

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 2280
 SPONSOR: Banking and Insurance Committee and Senator Atwater
 SUBJECT: Annuity Transactions pertaining to Senior Citizens

DATE: March 10, 2004 REVISED: _____

| | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION |
|----|---------|----------------|-----------|--------|
| 1. | Emrich | Deffenbaugh | BI | Fav/CS |
| 2. | _____ | _____ | AGG | _____ |
| 3. | _____ | _____ | AP | _____ |
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I. Summary:

Committee Substitute for Senate Bill 2280 would enact legislation based on model regulations adopted by the National Association of Insurance Commissioners (NAIC), which is intended to help protect senior consumers (age 65 or older) when they purchase or exchange annuity products.¹ The measure is designed to ensure that the insurance needs and financial objectives of senior consumers are appropriately addressed by establishing standards and procedures for insurance agents, or insurance companies if no agent is involved, so that:

- A reasonable determination has been made by the agent or insurer that the annuity transaction is suitable for the senior consumer, based on the financial information disclosed by the consumer;
- A reasonable effort has been made by the agent or insurer to obtain information about the senior consumer’s financial situation, tax status, and investment objectives as to whether the recommendations being considered fit into the consumer’s needs;
- If a senior consumer refuses to provide relevant information, or fails to provide complete or accurate information, to an agent or insurer, but insists on entering into an annuity transaction regardless of the agent’s or insurer’s recommendation, the actions of such agent or insurer will be considered reasonable based on the information provided at the time;
- An agent or insurer is required to actively supervise compliance with the provisions of this regulation, either through internal means or contracting with a third party to assure necessary oversight;
- Information records that formed the basis for the recommendation of an annuity transaction must be kept on file by the insurer or agent for 5 years after the transaction is completed, for review by the Office of Insurance Regulation (OIR) or the Department of Financial Services (DFS), respectively; and

¹ The NAIC model regulation is entitled “Senior Protection In Annuity Transactions.”

- Corrective action may be ordered by the OIR or the DFS upon determination that a senior consumer has been harmed by a violation of this regulation.

This bill creates section 627.4554 of the Florida Statutes.

II. Present Situation:

Annuities

Background - An annuity is generally defined as an insurance contract that provides a stipulated sum payable at certain regular intervals during the lifetime of a person or payable for a specified period. Annuities are regulated under part III, ch. 627, F.S., by two agencies, the Department of Financial Services (DFS), which exercises authority over insurance agents selling annuity products, and the Office of Insurance Regulation (OIR), which has regulatory jurisdiction over insurance companies. According to representatives with the DFS and the OIR, annuities can be an effective investment tool for many Floridians wanting to ensure a steady stream of income for retirement and achieve certain tax benefits. However, some of the state's senior citizens are falling victim to insurance agents who don't ensure that an annuity is suitable for their customers' financial needs and objectives.

These representatives state that due to the wide range and complexity of annuity products available, selling these products without an adequate assessment of the consumers' financial situation may be harmful to senior investors. More disconcerting are the few unscrupulous agents who are motivated solely by commission payments to lure consumers into purchasing annuities that are unsuitable.

Officials with the DFS assert that the agency has heard from hundreds of seniors and their families who say they were convinced to liquidate CDs, stocks, and savings accounts to fund annuities only to discover these actions were unsuitable and costly. Examples include individuals whose income and assets were such that no tax benefits could be realized. Two specific examples include Paul, a 75-year-old in poor health, who was interested in a short-term investment, but was persuaded to put his money into an annuity with a punitive surrender charge over the first 10 years; and Mary, 85, wanted to be sure her savings would go to her adult children upon her death, but she was sold an unsuitable annuity that required a beneficiary payout stretching over three years to avoid a financial penalty. Other consumers told officials with DFS that they placed a majority of their liquid assets into annuities, only to be forced to pay high surrender charges when they needed cash for unexpected expenses.

Representatives with the DFS believe that because there are more than 2.9 million Floridians over the age of 65, many will consider investing in annuities. Therefore, it is important to help protect senior investors by requiring insurance companies offering these products and their agents to conduct an assessment of a senior's financial circumstances to ensure the annuity meets the consumer's needs.

National Association of Insurance Commissioners - This legislation is based on the model regulation promulgated by the National Association of Insurance Commissioners (NAIC) which is called the "Senior Protection in Annuity Transactions Model Regulation." That model was

adopted by the NAIC on September 14, 2003, after years of development and negotiation with interested parties, including insurance companies, agents, and consumer representatives. According to officials with the DFS, the model was passed without significant objection from any of the parties and with an assurance from the American Council of Life Insurers that there would be no opposition in any state that adopted the model without change. The primary difference between this legislation and the NAIC model is that the bill makes changes to the model which are necessary to conform to Florida's unique regulatory structure in which the DFS exercises authority over agents and the OIR has jurisdiction over insurance companies.

The NAIC model and this legislation refer to rules adopted by the National Association of Securities Dealers (NASD), which apply to suitability and supervision provisions for the recommendation of variable annuities.² Specifically, the NASD has adopted Rule 3010 which requires each member to establish and maintain a system to supervise the activities of registered representatives to achieve compliance with securities law, regulations, and NASD rules. Variable life insurance and variable annuities are securities and their distribution is subject to the NASD rules. In a similar vein, the NASD has adopted Rule 2310 that pertains to suitability which requires members to make reasonable efforts to obtain information concerning a customer's financial and tax status, investment objectives, and such other information used in making recommendations to consumers concerning variable annuities. According to representatives with both the DFS and OIR, this provision is intended to grant a safe harbor when the NASD has reviewed a transaction and found that it complies with the NASD rules pertaining to suitability and supervision relating to variable annuities.

Current consumer protections pertaining to annuities - Under s. 626.99(4)(a) and (b), F.S., insurers must provide to each prospective purchaser of a fixed annuity,³ a buyer's guide to annuities and a contract summary as provided in the NAIC's Model Annuity and Deposit Fund Regulation, and the policy must contain a provision for an unconditional refund for a period of at least 10 days. The buyer's guide and policy summary must be provided by the insurer at the request of the prospective purchaser.

Under the unfair trade practices provisions of the Insurance Code,⁴ it constitutes a violation to knowingly misrepresent the benefits, advantages, conditions, or terms of any insurance policy.⁵ Pursuant to s. 624.418, F.S., an insurance company may have its certificate of authority suspended or revoked if it has violated a lawful order of the OIR as to any provision of the Insurance Code or has engaged in practices in the conduct of its business as to render further transactions injurious to policyholders. Under s. 626.611(5), F.S., an agent's license may be suspended or revoked if such agent makes willful misrepresentations as to an annuity contract or

² NASD is a private-sector provider of financial regulatory services. Pursuant to federal law, virtually every securities firm doing business with the public is a member of this not-for-profit organization. Approximately 5,200 brokerage firms, over 92,000 branch offices and more than 653,000 registered securities representatives come under NASD's jurisdiction. The association registers member firms, writes rules to govern their behavior, examines members for compliance and disciplines those that fail to comply.

³ A fixed annuity provides a guaranteed fixed benefit amount, payable for the life of the annuitant.

⁴ Section 626.9541, F.S. The Insurance Code includes chapters 624-632, 634-636, 641, 642, 648, and 651, F.S.

⁵ Fines may be imposed for willful and non-willful violations (s. 626.9521, F.S.)

willful deception with regard to such contract, done either in person or by any form of dissemination of information or advertising.⁶

III. Effect of Proposed Changes:

Section 1. Creates s. 627.4554, F.S., pertaining to annuity investments by seniors to provide that the purpose of the section is to establish standards and procedures for recommendations to senior consumers which result in a transaction involving annuity products to address the insurance needs and financial objectives of senior consumers at the time of the transaction. Nothing in the section is to be construed to create or imply a private cause of action for a violation of the section. The legislation applies to any recommendation to purchase or exchange an annuity made to a senior consumer by an insurance agent, or an insurer where no agent is involved, that results in the purchase or exchange recommended.

The bill defines three terms:

- “annuity” means a fixed or variable annuity that is individually solicited, whether the product is classified as an individual or a group annuity;
- “recommendation” means advice provided by an insurance agent, or an insurer if no insurance agent is involved, to an individual senior consumer which results in a purchase or exchange of an annuity in accordance with that advice; and
- “senior consumer” means a person 65 years of age or older. In the event of a joint purchase by more than one party, a purchaser is considered to be a senior consumer if any of the parties is age 65 or older.

The duties of insurers and agents are outlined to include the provision that in recommending to a senior consumer the purchase of an annuity or an exchange of an annuity that results in another insurance transaction, an agent, or insurer if no agent is involved, must have “reasonable grounds” for believing that a recommendation to a senior consumer is suitable for such person on the basis of the facts disclosed by the person as to his or her investments and other insurance products, and to his or her financial situation and needs. Before executing a purchase or exchange of an annuity resulting from a recommendation to a senior consumer, the agent or insurer if no agent is involved, must make reasonable efforts to obtain information concerning the senior’s financial and tax status, investment objectives, and other information considered to be reasonable by the insurance agent or insurer in making the recommendation.

An insurance agent, or an insurer if no agent is involved, shall not have any obligation to a senior consumer related to any recommendation if the senior refuses to provide relevant information requested by the agent or insurer, decides to enter into an insurance transaction that is not based on such recommendation, or fails to provide complete or accurate information.

An agent’s or an insurer’s recommendation shall be reasonable under all circumstances actually known to the agent or insurer at the time of the recommendation.

⁶ Section 626.611(5), F.S.

An insurer or agent shall ensure that a system to supervise recommendations which is reasonably designed to comply with this section is established to include maintaining written procedures and conducting periodic reviews of its records that are designed to detect and prevent violations of this section.

A managing general agent (MGA) and an insurance agency must adopt a “system” established by an insurer to supervise recommendations of its agents to achieve compliance with this section or must establish and maintain such a system to include:

- maintaining written procedures;
- conducting periodic reviews of records that are reasonably designed to assist in detecting and preventing violations of this section.

The legislation allows an insurer to contract with a third party, including a MGA or an insurance agency, to establish and maintain the above “system” with respect to agents under contract with or employed by the third party. An insurer must make reasonable inquiry to ensure that the third party is performing the specified functions and must take action, which is reasonable under the circumstances, to enforce the contractual obligation. In making reasonable inquiry, an insurer must annually obtain a certificate from a third party senior manager who has responsibility for the delegated functions that the manager has a reasonable basis to represent, and does represent, that the third party is performing the required functions; and, based on reasonable selection criteria, periodically select third parties for a review to determine whether the third parties are performing the required functions. An insurer that contracts with a third party and complies with the above requirements is deemed to have fulfilled its responsibilities.

However, an insurer, MGA, or insurance agency is not required to review all transactions solicited by an agent, or include in its system of supervision of insurance agent’s recommendations to senior consumers of products *other than* the annuities offered by the insurer, MGA, or agency. An insurer, MGA, or insurance agency contracting with an insurer shall, when requested, provide a certification or provide a statement that the MGA or agency is unable to meet the certification requirement.

The OIR and the DFS respectively, may order an insurer or agent to take corrective action for any senior consumer harmed by a violation of this section by such insurer or agent. A MGA or insurance agency may also take corrective action against an agent for similar violations. Any penalty under the Insurance Code for specified violations may be reduced or eliminated, according to a schedule adopted by the OIR or DFS, if corrective action for the senior consumer was taken promptly after discovery of the violation.

Insurers, MGAs, insurance agencies, and agents must maintain and make available to the appropriate agency records of the information collected from senior consumers used in making the recommendations that were the basis for insurance transactions for 5 years after the transaction is completed. Such records may be maintained in paper, photographic, mechanical, electronic or other specified media.

The bill exempts specified recommendations which pertain to:

- direct-response solicitations which do not involve recommendations based on information collected from a senior consumer; and
- contracts used to fund an employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act; plans specified under the Internal Revenue Code (IRC) if established by an employer; particular government or church plans under the IRC; nonqualified deferred compensation arrangements maintained by an employer or plan sponsor; settlements or assumptions of liabilities associated with personal injury litigation or claim resolution process; or prepaid funeral contracts.

The bill provides that compliance with the National Association of Securities Dealers (NASD) conduct rules in effect on January 1, 2004, will satisfy the requirements under this bill for the recommendation of variable annuities. However, this provision does not limit the enforcement by the DFS or the OIR of the provisions under the bill.

Section 2. Provides that the act shall take effect February 1, 2005.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Under the provisions of this bill, unsuitable annuity sales to senior investors may be curbed and thus these seniors could avoid costly financial mistakes. There would be an indeterminate administrative cost to life insurance companies that will now be required to train agents and develop procedures for keeping necessary documentation on annuity sale recommendations made to senior clients.

C. Government Sector Impact:

Representatives with both DFS and OIR state that there is no fiscal impact to either agency.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
