

DONALD J. WALTERS

DEPUTY DIRECTOR



February 5, 2001

Ms. Carolyn Johnson
National Association of Insurance Commissioners
2301 McGee, Suite 800
Kansas City, MO 64108-2604

Ms. Rosanne Mead
Chair, Suitability Working Group
National Association of Insurance Commissioners
Insurance Division, Iowa Department of Commerce
330 Maple Street
Des Moines, Iowa 50319-0065

Re: January 6, 2001 draft - Life Insurance And Annuities Suitability
Model Regulation

Dear Carolyn and Rosanne:

The following comments are submitted on behalf of the Insurance Marketplace Standards Association ("IMSA"), a national association designed to promote high ethical standards of conduct in the life insurance marketplace, whose 244 member companies represent in excess of 83% market share for individually-sold life insurance, annuity and long-term care insurance products in the United States.

IMSA appreciates the thoughtful evaluation of previous comments submitted to members of the NAIC Suitability Working Group (the "Working Group") which has led to the issuance of the January 6, 2001 draft of the proposed NAIC Life Insurance and Annuities Suitability Model Regulation (the "Model Regulation"). In particular, IMSA commends the Working Group's acknowledgment of IMSA membership by providing a "safe harbor" within the Model Regulation to the extent an insurer complies on a continuing basis with IMSA membership requirements which include IMSA's "needs-based selling" standard. We believe the "safe harbor" provision under Section 5, D., (1) of the Model Regulation is warranted for the reasons set forth below.

I. IMSA's "needs-based selling" standard.

IMSA's "needs-based selling" standard is embodied within IMSA Principle 1, Code A which reads as follows:

To conduct its business according to high standards of honesty and fairness, a company will implement policies and procedures designed to provide reasonable assurance that:

The insurable needs or financial objectives of its customers are determined based upon relevant information obtained from the customer and the company enters into transactions which assist the customer in meeting his or her insurable needs or financial objectives.

All IMSA member companies are required to abide by IMSA's "needs-based selling" standard on a continuous basis for IMSA membership purposes. IMSA has a "continuous improvement" concept embodied within IMSA standards and articulated in the April 2000 edition of the IMSA Assessment Handbook which provides that an IMSA member company is required to conduct periodic, regular evaluations of its compliance with IMSA standards and take corrective action, if necessary.¹ This "continuous improvement" concept suggests that IMSA membership is not a "one time snapshot" analyzing a company's compliance with IMSA standards at a point in time but rather connotes that compliance with IMSA standards is a dynamic process designed to occur at all member companies on a regular, continual basis.

II. NAIC Life Insurance And Annuities Suitability Model Regulation (January 6, 2001 draft).

A. Section 5, B.

Section 5, B. of the Model Regulation states:

An insurer's policies and procedures shall include at least the following:

- (1) Informing its producers of the requirements of this regulation and incorporating those requirements into any relevant producer training manuals prepared by the insurer;*
- (2) Providing each producer with the insurer's guidelines as to information that should be obtained from a customer prior to*

¹ Continuous Improvement, IMSA Assessment Handbook, April 2000 edition, p. 103-4.

making recommendations to a customer; and

- (3) *Establishing and maintaining a system reasonably designed to detect, on either an individual or aggregate basis, producer practices that are not in compliance with guidelines established in accordance with this section. Compliance with this regulation may include, but shall not be limited to, systematic customer surveys, interviews, confirmation letters or programs of internal monitoring.*

1. Section 5, B., (1)

Section 5, B., (1) of the Model Regulation requires insurers to inform their producers of the requirements of the Model Regulation and incorporate those requirements into any relevant producer training manuals. IMSA maintains similar requirements to the extent that all member companies are required to communicate to captive and independent distributors and appropriate company employees the company's policies and procedures designed to comply with IMSA standards (including IMSA's "needs-based selling" standard).² Further, IMSA requires that a company's distributors and appropriate company employees are trained in the company's policies and procedures, applicable laws and regulations and the Principles and Code of Ethical Market Conduct.³ To comply with this requirement training must include:

- How to analyze customer insurable needs and financial objectives to assist them with making buying decisions about what is appropriate for them;
- The use of fact-finding tools for determining customer needs and financial objectives;
- Complaint handling;
- Use and approval of marketing and sales materials;
- Fair competition guidelines, including those related to disparaging competitors or inappropriate statements regarding competitors;
- Replacement policies and procedures, including definitions and when replacements are appropriate;
- Licensing and appointment requirements;
- Qualifications for potential distributors;
- Company product features: benefits, limitations, costs, values, charges and operations;
- Preparation and use of sales illustrations;
- Updates on changes in laws and regulations and related

² IMSA Standards, Approach aspect, Component question 1, IMSA Assessment Handbook, April 2000 edition, p. 19.

³ IMSA Principle 2, Code C., IMSA Assessment Handbook, April 2000 edition, p. 62.

- changes to company policies and procedures; and
- Ethical Market Conduct practices.⁴

2. Section 5, B., (2)

Section 5, B., (2) requires an insurer to provide each producer with the insurer's guidelines as to information that should be obtained from a customer prior to making recommendations to a customer. Under IMSA standards, IMSA member companies are required to maintain policies and procedures which encourage the use of fact-finding tools to determine customers' insurable needs or financial objectives.⁵ As stated above, all IMSA member companies must communicate these policies and procedures to their distributors and appropriate company employees in order to comply with IMSA standards.

3. Section 5, B., (3)

Section 5, B., (3) requires an insurer to establish and maintain a system reasonably designed to detect, on either an individual or aggregate basis, producer practices of noncompliance with guidelines established in accordance with this section. To comply with this requirement insurers may use a variety of different techniques including systematic customer surveys, interviews, confirmation letters or programs of internal monitoring.

IMSA requires its member companies to establish and enforce policies and procedures reasonably designed to monitor compliance with the Principles and Code of Ethical Market Conduct and applicable laws and regulations.⁶ The primary purpose of such monitoring systems is to detect instances of non-compliance with a company's policies and procedures. By utilizing these monitoring systems, an IMSA member company has a greater likelihood of detecting isolated occurrences of non-compliant activity and correcting that behavior before it becomes a systemic practice.

IMSA member companies may fulfill IMSA's monitoring requirements through various means including internal auditing, telephonic or written surveys of captive or independent distributors and appropriate company employees, LIMRA CAP or other customer surveys, complaint analysis and information, lapse trends, replacement activity reports, customer transactions histories (surrenders, withdrawals, not-takens), underwriting exception reports, lists or numbers of rejected field advertising pieces submitted for home office

⁴ Comment to IMSA Principle 2, Code C., IMSA Assessment Handbook, April 2000 edition, p. 62-63.

⁵ Question 1.1., IMSA Assessment Handbook, April 2000 edition, p. 51.

⁶ Principle 6, Code D., IMSA Assessment Handbook, April 2000 edition, p. 99.

review and approval, disciplinary records and other appropriate measures.⁷

Most importantly, IMSA member companies are required to take corrective action when instances of non-compliance are detected. To determine when corrective action may be appropriate, companies may perform on-site office inspections, interview customers, interview captive or independent distributors and appropriate company employees, survey customers, survey captive and independent distributors or appropriate company employees, or use "mystery shoppers" to identify non-compliant practices in the sale of the company's products.

Based upon this comparison of IMSA standards to Section 5, B. of the Model Regulation, IMSA standards clearly require IMSA member companies to comply with each of the elements of Section 5, B. of the proposed Model Regulation.

B. Section 5, C.

Section 5, C. states:

An insurer may contract with a third party, such as an insurance agency or brokerage firm, to deliver information and perform the functions described in section 5, B. (1) and (2). An insurer utilizing such a contract shall perform a reasonable inquiry to assure the third party is performing all duties required by this regulation.

IMSA standards require member companies to maintain an adequate system of supervision of the sales and marketing activities of distributors and appropriate company employees in order to monitor their compliance with the Principles and Code of Ethical Market Conduct and applicable laws and regulations.⁸ IMSA standards also permit an insurer to delegate responsibility for supervising sales and marketing activities to independent intermediaries. However, ultimate responsibility to reasonably assure compliance with IMSA's supervision and monitoring requirements must be borne by the member company. In those instances in which supervision of monitoring requirements are delegated to independent intermediaries, the IMSA member company must continue to supervise the performance of those obligations and bears ultimate responsibility for compliance with all other provisions of the Principles and Code of Ethical Market Conduct in the sales and marketing of its covered products.

If an IMSA member company delegates any supervisory responsibility to

⁷ Comment to Principle 6, Code D., IMSA Assessment Handbook, April 2000 edition, p. 99.

⁸ Principle 6, Code B., IMSA Assessment Handbook, April 2000 edition, p. 92.

independent intermediaries, the company shall enter into a written agreement with the intermediary which specifies the responsibilities delegated. Thereafter, the IMSA member company must monitor whether the independent intermediary is performing those responsibilities according to the terms of the written agreement.

To monitor compliance, IMSA member companies are expected to maintain a monitoring system that routinely uses various testing methods to identify instances of non-compliance with its policies and procedures. These testing methods may include documentation review, interviews or field validation techniques, direct observation, sampling or surveys.

IMSA independent assessors must review the company's monitoring system during the independent assessment phase of the IMSA membership process. The independent assessor is asked to exercise professional business judgment to evaluate the company's monitoring system to determine the nature and scope of independent testing to be performed. It is expected that IMSA independent assessors will conduct testing methods to confirm that the company's home office and field distribution sales and marketing practices for covered products are conducted in a manner consistent with its policies and procedures.

IMSA's supervision and monitoring standards as outlined above require IMSA member companies to conduct something more than a reasonable inquiry to determine whether third parties are performing delegated duties. Since ultimate responsibility for compliance with IMSA's monitoring standards must be borne by the member company, some testing methods must be employed by the company and/or its independent assessor to determine whether the company's monitoring system and any monitoring duties delegated to third parties comply with IMSA standards.

III. Conclusion.

The information set forth above demonstrates that IMSA member companies, through their continuous compliance with IMSA standards, meet the requirements of the proposed Model Regulation. Accordingly, the "safe harbor" or "exemption" from compliance with the requirements of the proposed Model Regulation provided to IMSA member companies under Section 5, B., (1) of the Model Regulation is warranted.

IMSA would like to thank the members of the Working Group for their careful consideration of our earlier comment letters and their appropriate acknowledgment of the efforts IMSA member companies have undertaken to promote life insurance, annuity and long-term care insurance products sales

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designed to meet their customers' financial needs and objectives.

We look forward to continuing our dialogue with members of the Working Group at the upcoming interim meeting in Kansas City and at the NAIC Spring National Meeting in Nashville, Tennessee. Please do not hesitate to contact me via phone at (202) 624-2179 or via email at DonaldWalters@IMSAethics.org if you should have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Donald J. Walters". The signature is written in a cursive style with a large, stylized initial "D".

Donald J. Walters

Cc: Tim Mullen, NAIC