

## Regulators mull responses to R.I. decision on annuities

States considering new rules, sales practice reminders after judge says insurable-interest laws didn't apply in VA case

[By Darla Mercado](#)

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Several state insurance regulators are considering changes that could make sales of variable annuities more burdensome for financial advisers and agents, and may even discourage the use of such investments in certain situations.

Rhode Island, Connecticut and New Jersey are among a growing number of states whose insurance regulators are considering altering state laws or upping the pressure on insurers to bar sales of third-party annuities, following the dismissal last month of a key claim in a high-profile lawsuit in Rhode Island involving stranger-originated annuity transactions.

In that case, insurers Western Reserve Life Assurance Company of Ohio and Transamerica Life Insurance Co. alleged that an attorney had paired investors with terminally ill individuals who were paid a small sum to act as annuitants. The insurers claimed that those annuity transactions violated insurable-interest laws, which require policy owners to have a close relationship with the insured or a legal and economic interest in keeping that person alive.

U.S. District Judge William E. Smith, however, determined that state insurable-interest laws apply to life insurance policies but not to annuities — at least in this case.

As a result, some insurance regulators are looking into expanding their insurable-interest laws to include variable annuities.

“If we could come up with a model solution that works for all states, then that would be the better way to go,” said Joseph Torti III, Rhode Island's insurance superintendent.

“We might look at [insurable interest] in terms of contemplating changes to models, but I would need to confer with the other regulators to see if it's feasible,” said Thomas R. Sullivan, Connecticut's insurance commissioner, who is also chairman of the National Association of Insurance Commissioners' Life and Annuities Committee. “We'd have to step back from the Rhode Island decision, evaluate it and consider the next step — that could be a broad array of regulatory options.”

If those options include broadening insurable-interest laws, insurers may take the extra step of financial underwriting on annuities, much as they do with life insurance policies.

This added burden, according to some, could restrict the use of annuities in certain contexts. In a handful of states, including Nebraska, Florida and Alaska, annuities are already covered by insurable-interest requirements.

“Insurance agents aren't going to like [underwriting]; there is no upside from their perspective,” said Scott J. Witt, an actuary and fee-only insurance adviser with Witt Actuarial Services LLC.

Such underwriting would ensure that the situation warranted the size of the policy being purchased and that a relationship existed between the beneficiary and owner, Mr. Witt said. That extra step in the sales process could help stem stranger-originated annuity transactions, but it could also discourage the use of variable annuities with death benefits when a client is otherwise uninsurable, he said.

“It would be much more like the sales process that applies to classic life insurance: much more extensive, much more insured-focused, all of which would be appropriate,” said Stephen C. Baker, a partner at Drinker Biddle & Reath LLP.

All this would slow down the process of selling annuities in such situations, experts agree.

“If they want to define the relationship to the owner or beneficiary, then you may have to go under that secondary inspection,” said Thomas B. Hamlin, branch manager at Somerset Wealth Strategies, which manages \$435 million in assets and is the largest annuities producer in the Raymond James Financial Services Inc. system. “It would slow down the issuance of the policy.”

Another option for states is to release a bulletin calling upon insurers to watch out for stranger-originated annuity transactions and recommending that they come up with methods to identify agents writing that business.

New Jersey is drafting such a bulletin, said Thomas B. Considine, the state's insurance commissioner. Ohio released one in April 2009.

“The insurance industry has all the tools necessary to fix this problem,” Mr. Considine said. “If they have to do some limited medical underwriting into the lives of people who are applying for annuities, that's something that requires no regulatory action.”

Indeed, others agree that insurers themselves may be able to come up with solutions.

“I think [the judge's ruling] will embolden certain segments of the secondary market,” Mr. Baker said. “What it probably also does is send the product folks at the insurance

companies back to their desks to see how this kind of outcome can be avoided by some careful redrafting.”

Lawrence J. Rybka, president and chief executive of ValMark Securities Inc., agrees. “The point is that the companies could just ask one or two basic "knockout' questions [before OK'ing any transaction], like, "Are you residing in a nursing home?” he said.

Insurers can also refuse to allow contract owners and annuitants to be different people, as some already do.

Mr. Baker warned that more cases may need to be decided before any regulatory action takes place.

“This is like the New Hampshire primary of insurable-interest-annuity litigation,” he said. “New Hampshire is important because it's first, but there are lots of people who win the primaries there and don't go on to become president.”

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