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"Suitability in Annuity Transactions 2023 Revised"

Satisfies the once in a Lifetime self study course requirement under Title 50; Chapter 1; Subchapter ii; Part 3120

4 hours of CE credit;

Requires the successful completion of the accompanying 55 question self-study exam which must be graded by the course provider with a minimum passing score of 70%.

"Suitability in Annuity Transactions 2023 Revised"

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Introduction: Part 3120 “Suitability in Annuity Transactions”

Purpose

The purpose of this state law is to **require insurance producers to act in the best interest of the consumer when making annuity recommendations** and to require insurance companies to establish and maintain a system that supervises recommendations so that the consumer insurance needs and financial objectives at the time of the transaction are effectively met.

Scope

This Part applies to **any sale or recommendation of an annuity**.

Exemptions

Unless otherwise specifically included, this Part does not apply to then following transactions:

1- Direct response solicitations where there is no recommendation based on information collected from the consumer and

2- Contracts used to fund the following

• An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);

• A plan described by sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC) if established or maintained by an employer;

• 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;

•A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

• Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or

• Formal prepaid funeral contracts.

Definitions

“**Annuity”** means an insurance product under Illinois State law that is sold by insurance companies in which the insurer provides for either

1. A single income payment or
2. A series of income payments

at regular intervals in exchange for a single premium contribution or multiple premium contributions paid by the annuitant.

“Cash Compensation” means any discount, concession, fee, commission, sales charge, loan, override, or cash benefit received by an insurance producer directly from the consumer or in connection with the recommendation or sale of an annuity from an insurer or intermediary.

“Consumer Profile Information” means information that is reasonably appropriate to determine whether a recommendation addresses the consumer’s financial situation, insurance needs, and financial objectives, including, at a minimum, the following:

- Age;
- Annual income;
- Financial situation and needs, including debts and other obligations;
- Financial experience;
- Financial objectives;
- Intended use of the annuity;
- Financial time horizon;
- Existing assets or financial products, including investment, annuity and life insurance holdings;
- Liquidity needs;
- Liquid net worth;
- Risk tolerance including but not limited to willingness to accept non-guaranteed elements in the annuity; and
- Tax status.

"FINRA" means the Financial Industry Regulatory Authority or a succeeding agency.

"General Agency" means an insurance agency that provides supervision on behalf of an insurer's sales force in a particular geographic region.

"Independent Agency" means an insurance agency comprised of independent contractors who sell insurance with one or more insurers.

"Insurance Producer" means a person or entity required to be licensed under the laws of this State to sell, solicit, or negotiate insurance, including annuities. For purposes of this Part, "Insurance Producer" includes an insurer where no person or entity is involved.

"Insurer" means an entity required to be licensed under the laws of this State to provide insurance products, including annuities.

"Intermediary" means an entity contracted directly with an insurer or with another entity contracted with an insurer to facilitate the sale of the insurer's annuities by insurance producers.

"Material conflict of interest" means a financial interest of the insurance producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation. "Material conflict of interest" does not include cash compensation or non-cash compensation.

"Non-cash compensation" means any form of compensation that is not cash compensation, including, but not limited to health insurance, office rent, office support, and retirement benefits.

"Non-guaranteed elements" means the premiums, credited interest rates (including any bonus), benefits, values, dividends, non-interest-based credits, charges, or elements of formulas used to determine any of these elements, that are subject to insurance company discretion and are not guaranteed at issue. An element is considered non-guaranteed if any of the underlying non-guaranteed elements are used in its calculation.

"Recommendation" means advice provided by an insurance producer, or an insurer when no insurance producer is involved, to an individual consumer that was intended to result or does result in a purchase, exchange, or replacement of an annuity in accordance with that advice. "Recommendation" does not include general communication to the public, generalized customer services assistance or administrative support, general educational information and tools, prospectuses, or other product and sales material.

"Replacement" means any transaction in which a new annuity will be purchased, and it is known or should be known to the proposing insurance producer, or to the proposing insurer if there is no insurance producer involved, that because of the transaction an existing annuity or other insurance policy has been or is to be any of the following:

- Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer, or otherwise terminated;
- 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;
- Amended 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;
- Reissued with any reduction in cash value; or

  - Pledged as collateral or subjected to borrowing, whether in a single loan or under a schedule of borrowing over a period of time for amounts in the aggregate exceeding 25% of the loan value set forth in the policy.

"Replacing Insurer" means the insurance company that issues a new annuity which is a replacement of an existing policy or contract.

"SEC" means the United States Securities and Exchange Commission.

Insurance Producer Training

- An insurance **producer shall not solicit the sale of an annuity product unless the insurance producer has adequate knowledge of the product to recommend the annuity** and is following the insurer's standards for product training. An insurance producer may rely on insurer-provided product-specific training standards and materials to comply with this subsection.

- Training Requirements

  - An insurance producer who engages in the sale of annuity products **shall complete a one-time four-hour credit training course** approved by the Department and provided by a Department-approved education provider.

  - Insurance producers who hold a life insurance line of authority after July 31, 2023 and who desires to sell annuities shall complete the training requirements by February 1, 2024. Individuals who obtain a life insurance line of authority on or after February 1, 2024 may not engage in the sale of annuities until the annuity training course required under this regulation has been completed.

- The minimum length of the training required shall be sufficient to qualify for at least four CE credits but may be longer. When an annuity product offers any long-term care benefits as defined in 50 Ill. Adm. Code 2012.30, the insurance producer shall complete the training requirements in 50 Ill. Adm. Code 2012.121 which requires an initial 8 hr. course and a 4 hr. refresher course each licensing renewal period prior to selling the annuity product.

- **The training required under this Section shall include information on the following topics:**

  - The types of annuities and various classifications of annuities;
  - Identification of the parties to an annuity;
  - How product-specific annuity contract features affect consumers;

  - The application of income taxation on qualified and non-qualified annuities;
  - The primary uses of annuities; and
  - Appropriate standards of conduct, sales practices, replacement, and disclosure requirements.

- Providers of courses intended to comply with this Section shall cover all topics listed in the prescribed outline and **shall not present any marketing information or provide training on sales techniques or specific information about a particular insurer's products.** Additional topics may be offered in conjunction with and in addition to the required outline.

- A provider of an annuity training course intended to comply with this subsection (b) shall register as a CE provider in this State and comply with the rules applicable to insurance producer continuing education under Illinois law.

- An insurance producer who completes an annuity training course approved by the Department before August 1, 2023 shall, by February 1, 2024, complete either:

  - **A new four-credit training course** approved by the Department that covers the required topics, **or**

  - **A one-time one-credit training course approved by the Department and provided by a DOI-approved education provider on appropriate sales practices, replacement, and disclosure requirements** under this Part.

- Annuity training courses may be conducted and completed by classroom, webinar, or self-study methods in accordance with 50 Ill. Adm. Code 3119.30.

- An insurer shall verify that an insurance producer has completed the annuity training course required under this requirement before allowing the insurance producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this requirement by obtaining certificates of completion for the training course or obtaining reports provided by database systems or vendors sponsored by the insurance commissioners of other states or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

Record-keeping

Insurers, general agents, independent agencies and insurance producers shall maintain and be able to make available for the Director, the information collected from the consumer and other information used as the basis for making the insurance product recommendations for **7 years after the insurance transaction is completed by the**

insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

Records required to be maintained by this Part may be maintained in paper, photographic, microprocessor, magnetic, mechanical, electronic media, or by any process that accurately reproduces the original document.

Noncompliance

Violation of the requirements of this Part **may be considered evidence of misrepresentation** under the Illinois Insurance Code and/or a deceptive act or practice prohibited under the Illinois Insurance Code. Both misrepresentation and engaging in deceptive practices can result in suspension, revocation, or denial of a license and/or a civil penalty of up to $10,000.

Part 1- Types and Classifications of Annuities

The main concept behind an annuity is that it is not a death benefit; therefore it is the opposite of what most people think of when they think of life insurance. Although the annuity does not offer a death benefit in the traditional sense it is a life insurance contract and requires that an individual have a valid producer license to offer it for sale to the public.

An annuity is a periodic payment of money made to an annuitant over his or her expected lifetime or for a specific period of time. The annuitant is defined as the person who is receiving the benefits from an annuity payout. Annuitants must be natural persons and may not be any other entity. A simple way to distinguish between an annuity and a traditional life insurance policy with a benefit is:

- Life insurance begins payment upon the insured's death.
- Annuities usually STOP payment upon the death of the annuitant (recipient).

Until the annuitant receives payment, an amount of money is, or has been, invested. This capital (or principal) sum will earn an interest rate on a tax deferred basis. In return for the invested principal amount, the annuitant can receive benefit payment (usually monthly, quarterly, etc.) for the remainder of his or her lifetime.

The concept of the annuity actually dates back to the days of the Roman Empire when citizens could pay a single lump sum of money and purchase an “annua” which then entitled them to an annual income payment for life. In the late 1600’s countries in Europe, especially Great Britain, would use a form of annuity to fund expensive and long wars. It was not until early in the 20th century that the annuity would finally be made available for individual purchase by the general public although group annuities had been marketed in the USA as early as the birth of the Republic.

The first annuity offered was pretty bare bones compared to all the bells and whistles available to consumers today. The annuity gained in popularity near the end of the Great Depression as Americans became very involved in savings and felt that insurance companies were just about the safest place to invest money.

Today the annuity takes many different forms and functions ranging from fixed, variable, and indexed and is used for retirement funding, legal settlements and even to fund college tuition. The growth in the sale of annuities has been spectacular. It is estimated that annuity sales were about $100 billion in 1995 and then jumped by 50% over the next five years to more than $155 billion, of which approximately two-thirds were fixed annuities, largely due to the increased sale of the variable annuity. As recently as 2022, total annuity sales in the United States hit a record $310 billion and that number is expected to continue to grow projected to be around ten percent annually for the near future.

Types of Annuity

Single Pay

The single pay option allows a single lump sum of money to be deposited with an insurance company who will then invest it as directed by the annuity contract owner on a fixed, a variable or an equity-index basis. Typically, this lump sum of money comes from a deferred retirement program or out of the personal savings of the individual or from an inheritance, or it can even be derived from lottery winnings. Payments from this type of annuity can either be “immediate” or “deferred.” Since it requires a large, one-time money deposit, it tends to be rarely purchased and comprises about ten percent of all annuity sales annually. It is the oldest of all annuity products.

Immediate

When the contract owner wants to take regular payouts that begin as quickly as possible, then the immediate option is selected. Therefore, this is called a Single Pay Immediate Annuity. As the payouts take place either for a specified period of time or for the rest of the life of the annuitant, the remaining principal is invested by the insurance company as required by the terms of the contract. The individual utilizing this method of Single Premium Immediate Annuity (SPIA) is usually doing so to begin, or add, income to their retirement income flow. In the event they do not wish to begin taking payments from their lump sum at the current moment, they will likely turn to the next option, the deferred annuity.

Deferred

The other option available when the individual places a single annuity payment amount with an insurance company is to defer the payout until a later period of time rather than to generate immediate income. While the money is parked with the company it earns interest, on a tax-deferred basis, as determined by the contract between the parties and principal and income will be distributed at a later point chosen by the annuity contract holder. The reason for this selection is normally because the future annuitant would prefer to wait until an older age to annuitize so they can enjoy greater regular payment amounts. This product is called a Single Pay Deferred Annuity (SPDA).

For example, if a person just recently retired and their income flow is comfortable without accessing their lump-sum undistributed cash, they can wait years until the squeeze of inflation forces them to begin an additional income stream from their annuity cash stockpile. Doing so can again return them to a more comfortable cash flow situation.

Flexible Premium Deferred

Under the terms of a flexible premium deferred annuity (FPDA), the contract owner places sums of money into the annuity on a regular or an intermittent basis for the purpose of growing the money over a long period of time for later payout. Often, the individual choosing this method does not have a large sum to initially invest but wishes to create a large pile of money over time. The deposits into the annuity are flexible because the owner can fund them over time while varying the amounts of the deposits to suit their own budget.

Since the funding is small and limited in the beginning this annuity type is never an immediate payout to the annuitant because there is not yet enough cash in the annuity to generate enough of a steady income stream. Therefore, a flexible deferred immediate annuity does not exist.

Annuity Payout Options

When the annuity owner decides that the time has come to take principal and interest out of the annuity, they have three basic choices which are:

1- Lump Sum Distribution or
2- Annuitization or
3- Combination of 1 & 2

Lump Sum Distribution

The owner can **take all of the money out (principal and interest)** at once which is called a "lump sum distribution." Upon taking all of this money at once, the interest that has been earned for the entire accumulation phase of the annuity becomes taxable income in the year it is distributed. If it is a nonqualified annuity, the entire principal is returned income tax free since all the deposits were made originally with "after-tax" dollars. The advantage is the owner takes complete control of their money and can invest it or spend it in any way they see fit. The main disadvantage is that all that income tax is due to the interest plus the extra income will usually push the person into a higher tax bracket making all income from other sources subject to the higher rate as well.

For example, depending on the income tax rate of the state in which the annuitant resides, the annuitant could pay nearly as much as half of their entire annuity income earned in a single taxable year. The decision to take a lump sum should first be discussed with both financial and tax professionals to assess each individual's income needs before making the decision to take a lump sum.

Annuitization

With the annuitization option, the contract owner elects to keep the pile of money they have accumulated with the insurance company and to **take periodic payments either for a specified number of years or for the rest of their lifetime.** Any money received through an annuity payout that had not been previously taxed will be taxable when received. The portion of each payment that is considered, by tax rules, not to be income and a return of principal (based on the "exclusion ratio" as discussed below) while the balance of the payments will be considered to be taxable.

"The exclusion ratio" is the method used to determine what portion of the annuity payment is not subject to taxes and what portion is not taxed. The exclusion ratio is shown as either a fraction or as a percentage and is calculated by dividing the investment contained in the contract by the return that is expected. The **exclusion ratio is then applied to each annuity payment**, and this determines the portion of the payment that will be excluded from gross income. Therefore, the balance of the annuity payment is then included in gross income of the annuitant for the tax year in which it is received. When funds from an IRA, 401(k) or other tax-deferred retirement account are used to fund an annuity, the exclusion ratio does not apply, and the annuity payments received will be fully taxable.

EXAMPLE: Jones purchases a single premium immediate annuity for $100,000 and he expects to receive 120 monthly payments of $1,000 each. The total number of payments will equal $120,000. The exclusion ratio (amount or percentage that will be returned to the annuitant as "after tax" income) is determined by dividing as follows:

Exclusion Ratio = $100,000 / $120,000 = .83333 (83.33%)

For each monthly payment of $1,000 that Jones receives 83.33% is considered to be a return of principal ($833.33) while $166.67 or 16.67% of each payment is considered to be taxable income. The annual amount of income from this annuity that WILL NOT be excluded from income tax will be $2,000.04 ($166.67 X 12). This means that each year Jones will receive monthly payments from the annuity which total $12,000 but will only have to include $2,000.04 as income for tax purposes.

There are many annuitization options available to the contract owner and the choice depends on what the needs of the annuitant are. The most common options: life annuity, refund annuity, joint annuity, joint and survivor annuity and period certain (with or without life) annuities are discussed below.

Annuity Combination

In this withdrawal option, the contract owner can select a combination of lump sum and annuitize the remaining balance of funds. Any money taken as a lump sum is subject to ordinary income taxes in the tax year in which it is withdrawn on the portion deemed to be interest. For annuitized payouts where there is both principal and interest just the income portion of each payment will be taxed. For example, if the annuitant had one million accumulated dollars, they could take a half million dollars in a lump sum distribution and take the other half million dollars in the form any annuity payout option such as life, refund, joint or survivor or a period certain arrangement.

The concept of combining annuity payout options is to provide a lump sum of money in current time to address needs like investing or enjoying a purchase like buying a boat or a condo in a warmer climate for the winter months. The annuitant gets both cash now and an increased and regular income for the rest of their life from the portion of the funds that were annuitized.

Life Annuity

Under the terms of a life annuity, sometimes called a "pure" life annuity, **the annuitant cannot outlive the money** but will receive a periodic payment for as long as they are alive. Once the **annuitant dies the payment stops** and if any unpaid principal and interest remains in the annuity, it is retained by the company.

The advantage of this method is that the **insured will receive the highest guaranteed regular periodic payment possible, for life,** out of all the fixed options available. The disadvantage is that no remaining money in the annuity can be passed by the owner to another party of their choosing upon the death of the annuitant since the company then owns the money. This option would be selected by someone who does not care what happens to any remaining money upon death but does want the most guaranteed income they can get while alive.

Refund Annuity

The refund annuity guarantees both a lifetime income to the annuitant and permits any remaining balance of funds not paid out upon the death of the annuitant to be passed on to a beneficiary selected by the contract owner. The beneficiary generally has two options on how to take these remaining funds. The "installment" option will give the beneficiary a regular and period payment until the funds left are paid out while the "cash" option gives the beneficiary the balance of funds in a single payment. Since this option is paying out all the principal and interest to someone eventually, the periodic payment to the annuity will be less than the amount payable under the pure life annuity option.

This option is often available to add to a life annuity as a rider but doing so will increase the premium cost compared to a strict life annuity. It is designed for people who want the greatest guaranteed monthly payment possible but also want to leave any remaining funds their may be at their death to a beneficiary they select, rather than have the remaining funds go back to the insurer.

Joint Life Annuity (Joint and Survivor)

In a joint life annuity, there are two or more annuitants who each receive payments until all the joint lives die. **Upon the death of the first annuitant, a regular but reduced amount continues to be paid until the second life dies.** This annuity is usually purchased involving two spouses. The full periodic payment is made while both spouses are alive but when one dies, the remaining life will get the periodic payment, which is usually either two-thirds or half of what it was, when before the death of one annuitant occurred. In this selection multiple individuals are getting the highest guaranteed payments offered by an insurance company as long as they are all alive.

Some elements in considering the selection of a joint and survivor annuity are:

- Known income for the life of both annuitants.
- Income consistency aids in longer-term financial planning.
- Requires a large and upfront payment.
- Can begin immediately to pay out as soon as one month from deposit.
- Easy to create with no further consideration or monitoring.
- While the annuitants enjoy a fixed income without market fluctuations, the disadvantage is loss of future purchasing power due to inflation.
- The payout is structured and not liquid.

Period Certain

The period certain option can have two choices, either:

1. Straight period certain or
2. life with period certain.

In a straight period certain selection, the annuitant decides on a period of time, usually five, ten or twenty years in which to receive payments for that number of years and then the payment ends. However, the life with period certain annuity option will pay for a specified number of years selected or life, **whichever is longer**. If the annuitant dies before the period certain ends, then any remaining money is paid to a beneficiary selected by the annuitant. The straight period certain annuity pays a greater sum periodically than does the life with period of certain annuity because the company is guaranteeing less funds with straight period option.

For example: If John buys a straight period annuity with a twenty-year period certain and dies at the end of year 15, the money unpaid for the remained five years returns to the insurer. However, if John selected a twenty-year period certain of life annuity and dies at the end of year 15, the remaining five years will pass to his beneficiary of can elect to keep receiving payments for five years or take the remaining money in a lump sum payment.

Classification of Annuities

Annuities are classified in many different ways, one of them being based on the method of investment and growth. The available methods of return on principal are:

- Fixed
- Variable
- Indexed

Fixed

In a fixed annuity, the insurer guarantees a minimum rate of return on deposited principal for a specified period of time. This minimum percentage guarantee changes at calendar points as described in the contract. It is common for such a guarantee to be readjusted on an annual basis, but adjustments may occur at either shorter or even longer intervals of time.

In a fixed annuity, the principal funds of the policy-owner are deposited into the general investment fund of the insurance company. Investments made by insurers with general funds tend to be conservative in order to protect principal while still producing growth on the principal. Common places these funds are invested in are primarily government bonds, mortgages, and some highly rated corporate bonds. The annuity owner has no control over investment choices other than initially deciding which accumulation method to choose.

Returns in a fixed annuity, while guaranteed, can tend to produce returns over long periods of time that may not keep pace with inflation. Therefore, due to the inflation factor, future income produced by a fixed annuity may result in reduced purchasing power at the time of annuitization compared with the purchasing power the money had at the original time of placement into the annuity.

Since the insurer is guaranteeing that the stated minimal contractual interest rate will be met, all risk of achieving the financial return is on the company. Therefore, if the insurer experiences a return that is less than guaranteed, the extra funds will be supplied by the company.

The main advantage of the fixed annuity to the owner is that the principal invested is safe and the periodic rate of return, similar to a bank CD, is always known and guaranteed during the investment period. However, the main disadvantage of the fixed annuity is that the long-term return paid after the period of accumulation has ended may be less than the inflation rate over that same period of time. The failure of the principal and interest to keep pace with the inflation rate during accumulation will result in a loss of purchasing power. In other words, the money you receive later will be worth less than what you could have purchased with the funds today.

Over a thirty-year period, it could be quite likely that for each original dollar invested by the annuity owner, at the time of payout there may only be seventy cents on the original dollar left. Anyone who is investing long-term at guaranteed rates needs to understand the potential that inflation has in reducing future purchasing power.

Variable

A variable annuity is an insurance contract between the consumer and an insurer, under which the insurer promises to make periodic payments to the annuity owner at either the beginning or at a future point in time. A variable annuity contract can be purchased either with a single payment or by making a series of payments into the contract over time. At the heart of the variable annuity concept is that the investment is placed in a separate account (not the general account where returns are guaranteed by the insurance company) maintained by the insurer.

All financial risk of loss is borne by the contract owner and not by the insurance company. A common feature of variable annuities is the death benefit. If the annuitant dies before payments are started their beneficiary will be eligible to receive the greater of all the money in the account, or some guaranteed minimum.

There are many investment options available to the owner of a variable annuity. The investment value of a variable annuity will vary depending on the performance of the investment options selected by the consumer and all investment gains will be tax-deferred. The investment choices available for a variable annuity are normally mutual funds that invest in stocks, bonds, money market instruments, or some combination of the three. However, there are several differences between a just a mutual fund and a variable annuity and how they operate.

Since variable annuities can be very complex and difficult for consumers to understand, special licensing to market them is required. In addition to a state life insurance license, the seller of variable annuities must also hold an appropriate level securities license which is administer by FINRA (Financial Industry Regulatory Authority, through the SEC (Securities and Exchange Commission). The purpose of both these agencies is to protect investors.

There are two parts or “phases” in the variable annuity: the **accumulation phase** and a **payout phase** (also known as the distribution phase).

During the **accumulation phase**, the variable contract owner can allocate principal into a number of investment options. For example, a percentage of capital can go into a bond fund, another percentage can be placed into a U.S. stock fund, and the remaining capital could be placed into an international stock fund. The money allocated to each mutual fund investment option will increase or decrease over time, depending on how the fund performs during the accumulation phase. Also, variable annuities may allow you to place part of your payments into a fixed account. Again, a fixed account, unlike a mutual fund, pays a fixed rate of interest.

During this phase, money can be transferred from one investment option to another without paying tax on the investment income and gains. However, the insurance company may charge a fee for such transfers. If funds are withdrawn from the account during the early years of the accumulation phase, the contract owner may have to pay "surrender charges," which are discussed below. In addition, federal tax penalties may also be assessed for early withdrawal before reaching the age of 59 and 1/2.

The main source of information about a variable annuity's investment options is provided by the prospectus. The consumer can consider many factors with respect to each fund option, including the fund's investment objectives and policies, management fees and other expenses that the fund charges. Also included in the prospectus are the risks and volatility of the fund as well as whether the fund may help the consumer with the diversification of his or her overall investment portfolio.

At the beginning of the **payout phase**, you may receive your original principal plus accumulated interest and gains (if any) as a lump-sum payment, or you may choose to receive them as payment stream at regular intervals. Payment stream options and taxation are reviewed in a later section.

Variable Annuity contract valuation has, as the key concept, a "unit" type of measurement. The value of the investment portfolio of the Separate Account changes on a daily basis and it equals the total market value of all portfolio securities (at the market close) minus liabilities. There are two "units" to understand:

1) Accumulation Units determine the share of ownership of the separate account which is attributable to an individual owner during the accumulation phase of the deferred annuity contract. It shows what proportion of the Separate Account is owned by an annuitant.

2) Annuity Units - if **annuitization is selected,** are calculated by incorporating many variables: initial unit value, age and sex of the individual, selected payout option, accumulated value of the account and the assumed interest rate of the company. The insurance company determines the specific number of annuity units which will actually be used to calculate each payment.

The **only element fixed is the number of annuity units** which will be used to calculate each payment to the annuitant. **The annuitant's <u>payment will fluctuate</u>** because the value of the annuity units will fluctuate based on the performance of the investment portfolio of the Separate Account.

<u>Formulas</u>

VALUE OF AN ANNUITY =
VALUE OF ONE UNIT X TOTAL UNITS OWNED

MONTHLY ANNUITY PAYOUT =
VALUE OF FIXED UNITS LIQUIDATED X VALUE OF ONE UNIT

<u>Section 1035 Tax Exchange</u>

Section 1035 of the U.S. tax code allows an annuity owner to exchange an existing variable annuity contract for a new annuity contract without paying any tax on the income and investment gains in your current variable annuity account. These tax-free 1035 exchanges are desirable if another annuity has features that you prefer, including

Higher death benefit,
More beneficial annuity payout options
Greater selection of annuity choices

The owner may be required to pay surrender charges on the old annuity if it is still in the surrender charge period. Additionally, a new surrender charge period normally applies when you exchange into the new annuity. The result is that for a significant number of years, which can be as many as ten years, the owner will usually have to pay a surrender charge (which can be as high as 9% of the purchase payments) if funds are withdrawn from the new annuity. The new annuity may have higher annual fees and charges than the old annuity, which will reduce the product returns.

The main caution for an annuity owner contemplating a 1035 exchange is to compare the features of both annuities very carefully. It is advisable that unless you plan to keep the new annuity for a very long period of time, it may make more sense to keep the old annuity when considering the new surrender charge period. It is also advisable to consult a qualified tax professional to ensure any exchange will be tax-free.

<u>Equity Index</u>

The equity-index annuity is a hybrid between the guaranteed fixed and the non-guaranteed variable annuity products. Equity-indexed annuities are different from other fixed annuities because of the way interest is credited to the annuity's value. Fixed annuities generally only credit interest calculated at a rate as set forth in the contract. Equity-indexed annuities credit interest by utilizing a formula based on changes in an index that is linked to the annuity investment returns. This formula calculates how much additional interest may be credited. Any additional interest amount you earn as well as when the credit to your account may be made is based on the specific features of your particular annuity.

An equity-indexed annuity earns interest that is linked to an equity or bond index. The most popular index is the Standard & Poor's 500 Composite Stock Price Index (the S&P 500) but other US, European, and even exotic indices can be used. Sometimes the interest is even based on a blend of two, three, four or more indices that are weighted on some specific basis. Equity-index annuities offer a “floor” rate of return (commonly set at zero percent) which is the minimum index-linked interest rate the contract holder will earn**. A 0% floor means that even if the linked index decreases in value, the interest that will be earned will equal zero percent but will not result in a negative return.** Therefore, the worst the annuity owner can do is have no return with the added comfort that they can’t lose any principal.

The two main features that have the greatest impact on the amount of additional interest that may be credited to an equity-indexed annuity are the **indexing method** and the **participation rate**.

The indexing method is the basis used to measure the amount of change, if any, in the index. Some of the most common indexing methods include:

- annual reset
- high-water mark
- point-to-point.

Annual Reset – Advantages

The interest earned is "locked in" annually and the value of the index "resets" at the end of each year. Future decreases in the index will not affect the interest you have already earned. An annuity using the annual reset method may credit more interest than an annuity which uses other methods if the index fluctuates up and down often during the term. The annual reset design is more likely than others to give you access to index-linked interest before the term ends.

Annual Reset – Disadvantages

The participation rate of the annuity may change each year and will generally be lower than that of other indexing methods. Also, an annual reset design may use a “cap” (a stated maximum percent which is the most interest credit the annuity owner would enjoy, regardless of the actual interest percentage earned) or averaging to limit the total amount of interest you might earn each year.

High-Water Mark - Advantages

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 of the term, then drops off at the end of the term.

High-Water Mark - Disadvantages

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 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.

Point-to-Point Advantages

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.

The equity-index annuity would seem to offer the best of both worlds: protection from huge market downturn periods via the guaranteed floor minimums set at no lower than a 0% return, tempered with the ability to earn very nice percentage returns in periods when the markets are booming. The end result typically expected is a return that should exceed fixed, conservative rates but will not match anticipated long-term returns of a variable annuity. Compared with a variable annuity, the equity-index annuity has lows that are not as low, highs that are not as high and none of the investor risk of reduced capital.

Part 2- Parties to an Annuity

Since the annuity is a life insurance contract, the rules pertaining to any type of contract are in force, namely:

• There must be an offer and an acceptance.
• The parties to the contract must be competent.
• There must be consideration and
• The contract must have a legal purpose.

When applying for an annuity contract, the consumer is making an offer to the insurer to accept their funds, either in a lump sum or periodic payment, and when the company accepts the funds, they are accepting by making guarantees to the annuity owner as stated in the written agreement between the parties. While non-human entities, like insurance companies, corporations or trusts satisfy the legal requirement of competency by being properly structured and licensed, the individual is normally held to a standard of being of sound mind at the time of the initial transaction.

Consideration is an exchange of promises between the parties and in the annuity transaction this would typically be the exchange of funds by the owner to the company in exchange for the company's promise to follow the laws of investment and later return the money as agreed. Finally, all contracts require legal purpose to be valid legally and therefore, criminal pursuits, such as money laundering in the purchase of annuity would void the transaction. The four parties to an annuity contract discussed below are the owner, the annuitant, the beneficiary, and the insurer.

Owner

The owner of an annuity is usually a natural person, who is either accumulating a pile of money on a tax-deferred basis over time or has decided to park a sum of money for a period of time for later distribution. Every annuity contract must have an owner. Names given to the owner are customarily the owner, the contract owner, or the annuity owner. The owner of the annuity contract holds certain rights under the contract. The annuity owner has the right to name the natural person who will enjoy the income as the annuitant as well as the individual or entity that will be named as the beneficiary under the contract.

The owner of an annuity can also be a trust, a corporation or other business entity, but only a living person can be the annuitant or person receiving the benefits from an annuity upon distribution.

A trust is a fiduciary concept in which a third party, called a trustee, holds assets (in this case the value of an annuity) on behalf of the party or parties called beneficiaries, also known as beneficial interest holders. The flexibility of trust arrangements is unparalleled, and assets and their distribution can be arranged in many different ways. Another main advantage of a trust is that the assets held in them are not subject to probate proceedings. If the trust is irrevocable, it may not be includable in the gross estate resulting in lower taxes upon the death of the parties involved. Other advantages are:

- **Control** - terms of the trust can be specified to better control assets as to whom and when asset distributions are made.
- **Legacy Protection** - trusts can be used to insulate estate assets for beneficiaries from creditors and prevent beneficiaries who posses poor money management skills from accessing funds.
- **Privacy –** Since trust property is private, it prevents public exposure that would exist if the assets had to go through the probate process.

Annitant

The annuitant is the natural person (other entities like a trust or corporation may own an annuity but they can not be an annuitant since they can have an indefinite life span) named under the annuity contract that will be used by the insurer to calculate the benefits paid out under the contract. The Internal Revenue Code defines the annuitant as the individual whose life is of primary importance in affecting the timing or amount of the payout under the contract. The owner and the annuitant can be two different individuals, and each plays a different role in the contract. If the annuitant is also the contract owner, then the annuitant normally names themselves as the annuitant, but they could name another person as long as it is a natural life being.

Keys to the Annuitant are:

- Recipient of annuity benefits.
- Natural life selected determines payout.
- Can be the annuity owner or not.
- If not the owner, cannot make withdrawals until a specific date.
- If not the owner, they cannot make contributions into the annuity.
- Unless the owner, annuitant cannot name the beneficiary.
- Unless the owner, annuitant cannot change the contract or beneficiary.
- Cannot be the beneficiary.

Beneficiary

In the annuity contract, the named beneficiary is entitled to receive a death benefit when another party to the annuity contract dies. While the beneficiary has the right to receive the death benefit of the annuity, they have no other contractual right. Furthermore, once the settlement option and payout have been selected, the benefit payment arrangement cannot be altered by the beneficiary, including being able to take any lump sums or partial surrenders. Beneficiaries can either be a natural person or another entity such as a trust, charitable trust, or a corporation. The right to name the annuity beneficiary lies with the annuity owner who can change they beneficiary at any time prior to distribution as long as the named beneficiary is not irrevocable.

It is very important that a party or parties be named as the beneficiary because if there is no named beneficiary at the time of the death of the annuitant, remaining proceeds can revert back to the issuing institution. A named beneficiary receives the annuity proceeds outside of the probate process upon the death of the annuitant. A final caution is that minors are not considered as competent beneficiaries until age eighteen and this must be considered if the named beneficiary is a minor.

Insurance Company

The insurance company is the party who issues the annuity contract. The insurance company therefore has legal duties to fulfill any financial obligations that have been agreed to with the other parties to the annuity contract. The company will accept all principal payments which are entrusted to it by the owner and invest those funds as promised and credit all income earned into the policy. When the time comes for the owner to withdraw his money, it is the insurance company that pays out the money as determined by the owner to whomever the owner so directs, from the choices that were available.

Under the insurance code, Insurance companies have many duties and responsibilities to consumer during the marketing of annuity products. The central duty of the insurer is to assure that the annuity product sold is in the best interest of the consumer and meets their financial needs and goals according to a specific set of criteria that is detailed in Part 6 of this manual.

Part 3 Annuity Contract Features and How They Affect Consumers

As discussed, the annuity is a contract that binds several parties to the terms contained therein. While all parties are bound to each provision in the agreement, some of the provisions have a larger impact on the owner (consumer) of the annuity than do others. Several of these provisions have been selected below for discussion.

Cash Surrender

Annuities should generally be considered to be a long-term investment financial tool and therefore, once a consumer places their money into one, it is best to consider the money as being tied up for a very long period of time. Modern annuity contracts allow the owner to withdraw a limited percentage of the annuity capital in any given year, usually up to 10%. However, any withdrawal amount may result in income taxation and an additional 10% tax penalty if the owner is under the age of 59 and 1/2 at the time of withdrawal. Taking a small percentage of the capital is referred to a “partial surrender.” If the owner chooses to remove more than the contractual annual percentage or wishes to take all of the funds in the annuity to fully cash surrender the contract such withdrawal may be subject to surrender charges in addition to income taxation and possible tax penalties.

Surrender Charges and Liquidity

An annuity purchase will subject the owner to a stated “surrender charge” as listed in a surrender schedule in the contract. It is very important for the contract owner to understand that money placed in an annuity has limited liquidity, especially in the earliest years of ownership. Often annuities that have longer surrender charge periods offer up-front bonus amounts which are added to the lump sum deposited by the contract owner upon purchasing an annuity with an insurance company. There are also short surrender periods and no surrender annuities available, but these do not usually offer bonus amounts. Also, any partial withdrawals can result in both ordinary income taxation and tax penalties as well.

When there is a surrender fee for excessive amounts withdrawn from the annuity as stated in the contract an included fee schedule is applied. While surrender periods with fee charges for early and excessive withdrawals (sometimes called a "back-end" load or fee) can range from as short as a few years and as long as twenty years, they normally steadily reduce in percentage year after year until the surrender fee is completely gone. For instance, a 10-year surrender fee schedule, after which there is no surrender fee, might look like this:

Year	1	2	3	4	5	6	7	8	9	10
Fee	9%	9%	8%	7%	6%	5%	4%	3%	2%	1%

It is very important for the consumer to understand the penalty structure, if there is one, in the annuity they are purchasing and therefore not to commit funds for long periods if they may have a need for liquidity in the near future.

Free Look

The "free look" is the right of an insured to examine an insurance policy for a stated period, often 10 days, and if not satisfied for any reason, the consumer has the right to return the policy and receive a full refund of the initial premium. This is a right conferred under state law that can vary from state to state (Illinois has a 10-day free look). The free look period begins on the date the policy is delivered to the owner. After the free look period has ended, the purchased annuity will be subject to all terms and conditions of the contract, including any listed surrender fees and withdrawal limitations. Many companies allow up to a 30-day free look period on a voluntary basis.

Changes to Variable Portfolios

Variable annuities can offer hundreds of investment alternatives to the contract owner in dozens of combinations and are normally offered to the more financially educated and savvy consumer. Fund choices can include the following general concepts:

- Large Cap
- Mid cap
- Small Cap
- Large, Mid and Small Cap Blends
- Large, mid and Small Growth Stock Funds with Blending
- Global Markets
- Emerging Markets
- Investment in Specified Industry Funds
- Fixed and Guaranteed Alternatives

The consumer needs to be aware of specified fee charges that come with each portfolio as well as potential fees and charges that are assessed when the owner reallocates some or all funds from one or more alternatives, when allowed periodically to do so. Frequent shifting in and out of various fund alternatives can reduce the principal due to the fee structure in the contract. The most valuable benefit to the consumer is to read and consult the prospectus and to ask their representative about any concerns or questions they may have before moving money within the options available in the variable annuity contract.

Participating Index Rates and Caps

Earlier in the equity-index annuity section it was mentioned that the contract offers participation rates and investment return caps. The consumer will benefit greatly by having a working knowledge of, and understanding of how, their particular product operates in these areas.

The participation rate determines the percentage of increase in the index they are limited to. For example, if the calculated change in the index is 10% and the participation rate is 90%, the index-linked interest rate for your annuity will be 9% (10% x 90% = 9.0%). The insurance company can decide to set a different participation rate for newly issued annuities as frequently as daily although a monthly yardstick is more frequently used. The initial annuity participation depends on when it was issued by the company.

The company usually guarantees the participation rate for a specific period (this could be for as short as one year or as long as an entire term). When that period is over, the company can set a new participation rate for the next period. Annuities can also guarantee that a participation rate will never be set lower than a specified minimum or higher than a specified maximum. For a discussion on cap rates and investment floors, please refer to the earlier section in equity-index annuities.

Long term Care Riders

Long term care coverage began initially in the early 1980's, offered by a handful of insurance companies as a rider to life insurance policies. By the early 1990's a shift toward individual and group long term care policies replaced the long-term care rider. Currently more and more carriers are abandoning the individual and group long term care policy and replacing it with a long-term care rider that is added to an annuity contract.

The Pension Protection Act of 2006 allowed all benefits paid out of an annuity for long term care benefits to be considered tax qualified and could be paid income tax free out of annuities. This has led companies to offer more and more combinations of annuity with long-term care as a rider option. The concept is simple: if you don't need any of your annuity money to pay for long term care costs, you can use the funds to supplement your income (that portion which is income is taxable). On the other hand, if you do require long term care, the money in the annuity can be paid, income tax free, for a variety of long-term benefits including:

- Assisted Living Facility Care
- Nursing Home Care
- Adult Day Care
- Home Health Care
- Personal Care
- Homemaker Services
- Respite Care
- Hospice Care
- Care Coordination
- Caregiver Training

Furthermore, long-term care riders added to an annuity can offer guarantees of double and triple the amount of principal and interest accumulated in the future if long term care related payments are required by the contract owner. Therefore, once the money in the annuity is exhausted the company will continue to pay for long care expenses normally for a two, four and up to six-year period up until the double or triple benefit guarantee is exhausted.

Cost for this rider is usually based on the age of the purchaser at the time of policy issue and benefits for long term care often do not go into effect for the first to or three years. Long term care annuity riders are available on either a health underwritten or guaranteed issue basis.

Guaranteed Income Rider

An income rider on a fixed or fixed indexed annuity gives the annuity owner the opportunity to build a retirement income. The issuing insurance company promises to pay as long as the annuitant lives and bears all investment and performance risks on the guaranteed payout. This means that the purchaser is sheltered from investment and performance risks. Also, the annuitant has access to the annuity's outstanding value and will still be entitled to interest credits that are then added to the annuity's worth. While the annuity has an accumulation value to settle on the death benefit or annuitization, the rider adds another value - the income value.

The accumulation value operates normally as the annuity owner's principal earns additional interest that is stated and locked in advance or promised through the performance of an index (or indices) while simultaneously promising a minimum guaranteed interest.

With an income rider, the income value is separate from the accumulation value. The annuitant is allowed to withdraw money from principal and interest even after annuitization. While receiving these withdrawals, the annuitant has two guarantees:

1. Even though the yearly withdrawals are subtracted from the accumulation value, the extra interest carries on being credited to the accumulation value, and the annuitant keeps access to the outstanding accumulation value at all times.

2. Even if the yearly withdrawals eventually reduce the accumulation value, the carrier has to continue making the annual payments so long as the annuitant lives.

Part 4 Income Taxation of Qualified and Nonqualified Annuities

Taxation concepts start with the basic idea of qualified versus nonqualified. In other words, are you using after-tax dollars to fund the annuity purchase (this would be a non-qualified annuity) or are you using pre-tax dollars allowed through a specific Internal Revue Code (IRC) vehicle (qualified approach). Since the annuity already allows for tax deferred accumulation regardless of which funding concept the purchaser selects. The chart below highlights the central tax similarities and differences between the two funding approaches.

TAX QUALIFIED	TAX NONQUALIFIED
Tax-deferred earnings	Tax-deferred earnings
Early Withdrawal Penalty of 10% On Earnings Before age 59.5	Early Withdrawal Penalty of 10% On Earnings Before age 59.5
Invest Pre-Tax Dollars	Invest After-Tax Dollars
No Contribution Limits (but subject to the limits of the underlying IRA, 401(k), etc. rules)	No Contribution Limits
Withdrawals (RMDs) must begin by age 73	No federal withdrawal age limits

Qualified Annuities

Employers may allow employees to contribute to an annuity program in a qualified plan selection. This becomes an investment option in a salary reduction retirement plan under which the employee can allocate specific dollar amounts, allowed by law, to be taken out of salary without current income taxation to be invested into a variety or long-term investment vehicles. Therefore, utilization of this concept means that your current taxable salary is reduced and then it accumulates tax-deferred in the selected qualified mechanism. Employees of a non-profit organization are usually able to choose either a fixed or variable annuity or both. Small businesses and the self-employed may invest in a qualified annuity by establishing a Simplified Employee Pension (SEP) or a Keogh. Many financial plans are available that can be adopted by the employer, regardless of size, by utilizing an insurance professional for guidance in creating a plan.

Most qualified retirement plans are self-directed which means that the employee can choose where they want their money directed depending on what is offered by the employer. The employee then directs how to allocate the investment choices. For example, an employee can put 40% of the investment into one equity investment and then maybe another 40% into a different equity portfolio, and the remaining 20% into a money market or fixed-income account.

Federal law requires that everyone in the company, including the employer, be subject to the same eligibility rules. Employees are all on equal footing and each employee can contribute just as much as any other employee. Employers can require a minimum period of employment, such as one year, before an employee is eligible to contribute through salary reduction. Discussed below are some commonly used qualified plan options in which the annuity can be utilized, if desired.

SEP and Keogh

Both the SEP and the Keogh are designed for small businesses and the self-employed. The basics of each are:

Simplified Employee Pension (SEP) plans can provide a significant source of income at retirement by allowing employers to set aside money in retirement accounts for themselves and their employees. A SEP does not have the start-up and operating costs of a conventional retirement plan and allows for a contribution limit of 25 percent of each employee's pay or $66,000 which ever amount is lower for 2023.

- Available to sole proprietors, partnerships, and corporation.
  - Easily established by adopting IRC Form 5305-SEP, a SEP prototype or an individually designed plan document
    - If Form 5305-SEP is used, cannot have any other retirement plan (except another SEP)
- No filing requirement for the employer
- Only the employer contributes:
    - To traditional IRAs (SEP-IRAs) set up for each eligible employee
    - Employee is always 100% vested in (or, has ownership of) all SEP-IRA money.

SEP Pros and Cons:

- Easy to set up and operate.
- Low administrative costs.
- Flexible annual contributions – good plan if cash flow is an issue.
- Employers must contribute equally for all eligible employees.
- For 2023, the participant compensation limit is $330,000.

Before a tax law change in 2001, Keogh plans were a popular choice for high-income self-employed people, but they have effectively been replaced by SEPs. While Keogh and SEPs have the same contribution limits, the Keogh plan is complicated, has much greater paperwork and therefore higher administration costs. Keogh plans come in two varieties:

Defined contribution. These plans have two variations: profit-sharing and money-purchase. The profit-sharing version of the Keogh is most like the SEP; the limit on contributions is up to 25% of compensation or $66,000 for 2023, whichever is smallest, but the employee can contribute smaller amounts depending upon what they can afford. The contribution level can be changed each year.

Defined benefit. This type of Keogh program is like a traditional pension plan, except for the fact that it is self-funded. The individual selects the annual pension they desire and then contributes through salary reduction the amount required to reach that goal. This approach allows very high-income self-employed people (i.e., doctors and lawyers) to save more for retirement than many other plans.

IRA

The Individual Retirement Account was introduced in 1974 and allows individuals within certain income ranges to invest pre-tax dollars, up to annual limits set by the Internal revue Code, that earn income on a tax differed basis and become fully taxable upon distribution. Without penalty, the holder of an IRA can deduct money out of their account as early as age 59.5 and are required to start taking withdrawals by age 73.

In 1997, federal law allowed for a new type of account called the Roth IRA which allows certain individuals the ability to fund the account with after-tax dollars with the later benefit of tax-free distributions. While the Roth IRA also prohibits withdrawals without penalty before age 59.5, there is no requirement to withdraw by a specific age and the proceeds from a Roth IRA can be passed onto heirs in estate planning.

The annual contribution limits on an IRA are set by the IRC and in 2023 the maximum contributions were 100% of taxable income up to $6,500 ($7,500 for those aged 50 and older). Either type of IRA can use an annuity as the funding vehicle but the main advantage over a bank CD would be that an annuity often offers a greater guaranteed interest rate but cannot provide the safety offered by FDIC insurance when funds are deposited in a bank.

Tax Sheltered Annuity (TSA)

A 403(b) plan, also known as a tax-sheltered annuity (TSA) plan, is a retirement plan for certain employees of public schools, employees of certain tax-exempt organizations, and certain ministers.

Individual accounts in a 403(b) plan can be any of the following types.

- An annuity contract, which is a contract provided through an insurance company,
- A custodial account, which is an account invested in mutual funds, or
- A retirement income account established for church employees. Generally, retirement income accounts can invest in either annuities or mutual funds.

There are three benefits to contributing to a 403(b) plan.

- The first benefit is that you do not pay income tax on allowable contributions until you begin making withdrawals from the plan, usually after you retire. Allowable contributions to a 403(b) plan are either excluded or deducted from your income. However, if your contributions are made to a Roth contribution program, this benefit does not apply. Instead, you pay income tax on the contributions to the plan but distributions from the plan (if certain requirements are met) are tax free.

  Note. Generally, employees must pay social security and Medicare tax on their contributions to a 403(b) plan, including those made under a salary reduction agreement.

  The second benefit is that earnings and gains on amounts in your 403(b) account are not taxed until you withdraw them. Earnings and gains on amounts in a Roth contribution program are not taxed if your withdrawals are qualified distributions. Otherwise, they are taxed when you withdraw them.

- The third benefit is that you may be eligible to take credit for elective deferrals contributed to your 403(b) account.

The maximum TSA contribution in 2023 is $22,500. If you will be age 50 or older this year, you may make up for missed savings opportunities by making a $7,500 “catch-up” contribution for 2023. And, if you have at least 15 years of full-time, same-employer service, you may be eligible to make a “lifetime catchup” of an additional $3,000 per year for up to five years.

Nonqualified Annuities

As stated earlier, the nonqualified annuity is funded with after-tax contributions, but all income is earned on a tax deferred basis during the accumulation phase. If a lump sum distribution is eventually selected than all income earned during the accumulation phase is fully taxable as ordinary income in the year in whish it is distributed. Otherwise, the annuitization option will subject only that portion of regular periodic payments that are considered income, via the exclusion ration calculation, would be subject to income taxation. The vast majority of annuities purchased are nonqualified.

IRC Section 1035 Exchanges

Under section 1035 of the Internal Revenue Code, the owner of a life insurance, endowment, or annuity contract is allowed, subject to certain circumstances, to transact a "like-kind" property exchange. When all IRC rules are followed the main advantage is that the gain in the original policy will not be taxed at the time of the exchange. A 1035 exchange can be used by a life insurance contract owner to defer taxable gain on surrender of the old contract or to carry over cost basis from the original contract to the new contract.

Section 1035 allows the following types of exchanges:

- Life insurance contract for an annuity contract, endowment contract, or another life insurance contract.
- An endowment insurance contract for an annuity contract or another endowment contract.
- An annuity contract for another annuity contract.

Exchanges not listed above will trigger taxation of any gain in the original contract.

When one insurance contract is exchanged for another the contracts must involve the same insured. Therefore, a single life policy may not be exchanged for a joint life policy, and the reverse is also true. When the exchange involves annuity contracts, the regulations require that both contracts involve the same owner.
In a 1035 exchange, the owner's cost basis in the original contract is carried over to the new contract.

Part 5: Primary Uses of Annuities

There can be many reasons why an individual purchases an annuity and they are discussed below:

Retirement Income

The main reason that an individual buys an annuity is for retirement income. Since the annuity allows for tax deferred income accumulation, regardless of being qualified or nonqualified, it is an attractive vehicle for long term growth. Also, with all the modern annuity alternatives: fixed, variable and equity-index, the consumer can find a choice best suited to their needs and comfort level. However, the burden of making certain that the correct annuity alternative has been selected by the consumers is placed squarely on the producer and/or company that is marketing and issuing the contract.

As discussed earlier, the advantage of receiving periodic payments that are guaranteed for the life of the annuitant is a benefit unmatched by any other financial vehicle in the investment marketplace. Within this guaranteed context there are again many options available to meet the needs of a variety of consumers.

The concept of monetary projections based on changing time values of money is of critical concern for retirement planning. The concept of the “nest egg” comes into play when considering future retirement needs. A nest egg can be defined as a substantial sum of money that has been saved or invested for a specific purpose, in this case, retirement.

If several assumptions are made that you will have a fixed amount of money saved by retirement, the secondary issue becomes whether or not that sum of money will last a sufficient length of time for the party or parties involved when retirement commences. These assumptions and calculations are not an exact science but the more awareness and planning there is, the greater the chances for a financially comfortable retirement. Obviously, the more money that you set aside the better, but how much is enough? Following this discussion is a chart illustrating the process by which a nest egg evaluation and determination can be made. It's a very complex concept to determine nest egg sufficiency.

There is a five-step process in determining whether or not there is sufficient financing to maintain a desired retirement lifestyle, a five-step process can be used.

1) Add all current income sources (social security, private savings, and pension benefits).

2) Determine the amount of income necessary for the client to achieve the desired retirement lifestyle by calculating the percentage of a client's salary that client wishes to have available at retirement (normal ranges are from 70 to 90 percent) by taking an average of the last several years of income prior to retirement.

3) An estimate of the actual retirement income status at retirement must be made. This is achieved by determining the target requirement income in step 2 and subtracting from it the current estimate of what the actual retirement income will be. This amount may be positive or negative if it is negative, it indicates there is a deficit present and additional savings must be made.

4) Resources which need inflation protection must be determined because in order to appropriately calculate actual retirement need, inflation protection must be considered from a point of view of both before and after retirement.

5) Calculating the target amount of how much extra money is needed if a deficit is present. A person must decide how much money needs to be saved on a monthly and annual basis and in the manner which is most in keeping with the client's investment attitude.

There are several main concerns in the retirement planning process, but none is more crucial than protecting clients from outliving their income. Mortality tables must be used to determine over how long a period of time to liquidate assets but there is danger in relying solely on such tables. The main reason is that at least 50 percent of the population in America lives beyond the mortality table projections. Current demographic trends made available by the U.S. census bureau. Although there are several techniques an individual can use to assure that a client will not outlive a nest egg, the most common method has always centered around various annuity products (refer to the section on annuities).

Immediate Income

The annuity can be used as an immediate funding vehicle. If an older consumer receives a large sum of money through an inheritance for instance, they can quickly convert it to a single pay immediate annuity and enjoy guaranteed additional income for life. Another common source of funding for immediate annuity is when a retiring worker transfers the value of their 401(k) into an annuity for immediate income.

Long Term Care Funding

The need for long-term care is quietly revolutionizing the annuity industry. Recent tax law changes allow the proceeds distributed from an annuity to be tax free when used to pay for long-term care expenses have made annuities an attractive option. When you factor in annuity riders which can double and triple the cash value of the annuity to pay for ongoing long-term care costs you have the opportunity to make your hard-earned dollars automatically multiply. In the event the annuitant does not have any long-term care funding needs then the proceeds are used for retirement only.

Education Funding

Since annuities are long term funding vehicles with tax deferred income growth, they can also be an attractive method to save for the future educational needs of small children. The choices between fixed, variable and equity-index can raise some issues. Although the purchaser may have a 10-to-18-year investment window, a fixed annuity, while safe, may have a hard time keeping up with inflation. The selection of a variable annuity has a better potential of yielding higher returns that may keep pace with or even exceed the inflation rate. But what happens if your child enrolls in college just when the securities markets crash? The equity-index solution would seem to make the most sense because it should offer returns better than what is available while protecting the principal from a down equity market.

Structured Legal Settlements

Situations may arise in which a legal defendant is responsible for paying a large sum of money to an injured party. Often a property or casualty carrier is responsible for this payment when covered by insurance (such as an auto accident, an action under which a homeowner's policy will pay and for a workers compensation claim). If the lump sum is a very large amount, often a structured settlement will be used to compensate the injured party with a periodic and guaranteed payment for life or a specified period of time (sound familiar?).

Both parties benefit when using a structured settlement. The responsible party can spend less money to purchase the agreed upon income stream than it would cost to fully pay today in a lump sum. The injured party can receive income for life knowing that all their bills will be paid until they die and that they cannot squander some or all of the lump sum and then be financially destitute. Furthermore, the IRS allows the periodic payments offered through the structured settlement to be income tax free when funneled through a qualified vehicle like an annuity or a U.S. government bond.

Lottery Winners

Winners of huge grand prizes awarded by one of the national lotteries result in a choice of a one-time lump sum pay or the winner can elect to take the payout through a long-term series of annual payments lasting as long as thirty years. For example. A person wins a grand prize that will pay a one time $125 million dollars, all subject to the highest federal and state tax rates in effect at the time of collection or thirty annual annuity payments from an award of $210 million (the first payment year is the lowest and the final payment the highest because they use a graduated payment schedule which increase each annual payment by 5 percent.).

Focusing on taking the annuity payout method, the winner will pay taxes every year they collect an annual check. This person may have a disadvantage if tax rates increase on either the federal or state level or both, over the long collection period. Another disadvantage is that inflation will cause a reduction in purchasing power that will likely worsen over time. On the plus side, receiving money each year reduces the chances of spending the big prize in a few years as many grand prize winners have been prone to do. However, the annuitant would have the option of later selling their future payment rights but will do so at a hefty discount if they later decide they prefer a lump sum amount

Part 6: Standards of Conduct, Sales Practices, Replacement and Disclosure Requirements

Duties of Insurance Producers

Best Interest Obligations

Under the revised insurance regulation governing the actions of insurance producers when recommending an annuity product, requires the producer to **“act in the best interest of the consumer under the circumstances known at the time the recommendation is made without placing the insurance producer’s or insurer’s financial interest ahead of the consumer’s interest.”** This language codifies the basic ethical principles embodied in the concept that the needs of the client come before the needs of the advisor or whomever the advisor works for or with. This requirement places many burdens of proof on both companies and producers to place the consumer’s “best interest” ahead of their own interests at all times and will be explained in this course.

This standard of duty imposed on insurance producers now closely resembles the requirements that the Securities and Exchange Commission has placed on financial advisors who market securities or whose actions are expected to follow those stated in the Investment Advisors Act of 1940, which requires a fiduciary duty standard which requires a higher standard than when using the best interest standard. However, the manner in which the current annuity suitability “best interest” standard is enforced does closely resemble the higher fiduciary duty standard in many ways as it relates to disclosure requirements.

Care Obligation and Sales Practices

<u>Making Annuity Recommendations</u>

When an insurance producer makes an annuity recommendation, they must exercise reasonable diligence, care, and skill to accomplish the following four requirements:

1. The producer must have knowledge of the consumer’s financial situation, their insurance needs and the consumer’s financial objectives.

2. The producer must understand the available options they are recommending to the consumer after determining all of the options available to the insurance producer.

3. The producer must possess a reasonable basis for believing that the option being recommended to the consumer effectively addresses their financial situation, their insurance needs, and their financial objections for the life of the product as evaluated, considering the financial profile information obtained from the consumer.

4. The producer must effectively communicate the basis or bases of the recommendation to the consumer.

The dictionary can help us fully understand the gravity of the phrase "reasonable diligence." Reasonable means fair and sensible, the exercising of sound judgment to the extent no reasonable person would object to the effort put forth by the producer, which requires diligence, care and persistent effort by a knowledgeable and experienced insurance producer.

Obviously, the four requirements for making an annuity recommendation place a high standard of care on the producer and requires the gathering of personal consumer data and correctly interpreting that data to identify product options that are well suited to the needs of the consumer. Excellent communication skills will be necessary for the producer to be successful at annuity sales. The producer must explain all options in a manner by which the consumer can better understand the ramifications of any decision they make. The essence of these four requirements is the very basis of sound and ethical conduct required by every financial professional.

Other Annuity Recommendation Requirements

- The producer must make reasonable efforts to obtain consumer profile information before making any annuity recommendation. Since the producer has a duty to operate in the best interest of the consumer it only makes sense that this duty can only be properly exercised if the producer has successfully completed their due diligence task to secure this vital consumer information prior to a recommendation.

- The four requirements for making annuity recommendations demand that an insurance producer must consider the types of products they are authorized to sell which properly correspond to the consumer's financial situation, insurance needs and financial goals. However, the code makes it clear that the producer is not required to consider any products outside the producer's authority and license, including possible outside strategies or alternative products available in the market at the time of recommendation. For example, a producer not licensed to sell variable annuities is not required to consider such product possibilities in making a recommendation.

- The requirements under this code do not constitute a fiduciary duty, the duty is limited to the language in this code. This means the producer is held to the "best interest of the consumer" duty which is a lesser standard than would be imposed under "fiduciary duty."

- Another requirement focuses on all the elements of serving the consumer including:
    - Consumer profile information
    - Insurer characteristics
    - Product costs, rates, benefits, and features relevant in addressing the consumer's financial situation effectively, including insurance needs and financial objectives.
    - The code acknowledges that the level of importance of each of the above factors can vary according to each individual's need but that each factor should not to be considered in isolation of the other factors.
- The producer must have a reasonable basis to ensure that the consumer will benefit from features of the annuity such as annuitization, death or living benefit or other features related to insurance.

- The four requirements for making recommendations must be applied to a specific annuity as a whole as well as to the sub-accounts to which money is allocated at the time of annuity purchase, or annuity exchange, including any riders or other enhancements, if any are present.

- Nothing in the code requires that an annuity with the lowest compensation structure (one-time or multiple occurrence) must be recommended.

- It is established that while a fiduciary duty may be separately owed when consulting, advising or included in a financial planning agreement between the producer and the consumer, there is no requirement that a producer be obligated to provide ongoing monitoring to the consumer under the care obligations.

- These other requirements end with the disclaimer that nothing in this part of the annuity suitability code should be interpreted as requiring a producer to obtain any licensing other than the producer license in order to sell, solicit or negotiate insurance in Illinois. This includes, but is not limited to, any securities licensing in order to meet the duties and obligations of this regulation, provided that the producer does not give advice or provide services that are otherwise subject to securities laws or engage in any other activity that requires other professional licenses.

Annuity Replacement or Exchange

When an insurance producer is engaged in the exchange or replacement of an existing annuity, the producer has a duty to consider the transaction in its entirety, including the following considerations:

- Will the consumer incur a surrender charge, or be subject to starting a new surrender period? Will the consumer lose existing benefits including death, living or other contractual benefits or be subject to increased fees, or advisory fees or any charges for riders or other enhancements?
- A replacement annuity must substantially benefit the consumer when compared to the replaced product over the life of the product.
- The final consideration is whether the consumer has had another annuity exchanged or replaced within the preceding 60 months.

Disclosure Obligation

Under Part 3220, at the end, there are several Appendices relating to "Suitability in Annuity Transactions" including Appendices A, B and C and the producer must be familiar with them. It is strongly recommended that you download them from the Illinois Department of Insurance website: (***https://www.ilga.gov/commission/jcar/admincode/050/05003120sections.html***). This course will review the elements in each Appendix to enable the producer to fully understand their importance. These disclosures must be made prior to the producer either selling or making annuity recommendations and must use a format similar to Appendix A.

Appendix A

APPENDIX A Insurance Producer Disclosure for Annuities

At the top of this appendix is the statement**: Do Not Sign Unless You Have Read and Understand the Information in this Form.** It must be dated, and the producer must include their complete name, address and appropriate contact information followed by the printed first and last name of the consumer. This is followed by:

What Types of Products Can I Sell You?

I am licensed to sell annuities to you in accordance with Illinois law. If I recommend that you buy an annuity, it means I believe that it effectively meets your financial situation, insurance needs, and financial objectives. Other financial products, such as life insurance or stocks, bonds, and mutual funds, also may meet your needs.

The producer then must indicate which of the following products they offer:

- ***Fixed or Fixed Index Annuities***
- ***Variable Annuities***
- ***Life Insurance***

This section is then followed by a statement explaining that the producer needs a separate license to provide advice or to sell non-insurance financial products and then the producer must check below indicating which of the following products they are authorized to sell:

- **Mutual Funds**

  - ***Stocks/Bonds***
  - ***Certificates of Deposit***

These product disclosures are designed to reveal the scope and terms of the relationship the producer will have with the consumer in their transaction while providing an affirmative statement of the products the producer is authorized to sell.

A statement as to whose products the producer is authorized to sell includes checking from the following choices and then requires the producer to write the name(s) of the carriers:

- ***Annuities from Only One Insurer***
- ***Annuities from Two or More Insurers***
- ***Annuities from Two or More Insurers although primarily contracted to sell with one insurer.***

The remainder of the form has the following exact language, followed by the signatures of both the producer, the consumer, and the date signed:

How I'm Paid for My Work:

It's important for you to understand how I'm paid for my work. Depending on the particular annuity you purchase, I may be paid a commission or a fee. Commissions are generally paid to me by the insurance company while fees are generally paid to me by the consumer. If you have questions about how I'm paid, please ask me.

Depending on the particular annuity you buy, I will or may be paid cash compensation as follows:

☐ ***Commission, which is usually paid by the insurance company or other sources. If other sources, describe: ________________________***

☐ ***Fees (such as a fixed amount, an hourly rate, or a percentage of your payment), which are usually paid directly by the customer.***

☐ ***Other (Describe). ____***

If you have questions about the above compensation I will be paid for this transaction, please ask me.

I may also receive other indirect compensation resulting from this transaction (sometimes called "non-cash" compensation), such as health or retirement benefits, office rent and support, or other incentives from the insurance company or other sources.

By signing below, you acknowledge that you have read and understand the information provided to you in this document.

This document is designed to disclose to all consumers the exact nature of the individual producer's licensing authority and the types of products they are allowed to sell and for whom. The requirement to disclose to the consumer the manner in which the producer is paid is designed to help the consumer build trust in the producer and enhances the process of making an informed annuity decision.

Furthermore, at the time of the sale or recommendation of an annuity, the consumer must have a reasonable basis to believe that the consumer has been adequately informed of the many features of the annuity which includes the:

- potential surrender period and surrender charge,
- potential tax penalty if the consumer sells, exchanges, surrenders or annuitizes the annuity,
- mortality and expense fees, investment advisory fees, any annual fees,
- potential charges for and features of riders or other options of the annuity,
- limitations on interest returns,
- potential changes in non-guaranteed elements of the annuity,
- insurance and investment components, and
- market risk.

Other Producer Obligations

Conflict of Interest

The producer has a duty to identify, avoid, manage, and disclose any consumer material conflicts of interest, including conflicts of interest relating to an ownership interest.

Documentation Obligation

Appendix B - Consumer Refusal to Provide Information

Appendix B is used when the consumer refuses to provide accurate information to the financial professional but is still going to purchase an annuity product. This form begins with the admonishment to the consumer not to sign unless they have read and understood the information in this form. It then asks the question: ***"Why are you being given this form?"*** The answer is because the consumer is buying a financial product called an annuity.

Appendix B then explains to the consumer that the producer, broker, or company recommending such a product needs information about you, your financial situation, insurance needs and financial objectives in order to recommend a product that meets your needs and financial situation. By signing this form, the consumer acknowledges:

- they have not given the producer, broker, or company the required financial needs information about them and their financial situation, insurance needs and financial objectives and
- that the consumer may lose the protections granted to them under the Illinois Insurance Code if they sign this form or provide information to the producer, broker or company that is inaccurate.

This is followed by two boxes, called the **"Statement of Purchaser,"** one of which the consumer must check and then date and sign the form.

☐ ***I REFUSE to provide this information at this time.***
☐ ***I have chosen to provide LIMITED information at this time.***

Appendix C -Consumer Decision to Purchase an Annuity Not Based on a Recommendation

Appendix C is used when a consumer does provide accurate information to an insurance professional but decides to purchase an annuity that is not recommended by the professional to meet their needs under the requirements of the Annuity Suitability Code. The assumption is that the consumer has received sound professional advice but chooses to disregard it and buy an annuity not within the parameters that the professional advice offered.

Like Appendix B, above, this form begins with the admonishment to the consumer not to sign unless they have read and understood the information in this form. It then asks the question: ***"Why are you being given this form?"*** The answer is because the consumer is buying a financial product called an annuity.

The consumer is informed that in order to be properly advised by a producer, broker, or company to effectively meet their needs, objectives and situation, the professional has a duty to learn about the consumer and their individual financial situation, insurance needs and financial objectives.
The consumer is informed that by signing this form they are stating that they know they are buying an annuity that was not recommended by the producer. The following exact wording is what the consumer is attesting to by affixing their signature and date to this form, which is also signed by the insurance producer:

Statement of Purchaser:

I understand that I am buying an annuity, but the insurance producer, broker, or company did not recommend that I buy it. If I buy it without a recommendation, I understand I may lose protections under the Illinois Insurance Code.

Application of Best Interest

All requirements that apply to an insurance producer under this Annuity Suitability regulation applies to every insurance producer who:

- has exercised material control or influence in the making of a recommendation and
- has received direct compensation as a result of the recommendation or sale, regardless of whether the insurance producer had any direct contact with the consumer.

Those who are not subject to the best interest requirement include:

- providing or delivering marketing or educational materials,
- product wholesaling or other back-office product support, and
- general supervision of an insurance producer does not, in and of itself , constitutes material control or influence.

<u>Exceptions to Producer Duty</u>

The following activities are not considered an obligation of the producer to a consumer under the "care obligation" of the Annuity Suitability Code when transactions are not based on recommendation, including:

- No recommendation is made.
- A recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer.
- A consumer refused to provide relevant consumer profile information and the annuity transaction is not recommended; or
- A consumer decides to enter into an annuity transaction that is not based on a recommendation by the insurance producer.

However, this section does stipulate that when an insurer issues an annuity subject to these exceptions, such issuance shall be ***"reasonable under all the circumstances actually known to the insurer at the time the annuity is issued."***

Duties of Insurance Companies

The Annuity Suitability Code also imposes responsibilities on insurance companies that issue the annuity product must be sold by licensed and authorized insurance producers and brokers, including the maintenance of a very specific supervisory system as well as some other miscellaneous insurer duties.

Supervision System

- Except as permitted under "Exceptions to Producer Duties" listed above, insurers cannot issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity would effectively address the particular consumer's financial situation, insurance needs, and financial objectives based on the consumer's consumer profile information.
- An insurer's supervision system must have a design reasonable to achieve the insurer's and its insurance producers' compliance with the Annuity Suitability Code (ASC), including,

    - reasonable procedures to inform its insurance producers of the requirements of the ASC and must include the requirements of the ASC into related insurance producer training manuals.

  - The insurer provides insurance producer product training and must comply with the requirements of Title 50 Section 3120.60; "Insurance Producer Training."

  - Insurers must provide annuity product training explaining all material product features to their insurance producers.

  - Insurers must review recommendations prior to issuance to verify that recommended products meet the stated requirements under ASC to consumers. A screening system, either electronic or physical, must be established for reviews with a design that requires additional review for only the transactions identified as meeting selected criteria for additional review.

  - The insurer must create procedures to detect recommendations by insurance producers that are not in compliance with the ASC and can include:

    - confirmation of consumer profile information,
    - systematic customer surveys,
    - insurance producer and consumer interviews,
    - confirmation letters,
    - statements or attestations by producers verifying their compliance,
    - programs of internal monitoring.

- The insurer must have procedures to assess before issuing or upon the delivery of an annuity that the selling producer has provided to the consumer the information required to be provided under the ASC.

- Insurers must exercise a mechanism by which they can identify and address suspicious consumer refusals to provide consumer profile information (for example: if the insurers average of all consumer refusals is one of one-hundred consumers but producer X is running a twenty percent consumer refusal rate then that would be suspicious and should be addressed by the insurer with that individual producer).

- The insurer must identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation based on the sales of specific annuities within a limited period of time. This rule does not prohibit employees from receiving health insurance, office rent, office support, retirement benefits or other employee benefits as long as said benefits are not based upon the volume of sales of a specific annuity within a limited period of time.

Other Insurer Duties

Insurers must provide an annual written report to senior management (including the manager responsible for audit functions) detailing a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any. An insurer may contract the performance of supervision monitoring to outside contractors, but the insurer remains responsible for following all ASC duties and is subject to any penalties of failure to do so under this Code even if they contract these responsibilities to others.

The required Insurer's supervisory system includes supervision of contractual performance and the following:

- Monitoring and, as appropriate, conducting audits to assure that the contracted function is properly performed; and
- Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the function is properly performed.

Supervisory System Exemptions

Insurers are not required to include, in its system of supervision, the following:

- An insurance producer's recommendations to consumers of products other than the annuities offered by the insurer; or
- Consideration of or comparison to options available to the insurance producer or compensation relating to those options other than annuities or other products offered by the insurer.

Prohibited Practices

There is a prohibition that applies to both insurance producers and insurance companies that the insurer shall not dissuade, or attempt to dissuade, a consumer from:

- Truthfully responding to an insurer's request for confirmation of consumer profile information.
- Filing a complaint with the Illinois Department of Insurance or
- From cooperating with the investigation of a consumer complaint.

Safe Harbor

The “safe harbor “rules written into the ASC eliminates legal liability to insurers in specified situations under which specific conditions are satisfied. Insurers can meet the compliance requirements for annuity recommendations and sales by utilizing “comparable standards” (refer to definition section below). Using the alternative comparable standards tests even applies in the Code if that standard does not otherwise apply to the product or recommendation at issue. However, the right of the Director of Insurance to further investigate and enforce the code is not limited by safe harbor.

Recommendations and sales made in compliance with comparable standards shall satisfy the requirements of this Part. This subsection applies to all recommendations and sales of annuities made by financial professionals in compliance with business rules, controls, and procedures that satisfy a comparable standard even if that standard would not otherwise apply to the product or recommendation at issue. However, nothing in this subsection limits the Director's ability to investigate and enforce the provisions of this Part.

Nothing in safe harbor limits the insurer’s duty to comply with the provisions of the ASC as they apply to insurers, but the company can base its analysis on information supplied by either the financial professional or supervising entity of the financial professional.

The safe harbor provisions granted only apply when the insurer:

- Monitors the relevant conduct of the financial professional seeking to rely on or the entity responsible for supervising the financial professional, such as the financial professional’s broker-dealer or an investment adviser registered under federal or State securities laws using information collected in the normal course of an insurer’s business; and

- Provides to the entity responsible for supervising the financial professional, such as the financial professional’s broker-dealer or investment adviser registered under federal or State securities laws, information and reports that are reasonably appropriate to assist that entity in maintaining its supervision system.

Definitions

“Financial professional” means an insurance producer that is regulated and acting as:

- A broker-dealer registered under federal or State securities laws or a registered representative of a broker-dealer.

- An investment adviser registered under federal or State securities laws or an investment adviser representative associated with the federal or state registered investment adviser; or

- A plan fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1002(21)) or fiduciary under Section 4975(e)(3) of the Internal Revenue Code (IRC) (26 U.S.C. 4975(e)(3)) or any amendments or successor.

“Comparable standards” means:

- With respect to broker-dealers and registered representatives of broker-dealers, applicable U.S. Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) rules pertaining to best interest obligations and supervision of annuity recommendations and sales, including, but not limited to, Regulation Best Interest (17 CFR 240 (2022; this incorporation does not include any later amendments or editions)).

- With respect to investment advisers under federal or State securities laws or investment adviser representatives, the fiduciary duties and all other requirements imposed on such investment advisers or investment adviser representatives by applicable contract or under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.), including, but not limited to, the SEC's Form ADV (see https://www.sec.gov/about/forms/formadv.pdf); and

- With respect to plan fiduciaries or fiduciaries, means the duties, obligations, prohibitions, and all other requirements attendant to such status under ERISA or the IRC and any amendments or successor statutes.