

**PUBLIC PROTECTION CABINET**  
**Department of Insurance**  
**Health and Life Division**  
**(Amended at ARRS Committee)**

**806 KAR 12:120. Suitability in annuity transactions.**

RELATES TO: KRS 304.1-040, 304.5-030, 304.9-020(1), 304.9-025, 304.9-040, 304.9-390, 304.12-010, 304.12-030(1)(a), 304.99-020, 26 U.S.C. 401, 403, 408, 414, 457, 29 U.S.C. 1001-1461

STATUTORY AUTHORITY: KRS 304.2-110

NECESSITY, FUNCTION, AND CONFORMITY: KRS 304.2-110(1) authorizes the Commissioner of Insurance to promulgate administrative regulations necessary for or as an aid to the effectuation of any provision of the Kentucky Insurance Code, KRS Chapter 304. This administrative regulation requires licensees to act in the best interest of the consumer when making a recommendation of an annuity and to require insurers to establish and maintain a system to supervise recommendations so that the insurance needs and financial objectives of consumers at the time of the transaction are effectively addressed.

Section 1. Definitions.

(1) "Agent" is defined by KRS 304.9-020(1).

(2) "Annuity" is defined by KRS 304.5-030.

(3) "Cash Compensation" means any discount, concession, fee, service fee, commission, sales charge, loan, override, or cash benefit received by a producer in connection with the recommendation or sale of an annuity from an insurer, intermediary, or directly from the consumer.

(4) "Commissioner" is defined by KRS 304.1-050(1).

(5) "Comparable standards" means:

(a) With respect to broker-dealer and registered representatives of broker-dealers, applicable SEC and FINRA rules pertaining to best interest obligations and supervision of annuity recommendations and sales, including Regulation Best Interest and any amendments or successor regulations thereto;

(b) With respect to investment advisers registered under federal and state securities laws or investment adviser representatives, the fiduciary duties, and all other requirements imposed on investment advisers or investment adviser representatives by contract or under the Investment Advisers Act of 1940, including the Form ADV and interpretations; and

(c) With respect to plan fiduciaries or fiduciaries, means the duties, obligations, prohibitions, and all other requirements attendant to such status under the Employee Retirement Security Act of 1974 (ERISA) or the Internal Revenue Code (IRC) and any amendments or successor statutes thereto.

(6) "Consultant" is defined by KRS 304.9-040.

(7) "Financial professional" means a licensee that is regulated and acting as:

(a) A broker-dealer registered under federal and state securities laws or a registered representative of a broker-dealer;

(b) An investment adviser registered under federal and state securities laws or an investment adviser representative associated with the federal and state registered investment adviser; or

(c) A plan fiduciary under Section 3(21) of the ERISA or fiduciary under Section 4975 (e)(3) of the IRC or any amendments or successor statutes thereto.

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

(9) "Insurance producer" is defined by KRS 304.9-020(10).

(10) "Insurer" is defined by KRS 304.1-040.

(11) "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 producers.

(12) "Licensee" means agent, or an insurer if an agent is not involved, and consultant.

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

(14) "Non-cash compensation" means any form of compensation that is not cash compensation.

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

(16)

(a) "Recommendation" means advice provided by a licensee to an individual consumer that results in a purchase, exchange, or replacement of an annuity in accordance with that advice.

(b) Recommendation shall 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.

(17) "Replacement" is defined by KRS 304.12-030(1)(a).

(18) "SEC" means the United States Securities and Exchange Commission.[]

Section 2. Exemptions. This administrative regulation shall not apply to recommendations involving:

(1) Direct response solicitations without a recommendation based on information collected from the consumer pursuant to this administrative regulation; or

(2) Contracts used to fund:

(a) An employee pension or welfare benefit plan covered by the Employee Retirement and Income Security Act (ERISA), codified as 29 U.S.C. 1001 to 1461;

(b) A plan described by 26 U.S.C. 401(a), 401(k), 403(b), 408(k), or 408(p), as amended, if established or maintained by an employer;

(c) A governmental or church plan defined in 26 U.S.C. 414, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under 26 U.S.C. 457;

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

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

(f) Prepaid funeral contracts.

Section 3. Duties of Insurers and Licensees.

(1) Obligations . A licensee, when making a recommendation of an annuity, shall act in the best interest of the consumer under the circumstances known at the time the recommendation is made, without placing the licensee's or the insurer's financial interest ahead of the consumer's interest and does so by satisfying the following obligations regarding care, disclosure, conflict of interest and documentation.

(a)

1. Care obligation. The licensee, in making a recommendation, shall exercise reasonable diligence, care, and skill to:

- a. Know the consumer's financial situation, insurance needs, and financial objectives;
  - b. Understand the available recommendation options after making a reasonable inquiry into options available to the licensee;
  - c. Have a reasonable basis to believe the recommended option effectively addresses the consumer's financial situation, insurance needs, and financial objectives over the life of the product, as evaluated in light of the consumer profile information; and
  - d. Communicate the basis or bases of the recommendation.
2.
  - a. The requirements under subparagraph 1. of this paragraph shall include at a minimum, the following information to determine whether a recommendation addresses the consumer's financial situation, insurance needs, and financial objectives making reasonable efforts to obtain consumer profile information from the consumer prior to the recommendation of an annuity.
  - b. Consumer profile information shall include:
    - (i) Age;
    - (ii) Annual Income;
    - (iii) Financial situation and needs, including debts and other obligations;
    - (iv) Financial experience;
    - (v) Insurance needs;
    - (vi) Financial objectives;
    - (vii) Intended use of the annuity;
    - (viii) Financial time horizon;
    - (ix) Existing assets or financial products, including investment, annuity, and insurance holdings;
    - (x) Liquidity needs;
    - (xi) Liquid net worth;
    - (xii) Risk tolerance, including willingness to accept nonguaranteed elements in the annuity;
    - (xiii) Financial resources used to fund the annuity; and
    - (xiv) Tax status.
3.
  - a. The requirements under subparagraph 1. of this paragraph shall require a licensee to consider the types of products the licensee is authorized and licensed to recommend or sell that address the consumer's financial situation, insurance needs, and financial objectives.
  - b. The requirements under subparagraph 1. of this paragraph shall not require analysis or consideration of any products outside the authority and license of the licensee or other possible alternative products or strategies available in the market at the time of the recommendations.
4. The requirements under paragraph (a) of this subsection shall not create a fiduciary obligation or relationship and shall only create a regulatory obligation as established in this administration regulation.
5.
  - a. Factors relevant in making a determination whether an annuity effectively addresses the consumer's financial situation, insurance needs, and financial objectives shall include:
    - (i) Consumer profile information;
    - (ii) Characteristics of the insurer; and
    - (iii) Product costs, rates, benefits, and features.

- b. The level of importance of each factor under the care obligation of this paragraph may vary depending on the facts and circumstances of a particular case;
  - c. Factors shall not be considered in isolation.
6. The requirements under paragraph (a) of this subsection shall include having a reasonable basis to believe the consumer would benefit from certain features of the annuity, such as annuitization, death or living benefit, or other insurance-related features.
7. The requirements under paragraph (a) of this subsection shall apply to the particular annuity as a whole and the underlying subaccount to which funds are allocated at the time of purchase or exchange of an annuity, and riders and similar product enhancements, if any.
8. The requirements under paragraph (a) of this subsection shall not mean the annuity with the lowest one-time or multiple occurrence compensation structure shall necessarily be recommended.
9. The requirements under paragraph (a) of this subsection shall not mean the licensee has ongoing monitoring obligations. An obligation may be separately owed under the terms of a fiduciary, consulting, investment advising, or financial planning agreement between the consumer and the licensee.
10. In the case of an exchange or replacement of an annuity, the licensee shall consider the whole transaction, which shall include taking into consideration whether:
- a. The consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits, such as death, living, or other contractual benefits, or be subject to increased fees, investment advisory fees, or charges for riders and similar product enhancements;
  - b. The replacing product would substantially benefit the consumer in comparison to the replaced product over the life of the product; and
  - c. The consumer had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding sixty (60) months.
11. If the licensee does not give advice or provide services that are otherwise subject to securities laws or engage in any other activity requiring other professional licenses, this administrative regulation shall not be construed to require a licensee to obtain any license other than a license with the appropriate line of authority to sell, solicit, or negotiate insurance in this state, including any securities license, in order to fulfill the duties and obligations contained in this administrative regulation.
- (b) Disclosure obligation.
1. Prior to the recommendation or sale of an annuity, the licensee shall prominently disclose to the consumer on a form substantially similar to "Insurance Agent (Producer) Disclosure For Annuities":
- a. A description of the scope and terms of the relationship with the consumer and the role of the licensee in the transaction;
  - b. An affirmative statement on whether the licensee is licensed and authorized to sell the following products:
    - (i) Fixed annuities;
    - (ii) Fixed indexed annuities;
    - (iii) Variable annuities;
    - (iv) Life insurance;
    - (v) Mutual funds;
    - (vi) Stocks and bonds; and
    - (vii) Certificates of deposit;
  - c. An affirmative statement describing the insurers for which the licensee is authorized, contracted or appointed, or otherwise able to sell insurance products

using the following descriptions:

- (i) From one (1) insurer;
- (ii) From two (2) or more insurers; or
- (iii) From two (2) or more insurers although primarily contracted with one (1) insurer.

d. A description of the sources and types of cash compensation and non-cash compensation to be received by the licensee, including whether the licensee is to be compensated for the sale of a recommended annuity by commission as part of premium or other remuneration received from the insurer, intermediary, or other licensee, or by fee as a result of a contract for advice or consulting services; and

e. A notice of the consumer's right to request additional information regarding cash compensation described in subparagraph 2. of this paragraph;

2. Upon request of the consumer or the consumer's designated representative, the licensee shall disclose:

a. A reasonable estimate of the amount of cash compensation to be received by the licensee, which may be stated as a range of amounts or percentages; and

b. Whether the cash compensation is a one-time or multiple occurrence amount, and if a multiple occurrence amount, the frequency and amount of the occurrence, which may be stated as a range of amounts or percentages.

3. Prior to or at the time of the recommendation or sale of an annuity, the licensee shall have a reasonable basis to believe:

a. The consumer has been informed of various features of the annuity, including:

- (i) The potential surrender period and surrender charge;
- (ii) Potential tax penalty if the consumer sells, exchanges, surrenders, or annuitizes the annuity;
- (iii) Mortality and expense fees;
- (iv) Investment advisory fees;
- (v) Potential charges for and features of riders or other options of the annuity;
- (vi) Limitations on interest returns, potential changes in nonguaranteed elements of the annuity, insurance, and investment components;
- (vii) Market risk; and
- (viii) Annual fees.

(c) Conflict of interest obligation. A licensee shall identify and avoid or reasonably manage and disclose material conflicts of interest, including material conflicts of interest related to an ownership interest.

(d) Documentation obligation. A licensee shall at the time of recommendation or sale:

1. Make a written record of any recommendation and the basis for the recommendation subject to this regulation;

2. Obtain a consumer signed statement on a form substantially similar to "Consumer Refusal To Provide Information" documenting:

a. A consumer's refusal to provide the consumer profile information, if any; and

b. A consumer's understanding of the ramifications of not providing his or her consumer profile information or providing insufficient consumer profile information; and

3. Obtain a consumer signed statement on a form substantially similar to "Consumer Decision To Purchase An Annuity NOT Based On A Recommendation" acknowledging the annuity transaction is not recommended if a consumer decides to enter into an annuity transaction that is not based on the licensee's recommendation. [

(e)

1. Application of the best interest obligation. A requirement applicable to a licensee under this subsection shall apply to every licensee 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 licensee has had any direct contact with the consumer.

2. Activities providing or delivering marketing or educational materials, product wholesaling or other back office product support, and general supervision of a licensee shall not constitute material control or influence.

(2) Transactions not based on a recommendation.

(a) Except as provided under paragraph (b) of this subsection, the licensee shall not have an obligation to a consumer under this subsection or subsection (1)(a) of this section related to an annuity transaction if:

1. A consumer refuses to provide relevant consumer profile information requested by the licensee and the annuity transaction is not recommended;
2. A consumer decides to enter into an annuity transaction not based on a recommendation of the licensee;
3. A recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer; or
4. No recommendation is made.

(b) An insurer's issuance of an annuity subject to paragraph

(c) of this subsection shall be reasonable under all the circumstances actually known to the insurer at the time the annuity is issued.

(3)

(a) Except as permitted under subsection (2) of this section, an insurer shall not 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. ]

(b) An insurer shall establish and maintain a system that is reasonably designed to achieve a licensee's compliance with this administrative regulation, including the following:

1. The insurer shall establish and maintain reasonable procedures to inform its licensees of the requirements of this administrative regulation and shall incorporate the requirements of this administrative regulation into relevant licensee training manuals.
2. The insurer shall establish and maintain standards for licensee product training and shall establish and maintain reasonable procedures to require its licensees to comply with the requirements of Section 4 of this administrative regulation.
3. The insurer shall provide product-specific training and training materials that explain all material features of its annuity products to its licensees.
4. The insurer shall establish and maintain procedures for the review of each recommendation, prior to issuance of an annuity, that are designed to ensure there is a reasonable basis to determine that the recommended annuity would effectively address the particular consumer's financial situation, insurance needs, and financial objectives.
  - a. The review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means including physical review.
  - b. The electronic or other system for review procedures may be designed to require additional review only of those transactions identified for additional review by the selection criteria.
5. The insurer shall establish and maintain reasonable procedures to detect recommendations that are not in compliance with subsections (1), (2), (4), and (5) of this section. ] This may include confirmation of the consumer's consumer profile information, systematic customer surveys, licensee and consumer interviews,

confirmation letters, licensee statements or attestations, and programs of internal monitoring. An insurer may comply with this subparagraph by applying sampling procedures, or by confirming the consumer profile information or other required information under this section after issuance or delivery of the annuity.

6. The insurer shall establish and maintain reasonable procedures to assess, prior to or upon issuance or delivery of an annuity, if a licensee has provided to the consumer the information required to be provided under this section.

7. The insurer shall establish and maintain reasonable procedures to identify and address suspicious consumer refusals to provide consumer profile information.

8. The insurer shall establish and maintain reasonable procedures to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific annuities within a limited period of time. The requirements of this subparagraph shall not prohibit the receipt of health insurance, office rent, office support, retirement benefits, or other employee benefits by employees as long as those benefits are not based upon the volume of sales of a specific annuity within a limited period of time.

9. The insurer shall annually provide a written report to senior management, including to the senior manager responsible for audit functions, which details 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.

(c)

1. An insurer may contract for performance of a function, including maintenance of procedures, required under subsection (3) of this subsection.

2. An insurer's supervision system under this subsection shall include supervision of contractual performance under this subsection. This shall include the following:

a. Monitoring and, as appropriate, conducting audits to assure that the contracted function is properly performed; and

b. Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the manager represents, that the function is properly performed; and

3. If an insurer contracts for performance of a function and supervises the performance of the contract in accordance with subparagraph (c)2. of this section, the insurer shall remain responsible for taking appropriate corrective action and may be subject to sanctions and penalties pursuant to Section 5 of this administrative regulation.

(d)

1. An insurer shall not be required to include in its system of supervision a licensee's recommendations to consumers of products other than the annuities offered by the insurer; or

2. Include consideration of or comparison to options available to the licensee or compensation relating to those options other than annuities or other products offered by the insurer.

(4) Prohibited practices. A licensee or an insurer shall not attempt to influence a consumer from:

(a) Truthfully responding to an insurer's request for confirmation of the consumer profile information;

(b) Filing a complaint; or

(c) Cooperating with the investigation of a complaint.

(5)

(a)

1. Safe Harbor. Recommendations and sales of annuities made in compliance with comparable standards shall satisfy the requirements under this administrative regulation.

2. This subsection shall apply 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 the standard would not otherwise apply to the product or recommendation at issue

3. This subsection shall not limit the commissioner's ability to investigate and enforce the provisions of this administrative regulation.

(b) Nothing in paragraph (a) of this subsection shall limit the insurer's obligation to comply with subsection (3)(a) of this section, although the insurer may base its analysis on information received from either the financial professional or the entity supervising the financial professional.

(c) For paragraph (a) of this subsection to apply, an insurer shall:

1. Monitor the relevant conduct of the financial professional seeking to rely on paragraph (a) of this subsection or the entity responsible for supervising the licensee, such as the licensee's broker-dealer or investment adviser registered under federal securities laws using information collected in the normal course of an insurer's business; and

2. Provide to the entity responsible for supervising the licensee seeking to rely on paragraph (a) of this subsection, such as the financial professionals broker-dealer or investment adviser registered under federal securities laws, information and reports that are reasonably appropriate to assist the entity to maintain its supervision system.

(6) The requirements of this section are intended to supplement and not replace the disclosure requirements in 806 KAR 12:150.

#### Section 4. Licensee Training.

(1) An agent shall not sell, solicit, or negotiate an annuity product unless the agent has adequate knowledge of the product to recommend the annuity and completed training in accordance with 806 KAR 9:025

(2) A consultant shall not advise an individual regarding an annuity unless the consultant has adequate knowledge of the product to recommend the annuity and completed the training in accordance with 806 KAR 9:025 .

(3) A licensee shall maintain records documenting compliance with the training requirements in subsection (1) and (2) of this section, which shall be available:

(a) To the department, if requested; and

(b) For a period not less than five (5) years.

(4) An insurer shall verify that an agent has completed the annuity training course required under this subsection before allowing the agent to sell an annuity product for that insurer.

#### Section 5. Mitigation of Responsibility.

(1) An insurer shall be responsible for compliance with this administrative regulation. If a violation occurs, due to the action or inaction of the insurer or its licensee, the commissioner may require:

(a) An insurer to take appropriate corrective action for any consumer harmed by a failure to comply with this regulation by the insurer, an entity contracted to perform the insurer's supervisory duties, or by its licensees ;

(b) A licensee [a to take appropriate corrective action for any consumer harmed by the licensee's violation of this administrative regulation; or

(c) A supervising licensee that employs or contracts with another licensee to sell, or solicit the sale, of annuities to consumers, to take appropriate corrective action for any consumer harmed by the licensee's violation of this administrative regulation;



(2) The commissioner may require a consultant to take appropriate corrective action for any consumer harmed by the consultant's violation of this administrative regulation.

(3) Any applicable penalty under KRS 304.99-020 for a violation of this administrative regulation may be reduced or eliminated, if corrective action for the consumer is taken promptly after a violation is discovered.

Section 6. Recordkeeping. Licensees shall maintain records of the information collected from the consumer, disclosure made to the consumer, including summaries of oral disclosures, and other information used in making the recommendations that were the basis for insurance transactions in accordance with KRS 304.9-390 and 806 KAR 2:070. An insurer may maintain documentation on behalf of a licensee.

Section 7. Effective Date. The requirements of this administrative regulation shall not be implemented or enforced prior to the effective date, determined pursuant to KRS 13A.330, or January 1, 2022 , whichever is later.

Section 8. Scope. This administrative regulation shall not create or imply a private cause of action for violation of this administrative regulation.

Section 9. Material Incorporated by Reference.

(1) The following material is incorporate by reference:

(a) "Insurance Agents (Producer) Disclosure For Annuities", (7/2020);

(b) "Consumer Refusal To Provide Information", (7/2020); and

(c) Consumer Decisions To Purchase An Annuity NOT Based on A Recommendation", (7/2020).

(2) This material may be inspected, copied, or obtained, subject to applicable copyright law, at the Kentucky Department of Insurance, Mayo-Underwood Building, 500 Mero Street Frankfort, Kentucky 40601, Monday through Friday, 8 a.m. to 4:30 p.m.

(33 Ky.R. 4292; 34 Ky.R. 286; 728; eff. 11-2-2007; 37 Ky.R. 2754; 38 Ky.R. 44; eff. 9-2-2011; TAm eff. 4-10-2012; Crt eff. 2-26-2020; 47 Ky.R. 815, 1604; 48 Ky.R. 1144; eff. 1-4-2022.)

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