuant to this article;

(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.

NOTE: Authority cited: Sections 781, 783, 783.5, 789.6, 790.10, 1668, 1668.5, 1736, 1738, 1739, 1749.7, 10508, 10509.8, 10509.9, 12921, 12926, Insurance Code; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989); *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 781, 783, 783.5, 785, 789.3, 790.03, 790.035, 1668, 1668.5, 1736, 1738, 1739, 1749.8, 10508, 10509.8, 10509.9, Insurance Code.

Adopt Section 2695.188. Definitions.

(a) “Annuity” means an annuity that is an insurance product under California 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 hour as defined in subdivision (i) of Section 2188.2.

(c) “Continuing education provider” or “CE provider” means an individual or entity that is certified to offer continuing education courses pursuant to Section 2188 and subdivision (b) of Section 2186.1.

(d) “Insurer” means a company required to be licensed and/or hold a certificate of authority under the laws of this State to provide insurance products, including annuities.

(e) “Insurance producer” means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.

(f) “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, exchange or replacement of an annuity in accordance with that advice.

(g) “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.

(h) “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.

NOTE: Authority cited: Sections 781, 783, 783.5, 789.6, 790.10, 1668, 1668.5, 1736, 1738, 1739, 1749.7, 10508, 10509.8, 10509.9, 12921, 12926, Insurance Code; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989); *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 781, 783, 783.5, 785, 789.3, 790.03, 790.035, 1668, 1668.5, 1736, 1738, 1739, 1749.8, 10508, 10509.8, 10509.9, Insurance Code.

Adopt Section 2695.189. 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;

- (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 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, 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.

(c) Except as permitted under subdivision (d) of this Section 2695.189, 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. The preceding sentence and subdivision (d) notwithstanding, neither a producer nor an insurer shall in any event recommend the sale of an annuity to replace an existing annuity that requires that the insured will pay a surrender charge for the annuity that is being replaced where purchase of the annuity will not confer a substantial financial benefit over the life of the policy to the consumer so that a reasonable person would believe the purchase is unnecessary.

(d) (1) Except as provided under paragraph (d)(2) of this Section 2695.189, neither an insurance producer, nor an insurer, shall have any obligation to a consumer under subdivision (a) or (c) of this section arising from any annuity transaction if:

- (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;
 - (C) A consumer refuses to provide relevant suitability information and the annuity transaction is not recommended; or
 - (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 issuance of an annuity subject to paragraph (1) shall be reasonable under all the circumstances actually known to the insurer at the time 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 subdivision (a) of this Section 2695.189;
- (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.

(f)(1) An insurer shall establish a supervision system that is reasonably designed to achieve the insurer's and its insurance producers' compliance with this article, including, but not limited to, the following:

- (A) The insurer shall maintain reasonable procedures to inform its insurance producers of the requirements of this article and shall incorporate the requirements of this article into relevant insurance producer training manuals;
 - (B) 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 2695.190;
 - (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 procedures to detect recommendations that are not suitable. These may include, but are not limited to, confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters and programs of internal monitoring. Nothing in this subparagraph (f)(1)(E) 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) Nothing in this subdivision (f) restricts an insurer from contracting for performance of a function (including maintenance of procedures) required under paragraph (f)(1) of this Section 2695.189. An insurer is responsible for taking appropriate corrective action for the consumer and may be subject to sanctions and penalties pursuant to Section 2695.191 of this article regardless of whether the insurer contracts for performance of such function and regardless of the insurer's compliance with subparagraph (f)(2)(B) of this section.

- (B) An insurer's supervision system under paragraph (f)(1) of this Section 2695.189 shall include supervision of contractual performance under this paragraph (f)(2). 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.
- (3) An insurer is not required to include in its system of supervision an insurance producer's recommendations to consumers of products other than the annuities offered by the insurer.
- (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.

NOTE: Authority cited: Sections 781, 783, 783.5, 789.6, 790.10, 1668, 1668.5, 1736, 1738, 1739, 1749.7, 10508, 10509.8, 10509.9, 12921, 12926, Insurance Code; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989); *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 781, 783, 783.5, 785, 789.3, 790.03, 790.035, 1668, 1668.5, 1736, 1738, 1739, 1749.8, 10508, 10509.8, 10509.9, Insurance Code.

Adopt Section 2695.190. 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 subdivision (a).
- (b) (1) An insurance producer who is otherwise entitled to engage in this State in the sale of annuity products shall complete an eight (8) credit hour annuity training course approved by the Commissioner and provided by a Commissioner-approved education provider, prior to commencing the transaction of annuities.
- (2) In addition to the requirement set forth in paragraph (b)(1) of this Section 2695.190, every producer who engages in this State in the sale of annuity products shall satisfactorily complete four continuing education credits prior to license renewal every two years.
- (3) The training required under this subdivision (b) 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;
 - (F) Prohibited sales practices, as well as replacement and disclosure requirements for sales of annuities, including but not limited to sales of annuities to persons aged 65 and older, under California law, including but not limited to this article;
 - (G) The recognition of indicators that a prospective insured may lack the short-term memory or judgment to knowingly purchase an insurance product; and
 - (H) Fraudulent and unfair trade practices.
- (4) Providers of courses intended to comply with this Section 2695.190 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 Section 2695.190 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 Code section 1749.8, in subdivisions (d) and (e) of Insurance Code section 1749.1 and in Sections 2188, 2188.1, 2188.2, 2188.3, 2188.4, 2188.6, 2188.7, 2188.8, 2188.50 and 2188.9 of this chapter.
- (6) Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with Sections 2188.2 and 2188.3.
- (7) Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with Section 2188.8.
- (8) An insurer shall verify that an insurance producer has completed the annuity training required under this Section 2695.190 before allowing the producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this paragraph (b)(8) 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.

NOTE: Authority cited: Sections 781, 783, 783.5, 789.6, 790.10, 1668, 1668.5, 1736, 1738, 1739, 1749.7, 10508, 10509.8, 10509.9, 12921, 12926, Insurance Code; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989); *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 781, 783, 783.5, 785, 789.3, 790.03, 790.035, 1668, 1668.5, 1736, 1738, 1739, 1749.8, 10508, 10509.8, 10509.9, Insurance Code.

Adopt Section 2695.191. Compliance; Mitigation; Penalties.

- (a) An insurer is responsible for compliance with this article. 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 article;
 - (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 article; and

(3) Appropriate penalties and sanctions.

(b) Any applicable penalty under Insurance Code section 783.5, 789.3, 790.035, or 10509.9 for a violation of this article by an insurer shall be determined pursuant to Article 19 of Subchapter 3 of this Chapter 5, commencing at Section 2591. Any such penalty for a violation of this article by a producer may be reduced 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.

NOTE: Authority cited: Sections 781, 783, 783.5, 789.6, 790.10, 1668, 1668.5, 1736, 1738, 1739, 1749.7, 10508, 10509.8, 10509.9, 12921, 12926, Insurance Code; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989); *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 781, 783, 783.5, 785, 789.3, 790.03, 790.035, 1668, 1668.5, 1736, 1738, 1739, 1749.8, 10508, 10509.8, 10509.9, Insurance Code.

Adopt Section 2695.192. 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 article may be maintained in paper, photographic, micro-process, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

NOTE: Authority cited: Sections 781, 783, 783.5, 789.6, 790.10, 1668, 1668.5, 1736, 1738, 1739, 1749.7, 10508, 10509.8, 10509.9, 12921, 12926, Insurance Code; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989); *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). Reference: Sections 781, 783, 783.5, 785, 789.3, 790.03, 790.035, 1668, 1668.5, 1736, 1738, 1739, 1749.8, 10508, 10509.8, 10509.9, Insurance Code.