The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Banking and Insurance Committee

BILL: CS/SB 1372

INTRODUCER: Banking and Insurance Committee and Senator Bennett

SUBJECT: Insurance; Sales of Annuities to Seniors

DATE: March 10, 2009 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Burgess	BI	**Fav/CS**
2.			GA	
3.				
4.				
5.				
6.				

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE.....	X	Statement of Substantial Changes
B. AMENDMENTS........................		Technical amendments were recommended
		Amendments were recommended
		Significant amendments were recommended

I. Summary:

The Committee Substitute to Senate Bill 1372—entitled the Safeguard Our Seniors Act—strengthens regulations governing the sale of annuities to senior consumers.

Increased Penalty Provisions:

- Classifies as third degree felonies the unfair insurance trade practices known as “twisting” and “churning” when the victim is a senior age 65 or older.
- Prohibits the Department of Financial Services (DFS) from granting a license to an agent or customer representative whose license has been revoked due to the solicitation or sale of an insurance product to a person age 65 or older.
- Authorizes the DFS to suspend, revoke, or refuse to issue an insurance agent’s license if the agent has been disciplined for a violation of federal or state securities or commodities law (or rule or regulation).
- Authorizes the DFS to require an insurance agent to provide monetary restitution to a senior harmed by a violation of s. 627.4554, F.S. (regulations on annuity investments by seniors).
- Classifies third-party marketers as affiliates of an agent if the marketer aids or abets the licensee in an insurance code violation involving the sale of an annuity to a senior.

Regulation of Annuity Contracts and Life Insurance Policies:
- Requires an annuity contract to provide an unconditional refund period of at least 60 days to prospective purchasers 65 years of age or older.
- Limits deferred sales charges in an annuity contract issued to a senior to 5 percent, and requires that the charge be reduced to zero percent by the end of the fifth policy year.
- Prohibits designating family members of a life insurance agent placing coverage as life insurance beneficiaries unless the family member has an insurable interest in the insured.

Other Provisions:
- Specifies that the failure of an agent to make reasonable efforts to ascertain a consumer's age is not a defense to an unfair insurance trade practice violation.
- Permits the taking of a video deposition of a senior citizen who is the victim of an unfair insurance trade practice violation, which may be used in ch. 120, F.S., administrative hearings.

This bill substantially amends the following sections of the Florida Statutes: 624.310, 626.025, 626.621, 626.641, 626.798, 626.9521, 626.99, and 627.4554.

II. Present Situation:

Annuities
An annuity is a contract between a customer and an insurer for which the customer makes a lump sum payment or series of payments to an insurer that in return agrees to make periodic payments back to the annuitant at a future date, either for the annuitant's life or a specified period. Annuities are available in either immediate or deferred form. In an immediate annuity the annuity company is typically given a lump sum payment in exchange for immediate and regular periodic payments, which may be for as long as the contract owner lives. For a deferred annuity, premiums are usually paid either in a lump sum or by a series of payments, and are subject to an *accumulation phase*, when those payments experience tax-deferred growth, followed by the *anunitization* or *payout phase*, when the annuity provides a regular stream of periodic payments to the consumer.

Annuities are used for retirement planning because they provide a guaranteed source of income for future years. Immediate annuities are often used by senior citizens as a means to supplement their retirement income, or as a method of planning for Medicaid nursing care. The main advantage of deferred annuities is that the principal invested grows on a tax-deferred basis. However, unlike some other investments that are subject to the capital gains tax (maximum 15 percent), a deferred annuity is subject to the ordinary income tax rates of up to 35 percent. Both deferred and immediate annuities are long-term contracts that typically restrict the investor's ability to access money placed in the annuity. Deferred annuities may be unsuitable investments for many senior citizens because of this fact.

There are three basic annuity types:

Fixed Annuities – A fixed annuity guarantees fixed payments at a fixed interest rate to the annuitant, while a variable annuity provides a rate of return that is not guaranteed and is based on

the success of the investment option that underlies the annuity. Fixed annuities are considered insurance products that may be sold by a licensed life insurance and annuity agent.

Variable Annuities - In a variable annuity, the premium dollars are placed into a variety of investments called subaccounts. The performance of the investments in the subaccounts determines the performance of the annuity. Variable annuities are considered investment products and under the jurisdiction of both securities regulators and state insurance departments. Agents selling this type of annuity must hold a variable annuity license from the state insurance regulator, a securities license and an active securities registration with a broker/dealer.

Equity Indexed Annuities – An equity indexed annuity is a hybrid of a fixed and a variable annuity. Equity indexed annuities provide a “minimum guaranteed” interest rate in combination with an index-linked component. This is different from a traditional fixed annuity that provides a specific guaranteed rate of interest. Equity indexed annuities offer investors gains based on gains in the stock market, but generally at a lower rate than gains in the stock market. Though investors do not realize gains at the same level as in the stock market, they have the additional protection of a minimum guaranteed interest rate. Even with a guaranteed minimum interest rate, investors may still lose money purchasing an equity indexed annuity if the rate is less than the premium or initial payment. Investors who need to cancel an annuity to access funds prior to the maturity of the contract may lose principal through surrender charges. Equity indexed annuities are complex and sometimes contain detrimental features such as hidden penalties, fees, and large multi-year surrender charges.

Recently, the Securities and Exchange Commission (SEC) adopted Rule 151A, which classifies equity indexed annuities as securities and applies federal securities laws to them if the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract. The SEC ruling will apply only to annuities issued on or after January 12, 2011. Multiple companies that sell such products have filed suit in the U.S. Court of Appeals to overturn the rule, which will extend securities regulation over such products. The National Association of Insurance Commissioners and the National Conference of Insurance Legislators both oppose the SEC ruling and are also asking the federal court to overturn the SEC rule. The NAIC takes the position that such products are insurance and not a security, and opposes eliminating state insurance oversight in favor of federal securities oversight. Prior to this ruling these annuities were not considered securities and not required to register with the federal Securities and Exchange Commission, which is required of variable annuities. As a result, equity indexed annuities did not need to be accompanied with a prospectus that discloses possible investment risks. Additionally, the SEC ruling will eventually require insurance agents to have a securities license to sell equity indexed annuities. Currently, only the sale of a variable annuity requires a securities license.

Common Types of Annuity and Life Insurance Fraud

The sale of unsuitable annuities to consumers commonly involves inappropriate conduct by the agent such as misrepresentations and material omissions designed to hide the fact that the product is not suitable to meet the consumer’s needs. Forgeries are also commonplace. Annuity or life insurance transactions involving misrepresentations or material omissions are

administratively prosecutable under the Unfair Insurance Trade Practices Act in Chapter 626, F.S.

The Department of Financial Services provides the following example as a scenario in which annuity fraud occurs:

> A dishonest agent hosts a free meal seminar conducted by a third party marketer where the agent's qualifications and expertise are fraudulently exaggerated. The agent makes a high-pressure sales pitch and secures an appointment. At this point, the agent identifies all the senior's assets and liquidates them to fund an annuity, regardless of any penalties that may be incurred by surrendering other annuities or investments. The higher the dollar amount of the annuity, the higher the agent's commission. The agent places the senior consumer into a deferred annuity with extremely high surrender charges that are in force for a number of years. The annuity is clearly unsuitable to meet the needs of the senior consumer and has the effect of denying the senior consumer access to his or her assets for most of the rest of the consumer's life.

Two common unfair insurance trade practices are "twisting" and "churning." Twisting involves knowingly making misleading representations, or incomplete or fraudulent comparisons, or fraudulent material omissions regarding insurance policies or insurers in an attempt to induce a customer take an action regarding his or her current insurance policy or take out an insurance policy with another insurer.[1] Churning is similar to twisting, but involves the surrender or withdrawal from a product to fund another product issued by the same company.[2] Agents that engage in these practices do so to obtain additional agent commissions that range between 9 and 12 percent for most annuity sales (a $100,000 annuity would yield a commission between $9,000 and $12,000). The Department of Financial Services indicates that because such practices are misdemeanors by statute, state attorneys are reluctant to initiate criminal prosecutions of suspected violators who engage in twisting or churning.

Annuity Investments by Seniors

Section 627.4554, F.S., provides standards and procedures for recommending annuity products to seniors. The Office of Insurance Regulation may take reasonably appropriate corrective action on behalf of a senior consumer harmed by a violation of the section by an insurer or insurance agent. In 2008 the Legislature expanded this power to include ordering an insurer to rescind a life insurance policy or annuity and provide a full refund of the premiums paid or the accumulation value, whichever is greater.

Suitability - The suitability of an annuity is the appropriateness of a particular annuity product relative to the consumer's age, investment objectives, and current and future financial needs. In 2008 the Legislature acted to strengthen the suitability requirements of the statue. An insurance agent (or insurer if no agent is involved) recommending to a senior consumer that he or she purchase an annuity that results in another insurance transaction must have an objectively reasonable basis for believing that the recommendation is suitable. Further, insurance agents

[1] Section 626.9541(1)(l), F.S.
[2] Section 626.9541(1)(aa), F.S.

must obtain specified personal and financial information from the consumer that is relevant and necessary in order to make a suitable recommendation.

Disclosures - The insurer or agent must also provide a senior consumer with specified information concerning differences between the annuity recommended for purchase and the existing annuity to be surrendered or replaced. Additionally, s. 626.99, F.S., requires that each insurer must provide to all prospective purchasers of annuities (regardless of age) a buyer's guide to annuities and a contract summary as provided in the National Association of Insurance Commissioners (NAIC) Model Annuity and Deposit Fund Regulation.

Free Look Period – Each annuity policy must provide the purchaser (regardless of age) an unconditional refund for a period of at least 14 days. The 2008 Legislature expanded the free look period from 10 to 14 days and applied the requirement to all annuities, rather than only fixed annuities.

Unfair Insurance Trade Practices Act

The "Unfair Insurance Trade Practices Act" under s. 626.9541, F.S., specifies and prohibits practices that constitute unfair methods of competition or unfair or deceptive acts. Generally, s. 626.9521, F.S., provides that insurers, insurance agents, and any other person involved in the business of insurance can be fined for violating the act, up to $2,500 for each non-willful violation up to an aggregate $10,000 fine, and up to $20,000 for each willful violation up to an aggregate $100,000 fine. Willful violations of these provisions are also subject to criminal prosecution as a second-degree misdemeanor (s. 624.15, F.S.).

The unfair trade practice laws authorize the OIR or DFS to issue cease and desist orders against insurers and agents that violate those provisions (s. 626.9581, F.S.). Violation of a cease and desist order is subject to a penalty not to exceed $50,000 (s. 626.9601, F.S.). An insurance agent that violates this section is also subject to suspension or revocation of his or her license and an administrative penalty of up to $500 or, for willful violations, up to $3,500, under the authority of the Department of Financial Services (s. 626.681, F.S.).

In 2008, the Legislature enacted enhanced penalties in s. 626.9521, F.S., for fraudulently "twisting" and "churning," making the commission of either offense punishable as a first degree misdemeanor. The legislature also created two new violations of the act. The first is willfully submitting a false signature to an insurer on behalf of an insured, which is a third degree felony. The administrative penalties for "twisting," "churning," or willfully submitting a false signature were increased to $5,000 for each non-willful violation, up to an aggregate $50,000 fine; the fine for a willful violation was increased to $30,000 per violation up to an aggregate $250,000 fine. The second new violation is using designations or titles that falsely imply that a licensee has special financial knowledge or training, which is subject to the standard penalty provisions of the act.

III. Effect of Proposed Changes:

Section 1. Entitles the act the "Safeguard Our Seniors Act."

Section 2. Amends s. 624.310, F.S., adding within the definition of an "affiliated party" a third-party marketer that aids or abets a licensee in a violation of the insurance code relating to the sale of an annuity to a person 65 years of age or older. The classification will subject third-party marketers persons to misdemeanor penalties and provide the DFS authority to seek a cease and desist order against the marketer in circuit court.

Section 3. Amends s. 626.025(13), F.S., prohibiting designating a family member of a life insurance agent from being a beneficiary. The prohibition does not include life insurance policies sold to a family member. The provision is designed to prevent an unscrupulous agent from selling a policy to an outside party for the purpose of enriching the agent or the agent's family member.

Section 4. Adds subsection (13) to s. 626.621, F.S., which contains the grounds under which the Department of Financial Services may refuse, suspend, or revoke the license of an agent, adjuster, customer representative, service representative, or managing general agent. The bill authorizes the DFS to exercise this power when:

1) A licensee or applicant (or that person's license, permit, appointment, registration or other authorization to conduct business) has been the subject of…
2) …any decision, finding, injunction, suspension, prohibition, revocation, denial, judgment, final agency action, or administrative order…
3) …promulgated by any court of competent jurisdiction; administrative law proceeding; state agency; federal agency; or national securities, commodities, or option exchange or association…
4) …involving a violation of any federal or state securities or commodities law or any rule or regulation promulgated there under, a violation of any rule or regulation of any national securities, commodities, or options association or exchange.

The DFS intends for the section to be used to take disciplinary action against the license of an insurance agent who has been disciplined under a securities broker-dealer license or another related license.

Section 5. Amends s. 626.641(3), F.S., to prohibit the Department of Financial Services from granting or issuing a license to an individual whose license or eligibility for licensure as an agent or customer representative has been revoked due to the solicitation or sale of an insurance product to a person 65 years of age or older.

Section 6. Amends s. 626.798, F.S., to expand the prohibition against designating a life insurance agent as a life insurance beneficiary; the bill prohibits family members of the agent from being a beneficiary unless the family member has an insurable interest in the insured. "Family members" include the father, mother, son, daughter, sister, grandfather, grandmother, uncle, aunt, first cousin, nephew, niece, husband, wife, father-in-law, mother-in, law, brother-in-law, sister-in-law, stepfather, stepmother, stepson, stepdaughter, stepbrother, stepsister, half brother, or half sister.

Section 7. Amends s. 626.9521, F.S., the Unfair Insurance Trade Practices Act. The bill:

- Increases the criminal penalties for engaging in "twisting" or "churning" if the victim is age 65 or older. The bill makes engaging in such acts a third degree felony punishable by up to

5 years imprisonment. In order to apply a criminal penalty, the violator must have engaged in fraudulent conduct.

- Specifies that the failure of a licensee to make all reasonable efforts to ascertain a consumer's age at the time an insurance application is completed is not a defense to an unfair insurance trade practices violation.
- Permits taking a video deposition, attended by the parties, of a senior citizen who is a victim of an unfair insurance trade practice. The video deposition of the victim may be used for any purpose in a ch. 120, F.S., administrative proceeding.

Section 8. Amends s. 626.99(4), F.S., containing the disclosures an insurer must provide a prospective purchaser of life insurance. The bill requires an insurer to do the following:

- Provide a minimum 60-day unconditional refund period to an annuity purchaser who is at least 65 years old.
- Provide a contract summary and a DFS-developed buyer's guide on annuities and to each prospective purchaser (regardless of the purchaser's age) that informs the prospective purchaser how to contact the DFS or OIR if he or she has questions regarding the annuity offered.
- Attach a cover page to an annuity policy informing the purchaser (regardless of the purchaser's age) of the unconditional refund period, contact information for the issuing company, the DFS toll-free help line number, and other information required by the DFS by rule. The cover page is part of the annuity contract and is subject to review by the OIR pursuant to s. 627.410, F.S.

Section 9. Section 627.4554, F.S., contains the standards and procedures for recommending annuity products to senior consumers. The bill amends s. 627.4554(5), F.S., (as amended by s. 9 of ch. 2008-237, L.O.F.) to grant the DFS the authority to order an insurance agent to provide monetary restitution for penalties or fees incurred by a senior consumer for misappropriation of funds by the agent.

New subsection (10) prohibits including a deferred sales charge exceeding 5 percent within a contract to a purchaser who is 65 years old or older. Any deferred sales charge within such contract must be reduced to zero by the end of the fifth policy year.

Section 10. The act is effective July 1, 2009.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The Department of Financial Services states that fraudulent methods of selling annuities are a serious and increasing harm to Florida's seniors and that the provisions of the bill are necessary to combat such actions. The DFS asserts that making "twisting" or "churning" a third degree felony is appropriate, and would bring this violation in line with the penalty applied to securities broker-dealers (s. 517.302, F.S.). The department believes that often state attorneys do not prosecute instances of annuity fraud because it is only punishable by a first-degree misdemeanor. The DFS also indicates that capping surrender charges in annuity contracts will eliminate contracts with excessively high surrender charge provisions that can be as high as 25 percent and last up to 20 years.

Representatives of insurers and agents that sell annuity products to seniors have expressed concern that singling out "twisting" and "churning" for increased felony penalties casts their industry in an unfair light. They note that additional penalties for the two acts were recently enacted and only took effect January 1, 2009, and that insufficient time has passed in order to determine that a first degree misdemeanor is not an effective deterrent against fraud.

Representatives of insurers that offer annuity products state that extending for senior consumers the "free look" unconditional refund period from 14 to 60 days is problematic, particularly with regard to variable annuities that are subject to risk associated with the underlying stock markets they are partially based on. The provision may increase the use of the "free look" option for fixed annuities, not as a deterrent to fraud, but simply to get a better deal when interest rates rise.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

- Titles the act the "Safeguard Our Seniors Act."
- Removes the requirement that a violation of state or federal securities laws must involve fraud, breach of trust, dishonest dealing, fiduciary misconduct, or moral turpitude in order for the DFS to refuse to issue, suspend, or revoke an insurance agent's license.
- Specifies that regarding a video deposition of a senior harmed by annuity fraud as authorized by the bill, both parties must be permitted to be in attendance.
- Specifies that the DFS may order an agent to make monetary restitution for penalties or fees incurred by a senior consumer *for* misappropriation of funds by an agent.
- Specifies that an insurer must provide a DFS-developed buyer's guide to any prospective annuity purchaser.
- Specifies that the bill's requirement of an annuity cover page containing specified information is part of the contract and subject to OIR review.

B. Amendments:

None.

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.