Carl B. Wilkerson
Vice President & Chief Counsel, Securities & Litigation

March 23, 2012

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

By Electronic Delivery

Re: Dodd-Frank Act Study on Financial Literacy among Investors; Release No. 34-66164, File No. 4-645; 77 Federal Register 3294 (2012).

Dear Ms. Murphy:

The American Council of Life Insurers ("ACLI") greatly appreciates the opportunity to offer input in advance of the SEC's *Study on Financial Literacy among Investors*. ACLI has over 300 members that represent more than 90% of the assets and premiums of the life insurance and annuity industry. Life insurers provide financial and retirement security to millions of consumers through life insurance, annuities, disability insurance, and long-term care insurance. Our members offer these products through affiliated and independent distributors, including broker-dealers and investment advisers. The study, therefore, is germane to life insurers' products and services.

Regulatory Background

Section 917(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act") directed the SEC to conduct a study on financial literacy among investors and to elicit public comment on:

- "Methods to improve the timing, content and format of disclosure to investors regarding financial intermediaries, investment products, and investment services;
- The most useful and understandable relevant information that retail investors need to make informed financial decisions before engaging a financial intermediary or purchasing any investment products or service that is typically sold to retail investors, including shares of registered open-end investment companies; and,
- Methods to increase the transparency of expenses and conflicts of interest disclosure in transactions involving investment services and products, including shares of registered open-end investment companies."

The SEC release indicates that the Office of Investor Education and Advocacy "is conducting investor testing using qualitative and quantitative public opinion research methods." The SEC's study on financial literacy will be completed by July 21, 2012.

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Summary of Position

ACLI supports cost-effective initiatives enabling informed decision-making in the purchase of financial products and services. Enhancements to investors' financial literacy will help Americans achieve financial and retirement security. The three core elements of the Study—improving disclosure, enhancing financial decision-making, and increasing transparency—provide a meaningful framework for constructive improvement. ACLI has actively participated in numerous regulatory projects designed to enhance disclosure, spotlight expenses or conflicts, and buttress decision-making by consumers.

The SEC's Financial Literacy Study should also include several additional considerations, including:

- Appraisal of the economic and competitive impact of all recommendations;
- Evaluation of other existing, or proposed, state and federal requirements governing disclosure, expenses, conflicts, and financial decision-making;
- Implementation of new technology-based solutions to financial literacy, such as electronic delivery of disclosure through Internet channels;
- Incorporation of integrated disclosure concepts;
- Recognition of differences among products and distribution models or regulatory structures;
- Confining public opinion research to proven, sound, and statistically significant methods;
- Coordination with other state and federal regulators to avoid conflicting regulations and redundancies; and,
- Recognition that streamlining and reducing the volume of disclosure ("less is more") will generate user-friendly solutions to financial literacy.

Conceptual Framework

In selling investment products, financial entities should provide balanced and fair disclosure of material facts relevant to retail customers' investment decisions, including material conflicts of interest. The following factors provide an overarching conceptual framework for the questions on which the release elicits comment:

- **Simple, Clear and Concise Disclosure.** Retail customers should receive clear disclosure about the range of securities products and services that are offered to them. Core disclosures should include an informative description of expenses and conflicts associated with investments and the manner in which distributors are compensated.

- **Plain English.** Disclosure should be written in plain-English. Regulators and the financial services industry should jointly develop simplified approaches to disclosure that is helpful to retail customers.

- **Layered Disclosure.** Summary disclosure at or before the time of sale would be most useful to consumers, with additional information available to those who desire it through a website or in hard copy upon request. Summary disclosure could make it more likely that retail customers will read and understand essential information.

- **Use of Websites.** The Financial Literacy Study should consider approaches that enable financial institutions and distributors to provide concise and helpful written disclosures to retail customers, by enabling embedded links to their Websites for additional, detailed information. These disclosures could also refer retail customers to distributors' Website to access further information.[1]

- **Disclosure of Material Conflicts of Interest.** Perceived or actual conflicts of interest between financial institutions or distributors and their retail customers can arise in retail sales of investments and in some cases may be inherent in the relationship. Clear disclosure about conflicts of interest enables consumers to practice informed decision-making.

- **Disclosure of Compensation.** Retail customers should have access to a brief narrative description about compensation arrangements in the sale of securities products and services. With this information at hand, retail customer can evaluate potential or actual conflicts of interest in compensation arrangements. Concise information regarding how associated persons are compensated for various products and services, rather than the exact amounts of compensation, provides the most useful and understandable information.

Life Insurers' Role in Financial and Retirement Security

In order to meet the varied needs of consumers and the demands of a highly competitive marketplace, life insurers offer a wide range of financial products and services. Many of these products and services are subject to the federal securities laws. Life insurers must also fulfill comprehensive state insurance laws and regulations in every U.S. jurisdiction. As a result, life insurers and their affiliates frequently find themselves subject to the overlapping requirements of the federal securities laws and the insurance and securities regulations of the fifty states.

With the decline of defined benefit pensions and concerns over the future of Social Security, financial services consumers in the United States bear increasing personal responsibility for their own financial well-being. Life insurers and their affiliates have responded to consumers' needs with a wide range of products and services. These products and services often include:

- Term life insurance;
- Fixed and variable cash value life insurance;
- Disability income insurance;
- Long term care insurance;
- Fixed and variable annuity contracts;

[1] This position comports with SEC statements at the time of the recent amendments to the Form ADV Part 2. Amendments to Form ADV, Investment Advisers Act Release No. IA-3060 (July 28, 2010), available at http://www.sec.gov/rules/final/2010/ia-3060.pdf. The SEC stated in the adopting release that it "will continue to consider different approaches to delivering financial information to investors." *Id.* We urge that consideration of any additional disclosure approaches include a thorough analysis of the information that retail customers currently receive. For example, when purchasing a deferred variable annuity, a retail (and other) customer must be informed of the general terms of various features of deferred variable annuities, such as surrender period and surrender charges; potential tax penalties; mortality and expense charges; investment advisory fees; potential charges for and features of riders; the insurance and investment components; and market risk. Additionally, such retail (and other) customers must be provided with a product prospectus, which provides a comprehensive and detailed description of the variable annuity. Finally, such retail (and other) customers are provided prospectuses for the mutual funds underlying the product subaccounts in which they invest. Simply piling more disclosure on top of the above-noted disclosure information is more likely to result in "information overload" than an enhanced understanding of the product or transaction by retail customers.

- Investment brokerage services, including stocks, bonds, mutual funds, ETF's, and 529 savings plans;
- Investment advisory services, including financial planning, fee based wrap accounts, and separately managed accounts;
- Individual and business retirement planning;
- Estate planning and trust services;
- Non-qualified employee benefit consulting; and,
- 401(k) and other qualified plan design, funding and administration;

Many of these products and services are delivered through affiliated broker-dealers and investment advisers that, in turn, are also subject to the federal securities laws.

Accurate Depiction of Fees, Charges and Expenses Associated with Variable Contracts

Variable contract fees and charges are different from those associated with other products like mutual funds. Variable contracts have unique features, such as long-term mortality guarantees, and options for a variety of contract riders. Fees and charges for these features are fully discussed in variable contract prospectuses, and are required to be depicted in the fee table accompanying the prospectus.
A variable annuity is a long-term financial product that can provide a life-time stream of income, something offered by no other financial product. Values accumulate in the variable annuity based on the performance of underlying investment portfolios. Some variable annuities also protect beneficiaries' interests with life insurance in case the annuity owner dies before annuity payments commence.
Variable life insurance provides fundamental death benefit protection with account values correlating with the performance of allocation options in the separate account. Mutual funds, in contrast, do not contain death benefits or guaranteed streams of income. The fees and charges associated with variable contracts, therefore, are customer specific.
As a consequence of these unique features, variable annuities and variable life insurance are not directly "comparable" with other financial products. Forms N-4 and N-6 require a fee table "example" highlighting comparative variable annuity costs at one, three, five, and ten-year intervals. These costs include contract owner transaction expenses, contract fees, separate account annual expenses, and [portfolio company] fees and expenses. This presentation appropriately establishes a basis for accurate comparison with similar products—variable annuity to variable annuity, or variable life insurance to variable life insurance.

The prospectus example shows the impact of these collective fees and charges, including various surrender scenarios, on a $10,000 variable annuity account value assuming a 5% rate of return. This approach facilitates comparison shopping, fee translation, and performance visualization.

ACLI's Annuity Disclosure Templates—A Coordinated Approach to Streamlined Disclosure and Informed Decision-Making

ACLI developed disclosure templates for fixed, indexed and variable annuities that provide essential information in a streamlined, plain-English format. The templates help consumers make informed purchase decisions through uniform, comparable disclosure. ACLI's disclosure templates provide a rich source of ideas that could prove helpful as the SEC conducts its financial literacy study. **Appendix A** contains our disclosure templates, instructions, and examples. It also contains ACLI's Consumer Brochures on life insurance and annuities that may provide further sources of user-friendly information.

ACLI worked with FINRA staff so that the variable annuity template could be used as one means of fulfilling the disclosure requirements under Rule 2330, the suitability and supervision rule for variable annuities. FINRA found the template to be worthwhile, and recommended that ACLI staff share it with disclosure experts in the SEC's Division of Investment Management for input. The SEC generously offered three rounds of constructive input on the variable annuity disclosure template. ACLI incorporated all of the SEC's suggestions, with one exception concerning cost projections for riders accompanying the variable annuity.[2] The disclosure template advises users to briefly explain all available riders with a cross reference to additional prospectus disclosure, but does not contemplate cost disclosure for all combinations of riders.

ACLI also worked with the National Association of Insurance Commissioners ("NAIC") in support of its Suitability in Annuities Transactions Model Regulation, which has an informational disclosure requirement that can be satisfied through ACLI's disclosure templates. Effective, uniform patterns of disclosure can be further achieved through use of the variable annuity template in fulfillment of FINRA's Variable Annuity Suitability Rule 2330. With consistent, comparable point-of-sale disclosure that is flexible enough to accommodate the full range of product design available in the market, consumers will be well served. Uniform disclosure developed under the variable annuity template is preferable to less uniform, non-comparable disclosure developed by individual broker-dealers.

Multiple Regulatory Initiatives Warrant Coordination & Evaluation in the Study

An impressive number of state and federal initiatives are underway that address the supervision, suitability, and disclosure about variable contracts and insurance product distribution. With so many moving parts, it will be critically important that the Study's managers consider the unique aspects of life insurers' variable products and their distributors under these coextensive regulatory and disclosure initiatives. Several existing, comparable regulatory projects share common substance, including:

- FINRA Rule 2330 Suitability and Supervision in the Sale of Variable Annuities, which addresses disclosure and conflicts;
- FINRA Disclosure Concept Release;
- NAIC Suitability in Annuity Transactions Model Regulation;
- SEC Confirmation and Point of Sale Proposal;
- NAIC Annuity Disclosure Model regulation;
- NAIC Model Replacements Regulation;
- ACLI Disclosure Initiative for Fixed, Index, and Variable Annuities; and,

Additionally, changes to the standard of care for broker-dealers that may be implemented following the SEC's Section 913 Study could impact the distribution of variable products.

The Study's Interface with Other Regulatory Structures

Several aspects of the financial literacy study will evaluate issues addressed in other existing regulatory standards or administrative proposals. For example, the SEC has initiated a number of commendable plain-English initiatives that provide an excellent foundation for the subject of the Financial Literacy

[2] Cost projections for riders are dependent upon the unique factors of an individual purchaser, and did not lend easily to depiction in a standardized expense table.

Study.[3] It may be constructive to consider existing and proposed regulatory initiatives as resources for the financial literacy study. **Appendix B** highlights a number of existing standards and administrative proposals addressing the Study's core focus: improving disclosure, enhancing financial decision-making, and increasing transparency of expenses.

Balance and Objectivity in the Use of Interviews and Focus Groups

According to the Study Release, the Office of Investor Education and Advocacy "is conducting investor testing using qualitative and quantitative public opinion research methods" as part of the Study process. We strongly encourage methodology that ensures that insurance variable products are fully considered and generates statistically significant results. On a few occasions, SEC initiatives have employed analytical approaches that were relatively narrow in scope, and stated conclusions with respect to variable products when the methods addressed only retail mutual funds. A brief summary of these actions may be informative.

In 2004, the SEC released confirmation and point-of-sale disclosure proposals for mutual funds and variable insurance products, supported in part by a consultant's focus group testing. The use of the focus group study and results were fundamentally flawed, especially regarding conclusions about insurance products and distribution. We highlight this development to amplify our concern that the Study should be properly objective and thoroughly inclusive of data concerning the structure, operation, products, services and regulation of life insurers and their distributors.

Despite stating conclusions about variable products and mutual funds attributed to "many investors",[4] the underlying research was too narrowly constructed to reach any conclusions with respect to variable products and used too small a sample group to truly reach any conclusions at all. In the development of the proposal, the SEC retained consultants to elicit feedback from investors on "comprehensive" cost information in model point-of-sale documents.[5]The direction of the revised proposal relied heavily on the consultant's limited investor interviews. While we support the use of well-qualified outside consultants for this purpose, we were forced to question the validity of the survey methods used, especially regarding variable contracts, in this case.

The consultants' conclusions were based on individual one-hour interviews with 33 participants. The report characterizes these surveys as "in-depth" interviews. All participants in the study were

[3] Under the SEC's plain-English rule, issuers must use plain-English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors section in filings with the SEC's Division of Corporation Finance under the 1933 Act. When drafting the language for selected parts of the prospectus, issuers must comply with a series of specified plain-English principles. *See* "Plain-English Disclosure," the updated SEC Staff Bulletin No 7 at http://www.sec.gov/interps/legal/cfslb7a.htm . *See also* the SEC's "Plain-English Handbook" at http://www.sec.gov/news/extra/handbook.htm .

The SEC's web site references the Plain Writing Act of 2010 (Act) which is "intended to make it easy for the public to understand government documents." The SEC, like other federal agencies, must write documents in plain writing, defined under the Act as writing that is "clear, concise, well-organized, and follows other best practices appropriate to the subject or field or audience." Starting in October 2011, the Act requires the SEC to write new and substantially revised documents in plain language using the Federal Plain Language Guidelines . This Act and its guidelines may provide useful information as background for the SEC's Financial Literacy Study.

[4] *See* Investment Company Act Rel. No. 26778 (March 4, 2004) at text accompanying footnote 7 (emphasis added).

[5] The release cites the consultant's reports in footnote 12. *See* Investment Company Act Rel. No. 26778 (March 4, 2004).

required to have purchased a mutual fund within the past two years, but there was no requirement that they have had any experience with variable products.[6] Indeed, the report stated that:

> [g]enerally, *respondents had little experience with variable annuities*. While some had actually invested in them, even *they could not clearly describe the features of the product.*

Nevertheless, the consultants' report apparently provided a primary foundation for the point-of-sale documents proposed by the SEC.

The statistically insignificant sample size could not produce reliable research conclusions supporting major disclosure modifications for mutual funds, and even less so for the variable products with which the respondents were not familiar. While the point-of-sale report contained numerous observations, the scope and reliability of the sampling techniques raised significant questions about the validity of the conclusions and the point-of-sale documents they addressed. In our view, the SEC should always base significant new regulatory or disclosure practices on a more substantial and authoritative foundation.

The process of using survey and focus group information was also of concern in the SEC's RAND Study of Broker-Dealer and Investment Advisory Activities. In our submission on the RAND Study, we expressed great concern that the conclusions were incomplete regarding the life insurance industry because only a few insurance industry representatives were asked to participate in the process.[7] We raise this second example of an SEC study relying on incomplete statistical and focus group data because some of the subject matter and methodology bore parallels to the forthcoming SEC Study on Financial Literacy among Investors.

Conclusion

We greatly appreciate your attention to our views. If any questions develop, please let me know.

Sincerely,

Carl B. Wilkerson

Carl B. Wilkerson

[6] To qualify for the study, each participant: (i) either solely or jointly made investment decisions; (ii) graduated high school, attended some college or graduated college (those with graduate degrees were excluded); (iii) made a mutual fund purchase through a broker in person, over the phone or online in the past (those who had only purchased online were excluded); (iv) made a mutual fund purchase from a financial representative or broker within the past two years; (v) passed an articulateness test. *See* consultant's survey report at 10 [http://www.sec.gov/rules/proposed/s70604/rep110404.pdf and http://www.sec.gov/rules/proposed/s70604/suprep010705.pdf]. The survey's approach was principally geared to mutual funds and failed to generate a study population germane to variable contracts.

[7] ACLI's submission in response to the RAND Study outlined in detail the products, services and regulation of life insurance companies and their distributors. Little about the life insurance industry appeared in the Rand Report, which diminished its thoroughness and objectivity. The ACLI RAND Study submissions can be found with the ACLI's Comment Letter to the SEC regarding Section 913. *See* Letter from Carl Wilkerson to Elizabeth Murphy, Secretary, SEC, Appendix A available at http://www.sec.gov/comments/4-606/4606-2669.pdf .

Appendix A

IMPROVING ANNUITY DISCLOSURE

A LIFE INSURANCE INDUSTRY INITIATIVE

Templates, guidelines, and instructions for life insurers to prepare disclosure documents for fixed, index, and variable annuities

The American Council of Life Insurers is a Washington, D.C.-based trade association, whose 340 members account for 93 percent of the life insurance industry's total assets in the United States. ACLI member companies offer life insurance; annuities; pensions, including 401(k) plans; long-term care insurance; disability income insurance; reinsurance; and other retirement products.

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CONTENTS

INTRODUCTION

Everyone agrees that retirement today requires more planning than in previous generations. Americans are living longer, fewer workers are covered by traditional pension plans that guarantee an income for life, and Social Security likely won't provide the same level of benefits in the future as it does today.

Americans need ways to create and guarantee lifetime income so their standard of living does not decline with age. For many Americans, an annuity can help them achieve that goal. However, most consumers don't understand how an annuity works, its benefits and risks, and what their commitments are under an annuity contract.

In January 2005, ACLI's Board of Directors took steps to bridge this information gap for fixed, index, and variable annuities. A CEO-level task force was formed to develop recommendations to address the widespread criticism that annuities are misunderstood by consumers. Their first recommendations were to give increased attention to suitability and initiate an industry-wide emphasis on consumer empowerment through improved disclosure.

In the area of suitability, ACLI fully supported the NAIC recommendation to expand the Senior Protection in Annuity Transactions Model Regulation to apply to all ages. The NAIC adopted this change in June 2006, and ACLI has been actively pursuing uniform adoption of the expanded model (Suitability in Annuity Transactions) in the states.

With regard to improved disclosure, ACLI has been pursuing state adoption of the NAIC Annuity Disclosure Model Regulation. The model—developed nearly a decade ago, but not widely adopted—provides the necessary base for improved understanding of annuities. However, the companies that comprise ACLI agreed that the development of short, simple, and standardized disclosure documents that are company and product specific was an essential next step to further assist consumers in their purchasing decisions.

ACLI—working closely with member companies and other industry groups—developed a set of "templates" for presenting required disclosure information in a consumer-friendly manner. Disclosure templates for fixed and index annuities are based on the requirements set forth in NAIC's disclosure model regulation. The template for variable annuity products follows disclosure requirements under federal securities laws.

These templates were used to produce sample documents based on actual annuity products. The samples were tested in a series of focus groups and one-on-one interviews with retirees, baby boomers, and producers. The responses from all three groups was overwhelmingly positive. After each set of groups and interviews, recommendations were incorporated into the samples and retested.

As directed by its Board of Directors, ACLI has been meeting with federal and state regulators to have the templates become part of the regulatory regime. The templates have been well received by regulators.

The Iowa Division of Insurance launched a pilot program, beginning January 31, 2008, to introduce the templates to the marketplace. The Ohio Department of Insurance launched a similar program in April 2009. ACLI is hopeful other states will follow suit and embrace the templates as the preferred method of satisfying annuity disclosure requirements.

ACLI continues to work with the Securities and Exchange Commission and the Financial Industry Regulatory Authority to achieve regulatory acceptance of the variable annuity template in connection with federal disclosure and sales practice standards.

GENERAL GUIDELINES FOR WRITING READABLE DISCLOSURES

Measures of Readability

Writing More Readable Disclosures

Web Pages

GENERAL GUIDELINES FOR WRITING READABLE DISCLOSURES

The following guidelines were developed by Brenda J. Cude, Ph.D., Professor of Housing and Consumer Economics, at the University of Georgia. Dr. Cude is an expert on consumer protection and behavior whose interests focus on how consumers acquire and use information before making buying decisions. She represents the consumer perspective in policy discussions at national meetings of insurance regulators.

Effective writing for a general audience means writing in plain language. Adult literacy levels are relatively low; Adkins and Ozanne report that more than one-fifth of the U.S. adult population is functionally illiterate (lacks reading and writing skills needed to meet daily demands) and another 34 percent is marginally literate.[1] In addition, even literate people may read information too quickly to understand it or may not read it at all if it appears too complex.

Measures of Readability

There are two widely-used measures of readability: the Flesch Reading Ease Score and the Flesch-Kincaid Grade Level. Each is calculated based on a formula that uses average sentence length and average number of words per sentence. The Flesch Reading Ease Score ranges from 0 to 100, with a higher score indicating easier reading. The Flesch-Kincaid Grade Level formula converts the Flesch Reading Ease score to a U.S. grade school level.[2] Over one-half of the adult population has reading skills below sixth grade.[3] Recent versions of Microsoft Word calculate both the Flesch Reading Ease Score and the Flesch-Kincaid Grade Level.

Alternate measures of readability recognize other elements that affect readability. The FOG (Frequency of Gobbledygook) Index is based on average sentence length and the percentage of words with three or more syllables.[4] There's also a SMOG (Simple Measure of Gobbledygook) Index.[5]

The Cloze Test is a measure of how well "average" consumers understand written material. To use the Cloze Test delete every fifth word and ask one or more persons to fill in the blanks. If the information is well written, the reader should be able to fill in at least 60 percent of the blanks based on the rest of the sentence. If the reader can't complete at least 40 percent of the blanks, the information probably needs to be rewritten.[6]

Writing More Readable Disclosures

This section outlines a number of rules for writing more readable disclosures. An important resource used in writing this section was http://www.plainlanguage.gov.[7]

- Write for the average reader.
  - Know the expertise and interest of your average reader and write to that person. Pretest information with the average reader before releasing it publicly.
  - Don't write to the experts, the lawyers, or management, unless they are the intended audience.
  - Use common, everyday words.
- Organize to meet the needs of the reader.
  - Create a plan for organizing your document (most general to most specific, chronological, etc.) and explain to the reader how you've organized the document and how to use it.
  - Use descriptive headings to help your reader find specific information more easily.
  - Summarize complicated topics before you describe all the details.
  - Put items of most interest to your reader at the beginning.

- Include only the information your reader needs. Too much information and too much detail make it hard for consumers to find the important information.
- Use headings and make the headings useful.
  - Headings help the reader find their way through the material. Adults read to solve problems and answer questions. Headings help them find the information they need. A question format for headings is often a good way to help the reader find information.
  - Headings should describe all of the material under the heading. If they don't, you need more headings.
  - Every page should have at least one heading and most should have more than one. Don't use more than two or three subordinate levels of headings.
  - Headings should be visually different from the rest of the text and easy to identify. That's most likely to happen if the headings are relatively short—just a few words.
- Use "you" and other pronouns to help the reader understand the information.
  - Use pronouns to pull readers into the disclosure and make it more meaningful to them.
  - In a question, refer to the reader as I ("how do I," "how is my annuity"). In the answer, refer to the reader as you ("your annuity"). Refer to the company as "we" or use the name of the insurance company. Don't use the generic "insurer" or "company."
- Use active voice.
  - Writing in active voice is the single most powerful change to improve readability.
  - Use active voice to clarify who is doing what. If you use passive voice, who is doing what is often unclear.
  - Active voice is generally shorter, as well as clearer.
  - Active sentences are structured with the actor first (as the subject), then the verb, then the object of the action. (For example: You can't take any of the money out of your annuity after the payout begins, NOT A full surrender of your contract can be made at any time before payouts begin.)
- Use short sentences and short sections.
  - Use short sentences, paragraphs, and sections to help your reader get through the material. Long dense text with few headings increases the odds the reader will get lost.
  - If you "chunk" the information using columns, headings, and/or bullets, your document will have more white space. White space opens your document visually and makes it more appealing
  - Sentences should average 15 to 20 words and never be longer than 40 words.
  - Use the simplest tense possible. Use base verbs, not nominalizations (hidden verbs).
  - The simplest verb tense is the clearest and strongest; use simple present tense whenever possible. For example, say, "We credit interest every quarter," not "We will be crediting interest every quarter."
  - A nominalization is a verb that has been turned into a noun. For example, say, "We manage your investment portfolio" and "We analyze data," not "We are responsible for management of your investment portfolio" or "We conduct an analysis of the data."

- Eliminate all excess words.
  - Challenge every word—do you need it?
  - Use pronouns, active voice, and base verbs to eliminate excess words.
  - Eliminate all unnecessary modifiers. For example, in "The two groups issued a joint report," "joint" isn't necessary. In "this information is really critical," "really" isn't necessary.
- Use concrete familiar words.
  - Big words and unfamiliar words don't impress people; they confuse them.[8]
  - If your contract uses a unique term to refer to a contract feature, use that term but include a definition in parentheses after.
  - Use the term premium to refer to money the consumer pays you. Use the term payout to refer to money you pay the consumer.
  - If the contract uses another term for payout, the first time it appears put the other term in the disclosure followed by payout in parentheses. After the first time, use the generic term payout.
  - If the contract uses another term for surrender charge, the first time it appears in the disclosure, put the other term followed by surrender charge in parentheses. After the first time, use the generic term surrender charge. (Example: XYZ Life Insurance Company takes a contingent deferred sales charge (also known as a surrender charge).)
  - Put important terms in bold font the first time you use them. Be selective about what terms you consider important and thus put in bold font; if too many words are in bold, the technique loses its effectiveness.
  - Define (and limit) abbreviations.
  - Avoid jargon, foreign terms, Latin terms, and legal terms.
  - Don't use "and/or" or multiple negatives.
- Use "must" to state requirements. Avoid using the more ambiguous "shall."
  - "Shall" is ambiguous and a word we rarely use in everyday conversation.
  - "Must" (not "shall") is the clearest way to express a requirement or obligation.[9]
- Place words carefully.
  - Placing words carefully within a sentence is as important as organizing your document effectively.
  - Keep subject, verb, and object close together; put exceptions at the end.
- Use lists and tables to simplify information.
  - Lists and tables are one way to explain complex material in less space.
  - Lists and tables give the document more white space and make it more appealing to the reader.
  - If you use a table, explain the table. An example using information from the table is a good way to explain the table.

- Pay attention to format.
  - Make notes to text and tables less visually important than the text. One way to do that is to use a smaller font for notes.
  - Avoid "mice type" (small print) for important information.
  - Serif fonts such as Times and Times New Roman are generally considered most readable but there are ways to make any font more or less readable.[10] For example, each of the fonts below is 12 point but there's an obvious difference in readability.

    For example (Arial)
    For example (Bookman Old Style)
    For example (Arial Narrow)
    For example (Gil Sans MT Condensed)

  - Don't overuse **BOLD** and all **CAPITAL** letters for **EMPHASIS.**
  - Every page should have at least one heading—and most should have more.
  - "Chunk" the information using columns, headings, and/or bullets in your document to create more white space.
  - Use lists and tables to explain complex information.

Web Pages

Most of the preceding information applies to Web pages as well. Online, most people are looking for information to answer immediate questions. They scroll and scan pages looking for information and don't want to read much. These preferences suggest:[11]

- Break documents into separate topics.
- Use even shorter paragraphs than on paper.
- Use even more lists than on paper.
- Use even more headings with less under each heading.
- Keep the information on each page to no more than two levels; the Web has little room for indenting or showing levels of headings.
- Questions often make great headings because users come to the Web with questions in mind.

And, some thoughts on fonts online:[12]

- Use real text rather than text within graphics.
- Select basic, simple, easily-readable fonts.
- Use a limited number of fonts.
- Ensure sufficient contrast between the text and the background.
- Avoid small font sizes.
- Use relative units for font size.
- Limit the use of font variations such as bold, italics, and ALL CAPITAL LETTERS.
- Don't rely only on the appearance of the font (color, shape, font variation, placement, etc.) to convey meaning.
- Avoid blinking or moving text.

Notes

[1]Adkins, N.R., & Ozanne, J.L. (2005, June). The low literate consumer. *Journal of Consumer Research,* 12, 93-105.

[2]See Coh-Metrix, University of Memphis Department of Psychology at http://csep.psyc.memphis.edu/cohmetrix/readabilityresearch.htm or Readability Info at http://www.readability.info/ for more information.

[3]National Adult Literacy Survey 1992 at http://nces.ed.gov/naal/.

[4]See "Writing Tips" at http://process.umn.edu/groups/ppd/documents/information/Writing_Tips.cfm.

[5]See SMOG Index at http://en.wikipedia.org/wiki/SMOG_Index and a link to an online calculator to create a SMOG Index.

[6]Hochhauser, M. (2001-2005). Take the Cloze Test: Readability of a Financial Privacy Policy. Privacy Rights Clearinghouse. Available at http://www.privacyrights.org/fs/fs24b-ClozeFinancial.htm.

[7]The organization of this section follows the organization of the online Power Point presentation, "Writing in Plain Language on the TriCare Site" at http://www.tricare.osd.mil/webmaster/Plain-Language-Rules-Web-Toolkit-2005-07-27.ppt.

[8]For a list of complex words and simpler alternatives, visit http://employees.faa.gov/worktools/correspondence_writing/writing_resources/simple_words/index.cfm.

[9]For information about plain language in the legal sector, visit http://www.plainlanguage.gov/examples/legal/index.cfm.

[10]See http://www.webaim.org/techniques/fonts/ for more information about fonts.

[11]From "Writing in Plain Language on the TriCare Site" at http://www.tricare.osd.mil/webmaster/Plain-Language-Rules-Web-Toolkit-2005-07-27.ppt.

[12]From WebAIM.org at http://www.webaim.org/techniques/fonts/.

FIXED ANNUITY DISCLOSURE MATERIALS

How to Complete the Template for a Fixed Annuity Disclosure

Example 1A: Template for a Fixed Annuity Disclosure

Example 1B: Sample of a Fixed Annuity Disclosure

HOW TO COMPLETE THE TEMPLATE FOR A FIXED ANNUITY DISCLOSURE

The following is a guide to writing a disclosure for a fixed annuity. It includes general suggestions for writing statements; the types of information that should be covered under each required section, the headings to be used and questions to be answered; and in some cases, provides suggested language that can be used.

Example 1A on page 11 shows a graphic of a fixed annuity disclosure template; Example 1B on pages 12–13 is a sample of what an actual product disclosure may look like. Addendum X shows the disclosure document to scale. Companies are encouraged to follow the language used in the sample where possible. Disclosure documents should be kept short (preferably two pages).

Guide to Writing Disclosure Statements

- Make a clear distinction about whether a statement is true of all annuities ("an annuity") or all annuities of this type ("a deferred annuity") or this product ("this annuity," "this deferred annuity").
- In a question, refer to the reader as I (my annuity). In the answer, refer to the reader as you (your annuity). Refer to the company as "we" or use the name of the insurance company. Don't use the generic "insurer" or "company."
- Avoid statements that don't give specific information or don't give the reader information to find specific information. For example, "Interest is credited to your account" is a general statement that isn't very useful. "Interest is credited to your account daily" is a specific statement of information as is "Page 23 of your contract explains the different ways that interest may be credited to your account."
- Use specific terms (i.e. surrender) from your contract in the disclosure but include a definition in parentheses after.
- Put important terms in bold font the first time you use them. Be selective about what terms you consider important. If too many words are in bold, the technique loses its effectiveness.
- If you refer the reader to the contract for more information, be specific about what information is there and exactly where to find it (e.g. use page numbers or section titles).
- The phrasing "includes" (i.e. "Your options include") suggest there are other options not stated here. If you've stated all of the options, say "Your options are." If you plan to add options later, say, "Your options now are."
- The term "annuity" is easier for consumers to understand than "contract." Use "annuity contract" when you're referring the consumer to the written contract. Don't use the word policy to describe an annuity.
- When possible, present information in a bulleted list with a brief description and refer to a specific page number or heading in the contract for more information.

SECTION 1: INTRODUCTION

- Include your company name and name of the product at the top of the page. A company logo also may be inserted.
- Specify if the annuity is single-premium or flexible premium. (Suggested language: This annuity is single-premium which means you buy it with one premium (payment) **or** flexible premium, which means you can purchase it with multiple payments).
- Include statements that briefly explain each of the major features of the annuity. (Suggested language: This annuity is fixed, which means it earns a specified interest rate during the guaranteed period. This annuity is deferred, which means payouts begin at a future date. You don't pay taxes on the interest it earns until the money is paid to you.)
- Include a statement that the buyer can use an annuity for lifetime income but it is not meant for short-term goals. (Suggested language: You can use an annuity to save money for retirement and to receive retirement income for life. It is not meant to be used to meet short-term financial goals. You may pay a fee if you take out money before the end of a time period specified by the contract. You also may pay a tax penalty in addition to taxes due on earnings if you withdraw money before 59 1/2.)

SECTION 2: THE ANNUITY CONTRACT

How will the value of my annuity grow?

- Explain how the annuity earns interest, clearly distinguishing between guaranteed, nonguaranteed, and determinable elements, including their limitations.
- Explain any guarantees and the factors that affect the guarantees.
- Explain how and when interest is credited to the account.

Suggestions for writing statements in this section:

- When you use a table, explain the table. An example using information from the table is a good way to explain the table.

SECTION 3: BENEFITS

How do I get income (payouts) from my annuity?

- Outline choices in payout options, including whether there is a specified maturity date.
- Describe options and restrictions on withdrawing money from the annuity.
- Explain what happens if the annuitant doesn't choose a payout option.

Suggestions for writing statements in this section:

- Use the terms that are in the contract for payout options, but include a clear explanation of each.
- If the contract uses another term for payout, the first time it appears put the other term in the disclosure followed by payout in parenthesis. After the first time, use the generic term payout.
- Use the term premium to refer to money the consumer pays you. Use the term payout to refer to money you pay the consumer.

What happens after I die?

- Describe what happens if the owner (and annuitant if different) dies before and after the company starts to pay income from the annuity and any choices the owner will be asked to make.

SECTION 4: OPTIONAL BENEFIT RIDERS AND THEIR FEES

What other benefits can I choose?

- List all optional riders, briefly describe each, and include either the range or maximum fee charged for each option.
- If no optional benefit riders are offered, include a statement that none are available.

SECTION 5: FEES, EXPENSES & OTHER CHARGES

What happens if I take out some or all of the money from my annuity?

This section should outline:

- The amount of surrender charges and when they are paid.
- Any other charges or adjustments in the amount received when taking money from an annuity.

Suggestions for writing statements in this section:

- If the contract uses another term for surrender charge, the first time it appears in the disclosure, put the other term followed by surrender charge in parentheses. After the first time, use the generic term surrender charge. (Example: ABC Life Insurance Company takes a contingent deferred sales charge (also known as a surrender charge).
- State surrender charges in a table format and include an example to explain the table.
- Include an explanation of the market value adjustment, if applicable. (Suggested language: When you make a withdrawal, we also may increase or decrease the amount you receive based on a market value adjustment (MVA). If interest rates went up after you bought your annuity, the MVA likely will decrease the amount you receive. If interest rates went down, the MVA likely will increase the amount you receive.)

Do I pay any other fees or charges?

- Outline any other fees or charges that apply to the annuity, including contract fees and annual service fees, the amounts, and when and how they are collected.

Suggestions for writing statements in this section:

- When you use a table, include an example to explain the table.

SECTION 6: TAXES

How will payouts and withdrawals from my annuity be taxed?

This section should outline:

- The meaning of tax-deferred (Suggested language: This annuity is tax-deferred, which means you don't pay taxes on the interest it earns until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the earned interest. You also pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2.)
- If your company takes premium taxes from withdrawals or payouts, include a statement describing the deduction. (Suggested language: If your state imposes a premium tax, it will be deducted from the money you receive.)
- That one tax-deferred annuity can be exchanged for another without paying taxes on earnings. (Suggested language: You can exchange one tax-deferred annuity for another without paying taxes on the earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities.)

Does buying an annuity in a retirement plan provide extra tax benefits?

- Explain that there are no tax advantages to buying an annuity as part of a retirement plan. (Suggested language: Buying an annuity within an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. Choose your annuity based on its other features and benefits as well as its risks and costs, not its tax benefits.)

SECTION 7: OTHER INFORMATION

What else do I need to know?

All disclosures should include the following statements, modified as needed to match your situation.

Changes to your contract

We may change your annuity contract from time to time to follow federal or state laws and regulations. If this happens, we'll tell you about the changes in writing.

Compensation

We pay the agent, broker, or firm for selling the annuity to you. They may receive additional compensation for selling this annuity contract than for selling other annuity contracts.

Free Look

Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract (page x) to learn about your free look period. (Or replace suggested language with state and company specific information about free look.)

Include in this section other important information that doesn't appear elsewhere.

What should I know about the insurance company?

Provide a general description of the company as well as all contact information, including an address, phone number, website, and e-mail address (as applicable). You also may consider including financial strength ratings.

All disclosures should include the statement: *This is a summary document and not part of your contract with the insurer.*

EXAMPLE 1A

Template for a Fixed Annuity Disclosure

Example 1A shows how to group disclosure material into sections and in two-column format. Disclosure documents should be short (preferably two pages). The template also includes the section headings that are to be used, the questions that need to be answered, and provides direction. Refer to the accompanying instructions for more information about how to complete the template and for suggested language.

SECTION 1

[COMPANY NAME]
[PRODUCT NAME] Disclosure

[STATE COMPANY NAME AND NAME OF PRODUCT. SPECIFY IF THE ANNUITY IS A SINGLE- OR FLEXIBLE- PREMIUM ANNUITY. INCLUDE STATEMENTS THAT BRIEFLY EXPLAIN MAJOR FEATURES AND HOW IT ACCUMULATES VALUE. DISCLOSE THAT THE ANNUITY IS NOT MEANT TO BE USED TO MEET SHORT-TERM GOALS. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

SECTION 2

THE ANNUITY CONTRACT

How will the value of my annuity grow?

[EXPLAIN HOW THE ANNUITY EARNS INTEREST AND HOW AND WHEN INTEREST IS CREDITED TO THE ACCOUNT. DISTINGUISH BETWEEN GUARANTEED, NON-GUARANTED, AND DETERMINABLE ELEMENTS.]

SECTION 3

BENEFITS

How do I get income (payouts) from my annuity?

[OUTLINE VARIOUS PAYOUT OPTIONS AND INCLUDE IF THERE IS A SPECIFIED MATURITY DATE. DESCRIBE OPTIONS AND RESTRICTIONS ON WITHDRAWING MONEY, AS WELL AS WHAT HAPPENS WHEN A PAYOUT OPTION IS NOT SELECTED.]

What happens after I die?

[DESCRIBE WHAT HAPPENS IF DEATH OCCURS BEFORE AND AFTER INCOME PAYMENTS START AND ANY CHOICES THE ANNUITY OWNER WILL BE ASKED TO MAKE.]

SECTION 4

OPTIONAL BENEFIT RIDERS AND THEIR FEES

What other benefits can I choose?

[LIST AND DESCRIBE ALL OPTIONAL RIDERS. INCLUDE EITHER THE RANGE OF FEES OR MAXIMUM FEE CHARGED FOR EACH.]

SECTION 5

FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?

[STATE SURRENDER CHARGES AND PROVIDE EXAMPLE. INCLUDE EXPLANATION OF MARKET VALUE ADJUSTMENT, IF APPLICABLE. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

Do I pay any other fees or charges?

[OUTLINE OTHER FEES THAT APPLY.]

SECTION 6

TAXES

How will payouts and withdrawals from my annuity be taxed?

[DESCRIBE MEANING OF TAX-DEFERRED. INCLUDE STATEMENT DESCRIBING ANY DEDUCTION TAKEN FOR PREMIUM TAXES. EXPLAIN TAX TREATMENT OF EXCHANGES. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

Does buying an annuity in a retirement plan provide extra tax benefits?

[EXPLAIN THAT THERE ARE NO ADDITIONAL TAX BENEFITS. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

SECTION 7

OTHER INFORMATION

What else do I need to know?

Changes to your contract
[INCLUDE A STATEMENT EXPLAINING THAT THE CONTRACT OWNER WILL BE NOTIFIED IN WRITING OF ANY CHANGES TO THE CONTRACT. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

Compensation
[INCLUDE A STATEMENT EXPLAINING THAT THE SELLER MAY RECEIVE ADDITIONAL COMPENSATION FOR SELLING THIS ANNUITY. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

Free Look
[INCLUDE STATE AND COMPANY SPECIFIC INFORMATION ABOUT FREE LOOK. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

What should I know about the insurance company?

[PROVIDE OTHER RELEVANT COMPANY INFORMATION, INCLUDING ADDRESS, PHONE NUMBER, WEBSITE. INCLUDE THE STATEMENT: *THIS IS A SUMMARY DOCUMENT AND NOT PART OF YOUR CONTRACT WITH THE INSURER*.]

EXAMPLE 1B

Sample of a Fixed Annuity Disclosure

Example 1B is a sample of how a final disclosure document might look. This a only a sample and is not intended to serve as a model disclosure for all types of annuities. Disclosure documents for each company and product will vary. Disclosure documents should be kept short (preferably two pages).

Fixed Single-Premium Deferred Annuity Disclosure

XYZ LIFE INSURANCE

This document reviews important points to think about before you buy this XYZ Insurance Company annuity. This annuity is single-premium which means you buy it with one premium (payment). It is a fixed annuity which means it earns a specified interest rate during the guaranteed period. This annuity is **deferred,** which means payouts begin at a future date. You don't pay taxes on the interest it earns until the money is paid to you.

You can use an annuity to save money for retirement and to receive retirement income for life. It is **not** meant to be used to meet short-term financial goals.

If you have questions about this annuity, please ask your agent, broker, or advisor, or contact a company representative at 800–123–4567.

THE ANNUITY CONTRACT

How will the value of my annuity grow?
Your annuity earns **tax-deferred** interest at a **guaranteed minimum rate** for a **guaranteed period.** When you buy your annuity, you choose a guaranteed period of 5, 6, 7, 8, 9, or 10 years. The guaranteed rate depends on the guaranteed period you choose and current interest rates in the market. Interest compounds daily and is credited to your annuity account on the last day of each month.

Within 30 days after the end of each guaranteed period, you choose a new guaranteed period or surrender (cancel and withdraw the money from) your annuity. If you do nothing, a new guaranteed period begins that is the same length as the one before. The new guaranteed rate depends on the length of the new guaranteed period and current market rates. Interest compounds daily at the new rate in the new period.

The account value of your annuity cannot go down.

BENEFITS

How do I get income (payouts) from my annuity?
When you apply for your annuity, you choose a payout commencement date—when you start to get income from your annuity. You also choose how to get the income—the payout option. Your choices now are:

- **Life:** Guarantees income for as long as you live.
- **Joint and survivor life:** Guarantees income for as long as you or your joint annuitant (usually a spouse) live.
- **Life income with period certain:** Guarantees income for as long as you live. If you die within the "period certain" (usually 10 or 20 years), it pays income to your beneficiary for the rest of the period.
- **Designated period of time:** Pays income for that period.
- **Lump sum:** One payout.

You may change both the start date and the payout option up until payout begins.

If you don't choose an annuity payout option, we start payouts on [FILL IN DATE] and continue them for [FILL IN DURATION].

Once payouts begin, you can't surrender (cancel) your annuity.

What happens after I die?
If you die before we start to pay you income from your annuity, we pay the value of your annuity to your beneficiary. If you die after the payouts start, depending on the type of payout you chose, we pay the remaining value in the annuity, if any, to your beneficiary.

OPTIONAL BENEFIT RIDERS AND THEIR FEES

What other benefits can I choose?
This contract also offers other benefits for an extra cost. Your choices and the fees charged are described below. You will pay a fee for each option you choose every year you own the annuity. The annual cost will be reflected in a lower rate credited to your account balance than you would have received without the riders.

Annual Fees for Available Optional Benefit Riders	Maximum
<u>Principal Guarantee Rider</u> If you surrender your contract before the end of the guarantee period, this rider guarantees the amount you receive will never be less than your initial premium payment.	.10%
<u>Additional Liquidity Benefit</u> Allows you to withdraw up to 10% annually without charge.	.10%

FEES, EXPENSES & OTHER CHARGES

What happens if I take out some or all of the money from my annuity?
You can't take any of the money out of your annuity after the payout begins. Before it begins, you can take out all of your annuity's value **(full surrender)** or part of it **(partial surrender)**. You can take a partial surrender as long as the amount you take is at least $1,000 and you leave at least $5,000 in the account.

We take a **contingent deferred sales charge (also known as a surrender charge)** from amounts you withdraw before the end of the seventh contract year. Here's how the charge is calculated:

Contract year	1	2	3	4	5	6	7	8+
Surrender charge	7%	6%	5%	4%	3%	2%	1%	0

Example: If you withdraw $5,000 from your annuity in the third year contract year, your surrender charge is $5,000 x 0.05 = $250. If you take out any amount after the end of the seventh contract year, there's no charge.

When you make a withdrawal, we also may increase or decrease the amount you receive based on a **market value adjustment (MVA)**. If interest rates went up after you bought your annuity, the MVA likely will decrease the amount you receive. If interest rates went down, the MVA likely will increase the amount you receive.

Exceptions: In some cases, we may waive the surrender charge or the market value adjustment. For example, there's no surrender charge if we pay the remaining value of your annuity to a beneficiary after your death.

Do I pay any other fees or charges?
No. There aren't any other fees or charges on this annuity. Also, you pay only one premium for your annuity.

TAXES

How will payouts and withdrawals from my annuity be taxed?
This annuity is tax-deferred, which means you don't pay taxes on the interest it earns until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the earned interest. You also pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2. If your state imposes a premium tax, it will be deducted from the money you receive.

You can exchange one tax-deferred annuity for another without paying taxes on the earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities. You may pay a surrender charge if you make the exchange during the first seven years you own the annuity. Also, you may pay a surrender charge if you make withdrawals from the new annuity during the first years you own it.

Does buying an annuity in a retirement plan provide extra tax benefits?
Buying an annuity within an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. Choose your annuity based on its other features and benefits as well as its risks and costs, not its tax benefits.

OTHER INFORMATION

What else do I need to know?

Changes to your contract
We may change your annuity contract from time to time to follow federal or state laws and regulations. If we do, we'll tell you about the changes in writing.

Compensation
We pay the agent, broker, or firm for selling the annuity to you. They may receive additional compensation for selling this annuity contract than for selling other annuity contracts.

Free look
Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract (page x) to learn about your **free look** period.

What should I know about the insurance company?
XYZ Life Insurance Company offers a wide variety of retirement and financial security products, including life insurance, annuities, long-term care, and disability income insurance. We also are a leading provider of products and services to workplace-based pension plans—both defined contribution and defined benefit plans. Our financial strength ratings are: A+ (A.M. Best); AA (S&P); Aa3 (Moody's); and AA+ (Fitch).

XYZ Life Insurance Company
123 Main Street
Your Town USA
Telephone: 800–123–4567
http://www.xyzlife.com

This is a summary document and not part of your contract with the insurer.

XYZ LIFE INSURANCE

INDEX ANNUITY DISCLOSURE MATERIALS

How to Complete the Template for an Index Annuity Disclosure

Example 2A: Template for an Index Annuity Disclosure

Example 2B: Sample of an Index Annuity Disclosure

How to Complete the Template for Depicting Indexed Interest

Example 2C: Template for Depiction of Indexed Interest

Example 2D: Sample of Depiction of Indexed Interest

HOW TO COMPLETE THE TEMPLATE FOR AN INDEX ANNUITY DISCLOSURE

The following is a guide to writing a disclosure for an index annuity. It includes general suggestions for writing statements; the types of information that should be covered under each required section, the headings to be used and questions to be answered; and in some cases, provides suggested language that can be used.

Example 2A on page 19 shows a graphic of an index annuity disclosure template; Example 2B on pages 20–21 is an example of what an actual product disclosure may look like. Addendum X shows the disclosure doucment to scale. Companies are encouraged to follow the language used in the sample where possible. Disclosure documents should be kept short (preferably two pages). The font in the documents should be a minimum size of 11 point.

Guide to Writing Disclosure Statements

- Make a clear distinction about whether a statement is true of all annuities ("an annuity") or all annuities of this type ("a deferred annuity") or this product ("this annuity," "this deferred annuity").
- In a question, refer to the reader as I (my annuity). In the answer, refer to the reader as you (your annuity). Refer to the company as "we" or use the name of the insurance company. Don't use the generic "insurer" or "company.
- Avoid statements that don't give specific information or don't give the reader information to find specific information. For example, "Interest is credited to your account" is a general statement that isn't very useful. "Interest is credited to your account daily" is a specific statement of information as is "Page 23 of your contract explains the different ways that interest may be credited to your account."
- Use specific terms (i.e. surrender) from your contract in the disclosure but include a definition in parentheses after.
- Put important terms in bold font the first time you use them. Be selective about what terms you consider important. If too many words are in bold, the technique loses its effectiveness.
- If you refer the reader to the contract for more information, be specific about what information is there and exactly where to find it (e.g. use page numbers or section titles).
- The phrasing "includes" ("Your options include") suggest there are other options not stated here. If you've stated all of the options, say "Your options are." If you plan to add options later, say, "Your options now are."
- The term "annuity" is easier for consumers to understand than "contract." Use "annuity contract" when you're referring the consumer to the written contract. Don't use the word policy to describe an annuity.
- When possible, present information in a bulleted list with a brief description and refer to a specific page number or heading in the contract for more information.
- Disclosure documents should be kept short (preferably two pages). The font in the documents should be a minimum size of 11 point.

SECTION 1: INTRODUCTION

- Include your company name and name of the product at the top of the page. A company logo also may be inserted.
- Specify if the annuity is single premium or flexible premium. (Suggested language: This annuity is single-premium which means you buy it with one premium (payment) **or** flexible premium which means you can purchase it with multiple payments.)
- Include statements that briefly explain each of the major features of the annuity. (Suggested language: This annuity is deferred, which means payouts begin at a later date. You don't pay taxes on the interest it earns until the money is paid to you. This annuity can earn interest in two ways: 1) interest that is guaranteed in the first year and can't go below [Insert Rate/Percentage] after that, and 2) interest that depends on how one or more market indexes perform. This annuity doesn't participate directly in any stock or equity investments. You aren't buying shares of stock or an index. Dividends paid on the stocks on which the indexes are based don't increase your annuity earnings.)
- Include a statement that the buyer can use an annuity for lifetime income but it is not meant for short-term goals. (Suggested language: You can use an annuity to save money for retirement and to receive retirement income for life. It is not meant to be used to meet short-term financial goals. You may pay a fee if you take out money before the end of a time period specified by the contract. You also may pay a tax penalty in addition to taxes due on earnings if you withdraw money before 59 1/2.)

SECTION 2: THE ANNUITY CONTRACT

How will the value of my annuity grow?

- Explain how the annuity earns interest, clearly distinguishing between guaranteed, nonguaranteed, and determinable elements, including their limitations.
- Explain any guarantees and the factors that affect the guarantees.
- Explain how and when interest is credited to the account, including a depiction explaining the interest crediting strategy. (The depiction should be attached to the two-page disclosure document as supplemental material. A guide and template for developing the depiction are on pages 22–23.)
- Explain any caps or floors on interest and how they work.

Suggestions for writing statements in this section:

- When you use a table, explain the table. An example using information from the table is a good way to explain the table.

SECTION 3: BENEFITS

How do I get income (payouts) from my annuity?

- Outline choices in payout options, including whether there is a specified maturity date.
- Describe options and restrictions on withdrawing money from the annuity.
- Explain what happens if the annuitant doesn't choose a payout option.

Suggestions for writing statements in this section:

- Use the terms that are in the contract for payout options, but include a clear explanation of each.
- If the contract uses another term for payout, the first time it appears put the other term in the disclosure followed by payout in parenthesis. After the first time, use the generic term payout.
- Use the term premium to refer to money the consumer pays you. Use the term payout to refer to money you pay the consumer.

What happens after I die?

- Describe what happens if the owner (and annuitant if different) dies before and after the company starts to pay income from the annuity and any choices the owner will be asked to make.

SECTION 4: OTHER BENEFITS AND THEIR FEES

What other benefits can I choose?

- List all optional riders, briefly describe each, and include either the range of fees or maximum fee charged for each option.
- If no optional benefit riders are offered, include a statement that none are available.

SECTION 5: FEES, EXPENSES & OTHER CHARGES

What happens if I take out some or all of the money from my annuity?

This section should outline:

- The amount of surrender charges and when they are paid.
- Any other charges or adjustments in the amount received when taking money from an annuity.

Suggestions for writing statements in this section:

- If the contract uses another term for surrender charge, the first time it appears in the disclosure, put the other term followed by surrender charge in parentheses. After the first time, use the generic term surrender charge. (Example: XYZ Life Insurance Company takes a contingent deferred sales charge (also known as a surrender charge)…).
- State surrender charges in a table format and include an example to explain the table.
- Include an explanation of the market value adjustment, if applicable. (Suggested language: When you make a withdrawal, we also may increase or decrease the amount you receive based on a market value adjustment (MVA). If interest rates went up after you bought your annuity, the MVA likely will decrease the amount you receive. If interest rates went down, the MVA likely will increase the amount you receive.)

Do I pay any other fees or charges?

- Outline any other fees or charges that apply to the annuity, including contract fees and annual service fees, the amounts, and when and how they are collected.

Suggestions for writing statements in this section:

- When you use a table, include an example to explain the table.

SECTION 6: TAXES

How will payouts and withdrawals from my annuity be taxed?

This section should outline:

- The meaning of tax-deferred (Suggested language: This annuity is tax-deferred, which means you don't pay taxes on the interest it earns until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the earned interest. You also pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2.)
- If your company takes premium taxes from withdrawals or payouts, include a statement describing the deduction. (Suggested language: If your state imposes a premium tax, it will be deducted from the money you receive.)
- That one tax-deferred annuity can be exchanged for another without paying taxes on earnings. (Suggested language: You can exchange one tax-deferred annuity for another without paying taxes on the earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities.)

Does buying an annuity in a retirement plan provide extra tax benefits?

- Explain that there are no tax advantages to buying an annuity as part of a retirement plan. (Suggested language: Buying an annuity within an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. In that case, choose your annuity based on its other features and benefits as well as its risks and costs, not its tax benefits.)

SECTION 7: OTHER INFORMATION

What else do I need to know?

All disclosures should include the following statements, modified as needed to match your situation:

Changes to your contract

We may change your annuity contract from time to time to follow federal or state laws and regulations. If this happens, we'll tell you about the changes in writing.

Compensation

We pay the agent, broker, or firm for selling the annuity to you. They may receive additional compensation for selling this annuity contract than for selling other annuity contracts.

Free Look

Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract [Insert page number] to learn about your free look period. (Or replace suggested language with state and company specific information about free look.)

Include in this section other important information that doesn't appear elsewhere, such as what happens if the annuitant doesn't choose a payout option and information about the impact of riders.

What should I know about the insurance company?

Provide a general description of the company as well as all contact information, including an address, phone number, website, and e-mail address (as applicable). You also may consider including financial strength ratings.

All disclosures should include the statement: *This is a summary document and not part of your contract with the insurer.*

EXAMPLE 2A

Template for an Index Annuity Disclosure

Example 2A shows how to group disclosure material into sections and in two-column format. Disclosure documents should be short (preferably two pages). The template also includes the section headings that are to be used, the questions that need to be answered, and provides suggested language that can be used. If there is additional information that you need to include, including a depiction of how indexed interest is calculated, it should be attached to the disclosure.

SECTION 1

[COMPANY NAME]
[PRODUCT NAME] Disclosure

[STATE COMPANY NAME AND NAME OF PRODUCT. SPECIFY IF THE ANNUITY IS A SINGLE- OR FLEXIBLE- PREMIUM ANNUITY. INCLUDE STATEMENTS THAT BRIEFLY EXPLAIN MAJOR FEATURES AND HOW IT ACCUMULATES VALUE. DISCLOSE THAT THE ANNUITY IS NOT MEANT TO BE USED TO MEET SHORT-TERM GOALS. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

SECTION 2

THE ANNUITY CONTRACT

How will the value of my annuity grow?

[EXPLAIN HOW THE ANNUITY EARNS INTEREST AND HOW AND WHEN INTEREST IS CREDITED TO THE ACCOUNT. DISTINGUISH BETWEEN GUARANTEED, NONGUARANTED, AND DETERMINABLE ELEMENTS AND EXPLAIN ANY CAPS OR FLOORS ON INTEREST. ATTACH TO THE DISCLOSURE A DEPICTION OF HOW INDEXED INTEREST IS CALCULATED.]

SECTION 3

BENEFITS

How do I get income (payouts) from my annuity?

[OUTLINE VARIOUS PAYOUT OPTIONS AND INCLUDE IF THERE IS A SPECIFIED MATURITY DATE. DESCRIBE OPTIONS AND RESTRICTIONS ON WITHDRAWING MONEY, AS WELL AS WHAT HAPPENS WHEN A PAYOUT OPTION IS NOT SELECTED.]

What happens after I die?

[DESCRIBE WHAT HAPPENS IF DEATH OCCURS BEFORE AND AFTER INCOME PAYMENTS START AND ANY CHOICES ANNUITY OWNER WILL BE ASKED TO MAKE.]

SECTION 4

OPTIONAL BENEFIT RIDERS AND THEIR FEES

What other benefits can I choose?

[LIST AND DESCRIBE ALL OPTIONAL RIDERS. INCLUDE EITHER THE RANGE OF FEES OR MAXIMUM FEE CHARGED FOR EACH.]

SECTION 5

FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?

[STATE SURRENDER CHARGES AND PROVIDE EXAMPLE. INCLUDE EXPLANATION OF MARKET VALUE ADJUSTMENT, IF APPLICABLE. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

Do I pay any other fees or charges?

[OUTLINE OTHER FEES THAT APPLY.]

SECTION 6

TAXES

How will payouts and withdrawals from my annuity be taxed?

[DESCRIBE MEANING OF TAX-DEFERRED. INCLUDE STATEMENT DESCRIBING ANY DEDUCTION TAKEN FOR PREMIUM TAXES. EXPLAIN TAX TREATMENT OF EXCHANGES. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

Does buying an annuity in a retirement plan provide extra tax benefits?

[EXPLAIN THAT THERE ARE NO ADDITIONAL TAX BENEFITS. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

SECTION 7

OTHER INFORMATION

What else do I need to know?

Changes to your contract
[INCLUDE A STATEMENT EXPLAINING THAT THE CONTRACT OWNER WILL BE NOTIFIED IN WRITING OF ANY CHANGES TO THE CONTRACT. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

Compensation
[INCLUDE A STATEMENT EXPLAINING THAT THE SELLER MAY RECEIVE ADDITIONAL COMPENSATION FOR SELLING THIS ANNUITY. SUGGESTED LANGUAGE PROVIDED IN ACCOMPANYING INSTRUCTIONS.]

Free Look
[INCLUDE STATE AND COMPANY SPECIFIC INFORMATION ABOUT FREE LOOK. SUGGESTED LANUGAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.

What should I know about the insurance company?
[PROVIDE OTHER RELEVANT COMPANY INFORMATION, INCLUDING ADDRESS, PHONE NUMBER, WEBSITE. INCLUDE THE STATEMENT: *THIS IS A SUMMARY DOCUMENT AND NOT PART OF YOUR CONTRACT WITH THE INSURER.*]

EXAMPLE 2B

Sample of an Index Annuity Disclosure

Example 2B is a sample of how a final disclosure document might look. This a only a sample and is not intended to serve as a model disclosure for all types of annuities. Disclosure documents for each company and product will vary. Disclosure documents should be kept short (preferably two pages).

XYZ LIFE INSURANCE

Index Annuity Disclosure

This document reviews important points to think about before you buy this XYZ Life Insurance Company annuity. It is a single-premium annuity which means you buy it with one premium (payment).

This annuity is **deferred,** which means payouts begin at a future date. You don't pay taxes on the interest it earns until the money is paid to you.

This annuity can earn interest in two ways: 1) interest that is guaranteed in the first year and can't go below 1.5% after that, and 2) interest that depends on how one or more market indexes perform. This annuity does not participate directly in any stock or equity investments. You aren't buying shares of stock or an index. Dividends paid on the stocks on which the indexes are based don't increase your annuity earnings.

You can use this annuity to save for retirement and to receive retirement income for life. It is not meant to be used to meet short-term financial goals.

If you have questions about this annuity, please ask your agent, broker, advisor, or contact a company representative at 800–123–4567.

THE ANNUITY CONTRACT

How will the value of my annuity grow?
The XXX Annuity earns interest in two ways. One is a fixed rate that is guaranteed at x% for the first year. After the first year, the **fixed** rate is guaranteed to be at least 1.5%.

The value of this annuity also may grow through **indexed** returns. The amount of the index-linked interest depends on how the Dow Jones Industrial Average, a nationally recognized market index, performs. Your annuity contract (see page x or Section x) spells out how index-linked interest is credited to your annuity account at the end of each contract year.

How much index-linked interest is credited to your account annually depends on the sum of the **capped monthly returns.** These are the caps (or limits) we set on the effect on your account value of the positive change in the market index from one month to the next. We set the cap on the positive returns at the beginning of each contract year. That cap can change each year. **We guarantee the monthly cap will never be lower than 1%.**

However, interest earnings credited can never be less than zero, even if the sum of the monthly returns is negative.

Here's how the caps work. If the market index increases more than the cap, the monthly change increases by the amount of the cap. If the market index increases less than the cap, the monthly change increases by the amount of the increase. If the market index goes down, the monthly change goes down by the full amount of the decrease. The monthly changes are then added up at the end of the contract year and any interest earned is credited to your account. Each of the following could happen:

- A large decrease in index-linked interest in one month could wipe out some or all of the monthly increases from earlier months.
- Even if the index is up overall for the year, the annual index-linked interest credited could be lower (or zero).
- If the total of the capped monthly returns is negative, the index-linked interest for that year would be zero.

Attached is a depiction explaining how indexed interest is calculated.

BENEFITS

How do I get income (payouts) from my annuity?

Your annuity's account (the value while you're paying into your annuity) depends on your premium and any annual index-linked interest and guaranteed interest credited to your account. After five contract years, you can ask the company to pay the accumulation value of your contract to you as income. You can choose how to get the income. Your annuity contract describes your options in detail (see page x or Section x). Your current choices are:

- **Life:** Guarantees income for as long as you live.
- **Joint and survivor life:** Guarantees income for as long as you or your joint annuitant (usually a spouse) live.
- **Life income with period certain:** Guarantees income for as long as you live. If you die within the "period certain" (usually 10 or 20 years), it pays income to your beneficiary for the rest of the period.
- **Designated period of time:** Pays income for that period.
- **Lump sum:** One payout.

If you don't choose an annuity payout option, we start payouts on [FILL IN DATE] and continue them for [FILL IN DURATION].

Once you start to get income from your annuity, the account value stops earning index-linked interest. It will continue to earn guaranteed interest.

In the first 10 contract years, you can withdraw money from your annuity once a contract year without paying a fee. The most you can withdraw each year without paying a fee is 10% of the total premiums you've paid.

If you withdraw 50% or more of the premiums paid, you lose the right to make a withdrawal without paying a fee.

Once payouts begin, you can't surrender (cancel) your annuity.

What happens after I die?
If you die before we start to pay you income from your annuity, your beneficiary can choose to get the accumulation value of your annuity as one payment or as a series of payouts over time. If you die after payouts start, depending on the type of payout you chose, we pay the remaining value in the annuity, if any, to your beneficiary.

OPTIONAL BENEFITS AND THEIR FEES

What other benefits can I choose?

There are no optional benefits available with this annuity contract.

FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?
When you take money from your annuity, you may lose some or all of your credited interest. If you take out all **(full surrender)** or part **(partial surrender)** of the money, you also may have to pay a **surrender charge.** The amount of the charge depends on how long you've had the annuity and how much you withdraw. Here's how the charge is calculated:

Contract year	1	2	3	4	5	6	7	8+
Surrender charge	10%	9%	8%	7%	6%	5%	4%	0

Example: After two years, you've paid $10,000 in premium. You want to withdraw $1,100 from your annuity in the third year. Since $ 1,100 is more than 10% of the premium you've paid ($10,000 x 0.10 = $1,000), your surrender charge is $1,100 x 0.08 = $88. There's no surrender charge after the end of the seventh contract year.

When you make a withdrawal, we also may increase or decrease the amount you receive based on a **market value adjustment (MVA).** If interest rates went up after you bought your annuity, the MVA likely will decrease the amount you receive. If interest rates went down, the MVA likely will increase the amount you receive.

Do I pay any other fees or charges?
No. There aren't any other fees or charges on this annuity. Also, you pay only one premium for you annuity.

TAXES

How will payouts and withdrawals from my annuity be taxed?
This annuity is tax-deferred, which means you don't pay taxes on the interest it earns until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the earned interest. You also pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2. If your state imposes a premium tax, it will be deducted from the money you receive.

You can exchange one tax-deferred annuity for another without paying taxes on the earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities. You may pay a surrender charge if you make the exchange during the first seven years you own the annuity. Also, you may pay a surrender charge if you make withdrawals from the new annuity during the first years you own it.

Does buying an annuity in a retirement plan provide extra tax benefits?
Buying an annuity within an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. Choose your annuity based on its other features and benefits as well as its risks and costs, not its tax benefits.

OTHER INFORMATION

What else do I need to know?

Changes to your contract
We may change your annuity contract from time to time to follow federal or state laws and regulations. If we do, we'll tell you about the changes in writing.

Compensation
We pay the agent, broker, or firm for selling the annuity to you. They may receive additional compensation for selling this annuity contract than for selling other annuity contracts.

Free Look
Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract (page x) to learn about your **free look** period.

What should I know about the insurance company?
XYZ Life Insurance Company offers a wide variety of retirement and financial security products, including life insurance, annuities, long-term care, and disability income insurance. We also are a leading provider of products and services to workplace-based pension plans—both defined contribution and defined benefit plans. Our financial strength ratings are: A+ (A.M. Best); AA (S&P); Aa3 (Moody's); and AA+ (Fitch).

XYZ Life Insurance Company
123 Main Street
Your Town USA
Telephone: 800–123–4567
http://www.xyzlife.com

This is a summary document and not part of your contract with the insurer.

XYZ LIFE INSURANCE

HOW TO COMPLETE THE TEMPLATE FOR DEPICTING INDEXED INTEREST

The following is a guide for developing a depiction of how credited interest is calculated for an index annuity. A separate depiction for each indexed account offered under the annuity contract should be attached to the disclosure document as a supplement. Each depiction must include a written explanation of how interest is calculated. A graphic example supporting the explanation enhances consumer understanding.

Guidelines for developing a depiction

- Explain how indexed interest is calculated for a single index term. For example, if an indexed interest credit covers a 12-month period, then the examples should show how indexed interest is calculated for a 12-month period. If the indexed interest credit covers more than a 12-month period, such as a 5-year point-to-point account, then the examples should show how indexed interest is calculated for a 5-year period.
- If a non-guaranteed element such as a cap is involved in the interest calculation, the value used in the explanation should never be greater than the then-current value in effect for new policies. The minimum guaranteed value for such guaranteed element must be stated.
- If an annuity contract tracks different account values for different benefit streams such that there is more than one indexed interest credit for a given period, then the explanation must depict the calculation of indexed interest for each benefit stream.
- To assure that the explanation is balanced, it should provide examples explaining how interest is calculated under two index scenarios: one with positive indexed interest and one with zero indexed interest. A graphic example will enhance consumer understanding.
    - The positive example should portray a reasonably favorable change in the index constructed to produce an illustrative indexed interest credit equivalent to an annual effective rate of [6%], subject to any lower cap that may apply to the indexed account. If the indexed interest credit covers a time period other than 12 months, the resulting interest credit must also be expressed in terms of an equivalent annual effective rate.
    - The zero example should portray an equally negative index scenario that results in zero indexed interest.

EXAMPLE 2C

Template for Depiction of Indexed Interest

Example 2C is a template for developing a depiction of how credited interest is calculated for an index annuity. A separate depiction for each indexed account offered under the annuity contract should be attached to the disclosure document as a supplement. Each depiction must include a written explanation of how interest is calculated. A graphic example supporting the explanation enhances consumer understanding.

[COMPANY NAME] Depiction of Indexed Interest for the [NAME OF INDEXED ACCOUNT] Offered in the [ANNUITY CONTRACT NAME]

or

[COMPANY NAME] Depiction of Indexed Interest for the [ANNUITY CONTRACT NAME]

This document provides an explanation of how indexed interest is calculated for the [NAME OF INDEXED ACCOUNT].

Graphic Examples of How Indexed Interest is Calculated

- Positive Indexed Interest Result

  [INSERT: LINE OR BAR CHART CONTRASTING PERFORMANCE OF INDEX OVER THE CREDITING PERIOD WITH THE INDEXED INTEREST RESULT.] Graphic should be accompanied by a written explanation that explains what index is used, how interest is linked to the index, and what elements of the account are subject to change.

- Zero Indexed Interest Result

  [INSERT: LINE OR BAR CHART CONTRASTING PERFORMANCE OF INDEX OVER THE CREDITING PERIOD WITH THE INDEXED INTEREST RESULT.] Graphic should be accompanied by a written explanation that explains what index is used, how interest is linked to the index, and what elements of the account are subject to change.

EXAMPLE 2D

Sample of Depiction of Indexed Interest

The sample shows how indexed interest is credited for an XYZ Life Insurance Company annuity. See page 22 for instructions on how to complete the template for depicting indexed interest.

Index Annuity Disclosure: Indexed Interest Depiction for the XYZ Index Annuity

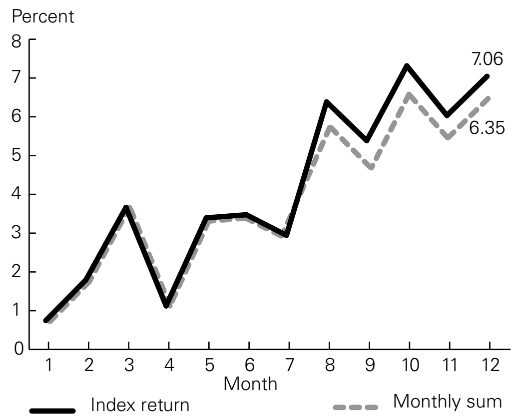
XYZ LIFE INSURANCE

Scenario 1 shows hypothetical index changes for a 12-month period in which the index performed favorably. The index return (solid line) shows the cumulative return that investing directly in the index would have achieved. The dotted monthly sum line represents the cumulative capped monthly sum, compounded, and assuming a 2.8% monthly cap. The cap may vary from year to year, but is guaranteed never to be less than 1.0%. **In scenario 1, the ending monthly sum is 6.35%—the interest rate that would be credited to the index annuity.**

Example: Favorable index performance

Month	Monthly index return (percent)	Monthly capped index return (percent)
1	0.70	0.70
2	1.05	1.05
3	1.87	1.87
4	–2.54	–2.54
5	2.27	2.27
6	0.08	0.08
7	–0.53	–0.53
8	3.44	2.80
9	–1.00	–1.00
10	1.94	1.94
11	–1.29	–1.29
12	1.01	1.01
Total (compounded)	7.06	6.35

Scenario 1: Positive indexed interest

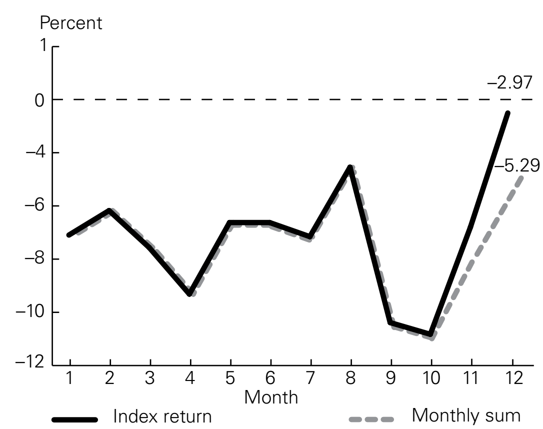


Scenario 2 shows hypothetical index changes for a 12-month period in which the index performed poorly. The solid black index return line represents the cumulative return that investing directly in the index would have achieved. The dotted monthly sum line represents the cumulative capped monthly sum, compounded, and assuming a 2.8% monthly cap. The cap may vary from year to year, but is guaranteed never to be less than 1.0%. **In scenario 2, since the ending monthly sum is negative (–5.29%) at the end of the year, 0 % interest would be credited to the index annuity.**

Example: Unfavorable index performance

Month	Monthly index return (percent)	Monthly capped index return (percent)
1	–7.15	–7.15
2	0.92	0.92
3	–1.39	–1.39
4	–1.75	–1.75
5	2.69	2.69
6	1.95	1.95
7	–2.48	–2.48
8	2.61	2.61
9	–6.04	–6.04
10	–0.24	–0.24
11	4.03	2.80
12	4.63	2.80
Total (compounded)	–2.97	–5.29

Scenario 2: Zero indexed interest



VARIABLE ANNUITY DISCLOSURE MATERIALS

How to Complete the Template for a Variable Annuity Disclosure

Example 3A: Template for a Variable Annuity Disclosure

Example 3B: Sample of a Variable Annuity Disclosure

HOW TO COMPLETE THE TEMPLATE FOR A VARIABLE ANNUITY DISCLOSURE

The following is a guide to writing a disclosure for an variable annuity. It includes guidance for writing statements; the types of information that should be covered under each required section, the headings to be used and questions to be answered; and in some cases, provides suggested language that can be used. **Disclosure documents must be prepared consistently with FINRA conduct rule 2210 (Communications to the Public).**

Example 3A on page 29 shows a graphic of a variable annuity disclosure template; Example 3B on pages 30–31 is an example of what an actual product disclosure may look like; Addendum X shows the disclosure document to scale. Companies are encouraged to follow the language used in the sample.

Note: **The variable annuity disclosure document may be presented in two forms: print or electronic. If distributed electronically, in addition to providing direct links to the annuity prospectus or supplement material for more information, companies also should keep references to specific pages (and, if appropriate, headings on that page) in the event consumers prefer to print hard copies.**

Guide to Writing Disclosure Statements

- Make a clear distinction about whether a statement is true of all annuities ("an annuity") or all annuities of this type ("a deferred annuity") or this product ("this annuity," "this deferred annuity").
- In a question, refer to the reader as I (my annuity). In the answer, refer to the reader as you (your annuity). Refer to the company as "we" or use the name of the insurance company. Don't use the generic "insurer" or "company."
- Avoid statements that don't give specific information or don't give the reader information to find specific information. For example, "Interest is credited to your account" is a general statement that isn't very useful. "Interest is credited to your account daily" is a specific statement of information as is "Page 23 of your annuity prospectus explains the different ways that interest may be credited to your account."
- Use specific terms (i.e. surrender) from your annuity prospectus in the disclosure but include a definition in parentheses after.
- Put important terms in bold font the first time you use them. Be selective about what terms you consider important. If too many words are in bold, the technique loses its effectiveness.
- If you refer the reader to the annuity prospectus for more information be specific about what information is there and exactly where to find it (e.g. use page numbers or section titles).
- The phrasing "includes" ("Your options include") suggest there are other options not stated here. If you've stated all of the options, say "Your options are." If you plan to add options later, say, "Your options now are."
- Use "annuity prospectus" when you're referring the consumer to the written prospectus.
- Don't use the word policy to refer to an annuity.
- When possible, present information in a bulleted list with a brief description and refer to a specific page number in the annuity prospectus for more information.

SECTION 1: INTRODUCTION

- Include your company name and name of the product at the top of the page. A company logo also may be inserted.
- Include statements that briefly explain each of the major features of the annuity. (Suggested language: This annuity is deferred, which means payouts begin at a future date.)
- Specify that this is a variable annuity and include a definition. (Suggested language: This is a variable annuity: the return on your investments will vary with changes in the market OR its value depends on the performance of the investments you chose.)
- Include a statement that the buyer can use an annuity for lifetime income but it is not meant for short-term goals. (Suggested language: You can use an annuity to save money for retirement and to receive retirement income for life. It is not meant to be used to meet short-term financial goals.)
- Specify if the annuity is single-premium or flexible premium. (Suggested language: This annuity is single-premium which means you buy it with one payment (premium) **or** flexible premium which means you can purchase it with multiple payments (premiums)).
- Include information about how the annuity accumulates earnings. For example: This annuity can accumulate earnings in two ways: 1) from various investment choices we offer and 2) from a fixed interest account of XYZ Life Insurance Company.

SECTION 2: THE ANNUITY CONTRACT

What are my investment options?

- Explain how the annuity accumulates earnings, clearly distinguishing between guaranteed, non-guaranteed, and determinable elements, including their limitations.
- List how many investment choices are currently available, explain the choices the consumer must make, and refer to the specific pages of the annuity prospectus where detailed information is available. (If the disclosure is online, this section may provide a link to more information about investment choices.)

SECTION 3: BENEFITS

What are the benefits of my annuity?

- List and describe the benefits of the annuity and include links, page numbers, or section headings for more information.

Guide to writing statements in this section:

- Use the term premium to refer to money the consumer pays you. Use the term payout to refer to money you pay the consumer.
- Use the same terms that are used in the annuity prospectus for payout options, but include a clear explanation of each.
- If the annuity prospectus uses another term for payout, the first time it appears put the other term in the disclosure followed by payout in parenthesis. After the first time, use the generic term payout.
- When you use a table, explain the table. An example using information from the table is a good way to explain the table.
- Be specific when you refer to the annuity prospectus; include links, page numbers and, if appropriate, headings on that page.

How do I get income (payouts) from my annuity?

- Mention the various payout options and provide a link to the annuity prospectus, page numbers, or section headings where more information is available.
- Explain what happens if the annuitant doesn't choose a payout option.

SECTION 4: OPTIONAL BENEFIT RIDERS AND THEIR FEES

What other benefits can I choose?

- List **all** optional riders, briefly describe each, and include either the range of fees or the maximum fee charged for each option. Include links, page numbers, or section headings and refer to specific page numbers or section headings in the annuity prospectus and supplement material for more information.

Guide to writing statements in this section:

- Present information in a chart or table.
- Be specific when you refer to the annuity prospectus; include links, page numbers and, if appropriate, section headings on that page.
- Use the same terms used in the annuity prospectus for riders, but include a brief explanation of what the rider offers.

SECTION 5: RISKS

What are the risks?

In this section, describe the types of risks in a bulleted list with a brief description of each. If online, include a link to the relevant information. Also include specific page numbers in the annuity prospectus for more detailed information. This section should describe:

- Risks to guaranteed elements.
- Risks associated with underlying investments.
- Options and restrictions on withdrawing money from the annuity.
- Tax consequences for early withdrawals.

Guide to writing statements in this section:

- Use the terms used in the annuity prospectus for risks, but include a brief explanation of what each risk is.
- Be specific when you refer to the annuity prospectus; include links, page numbers and, if appropriate, headings on that page.

SECTION 6: FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?

This section should outline:

- The amount of surrender charges and when they are paid.
- If the variable annuity contract is designed without surrender charges, the question should be answered to indicate that no surrender charges apply under the contract provisions for surrenders.
- Any other charges or adjustments in the amount received when taking money from an annuity.

Guide to writing statements in this section:

- If the annuity prospectus uses another term for surrender charge, the first time it appears in the disclosure, put the other term followed by surrender charge in parentheses. After the first time, use the generic term surrender charge. (Example: XYZ Life Insurance Company takes a contingent deferred sales charge (also known as a surrender charge) …).
- State surrender charges in a table format and include an example to explain the table.
- Be specific when you refer to the annuity prospectus; include links, page numbers and, if appropriate, headings on that page.

What fees or charges do you take from my annuity account value?

- List and describe contract fees, such as annual contract fees and annual portfolio expenses. You may list the range of each fee or the maximum fee charged for each.

Do I pay any other fees or charges?

- List and describe any other fees or charges that apply, such as maintenance charges or transfer fees. Include links, page numbers, or section headings in the annuity prospectus for more information.

Guide to writing statements in this section:

- A table may be useful to explain fees and charges. If you use a table, include an example to explain the table.

SECTION 7: TAXES

How will payouts and withdrawals from my annuity be taxed?

This section should outline:

- The meaning of tax-deferred (Suggested language: Variable annuities are tax-deferred which means you don't pay taxes on accumulated earnings until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the accumulated earnings. You also defer paying taxes on earnings if you move money from one investment option in your annuity to another. You may pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2.)
- If your company takes premium taxes from withdrawals or payouts, include a statement describing the deduction. (Suggested language: If your state imposes a premium tax, it will be deducted from the money you receive.)
- That one tax-deferred annuity can be exchanged for another without paying taxes on accumulated earnings. (Suggested language: You can exchange one tax-deferred annuity for another without paying taxes on the accumulated earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities.)

Does buying an annuity in a retirement plan provide extra tax benefits?

- Explain that there are no additional tax advantages to buying an annuity in an IRA, 401 (k) plan or other tax deferred retirement product. (Suggested language: Buying an annuity within an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. Choose your annuity based on its other features and benefits as well as its risks and costs, not its tax benefits.)

SECTION 8: OTHER INFORMATION

What else do I need to know?

All disclosures should include the following statements, modified as needed to match your situation.

Changes to your contract
We may change your annuity contract from time to time to follow federal or state laws and regulations. If this happens, we'll tell you about the changes in writing.

Compensation
Ask your sales representative how he or she is paid. We pay the sales representative and the firm he or she is associated with for selling this annuity to you. The compensation they receive could create an incentive for recommending one product over another.

Free look
Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract [Insert link, page number or section title] or the annuity prospectus [Insert link, page number or section title] to learn about your free look period. (Or replace suggested language with state and company specific information about free look.)

Include in this section other important information that doesn't appear elsewhere.

What should I know about the insurance company?

Include in this section a general description of the company as well as all contact information, including an address, phone number, Web site, and e-mail address (as applicable). You also may consider including financial strength ratings.

All disclosures should include the following statement, modified as needed to match your situation:

- Note: The about information is current as of the annuity prospectus dated___. This is a summary document. The prospectus contains important information required under the federal securities laws. If you wish to receive a paper copy of the prospectus and supplement material, click here or call 800-123-4567. There is no charge for paper copies.

EXAMPLE 3A

Template for a Variable Annuity Disclosure

Example 3A shows how to group disclosure material into sections and in two-column format. Disclosure documents should be kept short. The template also includes the section headings that are to be used, the questions that need to be answered, and provides direction. Refer to the accompanying instructions for more information about how to complete the template and for suggested language. Disclosure documents must be prepared consistently with FINRA conduct rule 2210 (Communications to the Public).

***Note:* The variable annuity disclosure document may be presented in two forms: print or electronic. If distributed electronically, in addition to providing links to the prospectus, keep references to specific pages in case consumers choose to print hard copies.**

SECTION 1

[COMPANY NAME]

[PRODUCT NAME] Disclosure

[STATE COMPANY NAME AND NAME OF PRODUCT. SPECIFY IF THE ANNUITY IS A SINGLE- OR FLEXIBLE- PREMIUM. INCLUDE STATEMENTS THAT BRIEFLY EXPLAIN MAJOR FEATURES AND HOW THE ANNUITY ACCUMULATES EARNINGS. DISCLOSE THAT THE ANNUITY IS NOT MEANT TO BE USED TO MEET SHORT-TERM GOALS. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

SECTION 2

THE ANNUITY CONTRACT

What are my investment options?

[EXPLAIN THE CHOICES THE CONTRACT OWNER MUST MAKE, INCLUDING HOW MANY INVESTMENT OPTIONS ARE AVAILABLE AND THEIR VARYING DEGREES OF RISK AND THE CURRENT RATE OF THE FIXED ACCOUNT.]

SECTION 3

BENEFITS

What are the benefits of my annuity?

[LIST AND DESCRIBE THE ANNUITY'S BENEFITS.]

How do I get income (payouts) from my annuity?

[DESCRIBE VARIOUS PAYOUT OPTIONS.]

SECTION 4

OPTIONAL BENEFIT RIDERS

What other benefits can I choose?

[LIST AND DESCRIBE ALL OPTIONAL RIDERS. INCLUDE EITHER THE RANGE OR MAXIMUM FEE CHARGED FOR EACH.]

SECTION 5

RISKS

What are the risks?

[LIST AND DESCRIBE RISKS TO GUARANTEED ELEMENTS, RISKS ASSOCIATED WITH THE UNDERLYING INVESTMENTS, RESTRICTIONS ON WITHDRAWING MONEY, AND TAX LIABILITIES FOR EARLY WITHDRAWALS.]

SECTION 6

FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?

[STATE SURRENDER CHARGES AND PROVIDE AN EXAMPLE.]

What fees or charges do you take from my annuity account value?

[LIST AND DESCRIBE CONTRACT FEES AND PROVIDE AN EXAMPLE.]

Do I pay any other fees or charges?

[LIST AND DESCRIBE ANY OTHER FEES OR CHARGES THAT APPLY.]

SECTION 7

TAXES

How will payouts and withdrawals from my annuity be taxed?

[DESCRIBE THE MEANING OF TAX-DEFERRED. INCLUDE A STATEMENT DESCRIBING ANY DEDUCTION TAKEN FOR PREMIUM TAXES. EXPLAIN TAX TREATMENT OF EXCHANGES. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

Does buying an annuity in a retirement plan provide extra tax benefits?

[EXPLAIN THAT THERE ARE NO ADDITIONAL TAX BENEFITS. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

SECTION 8

OTHER INFORMATION

What else do I need to know?

Changes to your contract

[INCLUDE A STATEMENT EXPLAINING THAT THE CONTRACT QWNER WILL BE NOTIFIED IN WRITING OF ANY CHANGES TO THE CONTRACT. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

Compensation

[INCLUDE A STATEMENT EXPLAINING THAT THE COMPENSATION RECEIVED BY THE SALES REPRESENTATIVE COULD CREATE AN INCENTIVE FOR RECOMMENDING ONE PRODUCT OVER ANOTHER. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

Free Look

[INCLUDE STATE AND COMPANY SPECIFIC INFORMATION ABOUT FREE LOOK. SUGGESTED LANGUAGE PROVIDED IN THE ACCOMPANYING INSTRUCTIONS.]

What should I know about the insurance company?

[PROVIDE RELEVANT COMPANY INFORMATION, INCLUDING ADDRESS, PHONE NUMBER, WEBSITE. ALSO INCLUDE THE FOLLOWING STATEMENT, MODIFIED TO MEET SPECIFIC COMPANY SITUATION: *Note: the above information is current as of the annuity prospectus dated____. This is a summary document. The annuity prospectus contains important information required under the federal securities laws. If you wish to receive a paper copy of the prospectus and supplement material, click here or call 800-123-4567. There is no charge for paper copies.*]

EXAMPLE 3B

Sample of a Variable Annuity Disclosure

Example 3B is a sample of how a final disclosure document might look. Addendum X shows document to scale. This is a only a sample and is not intended to serve as a model disclosure for all types of annuities. Disclosure documents for each company and product will vary. Disclosure documents must be prepared consistently with FINRA conduct rule 2210 (Communications to the Public).

Note: **The variable annuity disclosure document may be presented in two forms: print or electronic. If distributed electronically, in addition to providing links to the prospectus, keep references to specific pages in case consumers choose to print hard copies.**

Variable Annuity Disclosure

XYZ LIFE INSURANCE

This document reviews important points to think about before you buy this XYZ Life Insurance Company annuity. This variable annuity is a contract between you and our company. It is a single-premium annuity which means you buy it with one payment (premium).

This annuity is deferred, which means payouts begin at a future date. You can use an annuity to save money for retirement and to receive retirement income for life. It is not meant to be used to meet short-term financial goals. You may pay a fee if you take out money before the end of a time period specified by the contract.

This annuity is variable, which means its value depends on the performance of the investments you chose. This annuity can accumulate earnings in two ways: 1) from various investment choices we offer and 2) from a fixed interest account of XYZ Life Insurance Company.

If you have questions about this annuity, please ask your agent, broker, advisor, or contact a company representative at 800–123–4567.

THE ANNUITY CONTRACT

What are my investment options?
You can invest your money in our fixed interest account and in any or all of the investment choices we offer. Click on the links below or refer to pages of the annuity prospectus for more information about your choices.

- **Investment choices:** You may choose from 41 fund portfolios that have different investment objectives and levels of risk (see page 13).
- **Fixed account**: This choice offers a guaranteed rate of return, which currently is 3% (see page 12).

BENEFITS

What are the benefits of my annuity?
The benefits of your annuity are described below. Click on the links provided or read the section of the annuity prospectus for more information.

- **Death benefits:** This annuity includes a death benefit that will be paid to your beneficiary if you die before your income payouts begin. This benefit equals either your premium minus any withdrawals or the contract value, whichever is greater (see page 28).
- **Nursing care and terminal condition withdrawal:** If you or your spouse are in a hospital or nursing facility for 30 consecutive days or diagnosed with a terminal condidtion after the annuity was issued, you can take money from your annuity without paying a fee (see page 37).
- **Unemployment waiver:** If you (or your spouse) become unemployed, you won't pay fees when you take out money if certain conditions defined in the contract are met (see page 37).
- **Systematic payout option:** You can get monthly, quarterly, or annual payouts from your annuity in set amounts at any time without paying certain fees (see page 34).

What types of income (payouts) can I get from my annuity?
You can choose to get payouts for you and a joint annuitant for life or for a specific period of time or you can choose a lump sum payout. (Pages__ explain your payout options.)

OPTIONAL BENEFIT RIDERS AND FEES

What other benefits can I choose?
The contract also offers other benefits for an extra cost. Your choices and the fees charged are described below. You will pay a fee for each option you choose every year you own the annuity. The fee is calculated as a percentage of the value of your investments. Click on the links or refer to pages in the annuity prospectus and supplement material for more information, including how fees are calculated.

Annual Fees for Optional Benefit Riders

Additional Death Benefit Riders	CURRENT	MAXIMUM
Additional Death Distribution Option Pays your beneficiary an extra death benefit in specific situations (description of benefit: supplement pages 35–36; explanation of fee: supplement page 23).	.20%	20%

Living Benefit Riders	CURRENT	MAXIMUM
Guaranteed Minimum Accumulation Benefit: Guarantees a future value of your annuity no matter how the investment options you choose perform (description of benefit: supplement pages 4–5; explanation of fee; supplement pages 7–8).	.40%	.50%
Guaranteed Minimum Withdrawal Benefit: Guarantees an annual amount you can take out of your annuity regardless of its value (description of benefit: supplement pages 5–7; explanation of fee; supplement pages 7–8).)	.50% (single) .85% (joint)	1.00%

RISKS

This annuity has several risks. Click on the links below or read the annuity prospectus for more information about:

- **Risks of your annuity contract:** There's a risk that we won't be able to pay claims on guaranteed annuity contract benefits, such as the guaranteed minimum accumulation value (see page 12).
- **Risks based on the investment portfolio you choose:** The investments you choose may decrease in value; if any of them do, the value of your annuity will go down. You may lose money if you take money out in whole or in part when the value is down (see pages 15–16).
- **Access to your money:** You may pay a fee (surrender charge) if you take out money before the end of the fifth contact year (see the next section of this disclosure or pages 24–25).
- **Your tax liability:** You may pay a 10% federal income tax penalty on earnings in addition to taxes due on earnings if you withdraw money before age 59 1/2 (see section on "Taxes" or pages 29–34).

CONTRACT FEES, EXPENSES AND OTHER CHARGES

What happens if I take out some or all of the money from my annuity?
You may pay a surrender charge if you take out money before the end of the fifth contract year. Here's how the charge is calculated.

Contract Year	1	2	3	4	5	6+
Surrender Charge	5%	4%	3%	2%	1%	0

Example: If you withdraw $5,000 from your annuity in the third contract year, your surrender charge is $5,000 x .0.03 = $150. If you take out any amount after the end of the fifth contract year, there's no charge.

You may not have to pay a surrender charge if you take out part of your money (a partial surrender). **Click here** or see pages 20–21 of the annuity prospectus for more information about surrender charges.

What fees or charges do you take from my annuity account value?
You will pay fees every year you own the annuity. The fees are calculated as a percentage of the contract's value.

Annual Contract Fees
(not including fees for optional riders)

	Current	**Maximum**
Mortality and expense risk	.95%	1.35%
Administrative	.10%	.15%
Total annual contract fees	**1.50%**	**2.27%**

Example: Cost Based on Annual Contract Fees

Investment value	**Current (1.50%)**	**Maximum (2.27%)**
$1,000	$15.00	$22.70
$50,000	$759.00	$1,135.00
$100,000	$1,500.00	$2,270.00

Total Annual Portfolio Operating Fees

Minimum	.85%	Maximum	1.42%

Example: Cost Based on Annual Portfolio Operating Fees

Investment value	**Minimum**	**Maximum**
$1,000	$8.50	$14.50
$50,000	$425.00	$710.00
$100,000	$850.00	$1,420.00

Do I pay any other fees or charges?
There's also an annual service charge. We will tell you the amount of the service charge (between $0 and $35 per annuity) each year. There may be other charges in some cases. You may pay a contract maintenance or transfer fee. The maintenance fee is waived if the contact value is more than $50,000 on the contract anniversary or at the time of surrender. You also pay a fee for each optional rider you choose (see section on optional benefit riders and fees). **Click here** or see page 10 of the annuity prospectus for more information about fees and charges.

TAXES

How will payouts and withdrawals from my annuity be taxed?
Variable annuities are tax-deferred, which means you don't pay taxes on the annuity's accumulated earnings until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the accumulated earnings. You also defer paying taxes on earnings if you move money from one investment option in your annuity to another. You may pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2. If your state imposes a premium tax, it will be deducted from the money you receive.

You can exchange one tax-deferred annuity for another without paying taxes on the accumulated earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities.

Does buying an annuity in a retirement plan provide extra tax benefits?
Buying an annuity within an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. Choose your annuity based on its other features and benefits as well as its risks and costs, not its tax benefits.

OTHER INFORMATION

What else do I need to know?
Changes to your contract: We may change your annuity contract from time to time to follow federal or state laws and regulations. If we do, we'll tell you about the changes in writing.

Compensation: Ask your sales representative how he or she is paid. We pay the sales representative and firm he or she is associated with for selling this annuity to you. The compensation they receive could create an incentive for recommending one product over another.

Free Look: Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract (page ___) **or see page ______ of the annuity prospectus** to learn about your free look period.

What should I know about the insurance company?
XYZ Life Insurance Company offers a wide variety of retirement and financial security products, including life insurance, annuities, long-term care, and disability income insurance. We also are a leading provider of products and services to workplace-based pension plans—both defined contribution and defined benefit plans. Our financial strength is as follows: A+ (A.M. Best); AA (S&P); Aa3 (Moody's); and AA+ (Fitch).

XYZ Life Insurance Company
123 Main Street
Your Town USA
Telephone: 800–123–4567
www.XYZlife.com

Note: The above information is current as the annuity prospectus dated May 1, 2006. This is a summary document. The prospectus contains important information required under the federal securities laws. If you wish to receive a paper copy of the prospectus and supplement material, click here or call 800-123-4567. There is no charge for paper copies.

XYZ LIFE INSURANCE

AMERICAN COUNCIL OF LIFE INSURERS
101 Constitution Ave., NW, Suite 700
Washington, DC 20001–2133 **www.acli.com**

0410

The Individual Annuity

A RESOURCE IN YOUR RETIREMENT

Americans need ways to create and guarantee lifetime income.

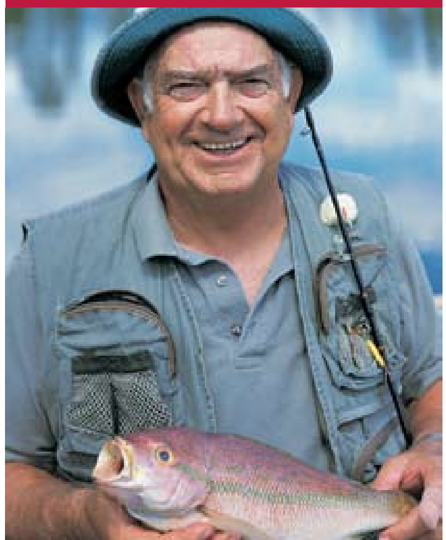
AN AGE OF DECISION

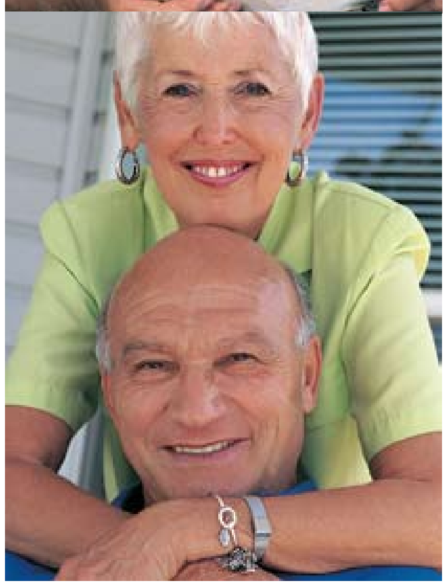
Retirement today requires more planning than for previous generations. Americans are living longer—many will live 20 to 30 years or more in retirement. Finding a way to make savings last over such a long period of time is one of the biggest challenges of today's retirees.

In addition, sources of steady retirement income have changed. Fewer workers are covered by traditional employer-provided pension plans that provide a lifetime benefit. Furthermore, Social Security is not likely to provide future retirees the level of benefits that it provides today. Americans need other ways to create and guarantee lifetime income so their standard of living doesn't decline with age.

To achieve a secure retirement, more and more retirees are including an individual annuity in their plans. An annuity can provide a steady stream of income for life, shifting the burden of managing savings from you to your life insurance company. No other personal financial product offers this guarantee of lifetime income. For many, the income guarantee helps offset worries associated with running out of money.

The American Council of Life Insurers has prepared this guide to help retirees understand what an individual annuity contract is, what options are available, and how the right choice might enhance retirement security.





Annuities are insurance contracts. They come in different types and offer many options to meet a variety of financial objectives.

A deferred annuity can address both pre-retirement savings and post-retirement income needs. For example, if you are years away from retirement—or are retired and have assets that don't need to produce income right away—a deferred annuity allows your savings to accumulate, tax deferred, until you choose to receive income payments. You decide how your money accumulates—at a fixed interest rate, an indexed interest rate, or based on the performance of stocks and bonds. You also select how you receive income—in a lump sum, payments over a specified number of years, or steady income you cannot outlive.

If you need a guaranteed income stream right away, an immediate annuity converts an initial lump sum of money into a series of monthly, quarterly, or annual payments that begin within a year after purchase. You decide if you want to receive those income payments over a specified number of years or as a steady stream of income you cannot outlive.

Accumulation Options For Deferred Annuities

Fixed Annuity

The money you put in a fixed annuity earns interest at a rate that is guaranteed for a specific period of time—ranging from one to five years or more, depending on the terms of the contract. When that period ends, a new rate may take effect—or the old rate may be offered again. In no case will the new interest rate be less than the guaranteed minimum rate defined in the contract.

When you begin receiving income, a fixed payment is guaranteed. Fixed annuities generally include death benefit protection so that if you die before payments begin, your beneficiary will receive at least the amount you contributed minus any withdrawals taken. These benefits are detailed in the annuity contract.

Index Annuity

An index annuity is a type of fixed annuity. With an index annuity, earnings accumulate at a rate based on a formula linked to one or more published equity-based indexes, such as the Standard & Poor's 500 Composite Stock Price Index™ (S&P 500), which tracks the performance of the 500 largest publicly traded securities.

An index annuity provides a guarantee of a minimum accumulation value, and may also offer death benefit protection and a variety of payout options.

The index used, the formula that determines the indexed rate and the guaranteed minimum value, can vary from insurer to insurer.

Variable Annuity

With a variable annuity, your money is put in subaccounts that are invested in stock and bond funds. You can respond to market conditions by moving your money from one subaccount to another—without incurring current taxes. The return on your investments is subject to the risk of market fluctuation. Your total account value depends on how much risk you take, the performance of the subaccounts, and what charges and fees are deducted. These factors are explained in the annuity's prospectus, which outlines the objectives and level of risk for each subaccount, operating expenses, and financial statements.

Over the long term, variable annuities reflect performance and growth in the economy and may serve as an effective hedge against inflation. However, it is possible to lose money in a variable annuity. Some variable annuities allow you to place some of your money in a fixed account with a guaranteed rate of return. Such diversification helps spread your risk. There are also optional guarantees that can be purchased to provide additional protection against downturns in the market.

Many variable annuities allow you to choose between fixed or variable income payments. A variable payment will fluctuate based on the performance of the underlying subaccounts. Some variable annuities guarantee that the payment will not fall below a set amount.

Like a fixed annuity, if you die before payments begin, your beneficiary may receive a death benefit, which is typically the greater of either the current account value of the annuity less withdrawals, or the amount of your initial contribution.

Income Options

When you decide you want to receive income from your annuity, a number of options are available. Common options are:

- Life income—You receive income as long as you live, even if payments exceed the amount of money you put into the annuity. When you die, no further payments are made to anyone. This income option, also referred to as a straight life option, usually provides the highest income payment.
- Joint and survivor life income—This option provides income for as long as you or the joint annuitant live. Because the survivor feature is an added benefit, the income payment is less than in a straight life option.
- Life income with refund—You receive income for life and, if you die before receiving the amount of money you contributed, your beneficiary collects the portion you had not yet received. Some policies pay the beneficiary a lump sum, and others may require benefits to be received in installments.
- Life income with period certain—Payments are made to you for as long as you live with the guarantee that, if you die within a certain period after you start receiving income (usually 10 or 20 years), your beneficiary will receive regular payments for the rest of that period.

Other income options are available. You also can choose to receive income in a series of payments for a specified number of years, or if you have a deferred annuity, in a lump sum. However, neither of these options has a lifetime guarantee.

Many deferred annuities allow you to take money out during the accumulation phase through periodic or systematic withdrawals. There generally is a limit on the amount you may withdraw each year.

Costs and Fees

All financial products have costs associated with them, and annuities are no different. An annuity is an insurance contract that is unique in its ability to guarantee a steady stream of income for life. This and other insurance features, such as death benefits, are included in the cost of the annuity.

In addition to the costs for insurance features, fees may be charged if you withdraw some or all of your money from your deferred annuity in the early years. These fees are commonly referred to as withdrawal or surrender charges. Often, after a time specified in the contract, these fees are eliminated. Some annuities waive these charges under specific circumstances such as death, confinement to a nursing home, or terminal illness. As mentioned in the previous section, some deferred annuities may allow annual withdrawals of a certain amount without triggering a surrender charge.

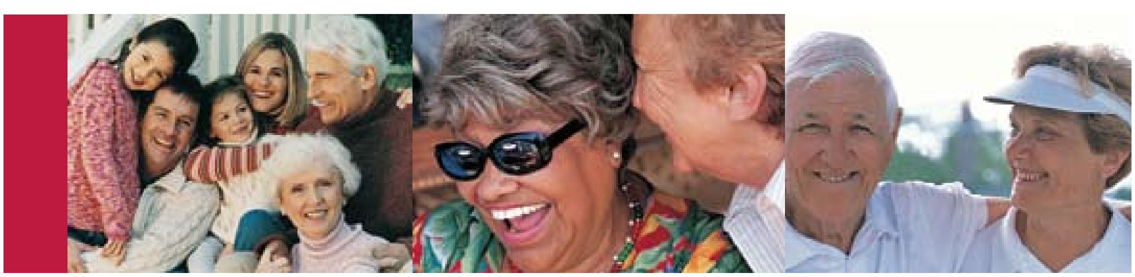
Other fees also may apply, such as transaction, market value adjustment, contract fees, and in the case of a variable annuity, portfolio management. Ask your agent or life insurance company for a description of all applicable charges and fees.

Federal Tax Treatment

Earnings on a deferred annuity build up free of current federal income tax. When you withdraw money or receive income payments, the portion that comes from earnings is taxed as ordinary income. With an immediate annuity, you pay ordinary income taxes on any earnings when you receive payments. The portion of the payment that represents your initial contribution is not taxed if your annuity was purchased with after-tax dollars.

Because taxes are deferred until money is withdrawn or received as income, there are tax penalties for early withdrawal. If you choose to withdraw money from your deferred annuity before you reach age 59 ½, you will trigger a 10 percent tax penalty on the earnings portion of the amount withdrawn plus the income tax due on earnings. The tax penalty is not applied to certain lifetime payouts, death benefits, or payments made if you become disabled. Other exceptions may apply.

Annuity earnings also may be subject to state taxes, which vary according to state. Check with a local tax advisor for more information.



Before a Purchase

Both you, the purchaser, and the life insurance company enter into to a long-term commitment under an annuity contract. It is important to carefully review your current finances, retirement goals, and anticipated needs before you make a purchase. To help you make an informed decision, consider or discuss the following with a financial planner, insurance agent, or broker.

Do you need to supplement current income?
You can convert assets to steady income right away through an immediate annuity. Many retirees purchase an immediate annuity with cash from a retirement plan, the sale of a home, life insurance benefits, or savings account. You choose whether the income payments continue for a specified number of years or for life.

Do you need less income in the early years of retirement than you will in the future?
A deferred annuity allows your savings to grow—tax deferred—until the date you decide to begin receiving payments. An immediate annuity that provides a cost of living adjustment also can address this need.

What is your tolerance for risk?
In a deferred annuity, you decide whether savings accumulate at a guaranteed rate, an indexed rate, or bear the risk of market fluctuations.

Do you need to ensure income or asset protection for a spouse after your death?
Certain annuities offer the option of continuing income payments to a spouse after your death. Some also provide death benefits if you die before income payments begin.

If you are purchasing a fixed annuity, ask about the current credited interest rate, how often it changes, and the minimum guaranteed rate.

If you are purchasing an index annuity, find out about the index, formula, and current factors applicable to the initial indexed interest period. Ask how often indexed interest is credited, how factors may change in subsequent periods, and level of minimum guaranteed values provided by the contract.

If you are purchasing a variable annuity, review the investment options currently available and read the prospectus for each subaccount.
A prospectus, which is required to be given to potential buyers, outlines the objectives and level of risk, as well as operating expenses and financial statements.

Ask if there are fees or charges for partial withdrawal of funds or full surrender of your deferred annuity contract. Find out how much the fees are and for how long they apply.

Compare similar contracts from several companies. Features, terms, and conditions vary from company to company. Comparing contracts—and the relative cost of features—may help you make a better decision.

Ask if there is a guaranteed death benefit.
Some deferred annuities include death benefits that may exceed the account value; some do not. Know what benefit is guaranteed, how and when it will be paid and whether increased benefits can be purchased.

Ask how long the "free-look" period is. The free-look period is the time you have the right to review the contract and return it if you have made the wrong choice. The company then will cancel the contract and, depending on your state, refund your initial contribution or the market value of the contract. Free-looks usually last at least 10 days, but rules vary from state to state and not every state guarantees free-look rights.

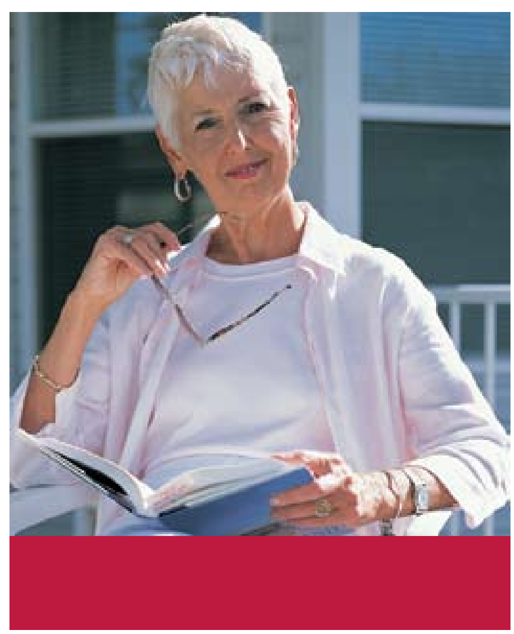
Evaluate the company issuing the annuity. Only life insurance companies can issue annuities, although they may be sold by other financial institutions such as banks and brokerage firms. Make sure the issuing company is licensed in your state and that the company is reputable, service oriented, and financially strong. Several services rate the financial strength of life insurance companies, such as A.M. Best, Fitch Ratings, Moody's, and Standard & Poor's. Ratings can be found in most public libraries or on a service's Web site (a small access fee may be charged).

Make sure your agent is licensed to sell annuities. To sell a fixed annuity requires only a license issued by your state insurance department. A variable annuity can be sold by a registered representative of a broker-dealer that is a member of the National Association of Securities Dealers (NASD). The representative also must be licensed by the state to sell variable insurance products.

After a Purchase

If you have a question or concern about your annuity contract after you have purchased it, talk to your agent or company representative. If you are having a problem with your agent, talk to a manager at the agency or contact the company represented by the agency. When contacting a company, direct your inquiry to the customer service department at the company's home office. Customer service offices are set up by most companies to handle inquires, solve problems, or direct people to an appropriate department. Your annuity contract will contain contact information.

If you continue to have problems with an issuing company, you can contact the department of insurance in your state. A state insurance department directory can be found at www.acli.com.



The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association whose 373 member companies account for 93 percent of the life insurance industry's total assets in the United States. ACLI member companies offer life insurance; annuities; pensions, including 401(k)s; long-term care insurance; disability income insurance; reinsurance; and other retirement and financial protection products.

Circular 230 disclosure: This document was not intended or written to be used, and cannot be used, to : (1) avoid tax penalties, or (2) promote, market or recommend any tax plan or arrangement.

PROTECTION. SAVINGS. GUARANTEES.

AMERICAN COUNCIL OF LIFE INSURERS
101 Constitution Avenue, NW, Suite 700
Washington, DC 20001–2133
www.acli.com

Life insurance protects your financial future. It provides the resources your family or business may need to pay immediate and continuing expenses when you die.

WHAT YOU SHOULD KNOW

About Buying Life Insurance

There are different types of life insurance and choosing a policy is an important decision. You should begin by evaluating the ongoing and future financial needs of those who depend on you. Then become familiar with the various policies available and how they work. You'll be in a better position to make a selection best suited to your financial needs and those of your family.

The American Council of Life Insurers (ACLI) has prepared this guide to help you understand the types of life insurance available and what questions to ask when you're buying life insurance.

AMERICAN COUNCIL OF LIFE INSURERS | PROTECTION. SAVINGS. GUARANTEES.
101 Constitution Avenue, NW, Suite 700, Washington, DC 20001–2133 www.acli.com

GETTING STARTED

As you prepare to buy a life insurance policy, evaluate your ongoing and future financial needs and review the products. To begin, ask yourself some basic questions:

Why do I need to buy life insurance?

If someone depends on you financially, the likelihood is that you need life insurance. Life insurance provides cash to your family after you die. The money your beneficiary receives (the death benefit) can be an important financial resource. It can help cover daily living expenses, pay the mortgage and other outstanding loans, fund tuition, and ensure that your family is not burdened with debt. Having a life insurance policy could mean your spouse or children wouldn't have to sell assets to pay bills or taxes. Another advantage is that beneficiaries won't have to pay federal income taxes on the money they receive.

How much life insurance do I need?

Everyone's needs are different. A life insurance agent or financial advisor can help you determine what level of protection is right for you and your family based on your financial responsibilities and sources of income. There are online calculators that also can help you; however, sitting down with an insurance professional to review your financial needs can give you a more personalized view of your needs.

> Beneficiaries won't have to pay federal income taxes on the money they receive from a life insurance policy.

In general, deciding how much life insurance you need means deducting the total income that would be lost upon your death from the total sum of your family's ongoing financial needs. Consider ongoing expenses (day care, tuition, mortgage, or retirement) and immediate expenses (medical bills, burial costs, and estate taxes). Your family also may need money to pay for a move or the costs of looking for a job.

While there is no substitute for evaluating needs based on your own financial information, some experts suggest that if you own a life insurance policy it should pay a benefit equal to seven to 10 times your annual income. Your need could be higher or lower depending on your situation.

TYPES OF LIFE INSURANCE

What are the different types of insurance?

There are two basic types of life insurance: *permanent* and *term.* Permanent insurance pays your beneficiary whenever you may die; term insurance pays your beneficiary if you die during a specific period of time.

What is permanent insurance?

Permanent (cash value) insurance provides lifelong protection as long as premiums are paid. It may build up cash value over time and the cash value grows tax deferred. With all permanent policies, the cash value is different from the face amount. Cash value is the amount available if you surrender (cancel) your policy before death. The face amount is the money that will be paid to your beneficiary if you die. Your beneficiary does not receive the cash value of your policy.

Cash value takes time to grow. But after you've held the policy for several years, its cash value can offer you several options:

- You can borrow from the insurer using your cash value as collateral. You can get the loan even if you don't have a good credit history. If you don't repay the loan (including interest), it will reduce the amount paid to your beneficiaries after your death.
- You can use the cash value to pay your premiums or to buy more coverage.
- You can exchange the policy by using the cash value for an annuity that will provide income for life or a specified period.
- You can cancel (surrender) the policy and receive the cash value in a lump sum. You would pay taxes on the value that exceeds what you've paid in premiums.

Basic types of cash value insurance

- **Whole life** (ordinary life) is the most traditional type of cash value insurance. Generally premiums and death benefits stay the same over the life of the policy. The policy's cash value grows at a fixed rate.
- **Variable life** With a variable life policy you can choose among a variety of investments offering different risks and rewards—stocks, bonds, combination accounts, or options that guarantee principal and interest. Death benefits and cash value will vary depending on the performance of the investments you select. By law, you'll be given a prospectus for variable life insurance. This prospectus will include financial statements and outline investment objectives, operating expenses, and risks. The cash value of a variable life policy is not guaranteed. If the market doesn't perform well, the cash value and death benefit may decrease, although some policies guarantee that the death benefit won't fall below a certain level.
- **Universal life** gives you flexibility in setting premium payments and the death benefit. Changes must be made within certain guidelines set by the policy; to increase a death benefit, the insurer usually requires evidence of continued good health. A universal life policy can have a variable component.

The money your beneficiary receives can help cover expenses and ensure that your family is not burdened with debt.

What is term insurance?

Term insurance provides protection for a defined period of time—from one to 10, 20, or even 30 years—and pays benefits only if you die during that period. Term insurance is often used to cover financial obligations that will disappear over time, such as tuition or mortgage payments. Premiums for term insurance either can be fixed for the length of the term or can increase at a point specified in the policy. They also can be less expensive than for a cash value policy.

Term policies can include a return of premium benefit that will refund all or some of the premiums paid at the end of a term if no death benefit was paid. Term policies with this feature are more expensive than those without.

Some term policies can be renewed at the end of a term. However, premium rates will usually increase upon renewal. Many policies require evidence of insurability to qualify for renewal at the lowest rates. At the end of a term, you also may be able to convert the policy to a cash value policy. Term policies don't usually build up a cash value, but policies with a return of premium benefit will have a small cash value.

WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF EACH TYPE OF INSURANCE?

Cash Value Insurance

Advantages

- Lifelong protection as long as the premiums are paid.
- Premium costs can be fixed or flexible to meet individual financial needs.
- A policy accumulates a cash value, which can be borrowed against, surrendered for cash, or converted to an annuity. The cash value also can be used to pay premiums or to buy more coverage.

Disadvantages

- Cash value insurance is designed to be kept for the long term.
- Cancelling a cash value policy after only a few years can be expensive. For the short term, term insurance may prove a better value.

Term Insurance

Advantages

- A policy can cover financial obligations that will disappear over time, such as a mortgage or college expenses.
- When you're young, premiums are generally lower than those for cash value insurance.

Disadvantages

- Provides protection for a specific period of time, not for life.
- Premiums increase as you grow older and your health status changes.
- Policies don't usually build up a cash value.

The agent should be able and willing to explain the different kinds of policies and other insurance-related matters.

HOW TO PURCHASE: CHOOSING A COMPANY OR AGENT

You can buy life insurance at an insurance agency, brokerage firm, bank, or directly from a life insurance company on the Internet, over the phone, or by mail. Most companies have websites describing their products and services and some will direct you to a local agent.

How do I choose a company?

Contact your state insurance department for a list of companies licensed in your state, then:

- Ask friends and relatives for recommendations based on their own experiences.
- Talk to an insurance agent or broker.
- Conduct an Internet search.
- Research companies at a public library.

Generally speaking, life insurers are in excellent financial health. They're required by law to maintain reserves to guarantee that they can meet obligations to their policyholders. However, you should still verify a company's financial strength.

You can check any company's financial condition by looking at its rating. Rating agencies, including A.M. Best Company, Fitch Ratings, Moody's Investor Services, Standard and Poor's Insurance Rating Service, and Weiss Ratings, assess the financial strength of companies. Rating information is available online or in publications usually found in the business section of your public library.

How do I choose an agent?

Collect the names of several agents through recommendations from friends, family, and other sources. Find out if an agent is licensed in your state by checking with your state's insurance department. Agents who sell variable products also must be registered with the Financial Industry Regulatory Authority (FINRA), and have an additional state license to sell variable contracts.

Ask what company or companies the agent represents and check his or her professional accreditations. Agents often belong to professional associations that offer continuing education and grant professional credentials. The National Association of Insurance and Financial Advisors offers local educational seminars for agents. The Society of Financial Service Professionals and the Financial Planning Association offer similar training for financial planners. Agents may earn such professional designations as Chartered Life Underwriter (CLU) and Life Underwriter Training Council Fellow (LUTCF). Agents who also are financial planners may carry such credentials as Chartered Financial Consultant (ChFC), Certified Financial Planner (CFP), or Personal Financial Specialist (CPA–PFS).

WORKING WITH AN AGENT

What should an agent do for me?

The agent should be able and willing to explain the different kinds of policies and other insurance-related matters. You should feel satisfied that the agent is listening to you and looking for ways to find the right type of insurance at an affordable price. After a purchase, your agent also should review your life insurance needs from time to time as your circumstances change, as well as help in the claims process. If you're not comfortable with the agent, or you aren't convinced he or she is providing the service you want, interview another agent.

What should I expect during my meeting with an agent?

An agent will begin by discussing your financial needs. You should have basic personal financial information available—along with a general idea of your goals—before you meet or talk with an agent. He or she will ask questions about your family income, other financial resources you might have, and any debts. With the information you provide, the agent will be better able to assess your needs.

What types of questions will I be asked?

In addition to questions about finances, be prepared to answer questions about your age, medical condition, family medical history, personal habits, occupation, and recreational activities.

Always answer questions truthfully; a company will use this information to evaluate your risk and set a premium for your coverage. For instance, you'll pay a lower premium if you don't smoke; on the other hand, if you have a chronic illness, you can expect a higher premium. When it's time to submit a claim, accurate and truthful answers will enable your beneficiary to receive prompt and full payment.

When you apply for life insurance, you may be asked to take a medical exam. In many instances, a licensed health care professional hired and paid for by the life insurance company will make a personal visit to your home to conduct the exam.

EXAMINING A POLICY

How do I know if a life insurance policy is right for me?

Read the policy carefully to make sure it meets your personal goals. Because your policy is a legal document, it's important that you understand exactly what it provides. Ask for a point-by-point explanation for anything that is unclear and make sure the agent explains items you don't understand.

If your agent recommends a cash value policy, ask:

- Are the premiums within my budget?
- Can I commit to these premiums over the long term?

Cash value insurance provides protection for your entire life. Cancelling a cash value policy after only a few years can be a costly way to get short-term insurance protection. If you don't plan to keep the policy for the long-term, consider another kind of coverage such as term insurance.

If you're considering a term policy, ask:

- How long can I keep this policy? If I want to renew it for a specific number of years, or until a certain age, what are the renewal terms?
- Will my premiums increase? If so, will increases start annually or after five or 10 years?
- Can I convert to a cash value policy? Will I need a medical exam if and when I convert?
- If it has a return of premium benefit, ask: What would the policy cost without this benefit? Will all of the premiums be refunded?

Is a policy illustration a legal document, like a contract?

A policy illustration is not part of the life insurance policy and is not a legal document. Legal obligations are spelled out in the policy contract. A policy illustration, however, can help you understand how a policy works.

What is in a policy illustration?

A policy illustration shows financial projections for each year you own the policy—including, but not limited to, premium amounts owed, cash values, and death benefits. For a term policy, the projections extend to the end of the term. With a cash value policy, projections extend past your 100th birthday.

Your actual costs and benefits could be higher or lower than those in the illustration because they depend on the future financial results of the insurance company. However, when figures are guaranteed, the insurance company will honor them regardless of its financial success. Ask your agent which figures are guaranteed and which are not.

A policy illustration can be complicated. Your agent or financial advisor can explain information you don't understand.

What should I look for in a policy illustration?

Study the policy illustration to answer the following:

- Is my classification (i.e., smoker/nonsmoker, male/female) correct?
- When are premiums due—monthly, annually, or according to some other schedule?
- What amounts are guaranteed and which are not?
- Does the policy have a guaranteed death benefit or could the death benefit change depending on interest rates or other factors?
- Does the policy offer dividends or interest credits that could increase my cash value and death benefit or reduce my premium?
- Will my premiums always be the same? Could premiums increase if future interest rates or investment returns are lower than the illustration assumes?
- If the illustration shows that I won't have to make premium payments after a certain period of time, is there any chance I would have to start making payments again at any time in the future?

An accelerated benefits rider lets you, under some conditions, receive the death benefits of your life insurance policy before you die.

FREQUENTLY ASKED QUESTIONS

What happens if I miss a payment?

If you miss a premium payment, you usually have a 30- or 31-day grace period in which to make your payment without consequences. If you die within the grace period, your beneficiary will receive the death benefit minus the overdue premium. However, the policy will lapse (terminate) if you don't make your payment by the end of the grace period. If you own a cash value policy, your company—with your authorization—can draw from your policy's cash value to pay the premium. This method of keeping your policy active can work only as long as your cash value lasts.

Do I have any recourse if my policy lapses?

Some life insurance contracts let you reinstate a lapsed policy within a certain time frame. However, you must prove insurability, pay all overdue premiums (plus interest), and pay off any outstanding policy loans.

In addition to the death benefit, are there other features I should be aware of when considering a life insurance policy?

Many policies offer purchase options or riders. Some riders let you buy more insurance without taking a medical exam; others waive premiums if you become disabled. Some policies offer an accidental death benefit that pays an additional amount if death occurs as a result of an accident. Some companies offer accelerated benefits, also known as living benefits. An accelerated benefits rider lets you, under some conditions, receive the death benefits of your life insurance policy before you die. Such conditions may include terminal or catastrophic illness, confinement to a nursing home, or need of other long-term care services. You also may combine a full long-term care insurance policy with a life insurance policy as a rider.

When will my policy take effect?

If you decide to buy a policy, find out when the insurance becomes effective. That date may be different from the date the policy is issued.

How is life insurance taxed?

Your beneficiaries won't pay income taxes on death benefits. If you own a cash value policy, you won't pay income taxes on the cash value unless you cancel the policy and withdraw the money. Then you'll pay taxes on the amount that exceeds what you've paid in premiums.

Tips on Buying Life Insurance

Make sure that you fully understand any policy you're considering and that you're comfortable with the company, agent, and product. Most states require insurers to provide a buyer's guide to explain life insurance terms, benefits, and costs. Ask your agent for a copy of your company's guide and follow the tips below:

- Ask for outlines of coverage so you can compare the features of several policies.
- Check with your state insurance department to make sure the company and agent are licensed in your state.
- Look for a company that is reputable and financially strong. A number of insurance rating services rate the financial strength of companies. You can get such information from your agent, public or business libraries, or on the Internet. Rating agencies include A.M. Best Company, Fitch Ratings, Moody's Investor Services Inc., Standard & Poor's Insurance Rating Services, and Weiss Ratings.
- Beware of offers for "free" life insurance. Investors may approach some seniors to offer them money to buy life insurance and then sell the policy to the investors. The investors expect to profit by receiving the death benefit when the senior dies. Often called stranger-originated life insurance, legislators and regulators are concerned about these transactions because they violate public policies against wagering on human life. Also, there may be hidden pitfalls, such as unexpected taxes, fees, and loss of privacy.
- Always answer questions on your life insurance application truthfully.
- Be sure your application has been filled out accurately. Promptly notify your agent or company of errors or missing information.
- When you buy a policy, make your check payable to the insurance company, not the agent. Be sure to get a receipt.
- Contact the company or agent if you don't get your policy within 60 days.
- After you've bought an insurance policy, you may have a "free-look" period—usually 10 days after you receive the policy—when you can change your mind. During that period, read your policy carefully. If you decide not to keep it, the company will cancel the policy and give you an appropriate refund. Information about the free-look period is in your contract.
- Always check the date the insurance becomes effective.
- Keep your life insurance policy with your other financial records or legal papers, or anywhere your survivors are likely to look for it. However, don't keep your policy in your safe deposit box. In most states, boxes are sealed temporarily on the death of the owner, delaying a settlement when funds may be needed most.
- Contact your original company, agent, or financial adviser before canceling your current policy to buy a new one. If your health has declined, you may no longer be insurable at affordable rates. If you replace one cash value policy with another, the cash value of the new policy may be relatively small for several years.
- If you have a complaint about your insurance agent or company, contact the customer service division of your insurance company. If you're still dissatisfied, contact your state insurance department. A state insurance department directory is available on www.acli.com.
- Review your policy periodically or when a major event occurs in your life—such as a birth, divorce, remarriage, or retirement—to be sure your coverage is adequate and your beneficiaries are correctly named.

Circular 230 disclosure: This document was not intended or written to be used, and cannot be used, to: (1) avoid tax penalties, or (2) promote, market or recommend any tax plan or arrangement.

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Reviewed by Brenda J. Cude, Ph.D., Professor, Department of Housing and Consumer Economics, University of Georgia, with concurrence by the Cooperative State Research, Education, and Extension Service, USDA.

The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. ACLI members represent more than 90 percent of the assets and premiums of the life insurance and annuity industry. In addition to life insurance and annuities, ACLI member companies offer pensions, 401(k) and other retirement plans, long-term care and disability income insurance, and reinsurance. ACLI's public Website can be accessed at ***www.acli.com***.

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APPENDIX B to ACLI Submission on the SEC's Financial Literacy Study

Existing Regulatory Provisions Relevant to the Financial Literacy Study

- **Form N-4 Synopsis, Fee Table and Risk Disclosure**.

Form N-4[1] provides streamlined, simplified disclosure required in variable annuity prospectuses. The form requires the prospectus to "clearly and concisely describe the key features" of the variable annuity and the issuing life insurer in an upfront synopsis. The form also requires a very detailed "fee table" that the SEC substantially upgraded in November 2002.[2] January 1, 2004 was the final date for compliance with these standards. The SEC staff identifies the fee table as the "current lynchpin of cost disclosure."[3] The fee table is a core feature of the SEC's prospectus simplification project that sought to replace "unintelligible, tedious, and legalistic" disclosure with meaningful information on which to make an informed purchase decision.[4]

The 2002 amendments to the variable annuity fee table require information about all recurring fees and charges. The enhancements also require a narrative that explains the purpose of the fee table and relevant cross-references to the prospectus. The revisions require specific explanatory narratives preceding each section of the fee table "to help investors better understand the information about fees and charges in that section." By way of exa

mple, Form N-4 requires the fee table to include a series of captions in front of different detailed tabular information stating that:

> *The following tables describe the fees and expenses that you will pay when buying, owning, and surrendering the contract. The first table describes the fees and expenses that you will pay at the time that you buy the contract, surrender the contract, or transfer cash value between the investment options. State premium taxes may also be deducted.*
>
> *The next table describes the fees and expenses that you will pay periodically during the time that you own the contract, not including [portfolio company] fees and expenses.*

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[1] Adopted in Release No. IC-14575 [CCH Fed. Sec. L. Rep ¶83,783], effective July 25, 1985, 50 FR 26145; amended in Release No. IC-16245 [CCH Fed. Sec. L. Rep ¶84,217], effective May 1, 1988, 53 FR 3868; Release No. IC-16766 [CCH Fed. Sec. L. Rep. ¶ 84,349], effective May 1, 1989, 54 FR 4772; Release No. IC-18005 [CCH Fed. Sec. L. Rep ¶84,710], effective May 1, 1991 for Item 1, generally effective June 1, 1991, 56 F.R. 8113; and Release No. FR-40A [CCH Fed. Sec. L. Rep ¶72,440], effective November 2, 1992, 57 FR 45287; Release No. IC-19284 [CCH Fed. Sec. L. Rep ¶85,112], effective November 1, 1993, 58 FR 14848; Release No. IC-20486 [CCH Fed. Sec. L. Rep ¶85,423, effective October 11, 1994, 59 FR 43460; corrected in Release No. IC-20486A, September 23, 1994, 59 FR 48798; Release No. IC-21221 [CCH Fed. Sec. L. Rep. ¶72,446], effective September 1, 1995, 60 FR 38918; and Release No. IC-21946 [CCH Fed. Sec. L. Rep. ¶ 85,805], effective June 14, 1996, 61 F.R. 24652; Release No. IC-22224 [CCH Fed. Sec. L. Rep. ¶ 85,845, effective October 7, 1996, 61 F.R. 49957; Release No. IC-22815[CCH Fed. Sec. L. Rep. ¶ 85,906, effective October 11, 1997, 62 F.R. 47934; Release No. IC-22921 [CCH Fed. Sec. L. Rep. ¶ 85,973], effective February 10, 1998, 62 F.R. 64968; Release No. 33-7684 [CCH Fed. Sec. L. Rep. ¶ 86,138], effective June 28, 1999, 64 F.R. 27888; Release No. 33-8147 [CCH Fed. Sec. L. Rep. ¶ 86,801], effective December 23, 2002, compliance and phase-in dates range from January 1, 2003, to January 1, 2004, see text of release for compliance details, 67 F.R. 69974; Release No. 33-8294 (¶86,968), effective for fund advertisements submitted for publication after March 31, 2004, 68 F.R. 57760; Release No. 33-8408 [CCH Fed. Sec. L. Rep. ¶ 87,173], effective May 28, 2004, 69 F.R. 22300.

[2] *See* Release No. IC-25802 (Nov 13, 2002) [CCH Fed. Sec. L. Rep 86801].
[3] *See* Report-Letter, CCH Fed. Sec. L. Rep. #2018, June 25, 2003.
[4] *See* Arthur Levitt, *Plain English in Prospectuses*, New York State Bar Journal (Nov. 1997) at 36.

The next item shows the minimum and maximum total operating expenses charged by the portfolio companies that you may pay periodically during the time that you own the contract. More detail concerning each [portfolio company's] fees and expenses is contained in the prospectus for each [portfolio company].

Form N-4 requires a fee table "example" highlighting comparative variable annuity costs at one, three, five, and ten-year intervals. A required caption in front of the example must state:

> This Example is intended to help you compare the cost of investing in the contract with the cost of investing in other variable annuity contracts. These costs include contract owner transaction expenses, contract fees, separate account annual expenses, and [portfolios company] fees and expenses.
>
> The Example assumes that you invest $10,000 in the contract for the time periods indicated. The Example also assumes that your investment has a 5% return each year and assumes the maximum fees and expenses of any of the [portfolio companies]. Although your actual costs may be higher of lower, based on these assumptions, your costs would be:
>
> (1) If you surrender your contract at the end of the applicable time period: …
> (2) If you annuitize at the end of the applicable time period: …
> (3) If you do not surrender your contract: ….

All of the variable annuity fee table requirements facilitate full disclosure of cost information in a uniform format that lends to comparison shopping. Guide 7 to Form N-4 provides guidance on the synopsis and states that it should contain a "full description" of any free look provision or a cross reference to equal information in the prospectus.

- **Form N-6 Synopsis, Fee Table and Risk Disclosure**.

Parallel fee, charge and expense provisions appear in the Form N-6, which sets forth registration and prospectus requirements for variable life insurance separate accounts organized as unit investment trusts.[5] As with the variable annuity fee table discussed above, VLI prospectus materials effectively and efficiently convey comparative expense, fee and cost information in a uniform and accurate fashion.

Prospectus illustrations, personalized illustrations, and underlying fund performance are three linked features that give consumers additional tools to evaluate a variable life contract and to make an "apples-to-apples" comparison among different variable life contracts, including the impact of charges on the contract.[6]

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[5] Sources of Form N-6 administrative history can be found in: Conner, *Converting Variable Life Prospectuses to the SEC's New Form N-6*, ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (2002); Breen and Lowson*, Form N-6: Where We Are and How We Got There*; ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (1998); Cohen, *Disclosure of Variable Insurance Products: Profile, Simplified and Electronic Prospectuses*; ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (1997); Wilkerson, *VLI Prospectus Simplification: A Worthy Work in Progress;* ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (1996).

[6] Consumers obtain an understanding of policy mechanics and the effect of fees and charges through hypothetical illustrations; A picture of how a VLI contract would fit the unique characteristics of a purchaser can be conveyed through personalized illustrations calculated according to factors independently selected by consumers, such as age, risk-class, policy size, and targeted rate of return; a barometer of the capacity of portfolio managers to achieve the rates of return selected by the consumer in the personalized illustrations can be conveyed through historic underlying fund performance

There are a variety of unique insurance product factors that warrant flexibility in the approach to recommended solutions in the Study. For example, VLI contracts have significant age, gender and risk class components in their pricing structure that does not lend to individualized cost computations in static disclosure. Some contracts are issued on a basis different from that for which the customer applied due to underwriting issues or maximum limits on contract size. In that case, information could be inaccurate for that customer.

The SEC's comprehensive prospectus simplification projects, particularly with regard to fees, charges and risks, provide a rich source of analytical approaches.[7] One of the central goals of the SEC's prospectus simplification project was to thwart corrosive "disclosure creep."[8] Unconsciously duplicative practices will counterproductively dilute the value of meaningful disclosure and overload consumers with information.

The SEC's Study should carefully focus on the totality of required disclosure confronting variable contracts as products fully regulated under both state insurance and federal securities laws. This is quite different from the more limited range of informational documents facing mutual fund customers.

If a replacement is involved, the state insurance law replacement materials will be delivered for a total of four document packages at the sales point. If the FINRA's risk disclosure document is adopted, consumers will face up to five disclosure documents at the outset.

State insurance laws establish meaningful free look provisions. These unique insurance product factors reduce the need for compressed and excessive disclosure all at the point of sale. The added time these provisions provide for unpressured evaluation of the variable contract reduces the need for redundant presentation of cost information. Indeed, the free look provisions may substantially increase the likelihood that customers make and take the time to read the prospectus, the fee table and the example. We have included a chart on free look provisions in the Appendix C to this letter.

- **State Insurance Regulation**.

Several state insurance laws and regulations provide relevant protections reducing the need for the point-of-sale document. A good example is the can be found in replacement regulations under state insurance laws. Of course, there are numerous other aspects of state insurance regulation that provide significant protections and disclosure standards for variable product consumers.

State replacement regulations require very detailed procedures protecting consumers against abusive replacements. Specific standards, undertakings, plain-English consumer disclosure, and acknowledgement forms already exist. For background, overviews of state replacement standards and other state insurance regulations relevant to the Financial Literacy Study are set forth in **Appendix C** to this comment letter.

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[7] The SEC has published Guide 13 to accompany Form N-4 that provides specific guidance in addition to the instructions in the form. The presentation of the fee table is thoroughly covered in Form N-4 and its amendments.

[8] *Id*. at _. Former SEC Chairman Levitt observed that the prospectus simplification project began "with the clear understanding that our eventual goal is to purge the entire document of words that, in the famous phrase of George Orwell, 'fall upon the facts like soft snow, blurring the outlines and covering up all the details.' " The point-of-sale document would create the very kind of blurring disclosure Chairman Levitt condemned.

- **FINRA Variable Annuity Suitability and Supervision Rule**

In 2008, the SEC approved new FINRA Rule 2330[9] governing suitability and supervision in the sale of variable contracts. Among other things, the rule requires broker-dealers to deliver meaningful succinct disclosure at the point-of-sale so that consumers can make informed purchase decisions about the individual variable annuity, notwithstanding the extensive disclosure in the VA prospectus, which may be delivered after the purchase decision, and is generally subject to free-look provisions under state insurance laws. Broker-dealers, or the issuers for whom they distribute, must generate this new point-of-sale disclosure. In an effort to promote meaningful summary disclosure on a uniform basis, the ACLI developed voluntary VA disclosure templates.[10] ACLI's VA disclosure templates summarize the impact of fees, charges, and compensation. We have shared this work with FINRA and the SEC throughout this process. FINRA staff has expressed support for the ACLI disclosure templates.

Many state insurance departments have supported and encouraged the parallel companion series of ACLI disclosure templates for fixed and index annuities. This new rule and the industry's disclosure solutions present a further regulatory development that overlaps aspects of FINRA's initiative that are import to holistically acknowledge.

- **Suitability and Supervision Standards**

Several FINRA suitability and supervision standards help ensure that consumers find a good match of their financial needs with variable products. A subset of this function includes the fees, charges and expenses associated with these products. These rules, as summarized below, provide another backstop consistent with the objectives of prospectus disclosure, the fee table and its accompanying example.

FINRA's current Rules, including Rule 2310[11] (Suitability), IM-2310-2 (Fair Dealing with Customers),

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[9] FINRA Rule 2330 is explained in detail in Wilkerson, *FINRA Rule 2821: Suitability and Supervision in the Sale of Variable Annuities,* ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (2008).

[10] ACLI's Annuity Disclosure Templates are explained in greater detail in Wilkerson, *ACLI Disclosure Initiative for Fixed, Index, and Variable Annuities: Constructive Change on the Horizon;* ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (2007).

[11] FINRA Rule 2310, Recommendations to Customers (Suitability), provides:

(a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

(b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning:

> (1) the customer's financial status;
>
> (2) the customer's tax status;
>
> (3) the customer's investment objectives; and
>
> (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

Rule 3010(d)(1)(Review of Transactions) and Rule 3110 and IM 3110-1 (Customer Account Information), impose meaningful standards that buttress the purpose of prospectus and cost disclosure.

Rule 2310(a) requires members to have reasonable grounds for believing that all recommendations to purchase, sell or exchange any security are suitable. Further, Rule 2310(b) requires a member to make reasonable efforts to obtain information about the customer's investment objectives and other information needed to make suitable recommendations.

This obligation is further embellished by the FINRA's position on "customer-specific" suitability practices: although a recommendation might be suitable for some investors, it must also be suitable for the *particular* investor.[12] These existing suitability standards apply to variable contract distribution and assure that customers' needs are paramount.

Similarly, FINRA Rules 2110, 2120, IM-2210-2 and 3010 require that broker-dealers and their associated persons have a reasonable basis to believe that the customer has been informed of the material features of variable contracts.

Rules 2310, 3010(d)(1) and 3110(c)(1)(C) require suitability determinations to be documented and signed by the associated person recommending the transactions, in addition to being approved by a registered principal, as required by paragraph (c) of the proposed rule.

In sum, these FINRA rules compliment the purposes of prospectus and cost disclosure.

Coextensive Regulatory Actions Merit Consideration in Financial Literacy Study

Perhaps at no other time, have there been more simultaneous and complicated regulatory or legislative initiatives that would govern fees, services, conflicts and concomitant disclosure. It is important, therefore, as a matter of timing and substance to recognize the multiple related proposals currently under consideration.

All of the multiple proposals could impose a significant and expensive impact on systems, disclosure, and distribution arrangements. Multiple, sequential changes to these factors would invoke expensive operations overhauls. In its Financial Literacy Study, it would be constructive for the SEC to consider these coextensive or overlapping initiatives as it studies financial literacy issues.

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[12] Factors in determining whether a recommendation is compatible with the "*customer specific*" suitability yardstick, the NASD staff emphasizes that:

- Customers' overall investment objectives should comport with recommendations.
- Consistency and proper weight should be given to customers' stated investment objective.
- If customers have more than one financial objective, broker-dealers should consider each objective when analyzing suitability of recommendations.
- Previous investment experience needs elicitation and evaluation.
- Prior investment experience if often viewed in combination with a customer's sophistication.

According to the NASD, a broker-dealer recommending a security should not only be satisfied that the security is suitable for the customer, but also that thee customer understands the "risks involved and is not only able, but willing to take those risks.'' The NASD recommends the broker-dealer also consider the percentage of the customer's overall investment portfolio that the recommended transaction represents, and notes that over-concentration in either a specific security or, in certain situations, even an industry sector can be problematic.

A brief summary of selected proposals highlights the complexity and interconnectedness of some of the initiatives, and their impact on repeated system rebuilds, disclosure, and distribution or service arrangements.

- **SEC Standard of Care Study**

As noted above, Section 913 of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act directed the SEC to conduct a Study Regarding Obligations of Brokers, Dealers, and Investment Advisers. The SEC Study[13] evaluated the effectiveness of existing standards of care for brokers, dealers, investment advisers, and associated parties under state, federal or SRO laws for providing personalized investment advice and recommendations about securities to retail customers. Among other things, the study evaluated whether it would better protect investors if broker-dealers and investment advisers fulfill a harmonized standard reflecting fiduciary duty and suitability concepts.

ACLI provided detailed input[14] on the SEC's proposal,[15] which could have a significant impact on broker-dealers and investment advisers distributing variable contracts. As we noted in our comment letter on the SEC's study required by Section 913 of the Dodd-Frank Act (Section 913 Study), ACLI supports the provision of simple, clear and concise disclosures by BDs when providing personalized investment advice about securities to retail clients. [16] The Study follows years of administrative rulemaking on this issue and litigation about it.[17]

Now that the SEC has completed its Section 913 Study, it may exercise rulemaking authority granted to it under the Dodd-Frank Act. Specifically, Section 913 of the Dodd-Frank Act provides the SEC rulemaking authority to "address the legal standards of care for brokers, dealers and investment advisers" and further to establish a standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers, and to disclose material conflicts of interest to such customers. Section 913 also specifically requires the SEC to "facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest."

Because the Section 913 Study seeks to facilitate "simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest," any rulemaking in response to the SEC's Section 913 Study should be integrated into the overall picture of existing regulation that will be germane to the SEC's Financial Literacy Study under Section 917 of the Dodd-Frank Act..

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[13] *See* Release No. 34-62577; IA-3058; File No. 4-606 (July 27, 2010).

[14] *See* ACLI letter of Comment dated Aug. 30, 2010, in the SEC comment file at http://sec.gov/comments/4-606/4606-2669.pdf or on ACLI's website at http://www.acli.com/ACLI/Issues/Members/Dodd-Frank+Implementation/CT10-119.htm?Issue=55 [ACLI offered recommendations about essential considerations in the SEC's Study, and outlined the industry's position on the harmonization of broker, dealer, and investment adviser regulatory structures. ACLI's submission explains insurance product distribution and the extensive regulatory network governing insurance product sales.]

[15] *See* Release No. 34-62577; IA-3058; File No. 4-606 (July 27, 2010).

[16] *See* Letter from Carl Wilkerson to Elizabeth Murphy, Secretary, SEC (Aug. 30, 2010), available at http://www.sec.gov/comments/4-606/4606-2669.pdf .

[17] *See*, Wilkerson*; The Status of Broker-Dealers Engaged in Investment Advisory Functions: Muddy Waters Slowly Clearing,* ALI-ABA Conference on Life Insurance Company Products: Current Securities and Tax Issues (2007).

- **FINRA Broker-Dealer Disclosure Initiative**

In late 2010, the Financial Institutions Regulatory Authority (FINRA) invited comment on a conceptual initiative about broker-dealer and investment adviser disclosure. Under the concept proposal, broker-dealers would be required "at or prior to commencing a business relationship with a retail customer, to provide a written statement to the customer describing the types of accounts and services it provides, as well as conflicts associated with such services and any limitations on the duties the firm otherwise owes to retail customers."

In explanation of its proposal, FINRA stated that

> With the enactment of Dodd-Frank, the [FINRA] staff believes the concept is even more appropriate, if not an outright necessity. The legislation requires the SEC to conduct a study of the obligations of broker-dealers and investment advisers, and authorizes subsequent SEC rulemaking to establish a fiduciary duty for broker-dealers. Notably, the study must consider the regulatory gaps between broker-dealer and investment adviser regulation, and the SEC has asked for comment as to how such gaps may be closed. Additionally, the legislation requires the SEC to facilitate simple and clear disclosures of material conflicts by both broker-dealers and investment advisers. Accordingly, in anticipation of satisfying any resultant rulemaking mandates and to enhance retail investors' understanding of the business, relationships and conflicts of their brokers, FINRA staff is seeing comment on the contours of a proposal that would require each firm to timely provide to retail customers a statement of services, conflicts and duties.

On December 27, 2010, ACLI filed a letter of comment with FINRA. To fulfill the objective of harmonizing BD and investment adviser ("IA") patterns of regulation, any rulemaking by FINRA regarding a "document similar in purpose to Form ADV" for broker-dealers should be informed by the SEC study required by Section 913 of the Dodd-Frank Act, and should be coordinated with SEC rulemaking implementing its Section 913 Study. ACLI also suggested that FINRA should carefully evaluate a number of significant coextensive regulatory initiatives governing parallel disclosure issues to avoid unnecessary duplications or conflicts.

ACLI's letter recommended that when providing personalized investment advice about securities to retail customers, BD's should be required to make balanced and fair disclosure of material facts relevant to the retail customer's investment decision, including material conflicts of interest. The Dodd-Frank Act defines "retail customer" as a natural person (or the legal representative of such natural person) who receives personalized investment advice from a BD or IA and who uses such advice primarily for personal, family, or household purposes.[18] The letter noted that this definition is tailored to provide protection to true retail clients without unnecessarily imposing obligations with respect to customers who have different needs or where the relationship is subject to other regulatory regimes.

[18] In some respects, the FINRA disclosure proposal would establish a new disclosure requirement for broker-dealers and investment advisers. While ACLI visualized FINRA's general objectives, the letter noted that FINRA currently lacks authority to regulate investment advisers, including the imposition of disclosure standards. Until Congress revises the Investment Advisers Act of 1940 to require investment advisers to belong to a self-regulatory organization, such as FINRA, or the SEC delegates ministerial oversight of investment advisers to FINRA, ACLI observed that the proposed rule has no relevant applicability to investment advisers. ACLI explained, therefore, that its comments evaluate the rule concerning its application to broker-dealers. If Congress or the SEC revised the regulatory authority of FINRA to govern investment advisers, then ACLI's comments concerning broker-dealers in this letter would also apply to investment advisers.

ACLI urged FINRA to conform to the Dodd-Frank Act's definition of retail customer in order to be consistent with any rulemaking likely to be engaged in by the SEC following the Section 913 Study. To the extent that FINRA is considering rules that would define retail customer more broadly, such as by reference to NASD Rule 3110(c)(4)'s definition of "institutional account," the letter emphasized that such a broadening of the definition of retail customer is likely to lead to confusion and inconsistency, without furthering the laudable goals that FINRA has expressed in the Concept Proposal.[19]

ACLI strongly advised that when FINRA does eventually make rules as a result of the information it gathers from this Concept Release, FINRA's rulemaking should contain a competitive and economic impact statement, and should quantify the burdens on broker-dealers, affiliates or third party service providers. Any new rulemaking should assess the aggregate costs of compliance so that the SEC can properly execute its statutory duties to screen SRO initiatives for anticompetitive effect.

- **SEC Initiative on Mutual Fund Distribution, Marketing and Service Fees**

On July 21, 2010, the SEC invited comment on a proposal[20] that would rescind Rule 12b-1 under the Investment Company Act of 1940, and replace it with a new framework for "marketing and service fees" and "ongoing sales charges." The proposal would also amend Rule 6c-10 under the investment Company Act to allow mutual funds the option of issuing shares at net asset value to broker-dealers, who could then establish and collect commissions or other sales charges to pay for distribution. The Rule12b-1 initiative contains four basic elements:

- New "marketing and service fees" under proposed Rule 12b-2;
- New "ongoing sales charges" under amended Rule 6c-10;
- New and revised disclosure requirements related to marketing and service fees and ongoing sales charges; and,
- A new option for "account level sales charges" where mutual funds issue shares at net asset value to broker-dealers, who establish and collect their own commissions and sales charges related to those shares.

The Rule 12b-1 proposal would require mutual funds to provide revised or additional prospectus disclosures concerning their use of marketing and service fees and ongoing sales charges. The proposal would also require broker-dealers to provide enhanced disclosures on transaction confirmations concerning the imposition of marketing and service fees, ongoing sales charges, and other charges. This reverses prior SEC guidance, which permits broker-dealers to exclude from confirmations information about mutual fund sales charges if the investor received a

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[19] Additionally, ACLI urged that the definition of "retail customer" used in any FINRA rules make clear that the term does not encompass employer-sponsored retirement plans, including defined contribution pension plans such as 401(k) and 403(b) plans, and their individual participants. The letter explained that providers to such plans are already subject to extensive disclosure requirements to plan sponsors and plan participants that have been imposed by the Department of Labor, and the imposition of additional, or perhaps conflicting, requirements would not further the worthwhile objectives that FINRA has expressed in the Concept Proposal. In its Comment Letter to the SEC regarding Section 913, ACLI urged the SEC to defer to the Department of Labor's extensive guidance addressing investor education and regulations governing advice, which impose fiduciary duties consistent with ERISA, in order to avoid imposition of conflicting fiduciary duty schemes in the pension plan context.

[20] *See* Release Nos. 33-9128; 34-62544; IC-29367; File No. S7-15-10 (July 21, 2010) available at http://sec.gov/rules/proposed/2010/33-9128.pdf .

prospectus containing that information. Under the proposal, broker-dealers would be required to provide the following categories of information in their confirmation statements:

- The amount of any-front and sales charge in percentage in dollar terms, together with the net dollar amount invested and any applicable breakpoints;
- The maximum amount of any deferred sales charge, as a percentage of net asset value at time of purchase or redemption;
- The annual amount of any marketing and service fees or ongoing sales charges and the aggregate amount of ongoing sales charges that may be incurred over time, both expressed as a percentage of net asset value, and the maximum number of months or years that the investors will pay ongoing sales charges;
- A statement to the effect that the investor will indirectly pay other-asset based fees charged by the mutual fund, such as management fees in addition to any marketing and service fees or ongoing sales charges; and,
- For redemptions, the amount of any deferred sales charge incurred or to be incurred, expressed in dollars and as a percentage of net asset value.

ACLI submitted a letter of comment [21] on the SEC's initiative. As of March 23, 2012, the SEC had not published notice of further action on the rulemaking package. Many elements of the SEC's Rule 12b-1 initiative may be relevant to the focus of the SEC's Financial Literacy Study.

- **FINRA Risk Disclosure Statement.**

FINRA proposed a rule that would require broker-dealers to provide variable annuity customers a current prospectus and a separate, brief, and easy-to-read risk disclosure document[22] that would highlight the main features of the particular variable annuity transaction, including, but not limited to:

- liquidity issues, such as potential surrender charges and the IRS penalty;
- sales charges;
- fees, such as mortality and expense charges, administrative fees, charges for riders or special features and investment advisory fees;
- federal tax treatment of variable annuities;
- any applicable state and local government premium taxes; and
- market risk.

The risk disclosure document also would have to inform the customer whether a "free look" period applies to the variable annuity contract, during which the customer can terminate the contract without paying any surrender charges and receive a refund of his or her purchase payments.

In addition, the risk disclosure document would require that broker-dealers inform customers that all applications to purchase or exchange a deferred variable annuity contract are accepted subject to

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[21] http://sec.gov/comments/s7-15-10/s71510-1114.pdf

[22] *See* FINRA Notice to Members 04-45 (June 2004). According to the FINRA's later filing with the SEC on this initiative, "FINRA has not included the written-disclosure requirements contained in its Notice to Members in the current proposed rule change, *but will continue to explore this issue and will separately consider whether to propose such requirements in the future*." [emphasis added]; *See* FINRA pending rule filing at 15 http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_012780.pdf . FINRA action would further add to "disclosure creep" criticized by former SEC Chairman Levitt.

review and approval by a designated registered principal. The broker-dealer would be required to provide the prospectus and risk disclosure document regardless of whether the transaction had been recommended.

- **Department of Labor Actions**

1. The Department of Labor ("DOL") recently published a proposal to greatly expand the definition of "fiduciary"[23] under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), for those who provide investment advice for a fee. The proposed regulations would:

- Broaden the range of entities subject to ERISA's strict fiduciary framework. The DOL believes this change would discourage consultants from being influenced by "inappropriate fee arrangements."

- Expand the definition of "investment advice" to include appraisal services. This change is meant to primarily address abuses in the area of employee stock ownership plans by aligning the interests of an appraiser with those of the plan.

The DOL explains that the proposed changes would better address conflicts of interest and fee arrangements resulting from changes in the investment climate since ERISA was enacted, including the growth of 401(k) plans and the complex investment opportunities available to defined benefit plans.[24] This action could directly impact providers of VA and VLI separate accounts used to fund ERISA covered plans. The DOL proposal could intersect or overlap with the SEC's Study as well as FINRA's several fiduciary duty initiatives.

These various administrative actions provide sufficient reasons for a postponement of any FINRA disclosure actions until the aggregate impact on systems changes, fees and disclosure can be reasonably ascertained. Without coordination and postponement, there may be overlapping or conflicting standards, and inefficient use of resources in designing systems, disclosure and procedures.

2. On October 20, 2010, the DOL published final regulations[25] regarding plan fee disclosures to participants, which requires the disclosure of certain plan and investment-related information,

[23] Under ERISA, a "fiduciary" includes an adviser who renders investment advice for a fee or other compensation, or has the authority or responsibility to do so. Longstanding DOL regulations provide that for an adviser who does not have any discretionary authority within a plan to be considered an ERISA fiduciary, the advice provided must serve as a primary basis for investment decisions and be provided on a regular basis.

[24] These elements may be difficult to establish in many common fact patterns and do not cover a variety of circumstances that the DOL believes may include fiduciary functions such as where consultants advise on investment-related matters, including a plan's investment in complex investment products.

[25] 75 Fed. Reg.202 (October 20, 2010) 64910, http://www.gpo.gov/fdsys/pkg/FR-2010-10-20/pdf/2010-25725.pdf .

including fee and expense information, to participants and beneficiaries in participant-directed individual account plans, such as 401(k) plans. This regulation is intended to ensure that all participants and beneficiaries in participant-directed individual account plans have the information they need to make informed decisions about the management of their individual accounts and the investment of their retirement savings. The new rule will be effective for plan years beginning on or after November 1, 2011.

Among other things, the rule requires, if applicable, an explanation that, in addition to the fees and expenses disclosed pursuant to other provisions of the rule, some of the plan's administrative expenses for the preceding quarter were "paid from the total annual operating expenses of one or more of the plan's designated investment alternatives (e.g., through revenue sharing arrangements, Rule 12b–1 fees, sub-transfer agent fees)."[26] This new requirement is intended to provide those participants in plans with revenue sharing arrangements that serve to reduce plan administrative costs with a better picture about how those costs are underwritten, at least in part, by fees and expenses associated with investment alternatives offered under their plans.[27]

3. On July 16, 2010, the DOL published "interim" final regulations[28] imposing new disclosure and related requirements under ERISA for certain service providers to retirement plans. Under ERISA, any person providing services to a retirement plan or its participants is a "party in interest" to the plan by reason of providing those services. ERISA Section 406(a), in turn, generally prohibits a party in interest from providing services to the plan, while Section 408 (b)(2) permits a party in interest to provide necessary services to the retirement plan, under a series of strong conditions.

The new DOL Rule 408(b)(2) imposes detailed compensation disclosure obligations on certain enumerated types of service providers, termed "covered service providers," that reasonably expect to receive $1000 or more in compensation from providing services to a covered plan. Rule 408(b)(2) provides for three broad categories of covered service providers, including ERISA fiduciaries and registered investment advisers, certain record keepers and brokers that make available investment options in connection with such recordkeeping and brokerage services to individual account plans, and service providers receiving indirect compensation.

Significantly, Rule 408(b)(2) requires detailed disclosure of indirect compensation, which is broadly defined and includes, among other things, compensation that is charged directly against the plan's investment and reflected in the net value of the investments, such as 12b-1 fees.[29] Service providers that make investment options available must also disclose compensation information about the investments for which it provides services, including: all sales loads, redemption fees and other compensation that will be charged directly against the

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[26] *Id.*
[27] *Id.* at 64913.
[28] 75 Fed Reg. 135 (July 21, 2010) at 41600.
[29] Under the new rules,

> "the covered service provider must separately disclose such compensation if it is set on a transaction basis (e.g., commissions, soft dollars, finder's fees or other similar incentive compensation based on business placed or retained) or is charged directly against the covered plan's investment and reflected in the net value of the investment (e.g., Rule 12b–1 fees). The final rule also requires the covered service provider to identify the services for which such compensation will be paid, the payers and recipients of such compensation, and the status of each payer or recipient as an affiliate or a subcontractor." [emphasis added] *Id.* at 41609.

plan's investments in connection with the acquisition or withdrawal of interest from the investment vehicle, the annual operating expenses of the investment vehicle, and any other ongoing expenses associated with the investment vehicle.

Rule 408(b)(2) disclosure must be provided before a new investment option is added to a plan, and regarding existing arrangements, disclosure must be provided by the July 16, 2011, effective date of the rule.

To satisfy these standards, a number of detailed compliance chores must be completed. Retirement plans and service providers must survey and identify arrangements that may be subject to Rule 408(b)(2) and develop compliant disclosure. Service providers must develop systems to identify and capture all the compensation required to be disclosed. Many service providers will also need to build an internal training program around these requirements and procedures necessary for compliance. Plan fiduciaries and sponsors will need to develop procedures for evaluating the information circulated by service providers. Collectively, these developments are formidable.

With so many moving and interrelated regulatory parts, it makes sense to allow the different new rules and proposals to further crystallize before FINRA moves forward on its broker-dealer and investment adviser disclosure concept. It would be worthwhile for FINRA to coordinate to make sure the two regulatory initiatives do not conflict or duplicate, before any FINRA initiative advances. Variable contract separate accounts serve as funding vehicles for ERISA covered plans, and individual retirement accounts and would also face these new DOL standards, which could also impact distributors of these contracts.

- **SEC Point-of-Sale and Confirmation Proposal.**

Another related, pending initiative includes the SEC's proposed point-of-sale and confirmation initiative[30] that would require broker-dealers to provide customers with targeted information about costs and conflicts of interest in the sale of mutual funds, college savings plans, and variable insurance products. The release specifically invited comment on the appropriateness of written point-of-sale disclosure for variable annuities and variable life insurance.

The ACLI submitted comments[31] on the proposal, noting that variable life insurance and variable annuity prospectuses promote informed purchase decisions and critical comparison shopping, including comparison of cost features. The SEC upgraded prospectus requirements for variable life insurance and variable annuities that provide plain-English disclosure and cost information in a clear fee table.[32]

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[30] *See* Release No. 33-8544; 70 Fed. Reg. 42 (March 4, 2005). On January 29, 2004, the SEC initially proposed two new rules and rule amendments under the Securities Exchange Act of 1934 designed to enhance the information broker-dealers provide customers purchasing variable contracts, mutual funds, and college savings plans. The initiative elicited over 5,000 letters of comment. On March 24, 2005, the SEC reopened the comment period and invited supplemental input on a new "point-of-sale" document. The proposal would require "targeted information" at the point-of-sale about fees, charges, and broker-dealer conflicts of interest. The initiative also proposed amendments to the post-sale confirmation statements required under the federal securities laws.

[31] *See* http://sec.gov/rules/proposed/s71004/cbwilkerson040405.pdf .

[32] Insurance and annuity purchasers have access to multiple sources of detailed information. In addition to the point-of-sale document, consumers also receive a prospectus, a variable contract, buyers' guides, NASD-approved sales literature, and replacement disclosure forms when a replacement is involved. Variable contracts are the only financial products in today's securities marketplace with free-look

According to the most recently published Unified Agenda and Regulatory Plan, the point-of sale proposal is still pending.[33] The FINRA disclosure concept should not be advanced while the SEC point-of-sale initiative is still pending. Coordination and clarification is incumbent on the administrative process.

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provisions. These features give consumers a meaningful opportunity to carefully evaluate purchases after the sale, and to change their mind for any reason, including cost factors.

2002 amendments to the variable annuity fee table in Form N-4 require information about all recurring fees and charges. The revisions also require a narrative that explains the purpose of the fee table and relevant cross-references to the prospectus. The changes require specific explanatory narratives preceding each section of the fee table "to help investors better understand the information about fees and charges in that section."

The SEC staff identifies the fee table as the "current lynchpin of cost disclosure." The fee table is a core feature of the SEC's prospectus simplification project that sought to replace "unintelligible, tedious, and legalistic" disclosure with meaningful information on which to make an informed purchase decision. *See* Arthur Levitt*, Plain English in Prospectuses*, New York State Bar Journal (Nov. 1997) at 36. Parallel fee, charge and expense provisions appear in Form N-6, which sets forth registration and prospectus requirements for variable life insurance separate accounts organized as unit investment trusts. VLI prospectus materials effectively and efficiently convey comparative expense, fee and cost information in a uniform and accurate fashion.

Prospectus illustrations, personalized illustrations, and underlying fund performance are three linked features that give consumers additional tools to evaluate a variable life contract and to make an "apples-to-apples" comparison among different variable life contracts, including the impact of charges on the contract and distribution fees.

[33] See the SEC's Spring 2010 Unified Agenda and Regulatory Plan for short term and long term rulemaking at http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201004&RIN=3235-AJ12 .

Appendix C to ACLI Submission on 2012 SEC Financial Literacy Study

Table of Contents

THE NAIC ANNUITY DISCLOSURE MODEL REGULATION: DISCLOSURE STANDARDS IN ANNUITY DISTRIBUTION

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

I. Scope of Outline

A. This outline summarizes the elements of the NAIC Annuity Disclosure Model Regulation, the required Disclosure Statement and the required NAIC Buyer's Guide to Fixed Deferred Annuities, including a supplement for Equity Indexed Annuities.

B. The NAIC Annuity Disclosure Model Regulation can be found at NAIC Model Reporting Service 245-I (April 2010).

II. Objective of the Annuity Disclosure Model Regulation

A. To provide standards for the disclosure of certain minimum information about annuity contracts to protect consumers and foster consumer education.

1. The regulation specifies the minimum information which must be disclosed and the method and timing of delivering it.

2. The regulation seeks to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts.

III. Annuities Covered by the Regulation

A. All group and individual annuity contracts, except:

1. Registered or non-registered variable annuities.

2. Immediate and deferred annuities having only non-guaranteed elements.

3. Annuities used to fund:

a) An employee pension plan which is covered by the Employee Retirement Income Security Act (ERISA);

b) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer,

c) A governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or a tax exempt organization under Section 457 of the Internal Revenue Code; or

d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

4. Structured Settlement Annuities.

5. Note: Under the model regulation, states may optionally elect to exclude charitable gift annuities and structured settlement annuities also.

IV. Information Mandated in Required NAIC Disclosure Statement

A. The generic name of the contract, the company product name, if different, form number, and the fact that it is an annuity;

B. The insurer's name and address;

C. A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate:

1. The guaranteed, non-guaranteed and determinable elements of the contract, and their limitations, if any, and an explanation of how they operate;

2. An explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;

3. Periodic income options both on a guaranteed and non-guaranteed basis;

4. Any value reductions caused by withdrawals from or surrender of the contract;

5. How values in the contract can be accessed;

6. The death benefit, if available, and how it will be calculated;

7. A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and

8. Impact of any rider, such as a long-term care rider.

D. Specific dollar amount or percentage charges and fees, which must be listed with an explanation of how they apply.

E. Information about the current guaranteed rate for new contracts that contains a clear notice that the rate is subject to change.

F. Insurers must define terms used in the disclosure statement in language understandable by a typical person in the target market.

V. Required NAIC Buyer's Guide to Fixed Deferred Annuities (appears at the end of the outline).

A. A Buyer's Guide prepared by the NAIC provides information about different aspects of annuities, such as

1. What an annuity is.

2. Descriptions of the different kinds of annuities.

   a) Single premium or multiple premium.

   b) Immediate or deferred.

   c) Fixed or variable.

3. How interest rates are set for the deferred variable annuity.

   a) Explanation of current interest rate.

   b) Explanation of minimum guaranteed rate.

   c) Explanation of multiple interest rates.

4. Description of charges in the contract.

   a) Surrender or withdrawal charges.

   b) Free withdrawal features.

   c) Contract fee.

   d) Transaction fee.

   e) Percentage of premium charge.

   f) Premium tax charge.

5. Fixed Annuity Benefits

   a) Annuity income payments.

   b) Annuity payment options.

      (1) Life only.

      (2) Life annuity with period certain.

      (3) Joint and survivor.

VI. Timetable for Delivery of Required Disclosure Statement and Buyer's Guide:

A. At or before the time of application if annuity application is taken in a *face-to-face meeting*.

B. No later than five (5) business days after the completed application is received by the insurer, if annuity application is taken by means *other than in a face-to-face meeting*.

1. With applications received from a *direct solicitation through the mail*:

   a) Inclusion of a Buyer's Guide and Disclosure Statement in the direct mail solicitation satisfies the requirement for delivery no later than five (5) business days after receipt of the application.

2. For applications received via the Internet:

   a) Taking reasonable steps to make the Buyer's Guide and Disclosure Statement available for viewing and printing on the insurer's website satisfies the requirement for delivery no later than five (5) business day of receipt of the application.

3. Annuity solicitations in other than face-to-face meetings must include a statement that the proposed applicant may contact the insurance department of the state for a free annuity Buyer's Guide. Alternatively, the insurer may include a statement that the prospective applicant may contact the insurer for a free annuity Buyer's Guide.

4. *Extended Free-Look Period*: where the Buyer's Guide and disclosure document are not provided at or before the time of application, a free look period of no less than fifteen (15) days shall be provided for the applicant to return the annuity contract without penalty. The free look runs concurrently with any other free look provided under state law or regulation.

VII. Required Report to Contract Owners

A. For annuities in the payout period with changes in non-guaranteed elements and for the accumulation period of a deferred annuity, the insurer must provide each contract owner with a report, *at least annually*, on the status of the contract that contains at least the following information:

1. The beginning and end date of the current report period;

2. The accumulation and cash surrender value, if any, at the end of the previous report period and at the end of the current report period;

3. The total amounts, if any, that have been credited, charged to the contract value or paid during the current report period; and

4. The amount of outstanding loans, if any, as of the end of the current report period.

VIII. A State-by-State Index to the NAIC Annuity Disclosure Model Regulation Appears on the pages following the program outline on the NAIC Protection in Annuity Transactions Model Regulation in this ALI-ABA course book.

IX. NAIC Buyer's Guide: Appears on Pages Immediately Following This Outline

A. Fixed Deferred Annuities are highlighted at the front of the Guide.

B. Equity Index Annuities are highlighted in a supplement at the back of the Guide.

Annuity Buyer's Guide

Prepared by the National Association of Insurance Commissioners

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various insurance departments to coordinate insurance laws for the benefit of all consumers.

This guide does not endorse any company or policy.

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It is important that you understand the differences among various annuities so you can choose the kind that best fits your needs. This guide focuses on fixed deferred annuity contracts. There is, however, a brief description of variable annuities. If you're thinking of buying an equity-indexed annuity, an appendix to this guide will give you specific information. This Guide isn't meant to offer legal, financial or tax advice. You may want to consult independent advisors. At the end of this Guide are questions you should ask your agent or the company. Make sure you're satisfied with the answers before you buy.

WHAT IS AN ANNUITY?

An annuity is a contract in which an insurance company makes a series of income payments at regular intervals in return for a premium or premiums you have paid. Annuities are most often bought for future retirement income. Only an annuity can pay an income that can be guaranteed to last as long as you live.

An annuity is neither a life insurance nor a health insurance policy. It's not a savings account or a savings certificate. You shouldn't buy an annuity to reach short-term financial goals.

Your value in an annuity contract is the premiums you've paid, less any applicable charges, plus interest credited. The insurance company uses the value to figure the amount of most of the benefits that you can choose to receive from an annuity contract. This guide explains how interest is credited as well as some typical charges and benefits of annuity contracts.

A deferred annuity has two parts or periods. During the accumulation period, the money you put into the annuity, less any applicable charges, earns interest. The earnings grow tax-deferred as long as you leave them in the annuity . During the second period, called the payout period, the company pays income to you or to someone you choose.

WHAT ARE THE DIFFERENT KINDS OF ANNUITIES?

This guide explains major differences in different kinds of annuities to help you understand how each might meet your needs. But look at the specific terms of an individual contract you're considering and the disclosure document you receive. If your annuity is being used to fund or provide benefits under a pension plan, the benefits you get will depend on the terms of the plan. Contact your pension plan administrator for information.

This Buyer's Guide will focus on individual fixed deferred annuities.

Single Premium or Multiple Premium

You pay the insurance company only one payment for a single premium annuity. You make a series of payments for a multiple premium annuity. There are two kinds of multiple premium annuities. One kind is a flexible premium contract. Within set limits, you pay as much premium as you want, whenever you want. In the other kind, a scheduled premium annuity, the contract spells out your payments and how often you'll make them.

Immediate or Deferred

With an immediate annuity, income payments start no later than one year after you pay the premium. You usually pay for an immediate annuity with one payment.

The income payments from a deferred annuity often start many years later. Deferred annuities have an accumulation period, which is the time between when you start paying premiums and when income payments start.

Fixed or Variable

- **Fixed**

During the accumulation period of a fixed deferred annuity, your money (less any applicable charges) earns interest at rates set by the insurance company or in a way spelled out in the annuity contract. The company guarantees that it will pay no less than a minimum rate of interest. During the payout period, the amount of each income payment to you is generally set when the payments start and will not change.

• **Variable**

During the accumulation period of a variable annuity, the insurance company puts your premiums (less any applicable charges) into a separate account. You decide how the company will invest those premiums, depending on how much risk you want to take. You may put your premium into a stock, bond or other account, with no guarantees, or into a fixed account, with a minimum guaranteed interest. During the payout period of a variable annuity, the amount of each income payment to you may be fixed (set at the beginning) or variable (changing with the value of the investments in the separate account).

HOW ARE THE INTEREST RATES SET FOR MY FIXED DEFERRED ANNUITY?

During the accumulation period, your money (less any applicable charges) earns interest at rates that change from time to time. Usually, what these rates will be is entirely up to the insurance company.

Current Interest Rate

The current rate is the rate the company decides to credit to your contract at a particular time. The company will guarantee it will not change for some time period.

• The initial rate is an interest rate the insurance company may credit for a set period of time after you first buy your annuity. The initial rate in some contracts may be higher than it will be later. This is often called a bonus rate.

• The renewal rate is the rate credited by the company after the end of the set time period. The contract tells how the company will set the renewal rate, which may be tied to an external reference or index.

Minimum Guaranteed Rate

The minimum guaranteed interest rate is the lowest rate your annuity will earn. This rate is stated in the contract.

Multiple Interest Rates

Some annuity contracts apply different interest rates to each premium you pay or to premiums you pay during different time periods.

Other annuity contracts may have two or more accumulated values that fund different benefit options. These accumulated values may use different interest rates. You get only one of the accumulated values depending on which benefit you choose.

WHAT CHARGES MAY BE SUBTRACTED FROM MY FIXED DEFERRED ANNUITY?

Most annuities have charges related to the cost of selling or servicing it. These charges may be subtracted directly from the contract value. Ask your agent or the company to describe the charges that apply to your annuity. Some examples of charges, fees and taxes are:

Surrender or Withdrawal Charges

If you need access to your money, you may be able to take all or part of the value out of your annuity at any time during the accumulation period. If you take out part of the value, you may pay a withdrawal charge. If you take out all of the value and surrender, or terminate, the annuity, you may pay a surrender charge. In either case, the company may figure the charge as a percentage of the value of the contract, of the premiums you've paid or of the amount you're withdrawing. The company may reduce or even eliminate the surrender charge after you've had the contract for a stated number of years. A company may waive the surrender charge when it pays a death benefit.

Some annuities have stated terms. When the term is up, the contract may automatically expire or renew. You're usually given a short period of time, called a window, to decide if you want to renew or surrender the annuity. If you surrender during the window, you won't have to pay surrender charges. If you renew, the surrender or withdrawal charges may start over.

In some annuities, there is no charge if you surrender your contract when the company's current interest rate falls below a certain level. This may be called a bail-out option.

In a multiple-premium annuity, the surrender charge may apply to each premium paid for a certain period of time. This may be called a rolling surrender or withdrawal charge.

Some annuity contracts have a market value adjustment feature. If interest rates are different when you surrender your annuity than when you bought it, a market value adjustment may make the cash surrender value higher or lower. Since you and the insurance company share this risk, an annuity with a MVA feature may credit a higher rate than an annuity without that feature.

Be sure to read the Tax Treatment section and ask your tax advisor for information about possible tax penalties on withdrawals.

Free Withdrawal

Your annuity may have a limited free withdrawal feature. That lets you make one or more withdrawals without a charge. The size of the free withdrawal is often limited to a set percentage of your contract value. If you make a larger withdrawal, you may pay withdrawal charges. You may lose any interest above the minimum guaranteed rate on the amount withdrawn. Some annuities waive withdrawal charges in certain situations, such as death, confinement in a nursing home or terminal illness.

Contract Fee

A contract fee is a flat dollar amount charged either once or annually.

Transaction Fee

A transaction fee is a charge per premium payment or other transaction.

Percentage of Premium Charge

A percentage of premium charge is a charge deducted from each premium paid. The percentage may be lower after the contract has been in force for a certain number of years or after total premiums paid have reached a certain amount.

Premium Tax

Some states charge a tax on annuities. The insurance company pays this tax to the state. The company may subtract the amount of the tax when you pay your premium, when you withdraw your contract value, when you start to receive income payments or when it pays a death benefit to your beneficiary.

WHAT ARE SOME FIXED DEFERRED ANNUITY CONTRACT BENEFITS?

Annuity Income Payments

One of the most important benefits of deferred annuities is your ability to use the value built up during the accumulation period to give you a lump sum payment or to make income payments during the payout period. Income payments are usually made monthly but you may choose to receive them less often. The size of income payments is based on the accumulated value in your annuity and the annuity's benefit rate in effect when income payments start. The benefit rate usually depends on your age and sex, and the annuity payment option you choose. For example, you might choose payments that continue as long as you live, as long as your spouse lives or for a set number of years.

There is a table of guaranteed benefit rates in each annuity contract. Most companies have current benefit rates as well. The company can change the current rates at any time, but the current rates can never be less than the guaranteed benefit rates. When income payments start, the insurance company generally uses the benefit rate in effect at that time to figure the amount of your income payment.

Companies may offer various income payment options. You (the owner) or another person that you name may choose the option. The options are described here as if the payments are made to you.

• Life Only - The company pays income for your lifetime. It doesn't make any payments to anyone after you die. This payment option usually pays the highest income possible. You might choose it if you have no dependents, if you have taken care of them through other means or if the dependents have enough income of their own.

• Life Annuity with Period Certain - The company pays income for as long as you live and guarantees to make payments for a set number of years even if you die. This period certain is usually 10 or 20 years. If you live longer than the period certain, you'll continue to receive payments until you die. If you die during the period certain, your beneficiary gets regular payments for the rest of that period. If you die after the period certain, your beneficiary doesn't receive any payments from your annuity. Because the "period certain" is an added benefit, each income payment will be smaller than in a life-only option.

• Joint and Survivor - The company pays income as long as either you or your beneficiary lives. You may choose to decrease the amount of the payments after the first death. You may also be able to choose to have payments continue for a set length of time. Because the survivor feature is an added benefit, each income payment is smaller than in a life-only option.

Death Benefit

In some annuity contracts, the company may pay a death benefit to your beneficiary if you die before the income payments start. The most common death benefit is the contract value or the premiums paid, whichever is more.

CAN MY ANNUITY'S VALUE BE DIFFERENT DEPENDING ON MY CHOICE OF BENEFIT?

While all deferred annuities offer a choice of benefits, some use different accumulated values to pay different benefits. For example, an annuity may use one value if annuity payments are for retirement benefits and a different value if the annuity is surrendered. As another example, an annuity may use one value for long-term care benefits and a different value if the annuity is surrendered. You can't receive more than one benefit at the same time.

WHAT ABOUT THE TAX TREATMENT OF ANNUITIES?

Below is a general discussion about taxes and annuities. You should consult a professional tax advisor to discuss your individual tax situation.

Under current federal law, annuities receive special tax treatment. Income tax on annuities is deferred, which means you aren't taxed on the interest your money earns while it stays in the annuity. Tax-deferred accumulation isn't the same as tax-free accumulation. An advantage of tax deferral is that the tax bracket you're in when you receive annuity income payments may be lower than the one you're in during the accumulation period. You'll also be earning interest on the amount you would have paid in taxes during the accumulation period. Most states' tax laws on annuities follow the federal law.

Part of the payments you receive from an annuity will be considered as a return of the premium you've paid. You won't have to pay taxes on that part. Another part of the payments is considered interest you've earned. You must pay taxes on the part that is considered interest when you withdraw the money. You may also have to pay a 10% tax penalty if you withdraw the accumulation before age 59 1/2. The Internal Revenue Code also has rules about distributions after the death of a contract holder.

Annuities used to fund certain employee pension benefit plans (those under Internal Revenue Code Sections 401(a), 401(k), 403(b), 457 or 414) defer taxes on plan contributions as well as on interest or investment income. Within the limits set by the law, you can use pretax dollars to make payments to the annuity. When you take money out, it will be taxed.

You can also use annuities to fund traditional and Roth IRAs under Internal Revenue Code Section 408. If you buy an annuity to fund an IRA, you'll receive a disclosure statement describing the tax treatment.

WHAT IS A "FREE LOOK" PROVISION?

Many states have laws which give you a set number of days to look at the annuity contract after you buy it. If you decide during that time that you don't want the annuity, you can return the contract and get all your money back. This is often referred to as a free look or right to return period. The free look period should be prominently stated in your contract. Be sure to read your contract carefully during the free look period.

HOW DO I KNOW IF A FIXED DEFERRED ANNUITY IS RIGHT FOR ME?

The questions listed below may help you decide which type of annuity, if any, meets your retirement planning and financial needs. You should think about what your goals are for the money you may put into the annuity. You need to think about how much risk you're willing to take with the money. Ask yourself:

• How much retirement income will I need in addition to what I will get from Social Security and my pension?

• Will I need that additional income only for myself or for myself and someone else?

• How long can I leave my money in the annuity?

• When will I need income payments?

• Does the annuity let me get money when I need it?

• Do I want a fixed annuity with a guaranteed interest rate and little or no risk of losing the principal?

• Do I want a variable annuity with the potential for higher earnings that aren't guaranteed and the possibility that I may risk losing principal?

• Or, am I somewhere in between and willing to take some risks with an equity-indexed annuity?

WHAT QUESTIONS SHOULD I ASK MY AGENT OR THE COMPANY?

• Is this a single premium or multiple premium contract?

• Is this an equity-indexed annuity?

• What is the initial interest rate and how long is it guaranteed?

• Does the initial rate include a bonus rate and how much is the bonus?

• What is the guaranteed minimum interest rate?

• What renewal rate is the company crediting on annuity contracts of the same type that were issued last year?

• Are there withdrawal or surrender charges or penalties if I want to end my contract early and take out all of my money? How much are they?

• Can I get a partial withdrawal without paying surrender or other charges or losing interest?

• Does my annuity waive withdrawal charges for reasons such as death, confinement in a nursing home or terminal illness?

• Is there a market value adjustment (MVA) provision in my annuity?

• What other charges, if any, may be deducted from my premium or contract value?

• If I pick a shorter or longer payout period or surrender the annuity, will the accumulated value or the way interest is credited change?

• Is there a death benefit? How is it set? Can it change?

• What income payment options can I choose? Once I choose a payment option, can I change it?

FINAL POINTS TO CONSIDER

Before you decide to buy an annuity, you should review the contract. Terms and conditions of each annuity contract will vary.

Ask yourself if, depending on your needs or age, this annuity is right for you. Taking money out of an annuity may mean you must pay taxes. Also, while it's sometimes possible to transfer the value of an older annuity into a new annuity, the new annuity may have a new schedule of charges that could mean new expenses you must pay directly or indirectly.

You should understand the long-term nature of your purchase. Be sure you plan to keep an annuity long enough so that the charges don't take too much of the money you put in. Be sure you understand the effect of all charges.

If you're buying an annuity to fund an IRA or other tax-deferred retirement program, be sure that you're eligible. Also, ask if there are any restrictions connected with the program.

Remember that the quality of service that you can expect from the company and the agent is a very important factor in your decision.

When you receive your annuity contract, READ IT CAREFULLY!! Ask the agent and company for an explanation of anything you don't understand. Do this before any free look period ends.

Compare information for similar contracts from several companies. Comparing products may help you make a better decision.

If you have a specific question or can't get answers you need from the agent or company, contact your state insurance department.

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APPENDIX I-EQUITY-INDEXED ANNUITIES

This appendix to the Buyer's Guide for Fixed Deferred Annuities will focus on equity-indexed annuities. Like other types of fixed deferred annuities, equity-indexed annuities provide for annuity income payments, death benefits and tax-deferred accumulation. You should read the Buyer's Guide for general information about those features and about provisions such as withdrawal and surrender charges.

WHAT ARE EQUITY-INDEXED ANNUITIES?

An equity-indexed annuity is a fixed annuity, either immediate or deferred, that earns interest or provides benefits that are linked to an external equity reference or an equity index. The value of the index might be tied to a stock or other equity index. One of the most commonly used indices is Standard & Poor's 500 Composite Stock Price Index (the S&P 500), which is an equity index. The value of any index varies from day to day and is not predictable. (Note: S&P 500 is a registered trademark of the McGraw-Hill Companies, Inc., used with permission.)

When you buy an equity-indexed annuity you own an insurance contract. You are not buying shares of any stock or index.

While immediate equity-indexed annuities may be available, this appendix will focus on deferred equity-indexed annuities.

HOW ARE THEY DIFFERENT FROM OTHER FIXED ANNUITIES?

An equity-indexed annuity is different from other fixed annuities because of the way it credits interest to your annuity's value. Some fixed annuities only credit interest calculated at a rate set in the contract. Other fixed annuities also credit interest at rates set from time to time by the insurance company. Equity-indexed annuities credit interest using a formula based on changes in the index to which the annuity is linked. The formula decides how the additional interest, if any, is calculated and credited. How much additional interest you get and when you get it depends on the features of your particular annuity.

Your equity-indexed annuity, like other fixed annuities, also promises to pay a minimum interest rate. The rate that will be applied will not be less than this minimum guaranteed rate even if the index-linked interest rate is lower. The value of your annuity also will not drop below a guaranteed minimum. For example, many single premium contracts guarantee the minimum value will never be less than 90 percent of the premium paid, plus at least 3% in annual interest (less any partial withdrawals). The guaranteed value is the minimum amount available during a term for withdrawals, as well as for some annuitizations (see "Annuity Income Payments") and death benefits. The insurance company will adjust the value of the annuity at the end of each term to reflect any index increases.

WHAT ARE SOME EQUITY-INDEXED ANNUITY CONTRACT FEATURES?

Two features that have the greatest effect on the amount of additional interest that may be credited to an equity-indexed annuity are the indexing method and the participation rate. It is important to understand the features and how they work together. The following describes some other equity-indexed annuity features that affect the index-linked formula.

Indexing Method

The indexing method means the approach used to measure the amount of change, if any, in the index. Some of the most common indexing methods, which are explained more fully later on, include annual reset (ratcheting), high-water mark and point-to-point.

Term

The index term is the period over which index-linked interest is calculated; the interest is credited to your annuity at the end of a term. Terms are generally from one to ten years, with six or seven years being most common. Some annuities offer single terms while others offer multiple, consecutive terms. If your annuity has multiple terms, there will usually be a window at the end of each term, typically 30 days, during which you may withdraw your money without penalty. For installment premium annuities, the payment of each premium may begin a new term for that premium.

Participation Rate

The participation rate decides how much of the increase in the index will be used to calculate index-linked interest. For example, if the calculated change in the index is 9% and the participation rate is 70%, the index-linked interest rate for your annuity will be 6.3% (9% x 70% = 6.3%). A company may set a different participation rate for newly issued annuities as often as each day. Therefore, the initial participation rate in your annuity will depend on when it is issued by the company. The company usually guarantees the participation rate for a specific period (from one year to the entire term). When that period is over, the company sets a new participation rate for the next period. Some annuities guarantee that the participation rate will never be set lower than a specified minimum or higher than a specified maximum.

Cap Rate or Cap

Some annuities may put an upper limit, or cap, on the index-linked interest rate. This is the maximum rate of interest the annuity will earn. In the example given above, if the contract has a 6% cap rate, 6%, and not 6.3%, would be credited. Not all annuities have a cap rate.

Floor on Equity Index-Linked Interest

The floor is the minimum index-linked interest rate you will earn. The most common floor is 0%. A 0% floor assures that even if the index decreases in value, the index-linked interest that you earn will be zero and not negative. As in the case of a cap, not all annuities have a stated floor on index-linked interest rates. But in all cases, your fixed annuity will have a minimum guaranteed value.

Averaging

In some annuities, the average of an index's value is used rather than the actual value of the index on a specified date. The index averaging may occur at the beginning, the end, or throughout the entire term of the annuity.

Interest Compounding

Some annuities pay simple interest during an index term. That means index-linked interest is added to your original premium amount but does not compound during the term. Others pay compound interest during a term, which means that index-linked interest that has already been credited also earns interest in the future. In either case, however, the interest earned in one term is usually compounded in the next.

Margin/Spread/Administrative Fee

In some annuities, the index-linked interest rate is computed by subtracting a specific percentage from any calculated change in the index. This percentage, sometimes referred to as the "margin," "spread," or "administrative fee," might be instead of, or in addition to, a participation rate. For example, if the calculated change in the index is 10%, your annuity might specify that 2.25% will be subtracted from the rate to determine the interest rate credited. In this example, the rate would be 7.75% (10% - 2.25% = 7.75%). In this example, the company subtracts the percentage only if the change in the index produces a positive interest rate.

Vesting

Some annuities credit none of the index-linked interest or only part of it, if you take out all your money before the end of the term. The percentage that is vested, or credited, generally increases as the term comes closer to its end and is always 100% at the end of the term.

HOW DO THE COMMON INDEXING METHODS DIFFER?

Annual Reset

Index-linked interest, if any, is determined each year by comparing the index value at the end of the contract year with the index value at the start of the contract year. Interest is added to your annuity each year during the term.

High-Water Mark

The index-linked interest, if any, is decided by looking at the index value at various points during the term, usually the annual anniversaries of the date you bought the annuity. The interest is based on the difference between the highest index value and the index value at the start of the term. Interest is added to your annuity at the end of the term.

Low-Water Mark

The index-linked interest, if any, is determined by looking at the index value at various points during the term, usually the annual anniversaries of the date you bought the annuity. The interest is based on the difference between the index value at the end of the term and the lowest index value. Interest is added to your annuity at the end of the term.

Point-to-Point

The index-linked interest, if any, is based on the difference between the index value at the end of the term and the index value at the start of the term. Interest is added to your annuity at the end of the term.

WHAT ARE SOME OF THE FEATURES AND TRADE-OFFS OF DIFFERENT INDEXING METHODS?

Generally, equity-indexed annuities offer preset combinations of features. You may have to make trade-offs to get features you want in an annuity. This means the annuity you chose may also have features you don't want.

Features	**Trade-Offs**
Annual Reset	
Since the interest earned is "locked in" annually and the index value is "reset" at the end of each year, future decreases in the index will not affect the interest you have already earned. Therefore, your annuity using the annual reset method may credit more interest than annuities using other methods when the index fluctuates up and down often during the term. This design is more likely than others to give you access to index-linked interest before the term ends.	Your annuity's participation rate may change each year and generally will be lower than that of other indexing methods. Also an annual reset design may use a cap or averaging to limit the total amount of interest you might earn each year.
High-Water Mark	
Since interest is calculated using the highest value of the index on a contract anniversary during the term, this design may credit higher interest than some other designs if the index reaches a high point early or in the middle	Interest is not credited until the end of the term. In some annuities, if you surrender your annuity before the end of the term, you may not get index-linked interest for that term. In other annuities, you may receive index-linked interest, based on the highest

of the term, then drops off at the end of the term.	anniversary value to date and the annuity's vesting schedule. Also, contracts with this design may have a lower participation rate than annuities using other designs or may use a cap to limit the total amount of interest you might earn.
Low-Water Mark	
Since interest is calculated using the lowest value of the index prior to the end of the term, this design may credit higher interest than some other designs if the index reaches a low point early or in the middle of the term and then rises at the end of the term.	Interest is not credited until the end of the term. With some annuities, if you surrender your annuity before the end of the term, you may not get index-linked interest for that term. In other annuities, you may receive index-linked interest based on a comparison of the lowest anniversary value to date with the index value at surrender and the annuity's vesting schedule. Also, contracts with this design may have a lower participation rate than annuities using other designs or may use a cap to limit the total amount of interest you might earn.
Point-to-Point	
Since interest cannot be calculated before the end of the term, use of this design may permit a higher participation rate than annuities using other designs.	Since interest is not credited until the end of the term, typically six or seven years, you may not be able to get the index-linked interest until the end of the term.

WHAT IS THE IMPACT OF SOME OTHER EQUITY-INDEXED ANNUITY PRODUCT FEATURES?

Cap on Interest Earned

While a cap limits the amount of interest you might earn each year, annuities with this feature may have other product features you want, such as annual interest crediting or the ability to take partial withdrawals. Also, annuities that have a cap may have a higher participation rate.

Averaging

Averaging at the beginning of a term protects you from buying your annuity at a high point, which would reduce the amount of interest you might earn. Averaging at the end of the term protects you against severe declines in the index and losing index-linked interest as a result. On the other hand, averaging may reduce the amount of index-linked interest you earn when the index rises either near the start or at the end of the term.

Participation Rate

The participation rate may vary greatly from one annuity to another and from time to time within a particular annuity. Therefore, it is important for you to know how your annuity's participation rate works with the indexing method. A high participation rate may be offset by other features, such as simple interest, averaging, or a point-to-point indexing method. On the other hand, an insurance company may offset a lower participation rate by also offering a feature such as an annual reset indexing method.

Interest Compounding

It is important for you to know whether your annuity pays compound or simple interest during a term. While you may earn less from an annuity that pays simple interest, it may have other features you want, such as a higher participation rate.

WHAT WILL IT COST ME TO TAKE MY MONEY OUT BEFORE THE END OF THE TERM?

In addition to the information discussed in this Buyer's Guide about surrender and withdrawal charges and free withdrawals, there are additional considerations for equity-indexed annuities. Some annuities credit none of the index-linked interest or only part of it if you take out money before the end of the term. The percentage that is vested, or credited, generally increases as the term comes closer to its end and is always 100% at the end of the term.

ARE DIVIDENDS INCLUDED IN THE INDEX?

Depending on the index used, stock dividends may or may not be included in the index's value. For example, the S&P 500 is a stock price index and only considers the prices of stocks. It does not recognize any dividends paid on those stocks.

HOW DO I KNOW IF AN EQUITY-INDEXED ANNUITY IS RIGHT FOR ME?

The questions listed below may help you decide which type of annuity, if any, meets your retirement planning and financial needs. You should consider what your goals are for the money you may put into the annuity. You need to think about how much risk you're willing to take with the money. Ask yourself:

- Am I interested in a variable annuity with the potential for higher earnings that are not guaranteed and willing to risk losing the principal?
- Is a guaranteed interest rate more important to me, with little or no risk of losing the principal?
- Or, am I somewhere in between these two extremes and willing to take some risks?

HOW DO I KNOW WHICH EQUITY-INDEXED ANNUITY IS BEST FOR ME?

As with any other insurance product, you must carefully consider your own personal situation and how you feel about the choices available. No single annuity design may have all the features you want. It is important to understand the features and trade-offs available so you can choose the annuity that is right for you. Keep in mind that it may be misleading to compare one annuity to another unless you compare all the other features of each annuity. You must decide for yourself what combination of features makes the most sense for you. Also remember that it is not possible to predict the future behavior of an index.

QUESTIONS YOU SHOULD ASK YOUR AGENT OR THE COMPANY

You should ask the following questions about equity-indexed annuities in addition to the questions in the Buyer's Guide to Fixed Deferred Annuities.

- How long is the term?
- What is the guaranteed minimum interest rate?
- What is the participation rate? For how long is the participation rate guaranteed?
- Is there a minimum participation rate?
- Does my contract have an interest rate cap? What is it?
- Does my contract have an interest rate floor? What is it?
- Is interest rate averaging used? How does it work?
- Is interest compounded during a term?
- Is there a margin, spread, or administrative fee? Is that in addition to or instead of a participation rate?
- What indexing method is used in my contract?
- What are the surrender charges or penalties if I want to end my contract early and take out all of my money?
- Can I get a partial withdrawal without paying charges or losing interest? Does my contract have vesting? If so, what is the rate of vesting?

Final Points to Consider

Remember to read your annuity contract carefully when you receive it. Ask your agent or insurance company to explain anything you don't understand. If you have a specific complaint or can't get answers you need from the agent or company, contact your state insurance department.

**NAIC INSURANCE AND ANNUITIES REPLACEMENT MODEL REGULATION:
A SYSTEMIC APPROACH TO APPROPRIATE SALES PRACTICES**

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation American Council of Life Insurers

I. NAIC Insurance and Annuities Replacement Model Regulation

A. In June 2000, the NAIC adopted substantial amendments to the 1998 Insurance and Annuities Replacement Model Regulation. This regulation establishes substantial protections for consumers through required systems of supervision, control, monitoring, and recordkeeping for insurers and producers. Additionally, the regulation requires plain-English notices, and signed disclosure about the replacement transaction.

1. The NAIC's Model Regulation and amendments promote uniformity among state insurance regulations.

2. Citation: Insurance and Annuities Replacement Model Regulation, NAIC Model Regulation Service-July 2000 at III-621-1.

B. **Approach of the amended regulation**

1. The amended regulation establishes duties for insurance producers, replacing insurers, and existing insurers designed to protect consumers.

   a. For example, insurers using insurance producers must, among other things:

      (1) Maintain a *system of supervision and control*;

      (2) Have the *capacity to monitor* each producer's life and annuity replacements for that insurer;

      (3) Ascertain that required *sales material and illustrations are complete and accurate*; and

      (4) *Maintain records* of required notification forms and illustrations that can be produced.

   b. A required notice of replacement must be presented, read to consumers, and signed by the producer and consumer.

2. The regulation lists illustrative violations, and establishes penalties that may include the revocation or suspension of a producer's or company's license, monetary fines, and forfeiture of commissions

or compensation. Commissioners may require insurers to make restitution, and restore policy values with interest when violation are material to the sale. [*See*, Section 8 of the regulation].

C. Overview of Issue

1. A replacement occurs when an individual uses existing life insurance policy or annuity contract values to purchase a new policy or contract.

2. A replacement may involve the use of the entire value of an existing policy or contract, as in the case of a surrender, or it may involve the use of only a portion of the existing values.

3. Under the NAIC Model as amended in 2000, the use of *any* portion of the values of an existing policy or contract to purchase a new policy or contract constitutes replacement, including borrowing, assigning dividends, lapsing, or forfeiting.

   a. External replacement occurs when a company replaces the life or annuity product of another company.

   b. Internal replacement occurs when a company replaces a life or annuity contract that it has already issued.

D. *Purpose* of the Amended NAIC Replacement Regulation

1. To regulate the activities of insurers and producers with respect to the replacement of existing life insurance and annuities.

2. To protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions, and to:

   a. Assure that purchasers receive information with which a decision can be made in his or her own best interest;

   b. Reduce the opportunity for misrepresentation and incomplete disclosure; and

   c. Establish penalties for failure to comply with the regulation.

E. Regulation *Applies to Variable Life Insurance and Variable Annuity Replacements*

1. The term *replacement* is defined in the regulation to mean 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:

a. Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;

b. 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;

c. Amended so as to effect either a reduction in force of for which benefits would be paid;

d. Reissued with any reduction in cash value; or

e. Used in a financed purchase.

2. The regulation excuses variable life and variable annuity contracts from requirements in Sections 5(A)(2) and 6(B) to provide illustrations or policy summaries.

   a. In place of the policy summaries and illustrations requirement, the regulation mandates “premium or contract distribution amounts and identification of the appropriate prospectus or offering circular” instead.

   b. In all other respects, the regulation fully applies to individual variable contract replacements.

F. *Exceptions* from regulation for group contracts

1. The regulation does not apply to transactions involving:

   a. Policies or 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) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer;

      (3) A governmental or church plan defined in Section 414, a governmental 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 Internal Revenue Code; or

      (4) A non-qualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

b. Group life insurance or group annuities where there is no direct solicitation of individuals by an insurance producer.

c. Credit life insurance.

G. Duties of Producers and Insurers in Replacement Transactions

1. Duties of insurers that use producers [Section 4.]

a. Under the regulation, each insurer must:

(1) *Maintain a system of supervision and control* to insure compliance with the requirements of this regulation that shall *include at least* the following:

(a) *Inform its producers of the requirements of the regulation* and incorporate the requirements of the regulation into all relevant *producer training manuals* prepared by the insurer;

(b) *Provide* to each producer *a written statement of the company's position with respect to the acceptability of replacements* providing guidance to its producer as to the appropriateness of these transactions;

(c) *A system to review the appropriateness* of each replacement transaction *that the producer does not indicate is in accord with the regulation's standards;*

(d) Procedures to *confirm* that the *requirements* of this regulation have been *met*; and

(e) Procedures to *detect transactions that are replacements of existing policies* or contracts by the existing insurer, but that have not been identified as such by the applicant or producer.

(2) *Have the capacity to produce*, upon request, and make available to the Insurance Department, *records of each producer's*:

(a) *Replacements*, including financed purchases, as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(b) *Number of lapses* of policies and contracts by the producer as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(c) Number of transactions that are *unidentified replacements of existing policies* or contracts by the existing insurer detected by the company's monitoring system as required by Section (4)(A)(5) of the regulation; and

(d) *Replacements, indexed by replacing producer and existing insurer*.

(3) Require with or as a part of each application for life insurance or an annuity a signed statement by both the applicant and the producer as to whether the applicant has existing policies or contracts;

(4) Require with each application for life insurance or an annuity that indicates an existing policy or contract a completed notice regarding replacements as contained in Attachment 1 to the regulation;

(5) When the applicant has existing policies or contracts, retain completed and signed copies of the notice regarding replacements in its home or regional office for at least five years after the termination or expiration of the proposed policy or contract;

(6) When the applicant has existing policies or contracts, obtain and retain copies of any sales material as required by Section 3(E) of the regulation, the basic illustration and any supplemental illustrations used in the sale and the producer's and applicant's signed statements with respect to financing and replacement in its home or regional office for at least five years after the termination or expiration of the proposed policy or contract

(7) Records required to be retained by the regulation may be maintained in paper, photograph, microprocess, magnetic, mechanical or electronic media or by any process which accurately reproduces the actual document.

2. Duties of Replacing Insurers that Use Producers [Section 6].

   a. Where a replacement is involved in the transaction, the replacing insurer shall:

      (1) Verify that the required forms are received and are in compliance with the regulation;

      (2) Notify any other existing insurer that may be affected by the proposed replacement within five business days of receipt of a completed application indicating replacement or when the replacement is identified if not indicated on the application, and mail a copy of the available *illustration or policy summary* for the proposed policy or available disclosure document for the proposed contract within five business days of a request from an existing insurer; [*note*: this illustration and policy summary requirement does not apply to variable contracts.]

      (3) Be able to produce copies of the notification regarding replacement required in Section 4(B), *indexed by producer, in its home or regional office* for at least five years or until the next regular examination by the insurance department of a company's state of domicile, whichever is later; and

      (4) Provide to the policy or contract owner notice of the right to return the policy or contract within thirty (30) days of the delivery of the contract and receive an unconditional full refund of all premiums or considerations paid on it, including any policy fees or charges or, in the case of a *variable or market value adjustment policy or contract*, a payment of the cash surrender value provided under the policy or contract plus the fees and other charges deducted from the gross premiums or considerations or imposed under such policy or contract.

   b. In transactions where the replacing insurer and the existing insurer are the same or subsidiaries or affiliates under common ownership or control [*internal replacements*] allow credit for the period of time that has elapsed under the replaced policy's or contract's incontestability and suicide period up to the face amount of the existing policy or contract. With regard to *financed purchases* the credit may be limited to the amount the face amount of the existing policy is reduced by the use of existing policy values to fund the new policy or contract.

c. If an insurer *prohibits the use of sales material other than that approved* by the company, as an alternative to the requirements of Section 3(E) the insurer may:

(1) Require with each application a statement *signed by the producer* that:

- Represents that the producer used only company approved sales material;
- *Lists*, by identifying number or other descriptive language, the *sales material that was used*; and

- States that copies of all sales material were left with the applicant in accordance with Section 3(D); and

o Within ten days of the issuance of the policy or contract:

(a) Notify the applicant by sending a letter or by verbal communication with the applicant *by a person whose duties are* ***separate from the marketing area*** *of the insurer*, that the producer has represented that copies of all sales material have been left with the applicant in accordance with Section 3(D);

(b) Provide the applicant with a *toll free number* to contact *company personnel involved in the compliance function* if such is not the case; and

(c) Stress the importance of retaining copies of the sales material for future reference; and

o Keep a copy of the letter or other verification in the policy file at the home or regional office for at least five years after the termination or expiration of the policy or contract.

3. Duties of the Existing Insurer [Section 6].

a. Where a replacement is involved in the transaction, the existing insurer shall:

(1) Upon notice that its existing policy or contract may be replaced or a policy may be part of a financed purchase,

retain copies of the notification in its home or regional office, *indexed by replacing insurer*, notifying it of the replacement for at least five years or until the conclusion of the next regular examination conducted by the Insurance Department of its state of domicile, whichever is later.

(2) Send a letter to the policy or contract owner of the right to receive information regarding the existing policy or contract values including, if available, an in force illustration or policy summary if an in force illustration cannot be produced within five business days of receipt of a notice that an existing policy or contract is being replaced. The information shall be provided within five business days of receipt of the request from the policy or contract owner.

(3) Upon receipt of a request to borrow, surrender or withdraw any policy or contract values, send to the applicant a notice, advising the policy or contract owner of the effect release of policy or contract values will have on the non-guaranteed elements, face amount or surrender value of the policy or contract from which the values are released. The notice shall be sent separate from the check if the check is sent to anyone other than the policy or contract owner. In the case of *consecutive automatic premium loans or systematic withdrawals* from a contract, the insurer is only required to send the notice at the time of the first loan or withdrawal.

4. Duties of Producers [Section 4].

a. A producer who initiates an application must submit to the insurer, with or as part of the application, a statement signed by both the applicant and the producer as to whether the applicant has existing policies or contracts. If the answer is "no," the producer's duties with respect to replacement are complete.

b. If the applicant answered "yes" to the question regarding existing coverage referred to in Subsection (A), the producer shall present and read to the applicant, not later than at the time of taking the application, a notice regarding replacements in the form as described in Attachment 1 to the regulation or other substantially similar form approved by the commissioner. *The notice shall be signed by both the applicant and the producer* attesting that the notice has been read aloud by the producer or that the applicant did not wish the notice to be read aloud (in which case the producer need not have read the notice aloud) and left with the applicant.

c. The notice shall list all life insurance policies or annuities proposed to be replaced, properly identified by name of insurer, the insured or annuitant, and policy or contract number if available; and shall include a statement as to whether each policy or contract will be replaced or whether a policy will be used as a source of financing for the new policy or contract. If a policy or contract number has not been issued by the existing insurer, alternative identification, such as an application or receipt number, shall be listed.

d. In connection with a replacement transaction *the producer shall leave with the applicant* at the time an application for a new policy or contract is completed *the original or a copy of all sales material*. With respect to electronically presented sales material, it shall be provided to the policyholder in printed form no later than at the time of policy or contract delivery.

e. Except as provided in Section 5(C) of the regulation, in connection with a replacement transaction the producer shall submit to the insurer to which an application for a policy or contract is presented, a copy of each document required by this section, *a statement identifying any preprinted or electronically presented company approved sales materials used*, and *copies of any individualized sales materials*, including *any illustrations* used in the transaction

H. Selected Definitions

1. Section 2(D) defines the term *financed purchase* as “the purchase of a new policy involving the actual or intended use of funds obtained by the withdrawal or surrender of, or by borrowing from values of an existing policy to pay all or part of any premium due on the new policy.”

a. If a withdrawal, surrender, or borrowing involving the policy values of an existing policy are used to pay premiums on a new policy owned by the same policyholder *within thirteen months before or after the effective date of the new policy* and is known by the replacing insurer, or if the withdrawal, surrender, or borrowing is shown on any illustration of the existing and new policies made available to the prospective policyowner by the insurer or its producers, it will be *deemed prima facie evidence of a financed purchase.*

2. Section 2(I) defines the term registered contract as “a variable annuity contract or variable life insurance policy subject to the prospectus delivery requirements of the Securities Act of

1933."

I. Several aspects of the amended NAIC model regulation parallel SEC and NASD positions concerning Section 1035 exchanges and bonus annuity sales.

1. Selected list of parallel regulatory concepts

   a. NASD Guideline on Variable Life Insurance Distribution: NASD NTM 00-44 (June 2000).

   b. NASD Guidelines on Supervisory Responsibilities: NASD NTM 99-45 (June 1999).

   c. NASD Statement on Variable Annuity Distribution: NASD NTM 99-35 (May 1999).

   d. SEC Office of Compliance Inspections and Examinations: Indicators of "Good" Internal Controls in Variable Contract Distribution.

      (1) A compilation of the SEC's indicators drawn from speeches and seminar comments is discussed in Wilkerson, *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 20.

   e. SEC Examination of Variable Annuity "Bonus" Programs

      (1) Several of the items requested in the SEC's inspection letter requested documents and information that the amended NAIC Model Replacement Regulation also addresses.

         (a) Scope of documents requested in the SEC's examinations was outlined in *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 6.

   a. NASD and SEC inspection sweeps focusing on "Section 1035 exchanges" of variable contracts and "life financing" arrangements (1998 and 1996.)

      (1) These sweeps and the documentation they elicited were discussed in *Variable Product Distribution: A Continuing Study of Compliance Examinations,*

Inspections Sweeps and Evolving Regulatory Standards, ACLI Compliance Section Annual Meeting (July 19, 2000) at 11 and 15.

J. NAIC Model Replacement Regulation: State-by-State Chart

1. A chart listing the status of the NAIC Model Replacement Regulation under state insurance law appears in the pages following Attachment 1 and 2 below.

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Attachment 1 to Model Replacement Regulation Outline

IMPORTANT NOTICE: REPLACEMENT OF LIFE INSURANCE OR ANNUITIES

This document must be signed by the applicant and the producer, if there is one, and a copy left with the applicant.

You are contemplating the purchase of a life insurance policy or annuity contract. In some cases this purchase may involve discontinuing or changing an existing policy or contract. If so, a replacement is occurring. Financed purchases are also considered replacements.

A replacement occurs when a new policy or contract is purchased and, in connection with the sale, you discontinue making premium payments on the existing policy or contract, or an existing policy or contract is surrendered, forfeited, assigned to the replacing insurer, or otherwise terminated or used in a financed purchase.

A financed purchase occurs when the purchase of a new life insurance policy involves the use of funds obtained by the withdrawal or surrender of or by borrowing some or all of the policy values, including accumulated dividends, of an existing policy, to pay all or part of any premium or payment due on the new policy. A financed purchase is a replacement.

You should carefully consider whether a replacement is in your best interests. You will pay acquisition costs and there may be surrender costs deducted from your policy or contract. You may be able to make changes to your existing policy or contract to meet your insurance needs at less cost. A financed purchase will reduce the value of your existing policy or contract and may reduce the amount paid upon the death of the insured.

We want you to understand the effects of replacements before you make your purchase decision and ask that you answer the following questions and consider the questions on the back of this form.

1. Are you considering discontinuing making premium payments, surrendering, forfeiting, assigning to the insurer, or otherwise terminating your existing policy or contract? ___ YES ___ NO

2. Are you considering using funds from your existing policies or contracts to pay premiums due on the new policy or contract? ___ YES ___ NO

> If you answered "yes" to either of the above questions, list each existing policy or contract you are contemplating replacing (include the name of the insurer, the insured, and the contract number if available) and whether each policy will be replaced or used as a source of financing:

INSURER NAME /CONTRACT OR POLICY# / INSURED OR ANNUITANT /REPLACED (R) OR FINANCING (F)

1.

2.

3.

Make sure you know the facts. Contact your existing company or its agent for information about the old policy or contract. [If you request one, an in force illustration, policy summary or available disclosure documents must be sent to you by the existing insurer.] Ask for and retain all sales material used by the agent in the sales presentation. Be sure that you are making an informed decision.

The existing policy or contract is being replaced because ____________________ ____.

I certify that the responses herein are, to the best of my knowledge, accurate:

____

Applicant's Signature and Printed Name   Date

____   _____________

Producer's Signature and Printed Name   Date

____   _____________

I do not want this notice read aloud to me. __________ (Applicants must initial only if they do not want the notice read aloud.)

A replacement may not be in your best interest, or your decision could be a good one. You should make a careful comparison of the costs and benefits of your existing policy or contract and the proposed policy or contract. One way to do this is to ask the company or agent that sold you your existing policy or contract to provide you with information concerning your existing policy or contract. This may include an illustration of how your existing policy or contract is working now and how it would perform in the future based on certain assumptions. Illustrations should not, however, be used as a sole basis to compare policies or contracts. You should discuss the following with your agent to determine whether replacement or financing your purchase makes sense:

PREMIUMS: Are they affordable?
Could they change?
You're older--are premiums higher for the proposed new policy?
How long will you have to pay premiums on the new policy? On the old policy?

POLICY VALUES: New policies usually take longer to build cash values and to pay dividends.
Acquisition costs for the old policy may have been paid, you will incur costs for the new one.
What surrender charges do the policies have?
What expense and sales charges will you pay on the new policy?
Does the new policy provide more insurance coverage?

INSURABILITY: If your health has changed since you bought your old policy, the new one could cost you more, or you could be turned down.
You may need a medical exam for a new policy.
Claims on most new policies for up to the first two years can be denied based on inaccurate statements.
Suicide limitations may begin anew on the new coverage.

IF YOU ARE KEEPING THE OLD POLICY AS WELL AS THE NEW POLICY:

How are premiums for both policies being paid?
How will the premiums on your existing policy be affected?
Will a loan be deducted from death benefits?
What values from the old policy are being used to pay premiums?

IF YOU ARE SURRENDERING AN ANNUITY OR INTEREST SENSITIVE LIFE PRODUCT;

Will you pay surrender charges on your old contract?
What are the interest rate guarantees for the new contract?
Have you compared the contract charges or other policy expenses?

OTHER ISSUES TO CONSIDER FOR ALL TRANSACTIONS:

What are the tax consequences of buying the new policy?
Is this a tax free exchange? (See your tax advisor.)
Is there a benefit from favorable "grandfathered" treatment of the old policy under the federal tax code?
Will the existing insurer be willing to modify the old policy?

How does the quality and financial stability of the new company compare with your existing company?

(Attachment 2 to Replacement Outline)

NOTICE REGARDING REPLACEMENT
REPLACING YOUR LIFE INSURANCE POLICY OR ANNUITY?

Are you thinking about buying a new life insurance policy or annuity and discontinuing or changing an existing one? If you are, your decision could be a good one--or a mistake. You will not know for sure unless you make a careful comparison of your existing benefits and the proposed policy or contract's benefits.

Make sure you understand the facts. You should ask the company or agent that sold you your existing policy or contract to give you information about it.

Hear both sides before you decide. This way you can be sure you are making a decision that is in your best interest.

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ACLI Disclosure Initiative for Fixed, Index and Variable Annuities: Constructive Change on the Horizon

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation American Council of Life Insurers

I. Background and Summary

A. Over the past several years, regulators, the press, and consumers have regularly observed that useful information about different annuities and sales practices needed improvement to facilitate informed decision-making and suitable matches of customer needs with products.

B. In January 2005, ACLI's Board of Directors took steps to enhance annuity disclosure and improve fixed, index, and variable annuity sales practices.

1. ACLI formed a CEO-level task force to develop recommendations addressing criticism that annuities are misunderstood by consumers. The Task Force emphasized increased attention to suitability, and prioritized enhanced consumer decision-making through improved disclosure with short, plain-English information.

2. To elevate consistently suitable annuity sales practices, ACLI strongly recommended expanding the Senior Protection in Annuity Transactions Model Regulation to all ages, rather than limiting it to age 65 and over.

a) The NAIC adopted ACLI's recommended enlargement to all ages in June 2006, renaming it the Suitability in Annuity Transactions Model Regulation. ACLI has actively advocated uniform adoption of this model suitability regulation in the states.

b) A chart accompanying this outline compiles the status of the NAIC Suitability in Annuity Transactions Model Regulation together with the status of the NAIC Annuity Disclosure Model Regulation in the states.

3. To constructively improve disclosure, ACLI actively advocated adoption of the NAIC Annuity Disclosure Model Regulation throughout the states. Although developed in 1995, it had not been widely adopted.

a) The disclosure model establishes an informational core of improved understanding about annuities.

b) Life insurers in the fixed, index and variable annuity markets emphasized design of short, simple, and comparable disclosure as an essential priority to meaningfully help consumers in purchase decisions.

C. The industry group developed a set of “templates” for presenting required disclosure information in a simplified plain-English presentation of information essential to an informed purchase decision.

1. The disclosure templates for fixed and index annuities implement standards mandated by the NAIC Annuity Disclosure Model Regulation.

2. The template for variable annuities parallels the approach of the mutual fund Profile Plus and would be followed by a full prospectus.

D. The industry group produced sample documents under the three templates based on actual fixed, variable and index annuities.

1. The samples were tested in a series of focus groups with retirees, consumers in the baby boomer age group, and annuity salespersons.

2. The various focus groups expressed constructive and positive reactions. The sample documents were revised to reflect focus group feedback and then retested again with the groups.

E. ACLI regularly shared the templates with the SEC, FINRA, and state insurance regulators as the designs evolved.

II. Ingredients of the Disclosure Template Project

A. General guidelines on how to write readable disclosure materials;

B. Instructions on how to complete a disclosure template;

C. Templates for fixed, index, and variable annuity disclosures;

D. Instructions and a template for depicting indexed interest crediting strategies; and,

E. A sample of what an actual disclosure might look like for each product.

F. The ACLI Disclosure Templates and Guides are attached at the back of this outline

III. The Guidelines to Readable Disclosure in ACLI’s Disclosure Initiative

A. The purpose and scope of ACLI’s readable disclosure guidelines directly parallel the SEC’s goals and structure in plain-English Rule 421(d) under the Securities Act of 1933.

1. Under the SEC’s plain-English rule, issuers must use plain-English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors section in filings with the SEC’s Division of Corporation Finance under the 1933 Act. When drafting the language for selected parts of the prospectus, issuers must comply with a series of specified plain-English principles.

a) See "Plain-English Disclosure," the updated SEC Staff Bulletin No 7 at http://www.sec.gov/interps/legal/cfslb7a.htm.

b) See also the SEC's "Plain-English Handbook" at http://www.sec.gov/news/extra/handbook.htm .

c) The rule and handbook extol clear, simplified narrative in disclosure, using basic rules of grammar and composition.

B. ACLI's Guideline to Readable Disclosure

1. The guideline outlines rules for writing more readable disclosures, and relied on parallel government endeavors as an important resource which is found at http://www.plainlanguage.gov.

a) Like the SEC Handbook, the ACLI guidelines emphasize clear, simplified disclosure, using basic rules of grammar and composition.

b) The guide instructs and encourages drafters to, among other things:

(1) Write for the average reader;

(2) Organize to meet the needs of the reader;

(3) Include only the information your reader needs;

(4) Use headings and make the headings useful

(5) Use short sentences and short sections; and,

(6) Use lists and tables to simplify information.

2. The structure of the guideline's follows the organization of the online presentation, "Writing in Plain Language on the TriCare Site" at http://www.tricare.osd.mil/webmaster/Plain-Language-Rules-Web-Toolkit-2005-07-27.ppt.

3. Brenda J. Cude, Ph.D., Professor of Housing and Consumer Economics, at the University of Georgia developed the guidelines for ACLI. In her work, Dr. Cude focuses specifically on consumer protection and behavior, including how consumers acquire and use information before making buying decisions.

a) She represents the consumer perspective in policy discussions at national meetings of insurance regulators.

State Laws Governing Suitability in Variable Life Insurance Sales

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

I. State Laws Governing VLI Suitability- Historical SEC & FINRA Parallels

II. Suitability Requirements in the NAIC Model Variable Life Insurance Regulation

A. Scope and Impact of Suitability Provisions in the NAIC Model Variable Life Insurance

1. Thirty-one jurisdictions have adopted the NAIC Model Variable Life Insurance Regulation, and an additional eleven have adopted related provisions.[1] Twenty-nine have specific provisions concerning suitability, which are set forth in a chart at the conclusion of this outline segment.

2. Suitability standards are explicit and unequivocal in NAIC Model Variable Life Insurance Regulation, as explained below.

B. Section 3 of the NAIC Model Variable Life Insurance Regulation establishes qualifications of insurers to issue variable life insurance, and Paragraph (C) sets forth detailed Standards of Suitability.

C. Section 3(C) states that:

1. Every insurer seeking approval to enter into the variable life insurance business in this state shall establish and maintain a *written statement* specifying the *standards of suitability* to be used by the insurer. *See*, NAIC Model Regulation Service (January 1996) at 270-731 [emphasis added].

2. The standards of suitability shall specify that no recommendation shall be made to an applicant to purchase a variable life insurance policy and that no variable life insurance policy shall be issued in the absence of reasonable grounds to believe that the purchase of the policy is *not unsuitable* for the applicant on the basis of information furnished *after reasonable inquiry* of the applicant concerning the applicant's insurance and investment objectives, financial situation and needs, and any other information known to the insurer or the agent making the recommendation. *Id.* [emphasis added].

D. The NAIC commentary on Section 3(C) provides additional clarification

1. This section imposes a duty on both the insurer and its agents to make *a good faith, reasonable inquiry as to the facts and circumstances concerning a prospect's insurance and financial needs* and to make no recommendation that a prospect purchase variable life insurance when such a purchase is not reasonably consistent with the information that is known or reasonably should be known to the insurer or agent. See, NAIC Model Regulation Service (January 1996) at 270-731 [emphasis added].

2. According to the commentary, some of the factors which would be considered

[1] *See*, NAIC Model Regulation Service (January 1996) at 270-771.

are:

a. age,

b. earnings,

c. marital status,

d. number and age of dependents,

e. the value of savings and other assets,

f. and current life insurance program.

3. The commentary explains that the substantive standard in Section 3(C) was derived from the federal securities laws. Id.

4. The commentary emphasizes that the duty to make a good faith reasonable inquiry must be stressed since an insurer or agent cannot continually seek to avoid the obligations imposed by this section by claiming that a prospect refused to divulge information sufficient to make a professional evaluation of the suitability of variable life insurance to particular circumstances. *Id.*

E. When the Model Variable Life Insurance Regulation was substantially amended in 1983 to accommodate flexible premium variable life insurance, this suitability provision was revised and updated to reflect state and federal regulatory changes that had evolved since the original Model Variable Life Insurance Regulation that governed only scheduled premium variable life insurance. The commentary explains that:

1. The 1983 amendments made changes in this section to achieve a more practical application of the suitability concept to sales of variable life insurance.

2. While the concept originally set forth in this section was substantially similar to that utilized in the federal securities laws, the application of the concept was exaggerated as part of the effort to avoid SEC regulation of variable life insurance.

a. For example, prior to the 1983 amendments, the section required that the insurer adopt the standards of suitability by *formal action of its board of directors*.

(1) This requirement of board adoption was found to be unprecedented in NAIC model insurance statutes and unnecessary to the application of the suitability concept to sales of variable life insurance.

b. Similarly, the standards of suitability were “applicable to and binding on the insurer’s officers, directors, employees, affiliates and agents with respect to the suitability of variable life insurance for the applicant.”

(1) The potential for mischief of this broad requirement was considerable, raising, for example, the possibility of liability for violations of the suitability standards being imposed on individual officers, directors, employees or agents who never even knew of the transaction involved.

(2) These two aspects of the original Model Variable Life Insurance

Regulation were deleted in the 1983 amendments. See, NAIC Model Regulation Service (January 1996) at 270-32.

F. Other NAIC interpretative guideposts on Secton 3(C) suitability appear in a NAIC staff report which the NAIC adopted in 1974, that emphasized *three basic areas of ideal suitability* concerning VLI:

1. needs *perceived* by the insured;
2. needs *perceived* by the agent; and
3. *persistency*. *See*, 1974 Proceedings of the NAIC II at 540 [emphasis added].

G. The NAIC staff report contains further interpretive guidance.

1. The NAIC staff report was adopted as an interpretive guide to Section 3(C) in 1974 and offers the following language "as an informal consensus" on the meaning of suitability in the model variable life insurance regulation.

   a. Definition–"Suitability" means the likelihood that the purchase of variable life insurance is reasonably consistent with:

      (1) The *expressed insurance objectives and needs* as perceived by the prospective insured;

      (2) The *reasonable objectives and needs* of the prospective insured as determined objectively by a professional agent after a diligent reasonable inquiry into relevant financial, family and other background information concerning the prospective insured; and

      (3) The *potential that the prospective insured will persist* with the policy for such a period of time that the insurer's acquisition costs are amortized over a reasonable period of time. *See*, 1974 Proceedings of the NAIC II at 547 [emphasis added].

   b. General Rules of Interpretation accompany the staff report that became the interpretive guide adopted by the NAIC, and explain:

      (1) When variable life insurance meets characteristics (1) and (3) or (2) and (3), it is probably still "suitable" in most instances.

      (2) Variable life insurance is clearly "unsuitable" when it meets none of the three characteristics for a given prospect.

      (3) Variable life insurance is probably "unsuitable" in the absence of extraordinary factors when it does not meet characteristic (3).

      (4) Other situations must be judged on their individual facts.

H. Even further clarifications to these VI standards of suitability were added in 1983. The commentary explains that:

1. In adopting the 1983 amendments, the NAIC recognized that the proliferation of variable life insurance product designs anticipated as a result of those amendments might make suitability, and particularly factors (1) and (2), even more important. *See*, NAIC Model Regulation Service (January 1996) at 270-33 [emphasis added].

2. On the other hand, it was understood that the possibility of more variable life

insurance products designed to compete with investment oriented products of other financial institutions will make factor (3) less significant because policyholders will be more likely to move among competing financial institutions will make factor (3) less significant because policyholders will be more likely to move among competing financial institution products for reasons such as rate of return, tax considerations and economic conditions. *As a result, persistency will be less and less relevant as a measure of suitability.* Id.

3. Section 3(C) requires the insurer to *formally adopt* its suitability standards.

   a. Earlier drafts of Section 3(C) specifically required that the insurer establish and file with the commissioner guidelines or *profiles of applicants and situations* in which variable life insurance would not generally be suitable.

   b. This specific requirement was deleted from Section 3(C).

I. Other aspects of interest concerning VLI suitability from the NAIC Model Variable Life Insurance Regulation

1. Private rights of action. The commentary notes that:

   a. As to the potential legal implications of adopting standards of suitability, it is not unlikely in those jurisdictions where the doctrine of implied rights of action is accepted, that the theory would give rise to an enforceable obligation to the insured[2]. *See*, NAIC Model Regulation Service (January 1996) at 270-33 [emphasis added].

   b. Furthermore, it is probable that the commissioner would have the authority (either formal or informal) to reverse an unsuitable sale upon the request of the policyholder. This would be in addition to the full range of sanctions available to him. *Id.*

2. Group Contracts

   a. The commentary states that the requirements of Section 3(C) would not be applicable with respect to each individual employee involved in a non-contributory pension plan situation. *See*, NAIC Model Regulation Service (January 1996) at 270-33.

3. Lapse Rates not Germane

   a. Prior to the 1983 amendments, the section included provisions pursuant to which lapse rates were to be utilized as indicators of suitability.

      (1) These provisions were based upon the realization that suitability is a difficult area to police and the hope that lapse rates, by indicating persistency, would be an accurate yardstick for suitability.

      (2) The 1983 amendments eliminated references to lapse rates as measures of suitability.

[2] *Anderson v. Knox,* 297 F.2d 702 (9th Cir.), *cert. Denied,* 370 U.S. 915 (1961), the U.S. Court of Appeals for the Ninth Circuit held that an insurance agent who had induced a client to purchase excessive amounts of bank financed insurance was liable for damages in common-law fraud because the policies were not suitable to the plaintiff's needs.

(a) The commentary explains that "[w]ith regard to conventional insurance policies, lapse rates, even those reflecting experience over a very long period of time, are suspect as an indicator of whether or not sales of insurance were suitable when made. Lapse rates are even less relevant to the suitability of sales of variable life insurance." *See*, NAIC Model Regulation Service (January 1996) at 270-33.

(b) Lapse rates are affected by a variety of factors, the most significant of which ordinarily is changes in the policyholder's perception of the attractiveness of the policy due to changes in the general economy and in the economic circumstances of the policyholder. *Id.*

(c) In the case of variable life insurance, an additional important factor is the performance of the separate account relative to other financial alternatives. Because of the significance of these factors, the use of lapse rates as a measure of suitability was found to be inappropriate. *Id*

J. Suitability Information Required on Applications

1. Section 8(C) the NAIC Model Variable Life Insurance Regulation requires that variable life insurance applications *contain questions designed to elicit suitability information from applicants*. *See*, NAIC Model Regulation Service (2010) at 270-18.

a. This requirement dovetails with the suitability requirements in Section 3(C) discussed above.

b. The commentary to Section 3(C) cross references the required application information in Section 8(C). *See*, NAIC Model Regulation Service (2010) at 270-64.

STATES WITH SUITABILITY PROVISIONS IN VARIABLE LIFE INSURANCE LAWS AND REGULATIONS

State	**Suitability Standard**	**Suitability Information in Application**
Arizona	Ariz. Rev. Stat. § 20-2602(C)	Ariz. Rev. Stat. § 20-2608
Arkansas	Ark. Code Ann. § 33-Article III	Ark. Code Ann. § 33- Article VIII.
California	Cal. Code Regs. tit. 10, § 2534.2(c)	
Colorado	Colo. Code Regs. § 4-1-3(V)	Colo. Code Regs. § 4-1-3(VI)
Connecticut	Conn. Agencies Reg. § 38a-433-3(c)	Conn. Agencies Reg. § 38a-433-8
Delaware.	Admin. Code § 44(3)	Del. Admin. Code § 44(8)

D.C.	D.C. Mun. Regs. Tit. 26, § 2704.1	D.C. Mun. Regs. Tit. 26, § 2730.1
Georgia	Ga. Comp. R. & Regs. R. 120-2-32-.03	Ga. Comp. R. & Regs. R. 120-2-32-.09
Indiana	Ind. Admin. Code tit. 760, r.1-33-3	Ind. Admin. Code tit. 760, r.1-33-8
Kentucky	806 Ky. Admin. Regs. 15:030	
Louisiana	La. Admin. Code tit. 35, § 8303(3)	
Maine	Code Me. R. § 02-031 Chapter 300 Article V § 3 Authority of Insurer to Issue Variable Life Insurance	Code Me. R. § 02-031 Chapter 310 Article V § 3Authority of Insurer to Issue Variable Annuity Contracts
Maryland	Md. Regs. Code tit. 31, § 09.12.01.02(D)	
Massachusetts	Mass. Regs. Code tit. 211, § 95.02 (3).	
Michigan	Mich. Admin. Code r. 500.844 Rule 4	Mich. Admin. Code r. 500.864 Rule 24
Mississippi	Miss. Reg. 84-101(3)(c)	
Missouri	Mo. Code Regs. Ann. Tit. 20, §400-1.030(2)(C)	Mo. Code Regs. Ann. Tit. 20, §400-1.030(7)(C)
Nebraska	Neb. Admin. Code 210.15.003.03	Neb. Admin. Code 210.15.008.03
New Mexico	N.M. Admin. Code tit. 13, § 9.8.10	N.M. Admin. Code tit. 13, § 9.8.35
North Carolina	N.C. Admin. Code tit. 11, r. 12 .0435(3)	N.C. Admin. Code tit. 11, r. 12 .0440
North Dakota	N.D. Admin. Code § 45-04-02-03(3)	N.D. Admin. Code § 45-04-02-07
Ohio	Ohio Admin. Code § 3901-06-08(D)	Ohio Admin. Code § 3901-06-08(I)
Pennsylvania	31 Pa. Code § 82.14.	31 Pa. Code § 82.62.
South Carolina	25A S.C. Code Ann. Regs. 69-12, Article III	25A S.C. Code Ann. Regs. 69-12, Article Viii
Texas	28 Tex. Admin. Code § 3.803(3)	28 Tex. Admin. Code § 3.808
Vermont	Vt. Code R. I-88-3(3)	Vt. Code R. I-88-3(8)
Virginia	14 Va. Admin. Code § 5-80-50	14 Va. Admin. Code § 5-80-310

NAIC Suitability in Annuity Transactions Model Regulation: A Coordinated Approach to Suitability and Supervision in the Sale of Individual Annuity Contracts

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I. Recent NAIC Modifications Enlarge Suitability and Supervision Responsibilities in NAIC Model Regulation Governing Individual Annuity Sales

A. The National Association of Insurance Commissioners (NAIC) adopted several evolving sets of revisions to its model regulation governing suitability and supervision in the sale of individual annuity contracts.

1. The NAIC's initial regulation was entitled the Senior Protection in Annuity Transactions Regulation, and governed suitability and supervision in annuity transactions with "senior consumers" age 65 or older.

2. The NAIC's 2006 revision to this regulation applied it to all individual annuity sales. To reflect the broader application of the regulation, it was re-titled the Suitability in Annuity Transactions Model Regulation. This regulation incorporated suitability and supervision practices parallel to those under the federal securities laws and FINRA rules.

3. In 2010, the NAIC added further amendments to the Suitability in Annuity Transactions Model Regulation. Among other things, the 2010 NAIC revisions to the regulation established new restrictions on supervisory delegation to third-party and reliance on producer suitability recommendations, established a new producer training requirement (which must be completed by producers prior to their being able to solicit the sale of annuities), and expanded powers of Commissioners to levy sanctions and penalties.

B. The evolving iterations of the NAIC model regulation can be found at NAIC Model Regulation Service II-275-1 (2010). Over 40 states have implemented the 2006 version of the model regulation. Over time, states will incorporate the 2010 revisions as they update their regulations.

C. In light of the majority of states currently following the 2006 model, its content and purpose are summarized first below. The 2010 changes to the model are summarized separately below, following the 2006 regulation's summary.

D. ACLI supports strong suitability standards to ensure annuity sales recommendations are suitable and will promote consumer confidence in making informed annuity purchase decisions.

II. Approach of the 2006 Revised NAIC Regulation

A. The regulation establishes standards and procedures governing recommendations in annuity transactions, to ensure “that insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed.”

B. The regulation imposes suitability and supervision duties for insurers and insurance producers, including requirements for maintaining written procedures and conducting periodic reviews of records to detect and prevent unsuitable sales practices.

III. Scope and Governing Framework of the 2006 Revised NAIC Regulation

A. The regulation applies to any recommendation to purchase or exchange an annuity made to a consumer by an insurance producer, or an insurer where no producer is involved, that results in the purchase or exchange recommended.

1. “Annuity” means a *fixed annuity or variable annuity* that is *individually solicited*, whether the product is classified as an individual or group annuity [Section 5 (A)].

2. “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 or exchange of an annuity in accordance with that advice [Section 5(D)].

B. The regulation does not apply to annuity transactions involving:

1. Direct response solicitations where there is no recommendation based on information collected from the consumer under the regulation;

2. Contracts funding specified retirement plans:

a) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);

b) 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;

c) 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;

d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

3. Settlements of, or assumptions of, liabilities associated with personal injury litigation or any dispute or claim resolution process; or

4. Formal prepaid funeral contracts.

IV. Duties Imposed Under the Regulation [Section 6]

A. **Suitability Standard**: 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.

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

2. "Insurance producer" means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.

3. Note: this suitability standard directly parallels the general standard of FINRA Suitability Rule 2310(a), set forth at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466 .

B. **Suitability Ingredients** [Section 6(A)]: Prior to the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain information concerning:

1. The consumer's financial status;

2. The consumer's tax status;

3. The consumer's investment objectives; and

4. Such other information used or considered to be reasonable by the insurance producer, or the insurer where no producer is involved, in making recommendations to the consumer.

5. Note: the suitability ingredients above precisely track those in FINRA Suitability Rule 2310(b) set forth at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466 .

6. An insurer or insurance producer's recommendation under the suitability standard and ingredients must be reasonable under all the circumstances actually known to the insurer or insurance producer at the time of the recommendation [Section 6(c)(2)].

a) Neither an insurance producer, nor an insurer where no producer is involved, has any obligation to a consumer under the suitability standard [Section 6(a)] related to any recommendation if a consumer:

(1) Refuses to provide relevant information requested by the insurer or insurance producer;

(2) Decides to enter into an insurance transaction that is not based on a recommendation of the insurer or insurance producer; or

(3) Fails to provide complete or accurate information.

(4) Note: these narrow exclusions directly parallel FINRA approaches to suitability in Rule 2310.

C. Supervision Standard

1. For insurers:

a) An insurer either (i) shall assure that a system to supervise recommendations that is reasonably designed to achieve compliance with the suitability standards in the regulation is established and maintained, or (ii) shall establish and maintain such a system, including, but not limited to:

(1) Maintaining written procedures; and

(2) Conducting periodic reviews of its records that are reasonably designed to assist in detecting and preventing violations of this regulation.

b) To fulfill the supervision standard, an insurer may contract with a third party, including a general agent or independent agency, to establish and maintain a system of supervision as required by Section 6(D)(1) regarding insurance producers under contract with, or employed by, the third party.

(1) To utilize a third party for supervision, an insurer must make reasonable inquiry to assure that the third party is performing the functions required under the regulation, and must take reasonable action under the circumstances to enforce the contractual obligation of the third party to perform the functions.

(2) An insurer may comply with its obligation to make reasonable inquiry by doing all of the following:

(a) Annually *obtain 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) Based on reasonable selection criteria, periodically select third parties for review to determine whether the third parties are performing the required functions. The insurer must perform those procedures to conduct the review that are reasonable under the circumstances.

c) Insurers that contract with a third party to perform supervision and that comply with the certification and periodic review procedures will fulfill their supervisory responsibilities under the regulation.

d) Note: the supervisory approaches implemented in the regulation parallel those in FINRA Rule 3010(a).

e) No one may provide a certification under the regulations supervisory delegation unless:

(1) The person is a senior manager with responsibility for the delegated functions; and

(2) The person has a reasonable basis for making the certification

2. For insurance producers:

a) A general agent and independent agency either must (i) adopt a system established by an insurer to supervise recommendations of its insurance producers that is reasonably designed to achieve compliance with the regulation, or (ii) establish and maintain such a system, including, but not limited to:

(1) Maintaining written procedures; and

(2) Conducting periodic reviews of records that are reasonably designed to assist in detecting and preventing violations of this regulation.

3. Scope of required system of supervision for insurers and producers:

    a) An insurer, general agent or independent agency is not required to review, or provide for review of, all insurance producer solicited transactions; or

    b) An insurer, general agent or independent agency 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, general agent or independent agency.

    c) Note: these clarifications to the scope of the supervisory requirements parallel those applied under FINRA Rule 3010.

4. Deference to FINRA Suitability rule for variable annuity sales:

    a) Compliance with FINRA's suitability rule will satisfy the regulation's suitability requirements for variable annuity recommendations.

    b) Deference to FINRA suitability standards and practices in variable annuity sales does not, however, limit the insurance commissioner's ability to enforce the regulation.

D. Recordkeeping

1. Insurers, general agents, independent agencies and insurance producers must 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 [a specified number of] years after the insurance transaction is completed by the insurer.

2. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

3. Records required to be maintained by this regulation may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

E. Enforcement Powers and Mitigation Provisions

1. To implement the regulation, the state insurance commissioner may order:

    a) 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 regulation;

    b) An insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this regulation; and

2. Any applicable penalty under the state code may be reduced or eliminated if corrective action for the consumer was taken promptly after a violation was discovered.

V. Observations on the NAIC Suitability in Annuity Transactions Model Regulation (2006 Revisions)

A. The NAIC's 2006 modifications to, and substance of, the regulation directly address a number of public concerns about annuity regulation.

1. Applying the regulation to all ages provides coordinated suitability and supervision standards covering all individual annuity sales promotes state regulatory uniformity modeled on FINRA approaches to supervision and suitability.

2. FINRA advocated similar patterns of regulation for fixed and variable annuities under state and federal regulation in a number of public forums, including:

a) The May 5, 2006 Annuity Roundtable which is available by archived webcast at http://www.nasd.com/RulesRegulation/IssueCenter/VariableAnnuities/NASDW_016465 .

b) Statements of FINRA representatives:

(1) FINRA believes that "rules governing the marketing and sale of annuity products - regardless of whether the particular annuity is regulated as an insurance product or a security - should be comparable.... In partnership with the Minnesota Department of Commerce, FINRA is working with the Securities and Exchange Commission and state insurance and securities regulators t*o bring the rules governing annuity sales, in both the insurance and securities regulatory regimes, into conformity."* (emphasis added); Maxey, *American Equity CEO: Slower Indexed Sales Won't Hit Net*, Dow Jones Newswires October 13, 2006;

(2) Mary Shapiro, Former FINRA Chairman & CEO stated:

(a) "Last, let me bring to your attention our efforts to *harmonize requirements across other financial products that compete with securities*. Variable annuity sales compete with equity-indexed and plain vanilla annuities. Variable annuities are securities, equity-indexed annuities may not be securities, yes the subject of another long and tortuous story, and plain vanilla annuities are not securities. These are *complex products in pricing, operation and structure* that may be purchased for similar purposes but are subject to *disparate levels of regulation and offer dissimilar levels of protection to investors*." SIA Compliance & Legal Division Annual Conference (March

20, 2006)(emphasis added). Available at http://www.nasd.com/PressRoom/SpeechesTestimony/MaryL.Schapiro/NASDW_016200 .

(b) Quasi-securities products like equity-indexed annuities also are on our radar screen, and we recently issued a Notice to Members on EIA's to our membership. Despite what you may read in the press, our goal is not to extend our jurisdiction to insurance companies. Rather, we simply believe that our *members need to be aware of the regulatory and supervisory risks that can arise when their registered representatives sell these products*, particularly when they are marketed as securities products and offer substantially greater sales compensation than traditional registered securities. SIA Mutual Fund Reform Conference (September 23, 2005) (emphasis added). Available at http://www.nasd.com/PressRoom/SpeechesTestimony/MaryL.Schapiro/NASDW_015070 .

(c) "The [post-annuity roundtable] working group will consider the issues of disclosure, suitability, supervision and marketing of fixed, variable and equity-indexed annuities. *Regardless of which regulator has jurisdiction over these products, investors deserve as level a playing field as possible.* When product lines blur and regulators' reach is limited, we have an important responsibility to ensure that we work closely together to ensure the highest quality of investor protection." NASAA Annual Conference (September 18, 2006) (emphasis added). Available at http://www.nasd.com/PressRoom/SpeechesTestimony/MaryL.Schapiro/NASDW_017410

B. The life insurance industry has responded to the public observations and has acted to support and promote enactment of the revised NAIC Suitability in Annuity Transactions Model Regulation.

1. The American Council of Life Insurers (ACLI) endorsed the 2006 removal of the age 65 limitation in the scope of the NAIC Senior Protection in Annuity Transactions Model Regulation, and supports adoption of the NAIC Suitability in Annuity Transactions Model Regulation, and the NAIC Annuity Disclosure Model Regulation.

a) *See* ACLI Press Release, NAIC Senior Protection in Annuity Transactions Model Should Cover All Consumers, ACLI SAYS ((Jan. 24, 2006) [The decision to support extending standards results from ongoing ACLI efforts to identify areas where the state laws or regulations governing annuity sales can be enhanced, and reflects a strong desire by U.S. life insurers to enhance Americans' retirement security]; available at http://www.acli.com/ACLI/Newsroom/News%20Releases/Text%20Releases/NR06-004

2. ACLI also established a CEO Task Force to develop constructive solutions to promote meaningful disclosure about annuities and suitable sales practices in September 2005 that has coordinated with FINRA and the SEC about a number of responsive industry developments in these areas. A summary about ACLI's disclosure initiatives appears in a separate outline in this appendix.

VI. Overview of the Modifications in the 2010 Revised NAIC Suitability in Annuity Transactions Model Regulation

A. Insurance producers are required to obtain information about the customer's needs and financial objectives when formulating a recommendation for an annuity purchase and must have reasonable belief that the recommendation is suitable. (NAIC Model Sec. 6(A)&(B)).

B. Insurers must assure that a system is in place to supervise compliance with the Model, including review of producers' recommendations. (NAIC Model Sec. 6(F)(1)(d)).

C. An insurer must conduct reviews of its records to assist in detecting and preventing violations of the regulation. (NAIC Model Sec. 6(F)(1)(e).

D. When an insurer contracts with a third party to establish a system of supervision, the insurer must monitor and audit, as appropriate, to assure that the third party is performing the required functions. (NAIC Model Sec. 6(F)(2)(b)(i)).

E. When an insurer relies on a third party to perform required suitability functions, the third party, when requested by the insurer, must give a certification that it is performing the functions in compliance with the regulation. (NAIC Model Sec. 6(F)(2)(b)(ii)).

F. Sales of annuities made in compliance with stringent federal securities rules pertaining to suitability and supervision (FINRA Rule 2330) satisfy the requirements under the Model. (NAIC Model Sec. 6(H)).

G. An insurance producer shall not solicit the sale of an annuity unless the producer has adequate knowledge of the product and shall be in compliance with the insurer's product training standards. (NAIC Model Sec. 7(A).

H. Insurance producers who engage in the sale of annuities must complete an annuity training course approved by the appropriate State. (NAIC Model Sec. 7(B)).

I. The Commissioner may order that an insurer or producer take appropriate corrective action for any consumer harmed by the insurer's, or producer's, violation of the regulation. (NAIC Model Sec. 8(A)(1)&(2)).

FINRA Rule 2330: Suitability and Supervision in the Sale of Variable Annuity Contracts

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I. Overview and Scope

A. FINRA Rule 2330 [Formerly NASD Rule 2821], which governs suitability and supervision in the sale of variable annuity contracts, was approved by the SEC in 2008, and was under development since 2004. The rule evolved through six different stages, five at the SEC, and one at FINRA.

B. This outline will summarize the elements of Rule 2330, and discuss its administrative history to illuminate FINRA's purpose and intent.

II. Substantive Overview: Rule 2330 has four primary provisions

A. Requirements governing recommendations, including a suitability obligation, specifically tailored to deferred variable annuity transactions;

B. Principal review and approval obligations;

C. A specific requirement for broker-dealers to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the rule's standards; and,

D. A targeted training requirement for broker-dealers' associated persons, including registered principals.

III. The Rule's Requirements in Greater Detail

A. Revised Rule 2330 established the following specific requirements:

1. *Recommendation Requirements.* When recommending a deferred variable annuity transaction, Rule 2330 requires broker-dealers and salespersons to have a reasonable basis to believe that the: customer *has been informed of, in a general fashion,* the various features of the deferred variable annuity,

a) customer *would benefit from* certain features of a deferred variable annuity (e.g., tax-deferred growth, annuitization or a death benefit); and

b) the deferred variable annuity *as a whole* and the underlying sub-accounts or riders are suitable for the particular customer.

c) the particular deferred variable annuity that the registered representative is recommending, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and the riders and similar product enhancements are suitable (and in the case of an exchange, the transaction as a whole also is suitable) for the customer based on the information the registered representative is required to make a reasonable effort to obtain.

2. Revised Rule 2330 requires these determinations to be *documented and signed* by the salesperson recommending the transaction.

a) Rule 2330 would also require salespersons to make *reasonable efforts* to obtain information concerning customers' age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the variable annuity, investment time horizon, existing investment and insurance holdings, liquidity needs, liquid net worth, risk tolerance, tax status and other information used by the salesperson in making recommendations.

3. *Supervisory Review.* Rule 2330(c) requires that a principal review each variable annuity purchase or exchange within seven business days after the signed application arrives at the broker-dealer's office of supervisory jurisdiction in good order. A registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity.

a) In reviewing the transaction, the registered principal would need to take into account the extent to which:

- the customer would benefit from certain features of a deferred variable annuity;
- the customer's age or liquidity needs make the investment inappropriate; and,
- the customer involved an exchange of a deferred variable annuity: will incur surrender charges, face a new surrender period, lose death or existing benefits,
- have increased mortality and expense fees, appears to have a need for any potential product enhancements and improvements, or had another deferred variable annuity exchange within the preceding 36 months.
- Under Rule 2330, the supervisory review standards must be signed and documented by the registered principal that reviewed and approved the transaction.

4. *Supervisory Procedures.* Rule 2330 requires broker-dealers to establish and maintain specific written supervisory procedures reasonably designed to achieve and evidence compliance with the standards in Rule

2330. The broker-dealer must have procedures to screen and have principal review of the recommendations requirements in Rule 2330, and determine whether the salesperson has a particularly high rate of effecting deferred variable annuity exchanges.

5. *Training.* Under the proposal, broker-dealers would need to develop and document specific training policies or programs designed to ensure that salespersons recommending transactions, and registered principals who review transactions, in deferred variable annuities comply with the requirements of Rule 2330 and that they understand the material features of deferred variable annuities, including liquidity issues, sales charges, fees, tax treatment, and market risks.

6. *Automated Supervisory Review***.** FINRA's submission on the rule indicated that the rule would not preclude firms from using automated supervisory systems, or a mix of automated and manual supervisory systems, to facilitate compliance with the rule.

a) In addition, FINRA delineated what, at a minimum, a principal would need to do if his or her firm intends to rely on automated supervisory systems to comply with the proposed rule.

b) Specifically, a principal would need to (1) approve the criteria that the automated supervisory system uses, (2) audit and update the system as necessary to ensure compliance with the proposed rule, (3) review exception reports that the system creates, and (4) remain responsible for each transaction's compliance with the proposed rule.

c) Finally, FINRA noted that a principal would be responsible for any deficiency in the system's criteria that would result in the system not being reasonably designed to comply with the rule.

7. *Tax Qualified Plans.* Rule 2330 does not apply to variable annuity transactions made in connection with tax-qualified, employer-sponsored retirement or benefit plans that either are defined as a "qualified plan" under Section 3(a)(12)(C) of the Exchange Act or meet the requirements of Internal Revenue Code Sections 403(b) or 457(b), unless, in the case of any plan, the broker-dealer makes recommendations to individual plan participants regarding the variable annuity.

IV. Review and Explanation of (Revised) Rule 2330

A. Supervisory review standards changed

1. FINRA enlarged the time period for supervisory review to seven days after the signed application arrives at the broker-dealer's OSJ in good order.

a) Compare to *prior* draft: "Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but *no later than seven business days after the customer signs the application*, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity."

b) Compare to earlier draft: the third amendment required the principal must review and approve the transaction "[n]o later than *two business days following* the date when a member or person associated with a member *transmits a customer's application* for a deferred variable annuity to the issuing insurance company for processing or *five business days from the transmittal date* if additional contact with the customer or person associated with the member is necessary in the course of the review."

2. FINRA rationale: ensuring that all broker-dealers have adequate time to perform a thorough principal review of these transactions.

a) In view of the variety of features and provisions in connection with the issuance of deferred variable annuity contracts, FINRA became persuaded that principal review of variable annuity sales requires greater time than reviews of many other securities transactions.

b) The provision of a reasonable amount of time for pre-transmittal review, however, posed potential problems related to other rules concerning the prompt handling of customer funds.

(1) For instance, FINRA Rule 2330 states generally that member firms shall not make improper use of customer funds, and FINRA Rule 2820 specifically requires member firms to "transmit promptly" the application and the purchase payment for a variable contract to the issuing insurance company.

(2) Similarly, Rules 15c3-1 and 15c3-3 under the 1934 Act require certain member firms to promptly transmit and forward funds.

(3) Rules 15c3-1(c)(9) and (10) under the 1934 Act define the terms "promptly transmit and deliver" and "promptly forward" funds as meaning "no later than noon of the next business day after receipt of such funds."

3. FINRA solution to regulatory conflicts with prompt pricing standards:

a) FINRA asked for, and obtained from the SEC, regulatory relief regarding Rules 15c3-1 and 15c3-3 when the same circumstances exist. As a companion to the rule approval, the SEC provided an exemptive order from the prompt pricing provisions.

b) FINRA made clear that a broker-dealer that is holding an application for a deferred variable annuity and a non-negotiated check from a customer written to an insurance company for a period of seven business days or less would not be in violation of FINRA Rules 2330 if the reason that the application and check are being held is to allow a principal to complete his or her review of the transaction pursuant to proposed Rule 2330.

B. Recommendation requirements revised

1. FINRA revised proposed Rule 2821to state that "[n]o member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member *has a reasonable basis to believe* that the transaction is suitable in accordance with Rule 2310."

2. FINRA is substituting the phrase "has a reasonable basis to believe" for "has determined," which appeared in the prior draft of the rule.

3. FINRA rationale: FINRA softened the review requirement in response to comments that the reasonable basis standard was more strict than with other similar financial products.

C. Non-recommended transactions conditionally excluded. FINRA revised the rule conditionally so that it does not apply to non-recommended transactions, such as situations where the member is acting solely as an order taker. FINRA believed Rule 2821 should not prevent a fully informed customer from making his or her own investment decision.

1. Conditional exclusion from rule, however.

a) A registered principal "may authorize the processing of the transaction if the registered principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the registered principal has not approved the transaction, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity."

2. FINRA rationale:

a) Change allows a customer to decide to continue with the non-

b) recommended purchase or exchange of a deferred variable annuity notwithstanding the broker-dealer's belief that the transaction would be viewed as unsuitable if it had been recommended.

c) The new requirement that the principal independently determine that the transaction was not recommended adds another layer of protection. Requirement "should discourage salespersons from attempting to bypass compliance requirements for recommended sales by simply checking the 'not recommended' box on a form."

d) Customers must indicate an explicit intent to continue with the non-recommended transaction notwithstanding the unsuitability determination, which will help ensure that the customer's decision is an informed one.

D. *"Undue concentration" standard eliminated.* FINRA eliminated prior requirements that registered principals consider "the extent to which the amount of money invested would result in an undue concentration in a deferred variable annuity."

E. The annuity or deferred variable annuities should be evaluated in "the context of the customer's overall investment portfolio."

1. FINRA Rationale:

a) Requirement was unclear and could cause confusion. Because other provisions in Rule 2330 already capture the important aspects of this "undue concentration" determination, FINRA has eliminated it as superfluous.

F. Generic disclosure allowed

1. Under recommendation requirements, FINRA clarified that required disclosure may be generic and not specific to the product. Clarification now requires that "the customer has been informed, *in general terms*, of various features of deferred variable annuities. . . ."

2. FINRA rationale:

a) Simply a clearer statement of original rule's intent.

G. "Unique features" requirement relaxed and expanded

1. Provision now states that salesperson must have "a reasonable basis to believe that . . . the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit."

2. FINRA Rationale:

a) FINRA accepted commenters' position that there are other financial products that have features similar to those of a deferred variable annuity, so a requirement that the customer would benefit from the *unique* features was relaxed to benefiting from *certain* features.

b) Living benefits added to the list of certain features that may be beneficial for customer in addition to death benefit.

H. Required surveillance practices for replacement activities clarified

1. FINRA indicated that principal need not examine *every* transaction when salesperson has a potentially higher rate of replacement sales. FINRA emphasized instead review on a periodic basis via exception reporting rather than as part of the principal review of each exchange transaction

2. FINRA revised the supervisory procedures guarding against inappropriate replacement practices so that, "the member also must (1) implement surveillance procedures to determine if the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable FINRA rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges."

V. ACLI Views on Rule 3220:Guideposts to Administrative History

A. Principal Review Provisions

1. ACLI recommend adding a further refinement allowing additional time, with customer consent, for processing to resolve incomplete portions of the application. ACLI's submission can be found at http://sec.gov/comments/sr-finra-2008-019/finra2008019-14.pdf

2. This suggestion follows the policy embodied in Rule 22c-1 under the Investment Company Act of 1940 allowing pricing of customer orders to extend beyond this rule's 5 day time period, with customer consent, to resolve deficiencies in the application.

a) The added time period for clarification of application deficiencies could be modeled after provisions in Rule 22c-1.

b) The recommended refinement would fulfill customer objectives and price the contract more promptly than if the application were suspended, returned and refilled.

c) By mandating advance consent and explanation before any delays to complete the application, customers will be protected and in control.

B. Non-recommended Transactions.

1. ACLI supported the application of the amended rule to recommended transactions only.

2. ACLI commended FINRA's flexibility and its willingness to carefully reconsider this issue. This revision will promote consistent, enterprise-wide uniformity in compliance practices.

C. Suspense Account Issues

1. ACLI noted that some life insurers believe the amended rule's treatment of suspense account issues may be feasible under their operation and structure, if certain aspects of the standards are changed.

2. ACLI noted that other companies, however, found that the revised rule would present significant problems for the movement of money after receipt from the customer.

3. ACLI suggested an alternative that would allow immediate transmittal to the insurance company suspense account without conditions, and would facilitate broker-dealer communication with life insurers once the principal's suitability review has been approved or rejected.

a) Customer funds could not be transferred from suspense accounts at the insurance company without completion of registered principal approval.

b) Such an amendment to the Rule with have the positive effect of promoting communication between the broker-dealer and the insurance company regarding the suitability of the recommendation, a positive step in ensuring the suitability of variable annuity sales.

D. Process Issues

1. The FINRA amendments introduce "supplementary material" for the first time in Rule 2821. ACLI noted that the legal status of these appendages is imprecise and unclear.

a) The latest proposal does not explain the purpose or intent of the rule's supplementary material. It is far preferable for administrative rulemaking to have all applicable provisions appear in the text of the rule rather than in "supplementary material."

b) ACLI observed that during the four year evolution and amendment of Rule 2821 [now renumbered as Rule 2330], FINRA has not provided any analysis of the proposal's economic and competitive impact. ACLI recommended that these economic reviews be developed and specifically reviewed by the SEC.

VI. Other Industry Comments: Guideposts to Administrative History

A. Principal review timetable

1. One Commentator supported the proposal to start the seven day principal approval period when a broker-dealer receives a "correct and complete" application at an office of supervisory jurisdiction ("OSJ") of the firm, and believed the standard is workable and should generally provide sufficient time for principal review. See comment filed by the Committee of Annuity Insurers, http://www.sec.gov/comments/sr-finra-2008-019/finra2008019-10.pdf

a) The Commentator, however, sought clarification that the trigger date does not begin when an application is received at any OSJ of the firm. Id. According to the commentator,, in order to be "correct and complete" the application must be received at the particular OSJ designated by the firm for processing such applications.

b) The Commentator also suggested that suggests that the Rule be revised to address infrequent situations when seven business days will not be a sufficient amount of time for the registered principal to conduct the required review. Id.

(1) For example, it was anticipated that there will be situations where a "complete and correct" application is received but a registered principal conducting a review needs further information or documentation from the selling representative or the customer.

(2) In order to address such situations, the Commentator believed that the Rule should permit a broker-dealer to obtain the consent of the customer to delay the seven day period. The letter noted that this exception could be patterned upon the provisions of Rule 22c-1 under the Investment Company Act of 1940. Id.

(a) The provisions of Rule 22c-1 relating to the two day/ five day procedure and the possibility of the customer consenting to a delay were adopted by the SEC in 1985, and have worked well for both customers and the industry for over twenty years.

(b) Rule 22c-1 provides that, in complying with the "two day/five day" time period to price the payments under a variable annuity contract, the insurance company may, if the application for the variable annuity is incomplete, refrain from returning the initial purchase payment when the two day/five day period expires if "the prospective purchaser specifically consents to the insurer retaining the purchase payment until the application is made complete."

(c) Under Rule 22c-1, the prospective purchaser must be informed of the reasons for the delay in pricing the contract.

VII. Administrative History of Rule 2821 [now renumbered as Rule 2330]

A. *Round Six*. On April 17, 2008, FINRA filed an amendment with the SEC requesting delayed implementation on provisions of Rule 2821.

1. On May 5, 2008, Rule 2821 [now renumbered as Rule 2330] became effective, except for paragraphs (c) and (d), which involve principal review, non-recommended transactions, and handling of customer funds pending supervisory approval.

2. The FINRA amendment requests an order from the SEC revising the implementation timetables for Rule 2821 (c) and (d) until 180 days after the SEC approves further supplemental changes to the rule. The rule's effectiveness, therefore, will have two stages, with one date certain and another yet to be determined.

3. FINRA's fifth amendment can be found at http://sec.gov/rules/sro/finra/2008/34-57920.pdf

B. *Round Five.* On March 5, 2007, FINRA filed its fourth amendment to the initial 2005 filing with the SEC on proposed Rule 2821 [now renumbered as Rule 2330] governing suitability and supervision in the sale of individual variable annuity contracts.

1. The fourth amendment dealt principally with modifications to supervisory review standards and recommendation requirements.

2. FINRA's fourth amendment can be found at http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_018737.pdf .

C. *Round Four.* On November 15, 2006, FINRA filed its third amendment to the initial 2005 filing with the SEC, which is discussed below. FINRA requested prompt SEC approval of the rule without the opportunity for notice and public

D. comment.

1. In brief, the third amendment addressed, among other things: the time period for supervisory review; non-recommended transactions; undue concentration criteria; specificity of disclosure; and recommendation requirements.

2. FINRA's third amendment to the proposal appears at http://www.nasd.com/RulesRegulation/RuleFilings/2004RuleFilings/NASDW_012781 .

3. As of November 15, 2006, the SEC staff did not intend to renotice FINRA proposal for public comment in light of amendment three. *See* comments of Catherine McGuire at ALI-ABA Seminar on Life Insurance Company Products (Nov. 15, 2006) at program MP3 §01:25:40.

E. Round Three. On June 6, 2006, the Securities and Exchange Commission invited comment on a revised FINRA suitability and supervision rule for variable annuity transactions recommended by registered representatives of broker-dealers. See Release No. 34-54023; File No. SR-NASD-2004-183, which appears at http://www.sec.gov/rules/sro/nasd/2006/34-54023.pdf .NASD filed two amendments to its initial 2005 rule proposal, at:

a) http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_016480.pdf

b) http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_014678.pdf

2. Over 1964 letters of comment were filed on the 2006 revisions, with the vast majority opposing all or parts of the FINRA initiative. A tiny fraction of the comments supported FINRA action. *See* the comment file at http://www.sec.gov/rules/sro/nasd/nasd2004183.shtml

F. *Round Two*. On July 19, 2005, the Securities and Exchange Commission invited comment on FINRA's initial free-standing suitability and supervision rule for variable annuity transactions recommended by registered representatives of broker-dealers. See Release No. 34-52046A; File No. SR-NASD-2004-183, which appears at http://www.sec.gov/rules/sro/nasd/34-52046a.pdf .

1. The SEC granted a 21-day extension to the initial 2005 comment period at Release No. 34-52191(Aug. 2, 2005) [File No. SR-NASD-2004-183] in response to ACLI's request dated July 27, 2005 (located in the comment file at http://www.sec.gov/rules/sro/nasd/nasd2004183/cbwilkerson072705.pdf).

2. The actual text of the proposal did not appear in the SEC's invitation of comment directly, but only through cross reference to FINRA's general website address. The text appears in full at *http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_012780.pdf*

3. Most of the 1396 commentators opposed Rule 2821, and either recommended its elimination or substantial overhaul, as discussed below. See *http://www.sec.gov/rules/sro/nasd/nasd2004183.shtml*.

G. *Round One.* Prior to the SEC invitation of comment, FINRA solicited comment in June 2004, on an earlier version of the proposal that sought to formally codify several interpretive positions on supervision and suitability in a rule of conduct, and would have required broker-dealers to prepare and deliver a written point-of-sale document to customers.

1. The proposal appeared in FINRA Notice to Members 04-45. See http://www.nasdr.com/pdf-text/0445ntm.pdf. and Wilkerson, Proposed Variable Annuity Suitability Rule and Risk Disclosure Statement, ALI-ABA Conference on Life insurance Company Products (Nov. 2002).

2. FINRA's draft proposal elicited 1,129 letters of comment.

a) According to the release, only fourteen of the commentators fully supported the proposal, and twenty offered partial or qualified support.

b) Using FINRA's numbers, 97% of the commentators opposed the initiative.

3. Companion Action by FINRA and SEC

a) On the same day of this FINRA rule proposal, the SEC and FINRA issued a joint report on inspection examination observations about the sale of variable insurance products.

(1) The joint report, which is referenced in ACLI General Bulletin No. O4-053, highlights both good practices by broker-dealers, as well as practices needing improvement.

(2) A copy of the report can be found at http://www.sec.gov/news/studies/secnasdvip.pdf

b) The SEC also issued an alert on June 9, 2004 "to remind investors that variable annuities are not suitable for all consumers, especially investors who need the money in the short term or who borrow against their home mortgage in order to purchase a variable annuity or variable life insurance product."

(1) The SEC's new alert is entitled Variable Annuities and Variable Life Products: Questions to Ask, and can be found at http://www.sec.gov/investor/pubs/varaquestions.htm

(2) SEC Chairman William Donaldson stated "[i]t is critical that broker-dealers ensure that the securities they sell are appropriate for the individual investor. Given the complexity of variable annuities, extra care is required. The findings of these examinations show that many firms

should take steps to improve their practices. Investors considering purchasing a variable annuity can obtain information about the product from the SEC and FINRA."

VIII. Implementation Timetable and History

A. The implementation dates on this new FINRA Rule have experienced several revisions.

B. On April 17, 2008, FINRA filed an amendment with the SEC requesting delayed implementation on provisions of Rule 2821, a new variable annuity suitability and supervision rule.

1. In part, the amendment responds to industry requests that FINRA delay the rule's implementation because several aspects of the proposed rule needed further clarification, and because the costs of developing systems in light of the evolving clarifications would be unnecessarily increased.

C. On May 5, 2008, Rule 2821 became effective, except for paragraphs (c) and (d), which involve principal review, non-recommended transactions, and handling of customer funds pending supervisory approval.

D. Originally, the SEC approved Rule 2821 on September 13, 2007 with an effectiveness date of May 5, 2008. On September 7, 2007, the U.S. Securities and Exchange Commission approved new FINRA Rule 2821, which establishes suitability and supervision standards for variable annuity sales. See 72 Fed. Reg. 177 (September 13, 2007) at 52403.

a) On January 29, 2008, however, the SEC issued an order at FINRA's request bifurcating implementation of Rule 2821 because of continued industry concerns about its proper application.

b) The SEC order granted (i) delayed implementation of paragraphs (c) and (d) until August 4, 2008 to allow FINRA time to address the challenged provision, and (ii) retained the original implementation date of May 5, 2008 for paragraphs (a), (b), and (e), that largely govern sales practice and training issues.

2. FINRA requested the amendment in response to interpretive and operational issues. ACLI asked FINRA to allow more time for systems development on Rule 2821, particularly in light of several outstanding operational issues.

a) On interpretive clarifications, ACLI recommended (i) additional time for principal review when applications are incomplete; (ii) exclusion of non-recommended transactions from principal review; and, (iii) authorized deposit of customers' initial premium payments in life insurers' suspense accounts pending principal review of the transaction.

In its meetings with the SEC and FINRA about delayed implementation and substantive clarification, ACLI strongly recommended that the SEC circulate subsequent revisions to the rule for notice and comment before approving the rule (i) to give all interested parties a fair opportunity to address the revisions, and (ii) to avoid further rule postponements and associated system expenses. The SEC staff indicated that it would not grant an order of approval until after the opportunity for notice and comment this time. In contrast, the September 7, 2007, SEC order had approved FINRA's Rule 2821 [now renumbered Rule 2330] amendments and instituted effectiveness dates, while inviting comment after

NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities

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I. On July 15, 2008, the NAIC Life Insurance and Annuities (A) Committee adopted a new Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities.

A. This NAIC regulation directly parallels the North American Securities Administrators Association (NASAA) credentialing regulations and was developed in close coordination with NASAA and supported by NASAA.

B. See http://www.nasaa.org/content/Files/Senior_Model_Rule110807.pdf

C. The NAIC regulation and an accompanying bulleting can be obtained on the NAIC website at http://www.naic.org/Releases/2008_docs/senior_sales.htm .

II. Purpose of the NAIC Regulation

A. The regulation establishes standards to protect consumers from misleading and fraudulent marketing practices with respect to the use of senior-specific certifications and professional designations in the solicitation, sale or purchase of, or advice made in connection with, a life insurance or annuity product.

B. The regulation will apply to any solicitation, sale or purchase of, or advice made in connection with, a life insurance or annuity product by an "insurance producer," that is defined as a person required to be licensed under the laws of this State to sell, solicit or negotiate insurance, including annuities.

III. Prohibited Uses of Senior-Specific Certifications and Professional Designations [Section 5]

A. Under the regulation, it will be an unfair and deceptive act or practice in the business of insurance within the meaning of the Unfair Trade Practices Act for an insurance producer to use a senior-specific certification or professional designation that indicates or implies in such a way as to mislead a purchaser or prospective purchaser that insurance producer has special certification or training in advising or servicing seniors in connection with the solicitation, sale or purchase of a life insurance or annuity product or in the provision of advice as to the value of or the advisability of purchasing or selling a life insurance or annuity product, either directly or indirectly through publications or writings, or by issuing or promulgating analyses or reports related to a life insurance or annuity product.

B. The prohibited use of senior-specific certifications or professional designations includes, but is not limited to, the following:

1. Use of a certification or professional designation by an insurance producer who has not actually earned or is otherwise ineligible to use such certification or designation;

2. Use of a nonexistent or self-conferred certification or professional designation;

3. Use of a certification or professional designation that indicates or implies a level of occupational qualifications obtained through education, training or experience that the insurance producer using the certification or designation does not have; and

4. Use of a certification or professional designation that was obtained from a certifying or designating organization that:

   a) Is primarily engaged in the business of instruction in sales or marketing;

   b) Does not have reasonable standards or procedures for assuring the competency of its certificants or designees;

   c) Does not have reasonable standards or procedures for monitoring and disciplining its certificants or designees for improper or unethical conduct; or

   d) Does not have reasonable continuing education requirements for its certificants or designees in order to maintain the certificate or designation.

5. Under the regulation, there is a rebuttable presumption that a certifying or designating organization is not disqualified solely for purposes of subsection A(2)(d) when the certification or designation issued from the organization does not primarily apply to sales or marketing and when the organization or the certification or designation in question has been accredited by:

   a) The American National Standards Institute (ANSI);

   b) The National Commission for Certifying Agencies; or

   c) Any organization that is on the U.S. Department of Education’s list entitled “Accrediting Agencies Recognized for Title IV Purposes.”

6. In determining whether a combination of words or an acronym standing for a combination of words constitutes a certification or

professional designation indicating or implying that a person has special certification or training in advising or servicing seniors, factors to be considered shall include:

a) Use of one or more words such as “senior,” “retirement,” “elder,” or like words combined with one or more words such as “certified,” “registered,” “chartered,” “advisor,” “specialist,” “consultant,” “planner,” or like words, in the name of the certification or professional designation; and

b) The manner in which those words are combined.

7. For purposes of this NAIC regulation, a job title within an organization that is licensed or registered by a State or federal financial services regulatory agency is not a certification or professional designation, unless it is used in a manner that would confuse or mislead a reasonable consumer, when the job title:

a) Indicates seniority or standing within the organization; or

b) Specifies an individual’s area of specialization within the organization.

8. Under this subsection, financial services regulatory agency includes, but is not limited to, an agency that regulates insurers, insurance producers, broker-dealers, investment advisers, or investment companies as defined under the Investment Company Act of 1940.