

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 Policy and Steering Committee on Ways and Means

BILL: CS/CS/SB 1372

INTRODUCER: Criminal Justice Committee; Banking and Insurance Committee; and Senators Bennett, Fasano, Lynn, and Deutch

SUBJECT: Insurance; Sales of Annuities to Seniors

DATE: April 23, 2009 **REVISED:** _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Knudson</u>	<u>Burgess</u>	<u>BI</u>	<u>Fav/CS</u>
2.	<u>Clodfelter</u>	<u>Cannon</u>	<u>CJ</u>	<u>Fav/CS</u>
3.	<u>Frederick</u>	<u>Kelly</u>	<u>WPSC</u>	<u>Favorable</u>
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE..... Statement of Substantial Changes

B. AMENDMENTS..... Technical amendments were recommended

Amendments were recommended

Significant amendments were recommended

I. Summary:

The bill—entitled the Safeguard Our Seniors Act—strengthens regulations governing the sale of annuities to senior consumers.

The bill:

- Classifies as a third degree felony the commission of fraud, including the unfair insurance trade practices known as “twisting” and “churning,” in connection with the offer, sale or purchase of financial products when the victim is 65 years of age or older. The bill exempts a number of fraudulent practices that are already prohibited.
- 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Department of Financial Services (DFS) from granting a license to an agent or customer representative whose license has been revoked due to the solicitation or sale of an insurance product to a person 65 years of age or older.
- Authorizes 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, rule or regulation.
- Authorizes DFS to require an insurance agent to provide monetary restitution of penalties and fees incurred by a senior consumer who is harmed by a willful violation of

s. 627.4554, F.S. (annuity investments by seniors). Also requires DFS to order payment of restitution to a senior consumer who is deprived of money by an insurance agent's misappropriation, conversion, or unlawful withholding of the senior consumer's money in the course of an annuity transaction.

- 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.
- Requires an annuity contract to provide an unconditional refund period of at least 30 days to a purchaser 65 years of age or older who is not an accredited investor, and for the annuity contract to include a cover page concerning the refund provision.
- Limits deferred sales charges in an annuity contract issued to a person who is 65 years of age or older to 10 percent, and requires that the charge be reduced one percent each year to zero by the end of the tenth policy year.
- Prohibits designating a family member of the life insurance agent who places coverage as a beneficiary of a life insurance policy unless the family member has an insurable interest in the insured.
- 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 sections 624.310, 626.025, 626.621, 626.641, 626.798, 626.9521, 626.99, and 627.4554, and creates section 817.2351, of the Florida Statutes.

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 *annuitization* 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 (NAIC) 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 SEC, 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.

DFS 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 to 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). DFS 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 statute. An insurance

¹ Section 626.9541(1)(l), F.S.

² Section 626.9541(1)(aa), F.S.

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 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 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 Office of Insurance Regulation 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 DFS (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., to add 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 to misdemeanor penalties and provide DFS with authority to seek a cease and desist order against the marketer in circuit court.

Section 3 amends s. 626.025(13), F.S., to prohibit a life insurance agent from writing a policy with his or her family member as 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., relating to the grounds upon which DFS may refuse, suspend, or revoke the license of an agent, adjuster, customer representative, service representative, or managing general agent. The bill authorizes 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.

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 DFS 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 the Unfair Insurance Trade Practices Act (s. 626.9521, F.S.). The bill:

- Clarifies that only a “natural” person can commit the offenses of “twisting, “churning,” or willfully submitting a fraudulent signature. A natural person is understood throughout the statutes to mean a living individual, as opposed to a non-living entity such as a corporation.³
- 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 making use of video deposition of a senior citizen who is a victim of an unfair insurance trade practice if all parties are given proper notice in accordance with the Florida Rules of Civil Procedure. 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., concerning the disclosures an insurer must provide a prospective purchaser of life insurance. The bill requires an insurer to:

- Provide a minimum 30-day unconditional refund period to an annuity purchaser who is at least 65 years old. For a fixed annuity contract, the refund includes premiums paid and any contract fees and charges. For a variable or market value annuity contract, the refund includes the cash surrender value provided in the contract and any fees or charges deducted from premiums or imposed under the contract. The 30-day refund provision for a variable or market value annuity contract does not apply to a prospective owner or an accredited investor as defined in Regulation D of the SEC.⁴
- Provide a contract summary and a DFS-developed buyer’s guide on annuities to each prospective purchaser (regardless of the purchaser’s age) prior to accepting any payment for an annuity contract.
- 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 DFS administrative rule. The cover page is part of the annuity contract and is subject to review by the Office of Insurance Regulation (OIR) of the Financial Services Commission pursuant to s. 627.410, F.S.

Section 9 amends s. 627.4554, F.S., relating to the standards and procedures for recommending annuity products to senior consumers. This section:

- Defines the term “accredited investor.” The definition is the same as the description of accredited investors who are natural persons in Regulation D adopted by the SEC.⁵

³ The term “natural person” is used numerous times throughout the Florida Statutes without definition. It is also used without definition in Article I, Section 2 of the Florida Constitution, in the phrase “[A]ll natural persons, male and female alike...”. The only definition in statute, which is found in s. 628.4615, F.S., and applicable only to that section, is that natural person means “an individual.”

⁴ Regulation D is found at 17 CFR 230.501–230.508. In the case of individual consumers, Rule 501 of Regulation D defines the term “accredited investor” to include: (1) any natural person whose individual net worth, or joint net worth with his or her spouse, exceeds \$1,000,000 at the time of purchase; and (2) any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with his or her spouse in excess of \$300,000 in each of those years, and has a reasonable expectation of reaching the same income level in the current year;.

⁵ See footnote 4, *supra*.

- Authorizes DFS to require an insurance agent to provide monetary restitution of penalties and fees incurred by a senior consumer who is harmed by a willful violation of s. 627.4554, F.S. (annuity investments by seniors).
- Requires DFS to order payment of restitution to a senior consumer who is deprived of money by an insurance agent's misappropriation, conversion, or unlawful withholding of a senior consumer's money in the course of an annuity transaction. Restitution is limited to the amount misappropriated, converted, or unlawfully withheld, and does not preclude the victim from seeking other legal remedies.
- Creates a new subsection (10) that prohibits an annuity contract issued to a senior consumer from including a surrender or deferred sales charge for withdrawal of money that exceeds 10 percent, which must be reduced by one percent each year to zero by the end of the tenth policy year.

Section 10 creates a new criminal offense to penalize fraudulent financial services transactions involving a victim who is 65 years of age or older. The new offense described in s. 817.2351, F.S., is committed when a natural person, in connection with rendering any advice or with the offer, sale, or purchase of any financial services product to a person who is 65 years of age or older, directly or indirectly:

- Employs any device, scheme, or artifice to defraud a person
- Engages in any transaction, practice, or course of business that operates or would operate as a fraud or deceit upon a person
- Knowingly and willfully falsifies, conceals, or covers up a material fact by any trick, scheme, or device
- Makes any false, fictitious, or fraudulent statement or representation, or
- Makes or uses any false writing or document while knowing that the writing or document contains any false, fictitious, or fraudulent statement or entry.

Both twisting and churning of insurance products are expressly included in the offense description, but are not the only actions that violate the statute. If twisting or churning is committed against a person who is 65 years of age or older in a manner that is prohibited by s. 817.2351, F.S., it will be a third degree felony punishable by up to 5 years imprisonment or a \$5000 criminal fine.⁶ Otherwise, twisting or churning is a first degree misdemeanor under s. 626.9521(3), F.S., and is punishable by imprisonment for up to one year. In addition, a person who violates s. 626.9521(3), F.S., is subject to an administrative fine of up to \$5000 for each non-willful violation and up to \$40,000 for each willful violation. It is unclear whether the administrative fine provision would apply to felony twisting and churning.

The new offense does not apply to transactions that are governed by the following statutes:

- Chapter 494 (Mortgage Brokerage and Mortgage Lending)

⁶For twisting or churning to be prosecutable as a felony under new s. 817.2351, F.S., it must be committed in a manner that is prohibited by that statute. It appears that most acts of twisting or churning would involve one of the prohibited actions, but because the elements of twisting, as defined in s. 626.9541(1)(l), F.S., and churning, as described in s. 626.9521(3)(a), F.S., are not the same as the elements of s. 817.2351, F.S., it cannot be stated with certainty that all acts of twisting and churning against a senior victim would be chargeable as a felony.

- Chapter 496 (Solicitation of Funds)
- Chapter 501 (Consumer Protection)
- Chapter 516 (Consumer Finance)
- Chapter 517 (Securities Transactions)
- Chapter 560 (Money Services Businesses)
- Section 775.15(8) (Florida Control of Money Laundering in Financial Institutions Act)

Section 11 provides an effective date of 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 bill will have a positive fiscal impact for senior consumers to the extent that it deters unscrupulous conduct with regard to financial service products. Also, provisions concerning restitution and limitation of surrender charges in annuity contracts could have a positive fiscal impact for an individual senior consumer.

C. Government Sector Impact:

According to the Department of Financial Services and Office of Insurance Regulation, the additional workload incurred as a result of the implementation of this bill can be handled with existing resources.

The Criminal Justice Estimating Conference has not yet estimated the potential impact of new third degree felony for fraudulent actions with regard to financial services products when the victim is 65 years of age or older.

VI. Technical Deficiencies:

None.

VII. Related Issues:

DFS 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. The CS addresses this concern by potentially including other fraudulent acts in the new felony offense.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

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

CS by Criminal Justice on March 25, 2009:

- Reduces the unconditional refund period for persons who are 65 years of age and older to 30 days from 60 days in the CS. Also provides that the special refund period does not apply to purchase of variable or market value annuity contracts by an accredited investor.
- Defines the term "accredited investor."
- Requires DFS to order an insurance agent to pay full restitution if he or she misappropriates a senior consumer's money in a transaction involving annuities. Use of other penalties by DFS and a civil claim by the consumer are not affected.
- Limits any surrender or deferred sales charge for withdrawal of money from an annuity contract issued to a senior consumer who is not an accredited investor to no more than 10 percent, which decreases by 1 percent each year until there is no charge after 10 years.
- Creates a new 3rd degree felony for defrauding a senior in the sale of a financial service product, including committing "twisting" and "churning." There are a number of exceptions for actions that are currently prohibited by other statutes.

CS by Banking and Insurance on March 10, 2009:

- 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 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 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 review by the Office of Insurance Regulation.

B. Amendments:

None.