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July 14, 2009

Legislative Reference Library  
645 State Office Building  
100 Constitution Avenue  
St. Paul, Minnesota 55155

Re: In The Matter of the Proposed Rules of the State Department of Commerce Governing  
Military Sales Practices, Minnesota Rules, chapter 2753; Governor's Tracking #AR 345

Dear Librarian:

The Minnesota Department of Commerce intends to adopt rules governing Military Sales Practices. We plan to publish a Notice of Intent to Adopt Rules without a Public Hearing in the July 27, 2009 State Register.

The Department has prepared a Statement of Need and Reasonableness. As required by Minnesota Statutes, sections 14.131 and 14.23, the Department is sending the Library a copy of the Statement of Need and Reasonableness at the same time we are mailing our Notice of Intent to Adopt Rules.

If you have questions, please contact me at (651) 296-8458.

Yours very truly,

A handwritten signature in blue ink, appearing to read 'Susan B.', with a long horizontal flourish extending to the right.

Susan Bergh  
Rules Coordinator  
Minnesota Department of Commerce

Enclosure: Statement of Need and Reasonableness

## **Minnesota Department of Commerce**

### **STATEMENT OF NEED AND REASONABLENESS**

#### **Proposed Permanent Rules Governing Military Sales Practices, Minnesota Rules, chapter 2753.**

### **INTRODUCTION**

The Minnesota Department of Commerce proposes adoption of new permanent rules governing insurance sales practices to military personnel. The primary purpose of the proposed rules is to protect members of the Armed Forces from unscrupulous practices regarding sales of insurance, financial, and investment products.

The U.S. Congress passed the Military Personnel Financial Services Act on September 29, 2006, finding that there is an immediate need to protect members of the U.S. Armed Forces from abusive and misleading sales practices in the sale of life insurance products at military installations. Congress mandated that all states work collectively with the U.S. Department of Defense (DoD) to ensure implementation of appropriate uniform standards to protect military personnel from these predatory sales practices. In response to this federal mandate, the National Association of Insurance Commissioners (NAIC) established a Working Group of member states to develop the Military Sales Practices Model Regulation ("Model Regulation"). Department of Commerce staff members participated in meetings of the NAIC Working Group to develop the Model Regulation, which addresses the deceptive trade practices and issues regarding suitability and product standards, especially with respect to the sale of insurance to active duty junior enlisted service personnel.

It is expected that all 50 states will enact the Model Regulation in compliance with the federal law and in the interest of establishing uniform standards nationwide. The Department of Commerce proposes to adopt the Model Regulation as rules, to assist in the establishment of uniform standards and to comply with the federal act.

### **ALTERNATIVE FORMAT**

Upon request, this Statement of Need and Reasonableness can be made available in an alternative format, such as large print, Braille, or cassette tape. To make a request, contact Heidi Retterath at the Minnesota Department of Commerce, 85 7<sup>th</sup> Place East, Suite 500, St. Paul, Minnesota 55101, phone 651-296-3528, email [rules.commerce@state.mn.us](mailto:rules.commerce@state.mn.us).

### **STATUTORY AUTHORITY**

The Department of Commerce's statutory authority to adopt the rules is set forth in Minnesota Statutes, section 72A.19, subd. 2, and section 45.023, which provides: "The commissioner of commerce may adopt, amend, suspend, or repeal rules in accordance with chapter 14, and as otherwise provided by law, whenever necessary or proper in discharging the commissioner's official responsibilities." Under these statutes, the Department of Commerce has the necessary statutory authority to adopt the proposed rules. This statutory authority was adopted and effective prior to January 1, 1996, and so Minnesota Statutes, section 14.125, does not apply. See Minnesota Laws 1995, chapter 233, article 2, section 58.

## REGULATORY ANALYSIS

Minnesota Statutes, section 14.131, sets out seven factors for a regulatory analysis that must be included in the SONAR. Paragraphs (1) through (7) below quote these factors and then give the agency's response.

*1. A description of the classes of persons who probably will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule.*

Affected classes of persons will be members of the Armed Forces; insurance company issuers of life insurance; and the Department of Commerce.

Insurance company issuers will bear the costs of educating their appointed producers and ensuring that comply with the proposed rules. The Department of Commerce will bear the costs of enforcement of the proposed rules.

Members of the Armed Forces will benefit from expanded consumer protection provided by the proposed rules.

*2. The probable costs to the Department of Commerce and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenues.*

The Department of Commerce may incur rulemaking costs estimated to be \$8,000. There is expected to be no additional cost to the Department of Commerce for enforcement of the proposed rules. The proposed rules are anticipated to have no effect on state revenues.

*3. A determination of whether there are less costly methods or less intrusive methods for achieving the purpose of the proposed rule.*

The United States Congress has determined that protection of members of the Armed Forces is needed and therefore has mandated passage of the proposed rules. The Department of Commerce's utilization of the NAIC's Military Sales Practices Model Regulation as the basis for the proposed rules was determined to be the least costly and intrusive method for achieving the purpose mandated by Congress.

*4. A description of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the Department of Commerce and the reasons why they were rejected in favor of the proposed rule.*

Notwithstanding Congress' clear mandate, some industry comments to the first Model Regulation draft questioned the need for additional regulation, arguing that military solicitation regulations and currently defined deceptive and unfair trade practice laws are more than adequate to protect service members. However, the existing laundry list of prohibited practices is inadequate to protect service members, especially as it applies to the continuing problems of access and improper influence. For example, it is not intuitively obvious that soliciting in barracks or without an appointment is either deceptive or misleading. The incorporation of

pertinent DoD regulations is one of the central features of the rules that will permit the efficient prosecution of agents and insurers that for too long have ignored DoD solicitation regulations. The adoption of the rules will foreclose any argument about whether violations of DoD regulations are actionable under state law.

*5. The probable costs of complying with the proposed rule, including the portion of the total costs that will be borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals.*

Insurance companies currently provide continuing education to their salespeople, so the requirements of these proposed rules could be incorporated into existing continuing education seminars at little cost.

*6. The probable costs or consequences of not adopting the proposed rule, including those costs or consequences borne by identifiable categories of affected parties, such as separate classes of government units, businesses, or individuals.*

Adoption of regulations to protect members of the Armed Forces from unscrupulous practices regarding sales of insurance, financial, and investment products is federally mandated.

*7. An assessment of any differences between the proposed rule and existing federal regulations and a specific analysis of the need for and reasonableness of each difference.*

The exemptions in Minn. Rules Part 2753.0300 are different from those found in the Federal Act. The Federal Act excludes only workers compensation insurance, medical indemnity health insurance, and property and casualty insurance, which are not “life insurance products” under state laws. However, the Federal Act’s definition of “life insurance” is not aligned with the narrower state definition of the term. Many life insurance products, such as credit life insurance, were not found to be an issue in federal state investigations of abusive sales practices. Therefore, the additional exemptions, as set forth in Minn. Rules Part 2753.0300, are appropriate to reduce confusion and to avoid inhibiting the sale and solicitation of insurance products that have not been subject to the abusive sales practices the rules are intended to address.

## **PERFORMANCE-BASED RULES**

Minn. Stat. §§ 14.002 and 14.131 require an agency that is developing rules to describe in the Statement of Need and Reasonableness how it considered ways it might afford flexibility for the regulated party in complying with the regulatory requirements being proposed while still meeting the agency’s objectives.

The NAIC Model Regulation was developed in consultation with the DoD, and it further reflects the comments of interested parties which were appropriate to adopt. This is consistent with Department of Commerce objectives and provides sufficient flexibility for the regulated insurance companies to comply with the rules.

## **ADDITIONAL NOTICE**

This Additional Notice Plan was reviewed by the Office of Administrative Hearings and approved in a June 23, 2009 letter by Administrative Law Judge Eric Lipman.

In addition to the statutory requirements to publish notice in the *State Register* and to mail notice to the persons on the Department of Commerce rulemaking list, the Department has provided the following additional notice:

1. Mailing the notice of the proposed rule amendments to the following persons:

Commissioner Clark Dyrud  
Minnesota Department of Veterans Affairs  
Veterans Service Building  
2nd Floor - Room 206-C  
20 West 12th Street  
St. Paul, MN 55155-2006

Major General Larry W. Shellito,  
The Adjutant General  
Department of Military Affairs  
Veterans Service Building  
20 West 12th Street  
St. Paul, MN 55155  
[webmaster@mn-arng.ngb.army.mil](mailto:webmaster@mn-arng.ngb.army.mil)

Stan Kowalski, State Commander  
Veterans of Foreign Wars  
B-52 Veterans Service Building  
20 West 12<sup>th</sup> Street  
St. Paul, MN 55155

Tom Argyle, Commander  
American Legion  
Room 300A – Veterans Service Bldg.  
20 West 12<sup>th</sup> Street  
St. Paul, MN 55155-2000

Cathy Wenzel  
Minnesota Veteran Family Support  
PO Box 4  
Hasting, MN 55033

Minnesota National Guard Family Assistance Office  
13865 S. Robert Trail  
Headquarters 34<sup>th</sup> Infantry Division  
Rosemount, MN 55068

Downing, Dittrich & Lawrence  
330 Wells Fargo Center  
21 First Avenue Southwest  
Rochester, MN 55902

C Bryon Cox  
Regional Vice President, State Relations  
American Council of Life Insurers  
101 Constitution Ave., NW, Suite 700  
Washington, DC, 20001-2133  
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Todd W. Johnson  
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[todd@naifa-mn.org](mailto:todd@naifa-mn.org)

Daniel D. Riley  
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Minnesota Independent Insurance Agents & Brokers  
7500 Flying Cloud Drive  
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Eden Prairie, MN 55344  
[driley@miia.org](mailto:driley@miia.org)

Professional Insurance Agents of Minnesota  
3600 Holly Lane North, # 90  
Plymouth, MN 55447  
E Mail: [gsather@piamn.com](mailto:gsather@piamn.com)

2. Notifying the Consumer Representatives of the NAIC of the proposed rule amendments.

Bonita Kallestad  
Attorney at Law  
Western Minnesota Legal Services  
P.O. Box 1866  
302 SW 5th Street Suite 202  
Wilmar, MN 56201  
[bkallestad@westernlegal.org](mailto:bkallestad@westernlegal.org)

**Dan Schwarcz**  
Associate Professor of Law  
University of Minnesota Law School  
Walter Mondale Hall,  
229 - 19<sup>th</sup> Ave S.  
Minneapolis, MN 55409  
[Schwarcz@umn.edu](mailto:Schwarcz@umn.edu)

3. Placing a summary of the notice of rulemaking on the Department of Commerce web page at [www.commerce.state.mn.us](http://www.commerce.state.mn.us).

The Department's Notice Plan also includes giving notice required by statute. We will mail the Notice of Intent to Adopt to everyone who is currently registered to be on the Department's rulemaking mailing list under Minnesota Statutes, section 14.14, subdivision 1a. The Department will also give notice to the Legislature per Minn. Stat. § 14.116. The notice and proposed rules will be published in the *State Register* on July 27, 2009.

### **CONSULT WITH FINANCE ON LOCAL GOVERNMENT IMPACT**

As required by Minnesota Statutes, section 14.131, the Department has consulted with the Commissioner of Finance. The Department did this by sending to the Commissioner of Finance copies of the documents sent to the Governor's Office for review and approval by the Governor's Office prior to the Department publishing the Notice of Intent to Adopt. We sent the copies on April 3, 2009. The documents included: the Governor's Office Proposed Rule and SONAR Form; almost final draft rules; and almost final SONAR. The Department of Finance sent a letter dated May 4, 2009, indicating that the proposed rules will not impose a cost on local governments.

### **COST OF COMPLYING FOR SMALL BUSINESS OR CITY**

Minn. Stat. §14.127 requires the Department of Commerce to consider whether the cost of complying with the proposed rules in the first year after the rules take effect will exceed \$25,000 for any small business or small city. The Department has determined that the cost of complying with the proposed rules in the first year after the rules take effect will not exceed \$25,000 for any small business or small city.

The compliance costs of the proposed rules will be borne largely by the insurance companies who issue the policies to be sold to military personnel, and they are all entities that do not qualify as small businesses.

### **LIST OF WITNESSES**

If these rules go to a public hearing, the Department anticipates having the following witnesses testify in support of the need for and reasonableness of the rules:

1. Mr. Brian Pennington, Department of Commerce, will testify about the NAIC Model Regulation development and background.
2. Mr. Paul Hanson, Department of Commerce, will testify about the NAIC Model Regulation development and background.

## **RULE-BY-RULE ANALYSIS**

**2753.0100 PURPOSE.** This rule states a purpose of protecting the interests of active duty service members of the United States armed forces from dishonest and predatory insurance sales practices by declaring certain identified practices to be false, misleading, deceptive, or unfair. The language of the section is taken from the NAIC Model Regulation.

**2753.0200 SCOPE.** This rule limits the application of the proposed rules to the solicitation or sale of any life insurance or annuity product by an insurer or insurance producer to an active duty service member of the United States armed forces, in order to address issues that are particular to this group. The language of the section is taken from the NAIC Model Regulation.

**2753.0300 EXEMPTIONS.** This rule exempts certain products and circumstances from the scope of the proposed rules. Many life insurance products, such as credit life insurance, were not found to be an issue in state investigations of abusive sales practices. Therefore, the exemptions are appropriate to reduce confusion and to avoid inhibiting the sale and solicitation of insurance products that have not been subject to the abusive sales practices the rules are intended to address. The exemptions are consistent with current NAIC Model Acts relating to life insurance and annuities, or were developed in consultation with the DoD, or reflect the comments of interested parties which the NAIC Working Group considered appropriate. The language of the section is taken from the NAIC Model Regulation.

**Subpart 1 (A).** The exemption for credit insurance was taken from the Life Insurance Disclosure and the Life Insurance and Annuities Replacement Model Act.

**Subpart 1 (B).** The exemptions for certain group contracts, applications to existing insurers, contracts intended to settle certain liabilities and for prearranged funeral contracts were taken from the Life Insurance and Annuities Replacement Model Act. These products are excluded only where there is no in-person, face-to-face solicitation of individuals by an insurance producer or where the contract or certificate does not include a side fund. There are two reasons for this exclusion. First, group life insurance and group annuities where there is no direct solicitation by an insurance producer, are excluded in the Life Insurance and Annuities Replacement Model Regulation, and direct response solicitations where there is no recommendation based on information collected from the senior consumer are excluded in the Suitability in Annuity Transactions Model Regulation. Second, state investigations of sales to the military did not find abusive practices when there was no solicitation by an insurance producer, in sales of group life insurance that had no side fund, or in the sale of group annuities.

**Subpart 1 (C).** The exemptions for exercising a conversion privilege, contractual change, or an approved replacement policy, are intended to accommodate appropriate changes to existing policies.

**Subpart 1 (D).** The exemption for individual stand-alone health policies, including disability income policies was derived by the NAIC Working Group to clarify language in the *Federal Act*.

**Subpart 1 (E).** The exemptions for contracts offered by Servicemembers' Group Life Insurance (SGLI) or Veterans' Group Life Insurance (VGLI), as authorized by 38 U.S.C. Section 1965 *et seq.* were included to address DoD concerns and because these products were not found to have been an issue with regard to abusive sales practices.



**Subpart 1 (F).** The exemptions for contracts offered through or by a non-profit military association qualifying under IRC Section 501 (c) (23) were included to address DoD concerns and because these products were not found to have been an issue with regard to abusive sales practices.

**Subpart 1 (G).** The exemptions for certain contracts used to fund ERISA pension or welfare benefit plans described by Internal Revenue Code (IRC) Sections 401(a), 401(k), 403(b), 408(k) or 408(p); government or church plans defined in IRC Sections 414 and 457; and nonqualified deferred compensation arrangements established or maintained by an employer or plan sponsor were taken from the Senior Protection in Annuity Transactions Model Act.

**Subpart 2. Commercial solicitations on DoD installations.** Protecting the ability of nonprofit organizations to educate members of the United States Armed Forces was added to accommodate the United States Armed Forces' need for assistance in providing financial education programs to military personnel.

**Subpart 3. Solicitation exemptions.** The exemptions for direct mail and internet marketing were added to accommodate industry comments that direct mail and internet marketers were ill-positioned to initially determine whether an individual is a service member and/or a service member in a pay grade of E-4 or below for the purposes of complying with these rules. General advertisements were excluded because such advertisements are allowed on military installations with the permission of the installation commander. Further, no evidence indicates that such advertisements are of any concern.

**2753.0400 DEFINITIONS.** This rule provides fourteen definitions for technical terms particular to the activities intended to be regulated and persons intended to be protected. Many of the definitions mirror those in DoD Instruction 1344.07 and Army Regulation 210-7, were provided by the DoD, or were modeled on language taken from other NAIC Model Acts and Regulations. The language of the section is taken from the NAIC Model Regulation.

**Subpart 1. Active Duty.** This definition was provided by the DoD.

**Subpart 2. Department of Defense (DoD) Personnel.** This definition was modeled on DOD Instruction 1344.07, Enclosure 2, E2.1.7. and on input from the DoD.

**Subpart 3. Door to Door.** This definition was taken from Army Regulation 210-7, 1-4. *d*.

**Subpart 4. General Advertisement.** This definition was modeled on the definition of "Institutional Advertisement" in the NAIC Advertisements of Accident and Health Insurance Model Regulation, Sec. 3(F.) and the Advertising of Medicare Supplement Insurance Model Regulation, Sec. 3(H).

**Subpart 5. Insurer.** This definition was taken from the NAIC Senior Protection in Annuity Transactions Model Act.

**Subpart 6. Insurance Producer.** This definition was taken from the NAIC Senior Protection in Annuity Transactions Model Act.

**Subpart 7. Known or Knowingly.** This definition was taken from relevant case law and are included because the Working Group recognized, and was sensitive to, the comments that an agent or producer may not be aware that an individual (1) is a service member or (2) a service member with a pay grade of E-4 or below for the purposes of complying with the Model Regulation. Inclusion of this standard in key provisions is intended to avoid an inadvertent violation.

**Subpart 8. Life Insurance.** This definition was derived from the definition of "life insurance" in the Federal Act.

**Subpart 9. Military Installation.** This definition was based on DOD Instruction 1344.07, Section E2.1.6.

**Subpart 10. MyPay.** This definition was provided by the DoD Defense Finance and Accounting Service.

**Subpart 11. Service Member.** This definition was crafted with input from the DoD.

**Subpart 12. Side Fund.** This definition identifies those life insurance products specified in the *Federal Act* and found to be at the heart of the abusive sales practices uncovered during both state and federal investigations. The definition was crafted in consultation with state insurance departments, consulting actuaries and commentators to the exposure drafts..

**Subpart 13. Specific Appointment.** This definition was taken from Army Reg 210-7. 1-4 e.

**Subpart 14. United States Armed Forces.** This definition was derived from the DoD DICTIONARY OF MILITARY AND ASSOCIATED TERMS. It is used to denote collectively only the regular components of the Army, Navy, Air Force, Marine Corps, and Coast Guard.

**2753.0500 PRACTICES DECLARED FALSE, MISLEADING, DECEPTIVE, OR UNFAIR ON A MILITARY INSTALLATION.** In the past, there have been assertions that state regulators do not have authority under state deceptive trade practices statutes to enforce or sanction insurers for violations of DoD or other military regulations. This rule is necessary to dispel any uncertainty as to state authority in these matters and to meet the expectations of the Congress. The language of the section is taken from the NAIC Model Regulation.

**Subpart 1. Face-to-face solicitations.** The acts and practices prohibited by this subpart are derived from DoD Instruction 1344.07 and Army Reg 210-7.

**Subpart 2. Other acts or practices.** The acts and practices prohibited by this subpart are derived from DoD Instruction 1344.07 and Army Reg 210-7.

**2753.0600 PRACTICES DECLARED FALSE, MISLEADING, DECEPTIVE, OR UNFAIR REGARDLESS OF LOCATION.** This rule is necessary because many of the more egregious practices were not confined to military reservations, but occurred off base as well. The language of the section is taken from the NAIC Model Regulation.

**Subpart 1. Corrupt practices, improper influences, or inducements.** This subpart protects armed services personnel from acts and practices that frequently occur off base. For example, the misuse and manipulation of the allotment system resulted in the abrogation of important rights guaranteed to service members, including the right to a cooling-off period and counseling.

This subpart also protects armed services personnel from improper influences and inducements. For example, as installation commanders began to strictly enforce DoD on-base solicitation rules that prohibited solicitation in barracks or without an appointment, much of the actual sales activity moved off base, frequently to agents' offices. Young trainees were invited off base through various inducements, including "pizza parties." During these events, life insurance applications were frequently solicited.

**Subpart 2. Confusion regarding source, sponsorship, approval, or affiliation.** This subpart protects armed services personnel from misrepresentations that the product is associated with the United States armed forces.

**Subpart 3. Confusion regarding premiums, costs, or investment returns.** This subpart protects armed services personnel from misrepresentations regarding net returns on interest rates, and from misrepresentations that the cost of a product is free..

**Subpart 4. Acts or practices regarding SGLI or VGLI.** This subpart protects armed services personnel from misrepresentations regarding SGLI or VGLI availability, suitability, amount, cost, exclusions, limitations to coverage, or conversion requirements.

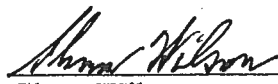
**Subpart 5. Disclosure.** This subpart protects armed services personnel by requiring disclosures regarding an explanation of any free look period and those regarding the written disclosure, schedule of effective rates of return. These disclosures are necessary because state investigators found that many service members were left no information about what they had applied for, and many service members did not discover they had a life insurance policy until they received the first annual statement.

**Subpart 6. Sale of certain life insurance products.** This subpart protects armed services personnel from improperly being offered high-cost securities and life insurance products by financial services companies engaging in abusive and misleading sales practices, and from improperly being offered certain life insurance products as investment products, providing minimal death benefits in exchange for excessive premiums that are front-loaded in the first few years, making them entirely inappropriate for most military personnel.

## CONCLUSION

Based on the foregoing, the proposed rules are both needed and reasonable.

7-14-09

  
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Glenn Wilson  
Commissioner of Commerce