



COMMONWEALTH OF PUERTO RICO  
**OFFICE OF THE COMMISSIONER INSURANCE**

Fermín M. Contreras Gomez  
Commissioner of Insurance

April 7, 2003

**CIRCULAR LETTER NO.: C-L-3-1676-2003**

TO ALL INSURERS THAT WRITE VARIABLE ANNUITIES AND VARIABLE LIFE INSURANCE IN PUERTO RICO AND ALL MANAGERS, GENERAL AGENTS, AND AGENTS AUTHORIZED TO TRANSACT VARIABLE ANNUITIES IN PUERTO RICO

**RE: SPECIAL PERMITS FOR THE SALE OF VARIABLE PRODUCTS**

Dear Sirs and Madams:

Section 3.070 of the Puerto Rico Insurance Code, 26 L.P.R.A. sec. 307, allows insurers to issue variable annuity contracts. Furthermore, Section 13.350 of the Puerto Rico Insurance Code, 26 L.P.R.A. sec. 1335, establishes that variable annuities shall be subject to the provisions of the Puerto Rico Uniform Securities Act and regulations that may be approved under such law.

The Puerto Rico Uniform Securities Act, 10 L.P.R.A. sec. 861 *et seq.* hereinafter "the PR Securities Act," provides that any person who is engaged in the sale of variable products, including annuities, shall obtain a license, by registering at the Office of the Commissioner of Financial Institutions, hereinafter the "OCIF" as agent of a broker-dealer. Likewise, any corporation engaged in the sale of variable products should be authorized to do so by registering as a broker-dealer at the OCIF.

In 1998 and 1999, several corporations that held insurance agent licenses, hereinafter "corporate agents," requested authorization by this Office to sell variable products underwritten by insurers. In view of the excessive burden that becoming broker-traders would represent for them, they requested they be allowed to sell variable products through some of the individuals who fulfilled all of the requirements set forth in the Securities Act to act as an agent of a broker-dealer and that are authorized to act on behalf of the *corporate agent*.

In response to this request, in 1999 the OCI began to issue special permits for the sale of variable products to individuals who are authorized to act on behalf of a *corporate agent* that were interested in selling such products and fulfilled the necessary requirements for the sale of such securities in Puerto Rico.

The US Securities and Exchange Commission (SEC) has officially expressed that corporations devoted to the sale of insurance that propose to offer and distribute variable products, underwritten by an insurer under a Networking Agreement with a broker-dealer, do not need to be registered under the provisions of the Securities Act for the sale of such. In view of this agreement, individuals who are authorized to act on behalf of such a corporation that meet the registration requirements as agents under the provisions of the PR Securities Act will become authorized representatives, both of the insurer and of the broker-dealer, for the distribution of the variable products.

In view of the above, the OCI made a thorough analysis of the desirability of maintaining the special permits in effect. As a part of this analysis, the OCI requested that the holders of the special permits itemize their activities and submit documentary evidence of such so that the OCI would be in a better position to make a decision.

Having completed our analysis, the OCI has decided that beginning on **June 30, 2003**, we will not renew these special permits, so that all *corporate agents*, that are interested in selling variable products, must fulfill the requirements set forth below for the sale of such.

1. Show evidence of being duly registered as a broker-dealer, or absent such, provide evidence that a Networking Agreement has been formalized with a broker-dealer and that the agreement has been approved by the OCIF<sup>1</sup>;
2. Have at least two directors authorized by the OCI to transact variable products. Any person who intends to act on behalf of the *corporate agent* in the sale of variable products shall be listed on the license of the corporate agent as though the person were an individual licensee and be registered at the OCIF as an agent of a broker-dealer<sup>2</sup>; and
3. Submit evidence that the individuals that are authorized to act on behalf of the *corporate agent* for the sale of variable products are duly registered at the OCIF as agents of a broker-dealer.
4. Comply with the additional requirements set forth in Appendix I of this Letter.

All individuals that appear on the *corporate agent* license as authorized to act on its

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<sup>1</sup> See Appendix I.

<sup>2</sup> Ibid.

behalf and that are currently transacting variable products under a special permit, shall be subject to compliance with the provisions of this letter.

Very truly yours,

SIGNED

Fermín M. Contreras-Gomez  
Commissioner of Insurance

Enclosure  
c: Mr. Alfredo Padilla  
Commissioner of Financial Institutions

*Appendix I***Additional Requirements applicable to *corporate agents* interested in selling securities in Puerto Rico**

1. The *corporate agent* will execute a Networking Agreement with a broker-dealer, which will govern the sale of the variable products.<sup>3</sup>
2. The Networking Agreement shall clearly specify the limits of liability of each one of the parties that enter into the agreement.
3. As a minimum, the *Networking Agreement* shall provide the following:
  - i. The client/purchaser will deliver the total amount of the premium payment to the *dual agent*, with a check made out to the order of the insurer that underwrites the variable product, hereinafter "the insurer," to be remitted and delivered by the latter according to the term set forth in NASD Rule 2820(d)<sup>4</sup>. No *dual agent*, *corporate agent*, or broker-dealer will collect checks for the payment of premiums, nor will they use any portion of such funds for the payment of commissions or other compensation, or for any other purpose.
  - ii. The *corporate agent* will consent that any *dual agent* whom the OCIF, the NASD or the SEC, suspends or expels from the association with any broker-dealer, be suspended from any activities of the *corporate agent* related to the sale of variable products;
  - iii. The individuals who are authorized to act on behalf of the *corporate agent* that are not *dual agents*, that is to say, that are not registered for the sale of variable products, may not sell securities or provide consultant services (including, but not limited to, the sale of variable products and annuities), nor may they receive any compensation whatsoever for the sale of securities or the provision of investment advice. These individuals will be required and instructed to refer all questions related to securities and variable products to the *dual agents*.
  - iv. The individuals who are authorized to act on behalf of the *corporate agent* who are not *dual agents*, that is to say, who are not registered for the sale of variable products, may not: (1) handle or maintain clients' funds related to securities transactions, (2) manage or maintain securities, or (3) participate in securities transactions;

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<sup>3</sup> In a letter dated September 28, 1995, the SEC set forth the criteria and conditions for accepting a Networking Agreement as a substitute for the registration requirement for a *corporate agent* as a broker-dealer. See "Securities and Exchange Commission", RE: First of America Brokerage Service, Inc., September 28, 1995, Lexsee 1995 SEC No-Act Lexis 732.

<sup>4</sup> If the *corporate agent* is in turn a general agent, the period for sending and delivering the total payment of the premium to the insurer shall also be the term set forth in NASD Rule 2820(d).

- v. The broker-dealer will provide the *corporate agent* with rules of conduct manuals to be used to educate the individuals who are authorized to act in its behalf, but who are not *dual agents*, regarding the limits between the corporate agent's activities and the activities carried out by the *dual agents*. The *corporate agent* will supervise and periodically review the activities of the individuals who are authorized to act on its behalf and who are not *dual agents*, in order to monitor compliance with the rules of conduct manual;
  - vi. The broker-dealer will approve and assume full responsibility for all advertising and promotional material before their publication and distribution, in order to ensure compliance with applicable legislation and regulations;
  - vii. The broker-dealer will maintain at the broker-dealer's office in Puerto Rico all of the books and records related to the variable products transactions and will ensure compliance with all legislation and regulations related to the conservation and availability for inspection of such records. The broker-dealer will also be responsible for fulfilling all of the reporting requirements related to the receipt and payment of commissions or other compensation related to the sale of variable products.
4. The *corporate agent* will report and certify to the OCIF that the Networking Agreement between the corporate agent and the broker-dealer for the sale of variable products complies with the requirements contained in this Appendix I and the provisions of applicable legislation and regulations.
  5. The Networking Agreement entered into by a *corporate agent* and a broker-dealer under the provisions of this Circular Letter to offer, sell, and manage variable products, shall be submitted to the OCIF for review before beginning to offer, sell or manage variable products in Puerto Rico.
  6. The broker-dealer with whom the corporate agent establishes the Networking Agreement shall be duly registered with the OCIF pursuant to Section 202 of the PR Securities Act. Furthermore, the broker-dealer must be registered with the SEC under Section 15(b) of the federal Securities and Exchange Act, 15 U.S.C. Sec. 780(b) and shall be a member of the National Association of Securities Dealers (the "NASD").

7. The sale of variable products under a Networking Agreement shall not entail a duplication of charges for the client/purchaser. All charges shall be duly specified and disclosed to the client/purchasers before the securities transaction is carried out.
8. Variable products will only be offered by persons who are authorized to act on behalf of the insurance *corporate agent* who are duly (i) authorized by the OCI for the sale of life insurance and variable products and are (ii) registered at the OCIF as agents for the sale of securities, as required in Section 202 of the PR Securities Act. Hereinafter, we will refer to such individuals as the "dual agents" to mean that they hold double licenses from the OCI and the OCIF.
9. *Dual agents will be* registered representatives<sup>5</sup> of the broker-dealer, as required by NASD Rules. Therefore, *dual agents* shall be "associated individuals" of the broker-dealer and shall have the obligation to comply with the provisions and requirements established in Section 201(b) of the PR Securities Act.
10. The designation of *dual agents* as registered representatives of the broker-dealer will be effected according to the provisions of the NASD membership rules.
11. *Dual agents* will be subject to the supervision of the broker-dealer in all matters related to the sale of variable products. Supervision of the *dual agents* by the broker-dealer will be carried out according to the provisions of NASD Rule 3010.
12. *Dual agents* and the *corporate agent* on behalf of whom they are authorized to act shall make available to the OCI and the OCIF all of the documents or records in their possession or control related to the sale of variable products when so requested.
13. Variable products sold by *dual agents* shall be (a) registered with the OCIF under Section 301 of the PR Securities Act, or (b) be exempt from registration under Section 402(a)(5) of the PR Securities Act. In addition, such variable products shall be (i) be underwritten by an insurer that is authorized to do business in Puerto Rico, and (ii) are registered with the SEC.
14. All *corporate agents and the* individuals that are authorized to act on behalf of such, that are engaged in the sale of variable products under the provisions herein, must comply with all of the applicable provisions of the PR Securities Act and Regulation Number 6078 of January 19, 2000, titled "Regulation

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<sup>5</sup> NASD Rule 1031(b) defines "representatives" as "Persons associated with a member [of NASD], including assistant officers other than principals, who are engaged in the investment banking or securities business for the member including the functions of supervision, solicitation or conduct of business in securities or who are engaged in the training of persons associated with a member for any of these functions...".

under the Puerto Rico Uniform Securities Act."

15. The books and records of the *corporate agent* related to the offer, sale, and management of variable products, shall be kept "readily available" to be inspected by the OCI and the OCIF. For the purposes of this paragraph, the phrase "readily available" means that the books and records shall be available for inspection by the OCI and the OCIF within thirty-six (36) hours from the time they are first requested.