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Suitability Policies and Procedures

Producers' Guide: Annuity Suitability

I. 2010 Suitability in Annuity Transactions – Model Synopsis

Purpose

The *2010 Suitability in Annuity Transactions Model Regulation*, amended and adopted by the National Association of Insurance Commissioners (NAIC), updates and revises previously established standards and procedures for suitable individual annuity recommendations to help ensure that consumers' insurance needs and financial objectives are appropriately considered and protected.

Scope

Where adopted, the regulation applies to any recommendation to purchase, exchange, or replace an annuity made to an individual consumer by an insurance producer and/or insurer.

Definitions

Annuity – a deferred or immediate fixed or variable annuity that is an insurance product under State law that is individually solicited.

Insurance Producer – a person required to be licensed under State law to provide insurance products, including annuities.

Recommendation – advice provided by an insurance producer, or an insurer where no producer is involved, to an individual consumer that results in the purchase, exchange, or replacement of an annuity in accordance with that advice.

Replacement – a transaction in which a new policy or contract is to be purchased and it is known to the proposing producer, or proposing insurer where no producer is involved, that by reason of the transaction an existing policy has been, or is to be: (1) lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated; (2) converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values; (3) amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid; (4) reissued with any reduction in cash value; or (5) used in a financed purchase.

Suitability Information – information that is reasonably appropriate to determine the suitability of a recommendation, including the following:

- Age
- Annual Income
- Financial Situation and needs (including the financial resources used for the funding of the annuity)
- Financial experience
- Financial objectives
- Intended use of the annuity
- Financial time horizon
- Existing assets (including investment and life insurance holdings)
- Liquidity needs
- Liquid net worth
- Risk tolerance
- Tax status

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Responsibilities of the Insurance Producers of the insurance companies of OneAmerica

A. When recommending an annuity, an insurance producer shall have reasonable grounds for believing that the recommendation is suitable for the consumer based on the following:
   1. The suitability information disclosed by the consumer;
   2. The consumer has been informed of the material features of the annuity, such as:
      a. Fees and charges, including potential surrender charges (if applicable), and/or potential tax penalties;
      b. Market risk and limitations on interest returns;
      c. Features of riders (if applicable);
      d. Insurance and investment components
   3. The consumer would benefit from specific features of the annuity;
   4. The annuity as a whole, including underlying subaccounts, riders, and other product enhancements (if applicable), is suitable for the consumer.

B. In the case of an exchange or replacement of an annuity, an insurance producer shall have a reasonable basis to believe that the exchange or replacement is suitable for the consumer including taking into consideration whether:
   1. The consumer will incur a surrender charge, be subject to a new surrender period, lose existing benefits, be subject to increased fees, investment advisory fees, or charges for riders and other product enhancements;
   2. The consumer would benefit from product enhancements and improvements;
   3. The consumer has had another annuity exchange or replacement within the preceding thirty-six (36) months, or preceding sixty (60) months where applicable.

C. Prior to completing an application for a recommended annuity, an insurance producer, or the insurer where no producer is involved, shall make reasonable efforts to obtain the consumer's suitability information.

D. An insurance producer, or the insurer where no producer is involved, shall not have an obligation to a consumer if:
   1. No recommendation is made;
   2. A recommendation is made and is later found to have been prepared based on materially inaccurate information provided by the consumer;
   3. A consumer refuses to provide relevant suitability information and the annuity transaction is not recommended[1];
   4. A consumer decides to enter into an annuity transaction that is not based on a recommendation of the insurance producer or insurer.

E. An insurance producer, or the insurer where no producer is involved, at the time of sale shall:
   1. Make a record of the recommendation;
   2. If applicable, obtain a consumer signed statement documenting his/her refusal to provide suitability information; and
   3. If applicable, obtain a consumer signed statement acknowledging that an annuity transaction is not recommended if a consumer decides to enter into an annuity transaction that is not based on the insurance producer's, or insurer's, recommendation.

[1]The insurance companies of OneAmerica may deem an annuity transaction not suitable if relevant information is not provided or if the information supplied is inconsistent or contradictory.

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F. An insurance producer shall not dissuade, or attempt to dissuade, a consumer from:
   1. Truthfully responding to an insurer's request for confirmation of suitability information;
   2. Filing a complaint; or
   3. Cooperating with the investigation of a complaint.

Insurance Producer Training Requirements

A. An insurance producer shall not solicit the sale of an annuity product unless he/she has adequate knowledge of the product to recommend the annuity, and he/she is in compliance with the insurer's standards for product training.

B. An insurance producer who engages in the sale of annuity products shall complete a state specific annuity training course (approved by the state department of insurance) and provide the insurer with the certificate of completion of the training course.

C. An insurance producer who engages in the sale of annuity products shall complete insurer product specific training prior to the solicitation or recommendation of an annuity.

D. If the Consumer Suitability and Due Diligence Questionnaire is received without proof of completed training, then the insurance producer must complete the training and submit a new application and a new questionnaire, affirming, post-training, that the product is suitable for the consumer.

Recordkeeping Requirements

A. Insurers, general agents, independent agencies, ***and*** producers are required to maintain or be able to make available to the state insurance commissioner or appropriate regulatory body records of the information collected from the consumer that was used in making the recommendations for the insurance transaction, including annuity purchases or exchanges, for seven (7) years after the insurance transaction is completed by the insurer.

B. Records that are required to be maintained because of the "Consumer Suitability in Annuity Transactions" regulation may be paper, photographic, microprocess, magnetic, mechanical or electronic media, or by any process that accurately reproduces the actual document.

Responsibilities of Insurer – the insurance companies of OneAmerica

The insurance companies of OneAmerica will:

A. Establish and maintain written procedures to assure that a system to supervise recommendations is reasonably designed.
B. Establish standards for insurance producer product training and provide product-specific training which explains material features of its annuity products.
C. Maintain procedures to review a recommendation prior to issuance of an annuity.
D. Maintain procedures to detect recommendations that are not suitable.
E. Conduct periodic reviews of its records, designed to assist in detecting and preventing violations of this regulation.

II. Standards of Suitability of the insurance companies of OneAmerica

Annuities are primarily designed to be a long term savings vehicle. Recommendations made by our producers for annuity purchases are based on individual's needs, goals, and circumstances. Realizing that each client and each situation is unique, the following **"Standards of Suitability"** should be used as a basis when determining the suitability of an annuity for an individual's needs:

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A. General Suitability
   1. How/why is an annuity, in general, a suitable recommendation to your client?
   2. How/why is the ***specific*** annuity product (such as Annuity Care, Indexed Annuity Care, Freedom Builder, etc.) being recommended suitable? If applicable, this includes subaccount allocations, product features, riders and similar product enhancements, and whether the annuity is immediate or deferred.
   3. In the case of an exchange or replacement of an annuity:
      a. Will the client be adversely affected by an exchange or replacement, such as incurring a surrender charge, subject to a new surrender period, loss of existing benefits (such as death, living or other contractual benefits), or be subject to increased fees or charges (including for riders and similar product enhancements)?
      b. Will the client benefit from product enhancements and improvements?
      c. Has the client had another annuity exchange or replacement (with you or with another producer/carrier) and, in particular, an exchange or replacement in the preceding 36 months (or 60 months, where applicable)?

B. Age
   1. When considering a client's age as part of a suitability analysis, a producer should consider if the client is:
      a. Senior Client
         Clients who are of an advanced age may not need or want an annuity as a long term savings instrument. Consider whether a minimum holding period is necessary before the tax deferral benefits offered by an annuity outweigh the potential fees imposed on an early annuity distribution.
      b. Under the age of 59½
         In addition to any applicable surrender charges, clients under the age of 59½ who access their cash value may be subject to a federal tax penalty of 10% on those distributions. Consider the implications of this federal tax penalty as it may apply to future distributions to your client.
   2. Additional considerations, for clients of any age, may include:
      a. Number of years to retirement
         Consider if the client is accumulating retirement savings, preparing for retirement income distributions, and/or has immediate income needs.
      b. Specific benefits/riders
         Consider if a minimum holding period is necessary before the features/benefits offered by the annuity outweigh the potential fees for that feature or rider.

C. Annual Income
   Annual income is earned or unearned income received during a calendar year. Consider if a client's annual income can support the purchase of an annuity product without adversely affecting his/her lifestyle as a client's annual income should be sufficient to cover his/her expenses. If the purchase of an annuity adversely affects the client's lifestyle, it may be unsuitable.

D. Financial Situation and Needs; Funding Source
   Consider the client's current and future financial needs and whether or not funds will need to be available sooner rather than later to meet those needs. Does the client expect major changes in his/her financial situation within the next 12 months, such as retirement or major medical expenses? Does the client have a need to provide sufficient funds for dependents to help ensure financial independence? If

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funds for the annuity are from savings or checking accounts, will enough liquid funds be left for daily expenses? If replacing another annuity, will the client incur surrender charges and/or penalties? Is the client selling other assets such as stocks or mutual funds to purchase the annuity? If so, is there a taxable event?

E. Financial Experience
Consider the client's financial education and investment experience. Annuities are investments and should not be sold to clients who do not understand the benefits and the risks. If applicable, clients should have a level of understanding regarding insurance components, such as death benefits, interest returns, and investment components, such as the use of subaccounts, prior to purchasing an annuity.

F. Financial Objectives
Consider what the client is expecting to achieve with the purchase of an annuity. Are the features of the annuity consistent with the client's financial objectives and needs, such as, immediate income, tax deferred growth, preservation of capital, or asset-based long term care benefits? A client's objective(s) can indicate whether or not an annuity is a suitable investment.

G. Intended Use of the Annuity
Determine the purpose for which the consumer is considering the purchase of an annuity. Evaluate whether features, benefits, and/or riders of a particular annuity help to achieve the client's intent. A client's intended use can indicate whether an annuity and the riders are a suitable investment, or, if another product would better meet the client's expectations.

H. Time Horizon
Annuities are generally designed to be long term savings vehicles. Consider how long an individual anticipates keeping the product. Surrender charge periods, tax penalties, and an individual's personal goals may make an annuity recommendation unsuitable for some clients. Generally, the anticipated time horizon should exceed the surrender period.

I. Existing Assets
Consider the client's existing assets and investments weighing factors such as investment experience, time horizon, risk tolerance, and intended use. The client should have a reasonable balance between short term and long term investments. A suitability analysis should include how the recommendation to purchase or replace an annuity fits into the client's overall financial picture which includes existing assets.

J. Liquidity Needs/Sufficient Funds Available
Before recommending an annuity to a client, it is important to consider the client's liquidity needs for the foreseeable future. Verify that your client has sufficient cash or other liquid assets for living expenses and unexpected emergencies, such as medical expenses. There may be surrender charges or early withdrawal tax penalties associated with an annuity.

K. Liquid Net Worth
Liquid net worth is the part of an individual's net worth that can be readily converted into cash. Liquid net worth could include stocks, bonds, mutual funds, other securities, and bank accounts. It does not include assets that cannot be converted quickly and easily into cash, such as real estate, business equity, personal property, automobiles, expected inheritances, and investments or accounts subject to substantial penalties if they are sold or if assets are withdrawn from them. A thirty percent (30%) or

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higher percentage of liquid net worth used to purchase an annuity generally represents a significant portion of an applicant's liquid net worth and therefore an annuity recommendation that represents thirty percent (30%) or higher percentage of a client's liquid net worth may not be suitable.

L. Risk Tolerance
Risk tolerance is the degree of uncertainty that an investor can reasonably accept with regard to a negative change in his/her investments. The range of risk tolerance includes the extremes of "conservative" (accept little or no risk) to "aggressive" (willing to sustain losses or loss of principle in pursuit of higher returns). Consider a client's risk tolerance, especially concerning variable annuities and subaccount allocations because a client's stream of income and the underlying annuity value may be diminished depending on how the funds in the annuity are invested.

M. Tax Status
The client's intended use of the annuity, current and anticipated future tax status, and potential tax consequences, especially in the event of an exchange, annuitization, and/or withdrawal of funds from the annuity, should be considered when making a recommendation.

When outside these standards, producers should use the space provided on the Consumer Suitability and Due Diligence Questionnaire (I-22733) to provide an explanation as to why the producer or applicant believes the annuity recommendation is suitable.

Additional Points to Discuss with the Client

In addition to the Standards of Suitability of the insurance companies of OneAmerica, producers are required to discuss the following with their clients:

A. Surrender Charges for Early Termination
   1. Surrender charges, fees, or penalties may be incurred when using an existing policy or contract as a source of premium. Make sure that your client understands and accepts the possibility of incurring such charges, fees, or penalties.
   2. Most annuity contracts have surrender charges for early termination. If the product being recommended has applicable surrender charges, fully disclose these to your client, and make sure that your client understands and accepts the possibility of incurring such charges.

B. Annual Expense Charges
Be familiar with the features and costs associated with each recommended annuity. This should include, if applicable, mortality and expenses, annual administrative charges, and the fees for the riders or similar product features of the recommended annuity.

C. Qualified and Non-Qualified Annuity Contracts
You must differentiate qualified funds from non-qualified funds when determining the suitability of an annuity contract.
   1. Due to the tax deferred nature of both a qualified retirement account and annuities, purchasing an annuity for tax deferral cannot be the sole reason to invest qualified retirement account funds. Qualified accounts are required to have non-tax related objectives for the purchase of an annuity.
   2. Non-qualified annuities may have tax penalties if withdrawn before age 59½. Liquidity needs should be considered prior to the investment into an annuity contract. The producer should have an understanding of potential liquidity needs of their client.

III. Procedures of the insurance companies of OneAmerica

A. Producers shall make reasonable efforts to collect financial data on the Consumer Suitability and Due Diligence Questionnaire ("Form"), so that:
   1. Compliance with federally mandated Anti-Money Laundering (AML) requirements of the USA Patriot Act are met;
   2. Compliance with various state mandated consumer suitability statutes for annuities are met; and
   3. All state variations of information required to be obtained from the applicant to determine suitability are included on the Form. By completing the Form in its entirety, producers are fulfilling these federal and state law requirements.

B. Producers must submit a completed Form to the Home Office with each application for individual annuities, **EXCEPT:**
   1. Variable annuities (accompanied by a New Account Form) submitted through OneAmerica Securities;
   2. Florida, where various Florida mandated forms apply;
   3. Massachusetts, which requires a Massachusetts state specific form, I-22733 (MA); and
   4. Distributors who have entered into a suitability delegation amendment approved by the Legal Department of The State Life Insurance Company® (State Life) to accept the responsibility for performing all the suitability functions ordinarily performed by OneAmerica.

C. If no Form is received with the application, the Form will be added as a pending requirement. A policy and/or contract cannot be issued or transfer or 1035 money cannot be requested until a completed Form is received and reviewed by Home Office.

D. The *US Patriot Act Notice, Customer Identification Verification, and Verification of Source of Funds* form (7-17078) is required for all life and annuity applications except term life insurance, unless when converting term to a cash value policy or contract.

E. During regular New Business processing, Home Office Personnel will review the Form for completeness.
   1. If the Form is signed and complete:
      a. Home Office Personnel will continue to process the application following standard procedures.
   2. If the Form is incomplete:
      a. If the Form is missing a signature, but is otherwise complete, the required signature will be added as a pending requirement.
      b. If the Form is incomplete, Home Office Personnel may need to request and receive additional information, explanations, or clarification from the Producer[2].
   3. A policy and/or contract cannot be issued or transfer or 1035 money requested until a completed Form is received in the Home Office.
   4. Any additions, updates, and/or corrections to the Form from the Producer must be in writing. Faxes and e-mails are acceptable. Updates and/or corrections via the telephone are not permissible.

[2] Information requested/required by the Home Office may not be limited to the forms provided. Producers are encouraged to make notes and use additional paper as needed to submit a more detailed description of the recommended sale.

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F. In addition to the "Completeness Review", annuity files will be reviewed for suitability by Home Office Personnel, as described below:
   1. During the "Suitability Review", Home Office Personnel may request that the Producer provide additional information, explanations or clarifications.
   2. All additional information provided by the Producer must be in writing.

G. Home Office Personnel may, but are not limited to:
   1. Approve the transaction with no further information requested;
   2. Request additional information and proceed with the suitability review;
   3. Determine that the recommendation is unsuitable.

H. If Home Office Personnel determines the recommendation to be outside the **Standards of Suitability** (as described earlier in this document), further suitability review may be warranted. Home Office Personnel will follow established escalation procedures for the review and handling of annuity transactions.

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