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Re: Comments on November 27, 2000 Memorandum to the NAIC Suitability Working Group

Dear Ms. Mead:

We appreciate your willingness to consider comments provided by the industry and on behalf of our companies on this important initiative. This letter will expand upon and supplement our comments on the NAIC Suitability Working Group's August 2, 2000 draft of the proposed NAIC Suitability of Sales of Life Insurance and Annuities Model Regulation made by letter dated October 13, 2000, and during the Winter 2000 NAIC meeting in Boston. We have organized our comments to respond to general points raised in your November 27, 2000 outline. Due to the short turn around time, and the holidays, we did not have an opportunity to consult with many of the persons in our companies who would have an interest in and wish to contribute to the content of this letter. We believe this letter accurately reflects the views of our member companies, but respectfully reserve the right to refine our position, if need be, given the opportunity.

Definition of the Desired Conduct

Our companies would favor Iowa's position that the Model Regulation should apply to recommendations by producers that result in purchases of insurance products. Thus, in transactions where there are no producer recommendations, such as an internet sale where the customer shops among various websites of his own choosing, selects a carrier and product, and makes a purchase without insurer or producer input, the Regulation would not apply. Similarly, where recommendations do not result in purchases, the Regulation would not apply. We believe this is an issue to be addressed in the Regulation's scope, rather than in the exemptions, which are discussed later in this letter.

Also, since by definition any replacement transaction would involve the purchase of a new product, we believe it is unnecessary to state in the regulation that it applies to recommendations to purchase or replace.

Insurer's v. Producer's Responsibilities

In detailing the responsibilities of insurers and producers under any suitability model regulation applicable to recommendations to purchase, our companies support an approach similar to that outlined in the NAIC Model Replacement Regulation. In general, [and subject to specific language drafted], our companies favor a Model Regulation under which:

- A producer who makes a recommendation to purchase insurance products, must make recommendations to purchase products that are reasonably designed to assist the customer in meeting his or her stated insurable needs or financial objectives
- Prior to making recommendations to purchase, producers must make reasonable efforts to obtain information pertaining to a customer's insurable needs or financial objectives
- Where customers refuse to provide the required information, or where the customer makes a purchase against the recommendations of the producer, these circumstances are documented in the producer's file
- Insurers are responsible for developing or approving guidelines designed to assist the producer in determining whether, or under which circumstances, the insurer's product may meet the needs or financial objectives of consumers
- Insurers are responsible for providing training, or making training available to independent producers, on these guidelines
- Producers are required to certify to insurers whether recommendations to purchase insurance products covered by the regulation were made in accordance with the insurer's approved guidelines
- Insurers are required to monitor producer certifications indicating whether recommendations to purchase were made in accordance with the insurer's guidelines
- Insurers must review the appropriateness of any recommendation that the producer does not indicate is in accordance with the insurer approved guidelines
- Where insurers receive a complaint from a customer that a producer's recommendation to purchase was not in accord with a customer's insurable needs or financial objectives, insurers must review the appropriateness of a transaction to determine whether there was a reasonable basis to believe the recommendation to purchase met the customer's insurable needs or financial objectives based upon the information provided by the customer at the point of sale.
- If the insurer determines as a result of that review that there was not a reasonable basis to believe the recommendation to purchase was consistent with the customer's insurable needs or financial objectives based upon the information obtained from the customer at the point of sale, the company should take corrective action. Corrective action may include, but not be limited to: reimbursing the customer for financial loss, revising its guidelines, training, educating or disciplining producers.

We have proposed possible language to accommodate this approach in an attachment to this letter.

Rationale for this Approach

Recommendations v. Sales

As referenced above, our companies favor a Model Regulation [again, dependent upon the language used] that applies to recommendations by producers that result in the purchase of insurance products. As was discussed by the Working Group and interested parties at the meeting, not all purchases are the result of recommendations. Purchases of insurance or annuities by the customer without recommendations by the insurer or producer are a frequent occurrence in direct mail transactions, on the internet and in some group/employment enrollments. These transactions should not fall within the scope of the Regulation, as there is no recommendation.

Recommendations to purchase that do not result in purchases should also not be covered by the Regulation. If a customer does not want an insurance product, the producer should not be required to go through the exercise of assessing the customer's insurable needs or objectives or maintaining documentary evidence that such an inquiry occurred. Where the customer makes a purchase that is contrary to the producer's recommendation, the producer should retain documentation supporting his or her recommendation in his copy of the customer's file for his own benefit, and should in some fashion, notify the insurer of this situation. In some instances, however, this will mean that, despite the fact that the agent followed the insurer's guidelines in making his recommendation, the customer purchased another carrier's product, or a non-insurance product. This does not appear to be a situation that should trigger a follow up obligation on behalf of the insurer whose product was not purchased (absent a replacement, or some other special circumstance).

The focus of the Regulation should be upon the interaction between the client and the producer leading up to, and at the point of sale, where reasonable inquiries can be made, customer information collected, and the producer, using his or her judgment and training, can recommend, from among the products he or she is licensed and appointed to sell, a product that will be appropriate to meet the customer's stated needs and objectives. The goal can not be to have the producer recommend the MOST appropriate or MOST suitable product, as reasonable minds could differ on the meaning of these terms. Rather, the standard should be that, where the producer makes a recommendation from among the products he is qualified to sell, the product recommended is one that could reasonably be expected to assist the customer in meeting his needs or objectives (i.e., is "suitable," "not unsuitable," whatever standard is ultimately applied).

Insurer's Responsibilities

We acknowledge and support the premise that the insurer cannot place all responsibility for compliance with the Model upon the producer. The insurer's responsibilities under a Model Regulation should include:

- Responsibility for developing or approving guidelines to assist producers in determining whether the insurer's products meet customers' insurable needs or financial objectives,
- Responsibility for communicating these guidelines and having some system for monitoring whether producer recommendations to purchase insurance products are consistent with the guidelines.

While the producer is in the best position to collect information regarding, and to assist the customer in meeting, his or her insurable needs or financial objectives, the insurer as the issuer and underwriter of the product is in the best position to know the product and its benefits and limitations. It would seem appropriate then that the insurer develop or approve guidelines to help producers determine the types of customers for whom the product would be appropriate, not unsuitable or suitable, etc.

The insurer should be responsible for providing or making the guidelines available to the producer. The producer should then have responsibility at the time of application, for complying with the guidelines and assisting the customer in determining whether this product may be appropriate to meet the needs or objectives the customer has identified, or whether another insurer's products are appropriate, based upon that insurer's guidelines. Only the producer, who actually meets with the client, is in a position to determine whether an insurer's product guidelines fit the particular circumstances of the customer.

Delegation of Duties/Responsibilities

The reality of the current culture and economy is that insurers must have the discretion to delegate to intermediaries, responsibility for performing the insurer's responsibilities under the regulation (e.g. reviewing applications for producer certifications of compliance with company suitability guidelines, developing guidelines, and/or training agents) in order to tap into the efficiencies of the market place. Without this, insurers cannot effectively compete with other financial product offerers

However, our companies' agree that the delegation of an insurer's duties under the Regulation, does not mean the insurer is absolved of all further responsibilities under the act. By way of example, under existing state laws and regulations, the insurer may only sell its products through licensed and appointed producers. Many insurers market through general agencies, to whom the insurer has delegated responsibility for recruiting, licensing and appointing agents. The failure of that general agent to appoint a producer properly, does not release the insurer from its obligations to sell products only through licensed and appointed producers.

However, the existence of independent intermediaries, such as general agents or broker-dealers, may reduce the amount of control the insurer has over the independent producer

who ultimately sells the product to the consumer. General agencies selling the products of multiple insurers, can not realistically be expected to track product suitability guidelines developed by different insurers. By necessity, these general agencies will have to develop their own guidelines for assisting their producers in determining whether, for example, universal life products are appropriate for customers. The insurer should be able to fulfill its responsibilities under the Regulation by reviewing and approving these general guidelines, if they accurately reflect the issues to be considered in determining whether the insurer's universal life product reasonably meets the customer's needs. The insurer should also be able to satisfy its obligations under the suitability Regulation by monitoring agent certifications that these guidelines were followed in making any recommendations to the customer, as is permitted under the 1998 NAIC Model Replacement Regulation.

Many general agencies, bank-affiliated insurance agencies and broker-dealers who have direct supervisory relationships with producers soliciting and selling insurers' products may also have developed their own financial planning or needs analysis tools that are designed to be used for multiple carriers' products or services, or even for purposes other than determining the appropriateness of the purchase of particular insurance products. For example, the agency may offer non-insurance products (certificates of deposit, Internet services, financial planning services) to which information gathered may pertain. This information may be not directly applicable to insurance needs analysis.

In addition, producers or their agencies may take the position that the information gathered during customer development is the property of the agency to be used in cross selling whatever other products the general agency may offer. Laws and regulations designed to protect consumer privacy may support this notion. Needs analysis tools developed by these agencies may also be proprietary or considered agency property. As a result, the agency may not be willing or able to share the actual tools or information gathered through these tools with multiple insurers, out of fear of losing its proprietary interest. For these reasons, in many insurance solicitations, insurers will not have access to, much less control of, information necessary to review the producer's customer needs analysis. In these channels, insurers must rely upon the producers to perform the needs analysis using their own tools. Under our proposal, the insurer-approved guidelines could be used in conjunction with the intermediaries' needs analysis tools to assist the producer in making a recommendation to purchase a product to meet the customers' needs. Under our proposal, the insurer could monitor the producer's certification that his recommendations were made in accordance with the insurer's guidelines to fulfill its responsibilities.

It should also be pointed out that insurers may not be able to anticipate or prevent, nor should any Model Regulation be drafted to make an insurer strictly liable for, every form of producer or intermediary misconduct that results in the purchase of a product that does not meet the needs of the customer. Insurers should not be held liable, for example, for the conduct of a producer or intermediary who exceeds the scope of his authority, violates the insurer's guidelines or engages in conduct the insurer can not be reasonably expected to detect through its monitoring systems.

Exemptions

Consistent with our comments provided to you by letter dated 10/13/2000, we continue to believe that certain products or distribution channels should be exempted from the Regulation's requirements, or that modifications to the Regulation's requirements would be appropriate for these products and distribution channels. Our companies support exemptions from any Model Regulation for the following products:

- (1) Consistent with Section 3,B, 2 of the ACLI's December 2000 draft Model Regulation, our companies support an exemption for variable life insurance and variable annuity contracts subject to SEC and NASD requirements..

As discussed in the NAIC's White Paper on Suitability at pages 4-5, all variable life insurance and variable annuities are sold by representatives who must be registered with the National Association of Securities Dealers. These representatives are subject to NASD Rule 2310 which provides that in recommending the purchase, sale or exchange of any security, a registered representative must have reasonable grounds to believe that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his security holdings and as to his financial situation and needs. The rule further requires registered representatives to make reasonable efforts to obtain information concerning: financial and tax status, investment objectives and other information used or considered to be reasonable in making a recommendation to a customer. The requirements of this NASD rule and other rules governing sales practices apply to all securities products sold by registered representatives, whether registered with the SEC or exempt from the registration provisions of the Securities Act of 1933. See NASD NTM 97-27.

Additionally, the registered broker-dealers with whom these representatives are required to be associated must review the suitability determinations of these representatives for compliance with NASDR rules and SEC regulations requiring supervision of registered representatives.

Imposing a separate and additional suitability obligation at the state level upon insurers for products sold through this distribution channel would create an unnecessary layer of regulation, and a third layer of suitability review, without any added consumer protections. It is also another impediment to insurers' ability to compete effectively against federally regulated and/or non-insurers offering non-insurance products in the marketplace.¹

¹ It should be noted that in 1999, financial institutions rejected "know-your-customer" rules proposed by the Federal Reserve Board that would have require banks to monitor every customer and every transaction.

As discussed above, the registered representatives and broker-dealers have access to Customer Account Information, which is required to be gathered for NASD and SEC purposes. This information is viewed by the broker-dealer to be the property of the broker-dealer and is generally not made available to the insurance company. Further, any state regulation may create conflicts in standards and confusion among registered representatives who are licensed and appointed insurance producers about which standards apply to a which products, and whether the producers might be able to pick and choose between complying with broker-dealer standards, or those established by insurers for state insurance law purposes.

The NASD Rules apply to all securities, including individual and group variable life insurance and annuities. There is a sufficient regulatory scheme in place applicable to these products.

- (2) Consistent with Section 3,B,3 of the ACLI's December 2000 Draft Life Insurance and Annuities Suitability Model Regulation, we support an exemption for long term care products. The existing NAIC Model Long Term Care Regulation as adopted in most states already imposes upon insurers the obligation to develop suitability standards for these products, and the obligation upon agents to use the insurer developed standards in marketing long term care insurance.
- (3) Consistent with Section 3,B,1 of the ACLI's December 2000 draft Model Regulation, we support an exemption for direct response solicitations. Products sold through direct response marketing generally do not involve any recommendation to purchase. Rather, customers receive mailings sent to the general public, view television commercials or access websites that contain general information about the product. The insurer provides a general notice that the product is available and general information about the product from which a customer then makes the determination to apply, inquire further, or throw out the advertisements. There is no face to face transaction, and no producer who receives a commission, thus there is no incentive to use high pressured sales tactics to encourage a customer to purchase a product that may not be suitable.
- (4) Consistent with Section 3,B,4 of the ACLI's December 2000 Draft Life Insurance and Annuities Suitability Model Regulation, we support an exemption for products sold to institutions or trusts, individuals represented by certified public accountants or legal counsel in the purchase, and other "sophisticated purchasers" which products may include, business-owned life insurance, business related or employer-sponsored life insurance, corporate-owned life insurance, structured settlement contracts, funding agreements, and life insurance owned by a tax exempt organization under the Internal Revenue Code §501.

This exemption would exclude the need to separately apply the Model to sales to individuals who are either sufficiently sophisticated (based upon education or asset level) to make their own decisions about what is appropriate to help them meet their needs, or they are represented by professionals paid to oversee the customer's

interests in the transaction. The SEC has an “accredited investor” exemption that applies to many of its requirements, in recognition of the fact that these individuals in many cases know more than the agents selling the products or would have representatives involved in a transaction responsible for protecting their interests.

Structured settlements should also be exempt under this criteria. “Structured settlements” are defined under state law as arrangements for periodic payment of damages for personal injuries established by settlement or judgment in resolution of a tort claim. The selection of the annuity and carrier is performed by a “broker” who acts as an intermediary for the property/casualty company that owes the injured party a sum of money and/or attorneys for the parties to the personal injury suit, and the issuers of the annuity. The method of paying the customer through a series of payments has already been established at the time the annuity is purchased. The only remaining decision in these cases is for the property and casualty company or their attorneys to get the best price offered by a number of insurers that will generate the income amount. The consumer’s interest has already been protected by the court in the form of a legal judgment and the consumer is represented by an attorney. There is no interaction with the consumer in these sales, only with the property and casualty insurer or the insurer’s attorneys.

- (5) Consistent with Section 3,B, 6 of the ACLI’s December 2000 Draft Life Insurance and Annuities Suitability Model Regulation, we support an exemption for policies or contracts used to fund (i) an employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA); (ii) a plan described by Sections 401(a), 401 (k) or 403(b) of the Internal Revenue Code (“IRC”), as amended, is established or maintained by an employer; (iii) 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; or (iv) a nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor
- (6) Group/mass marketed life insurance or annuity sales to employers – We support the approach taken in Section 4 of the August 2, 2000 draft of the regulation which clarifies that recommendations pertaining to life insurance or annuity contracts should focus upon the suitability of that product for the group, not the individual employees or participants. Generally in these situations, the presentation is made to the employer, the employee is then advised by the employer of the opportunity to enroll in a single life plan, a single accident and sickness plan, or other plans made available through the employer. Whether the policy is a group or individual policy, the product is sold the same way (to the employer) and it is in turn made available to the employee. The purchase recommendation is made to the employer, based upon the demographics of his/her employees and the array of products currently available to the employee through the employer. The employee’s only decision is whether to enroll or purchase, and which amount (if any) being offered best suits their needs and wants. Our companies support the idea of furnishing the employees

with the information necessary for the individual employee to make the proper decision about purchasing any of the coverage offered through his/her employer. However since any purchase recommendation is made by the producer to the employer, products sold through this channel should be exempt from the Regulation.

- (7) Sales of insurance that do not involve a recommendation to purchase. In the event that the Working Group does not accept the notion that the scope of the Model should be limited to “recommendations to purchase,” we’d propose an exemption for any transaction in which there has been no recommendation to purchase. This exemption would apply to customer initiated internet transactions in which the customer uses the internet to shop for the lowest rate term product available, and purchases without any agent involvement and any other transaction that does not involve a producer recommendation that results in a purchase.
- (8) Term insurance - These products traditionally have been undersold, rather than oversold. Moreover, term products tend to be sold to applicants who have a well-defined need for a specific death benefit amount. Therefore, for these products, there should be at least a truncated review that is limited to describing the need for the insurance and the amount required to fulfill that need.
- (9) Small face amount policies/Home Service policies - During the Life (A) Committee meeting at the December NAIC meeting, the Chair invited comment from the industry on a proposal that would appear to collide with the work of this Working Group. As we understood that proposal, the Chair suggested that for small face amount life insurance policies, producers should have a duty to advise customers of all other life insurance policies available from the same carrier before accepting an application for a small face amount life insurance policies. This proposal appears to be approaching the “most suitable” analysis requirement already rejected by this Working Group.

Like term life insurance, sales of small face amount policies usually involve simpler situations, simpler needs, and simpler products. The customer in such a situation may not want an elaborate needs analysis process. Failure of the industry to provide an easy, quick, and convenient way to do business may mean that the customer's needs will go unmet.

Whatever is ultimately adopted needs to be clear and consistent with other Model Regulations. If a separate standard of conduct is to be developed for products sold through the home service distribution channel, these products will need to be carved out of any Model Regulation developed by this Working Group, or the differences in treatment of these policies somehow incorporated into the regulation.

Our companies would also support a “safe harbor” from the requirements of the Model Act imposed upon insurers for IMSA member companies who must subscribe to that

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organization's Principles and Code provisions and undergo an independent assessment of compliance with those provisions every three years.

Again, we appreciate the opportunity to offer comments on the Working Group's efforts. Please feel free to contact any one of us with any questions on this submission.

Submitted on behalf of the life insurance companies of AEGON Insurance Group by:

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cc: Commissioner Vaughan

**PROPOSED LANGUAGE TO ARTICULATE
THE DUTIES OF INSURERS AND PRODUCERS UNDER
THE NAIC SUITABILITY OF SALES OF
LIFE INSURANCE AND ANNUITIES MODEL REGULATION**

Section 5 Duties of Producers

- A. A producer shall not make recommendations to purchase insurance products that are not reasonably designed to assist in meeting the customer's insurable needs or financial objectives.
- B. Prior to making a recommendation to purchase an insurance product, a producer shall make reasonable inquiries to assist the customer in determining his or her insurable needs or financial objectives. Where a customer refuses to provide information in response to the producer's reasonable inquiries, the producer's obligations under this Regulation are discharged.
- C. A producer who makes a recommendation to purchase an insurance product shall certify at the time of application that any recommendation to purchase was made in accordance with the insurer's approved guidelines referred to in Section 6,A of this Regulation.
- D. Where a consumer purchases an insurance product subject to this Regulation in contravention to the producer's recommendation which was reasonably designed to meet the customer's insurable needs or financial objectives, the producer shall retain supporting documentation for three (3) years from the date of the transaction.

Section 6. Duties of Insurers

- A. Insurers shall develop or approve guidelines designed to reasonably ensure its producers make recommendations to purchase insurance products that are reasonably designed to meet customers' insurable needs or financial objectives.
- B. Insurers shall train producers, or make training available to independent producers, on guidelines designed to implement Section 6,A of this Regulation.
- C. Insurers shall maintain a system of monitoring to insure its producers comply with this regulation that shall include at least the following:

1. A procedure to inform its producers of the requirements of this regulation and incorporate the requirements of this regulation into relevant producer training manuals prepared by the insurer;
 2. A procedure to provide to each producer a copy of insurer approved guidelines designed to ensure that a recommendation made by its producers is reasonably designed to meet the customer's insurable needs or financial objectives.
 3. A system to review the recommendations of producers who indicate that a recommendation to purchase was not made in accordance with company guidelines developed under Section 6,A.
 4. A system to review a producer's recommendation to purchase for compliance with insurer guidelines developed under Section 6,A where the company receives a complaint or inquiry alleging that, at the time of application, the producer's recommendation was not reasonably designed to assist the customer in meeting its insurable needs and objectives
- D. Where the insurer determines, as a result of a review performed in accordance with Section 6,C, that a producer's recommendation to purchase a product does not comply with insurer guidelines developed under Section 6,A, the insurer shall take corrective action. Such corrective action may include, but not be limited to: reimbursing the customer for any loss, training or educating the producer on the insurer approved guidelines, revising the insurer approved guidelines or taking disciplinary action against the producer.