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 Committee on Judiciary

BILL: CS/CS/SB 166

INTRODUCER: Judiciary Committee; Banking and Insurance Committee; and Senator Richter

SUBJECT: Annuities

DATE: March 7, 2013 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Burgess	BI	**Fav/CS**
2.	Brown	Cibula	JU	**Fav/CS**
3.			RC	
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:

CS/CS/SB 166 substantially revises Florida consumer protection laws relating to sales of annuities by incorporating the 2010 National Association of Insurance Commissioners (NAIC) model regulation on annuity protections.[1] The bill expands the scope of the consumer protection laws to generally include all consumers purchasing annuities. Current law only applies the protections to consumers aged 65 and older. The bill also retains current law limiting the surrender charges and deferred sales charges that may be imposed upon senior consumers.

The primary consumer protections contained in the bill:

Suitability of Annuities – The bill requires an insurer or insurance agent recommending the purchase or exchange of an annuity that results in an insurance transaction to have reasonable grounds for believing the recommendation is suitable for the consumer, based on the consumer's

[1] The National Association of Insurance Commissioners established the model act to better protect consumers from inappropriate and abusive marketing practices. The model act of 2010 represents a revision of the original 2003 act, initially revised in 2006. The NAIC website is available at: http://naic.org/. A press release on the model act of 2010 is available at: http://www.naic.org/Releases/2010_docs/annuity_marketing_protections.htm. (last visited March 1, 2013).

suitability information. The bill imposes additional duties on insurers and insurance agents when a transaction involves the exchange or replacement of an annuity.

Documentation of Sales Transaction – The bill requires agents and agent representatives to record recommendations made to a consumer.

Prohibitions on Agents – The bill prohibits agents from dissuading or attempting to dissuade a consumer from truthfully responding to the insurer's request for suitability information, filing a complaint, or cooperating with the investigation of a complaint.

Unconditional Refund Period – The bill expands to 21 from 14 days the unconditional refund period for all purchasers of fixed and variable annuities.

Limit on Surrender Charges – The bill retains the prohibition against surrender charges or deferred sales charges in annuity contracts issued to a senior consumer exceeding 10 percent of the amount withdrawn. The charge must be reduced so that no surrender or deferred sales charge exists after the end of the 10th policy year or 10 years after the premium is paid, whichever is later.

Penalties – Authorizes the imposition of corrective action, appropriate penalties, and sanctions on insurers, agents, managing general agencies, or insurance agencies that violate the requirements of s. 627.4554, F.S. An insurance agent must pay restitution to a consumer whose money the agent misappropriates, converts, or unlawfully withholds.

This bill substantially amends sections 627.4554 and 626.99, Florida Statutes.

II. Present Situation:

Annuities

An annuity is a contract between a consumer and an insurer wherein the customer makes a lump sum payment or series of payments to an insurer. In return, the insurer 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 a lifetime. For a deferred annuity, premiums are usually either paid in a lump sum or through a series of payments, and the annuity is 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.

Annuities are often 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 tax-deferred. Both deferred and immediate annuities are long-term contracts that typically restrict an investor's ability to access money placed in the annuity. Restricted access may make these annuities unsuitable for some consumers.

Fixed vs. Variable Annuities

The fixed annuity and the variable annuity are the two basic annuity types. A fixed annuity guarantees fixed payments to the annuitant. During the accumulation phase, the insurance company agrees to pay no less than a specified rate of interest. The insurance company also agrees that during the annuitization phase periodic payments will be a specific amount. These periodic payments may last for a definite period, such as 20 years, or a lifetime. Licensed life insurance and annuity agents sell fixed annuities, considered insurance products.

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. In a variable annuity, premium dollars are placed into a variety of investments known as subaccounts. The performance of the investments (usually stocks, bonds, or money market instruments) in the subaccounts determines the performance of the annuity. Variable annuities offer a wide range of subaccount investment options with varying degrees of risk. Variable annuities are considered investment products and are regulated by 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. Variable annuity sales are subject to the suitability standards contained in Financial Industry Regulatory Authority (FINRA) Rule 2330.[2]

Equity Indexed Annuities

Equity indexed annuities are defined and regulated as fixed annuity products, but operate as more of a hybrid of a fixed and variable annuity. Equity indexed annuities provide a "minimum guaranteed" interest rate in combination with an index-linked component. In contrast, a traditional fixed annuity provides a specific guaranteed rate of interest.

The investment industry often aggressively markets equity indexed annuities to seniors in Florida. The products are touted as a vehicle for investors to realize gains similar to those in the stock market without the corresponding risk. However, such annuities rarely provide returns that are the equivalent of a stock market index. Additionally, even with a guaranteed minimum interest rate, investors may still lose money on 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 can contain many detrimental features such as hidden penalties, fees, and large multi-year surrender charges. The federal Securities and Exchange Commission does not require these annuities to be registered as they do variable annuities, as equity indexed annuities are not securities. As a result, the law does not require a prospectus that

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2 Financial Industry Regulatory Authority, Regulatory Notice 10-05: Deferred Variable Annuities (Jan. 2010) *available* at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120756.pdf. The Financial Industry Regulatory Authority (FINRA) is an independent regulator for all securities firms operating in the United States. FINRA's mission is to protect U.S. investors by ensuring fair and honest operation by the securities industry. FINRA oversees about 4,275 brokerage firms, about 161,495 branch offices and approximately 630,010 registered securities representatives. Read more at: http://www.finra.org/AboutFINRA/ (last visited March 1, 2013).

discloses possible risks to accompany equity indexed annuities. Additionally, unlike variable annuity products that may only be sold by agents holding securities and insurance licenses, agents holding just an insurance license may sell equity indexed annuities.

Equity based annuities have several unique factors used to calculate interest that may affect potential return.

- Interest Rate Caps – A maximum rate of interest that an investor will receive, even if the underlying stock market index performs well. For example, if an equity indexed annuity has a cap of 6 percent the investor is limited to a 6 percent return even if the underlying investment index earns a much higher percentage.
- Participation Rates – A participation rate determines how much of the increase or return of the underlying stock market index will be used to calculate the annuity's return on investment. For example, if the participation rate is 70 percent, and the index increases by 20 percent as a multiplier, the return credited to the equity indexed annuity will be only 14 percent.
- Index Crediting Methods – An index crediting method permits investors to choose how interest is credited to equity indexed annuities. For instance, the annual ratchet method usually credits an amount of interest based on the increase (if any) in value of the underlying index from the beginning to the end of the year. The point-to-point method credits an amount of interest based on any increase in the value of the underlying index from the beginning to the end of a specific period of time, sometimes based on the contract date.

Equity indexed annuities often have various fees and charges. These include:

- Surrender Charges – These vary dramatically among annuities and can be as high as 25 percent and be valid for up to 20 years.
- Administrative Fees or Margins – The fees in some equity indexed annuities amount to the difference between the percentage gain in the index and the actual amount credited to the investor. These fees or "margins" are not always disclosed clearly in marketing materials or contracts.
- Market Value Adjustments – These typically function to alter or reduce the cash value of an annuity dependent on changes in the interest rate since the contract's issue. Such adjustments may result in a loss of previously credited bonuses or interest credits.
- Asset Fees – These fees are charged by the company, based upon a percentage of the value of the annuity, sometimes subject to change annually.

It is important to note that whether an annuity is fixed, variable or equity indexed, the industry does not require that the annuity contract be provided to the consumer prior to or at the time of purchase. Thus, the consumer must rely on the representations of the agent. Florida requires that contracts contain a free look provision that allows consumers to read and review their contracts and request cancellation within 10 days after receiving the contract.

Common Types of Annuity and Life Insurance Fraud

When unsuitable annuities are sold to consumers, the transaction 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. Forgery is 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.

Two common unfair insurance trade practices are "twisting" and "churning." Twisting involves knowingly making misleading representations, 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 their current insurance policy or purchase a policy from another insurer.[3] Churning is similar to twisting, but instead involves the surrender or withdrawal from a product to fund another product issued by the same company.[4] Agents that engage in these practices do so to obtain additional agent commissions.

Suitability of Annuity and Life Insurance Products

In Florida, the suitability, or the appropriateness of a particular product relative to the consumer's age, investment objectives, and current and future financial need, is a primary concern with regard to transactions involving senior consumers. In 2004, the Florida Legislature enacted the Annuity Transactions Model Regulation of the National Association of Insurance Commissioners in s. 627.4554, F.S.[5] The 2008 Legislature subsequently passed the John and Patricia Seibel Act, which strengthened Florida's annuity standards and procedures.[6] The 2010 Legislature further strengthened these standards.[7]

Section 627.4554, F.S., provides standards and procedures to follow when recommending the purchase of an annuity product to senior consumers (age 65 and older). The agent or insurer must make reasonable efforts to obtain information about the senior's financial status, tax status, and investment objectives before selling an annuity. The agent or insurer must have objectively reasonable grounds for recommending the annuity based on facts disclosed by the senior consumer as to current investments, other insurance products, financial situation, and needs.[8] If an agent recommends replacing or exchanging an existing, for a new annuity, the agent must provide a written summary detailing the differences between the two products.[9] The disclosure must provide benefits, terms, limitations, fees, and charges of each annuity, and the basis for the agent's recommendation, including all relevant information considered.[10] Insurers and insurance agents are required to develop written procedures to ensure compliance with statutory disclosure requirements.

Florida law also allows consumers to obtain an unconditional refund within 14 days of entering into a fixed or variable annuity contract.[11] Senior consumers may obtain these refunds within 21 days. Annuity contracts issued to senior consumers cannot include a surrender or deferred sales

[3] Section 626.9541(1)(l), F.S.
[4] Section 626.9541(1)(aa), F.S.
[5] Section 146, ch. 2004-390, L.O.F.
[6] Section 9, ch. 2008-237, L.O.F.
[7] Section 52, ch. 2010-175, L.O.F.
[8] Section 627.4554(4), F.S.
[9] Section 627.4554(4)(d), F.S.
[10] The written disclosure must be made on a form developed by the Department of Financial Services.
[11] Section 626.99(4)(b), F.S.

charge for a withdrawal of money that exceeds 10 percent of the amount withdrawn.[12] Florida law requires surrender or deferred sales charges to expire after the end of the 10th policy year or 10 years after the premium is paid, whichever is later.

If a senior consumer is harmed due to the failure of an insurer or insurance agent to comply with the provisions, the insurer or insurance agent may be ordered to take corrective action.[13] The Office of Insurance Regulation (OIR) has authority to order the rescission of the annuity contract and order the refund of all premiums paid or the accumulation value of the annuity, whichever is greater. The Department of Financial Services (DFS) may order an insurance agent to provide monetary restitution of all monies misappropriated, converted, or unlawfully withheld as well as restitution of penalties and fees incurred by a senior consumer. The DFS may also require insurance agencies to take reasonably appropriate corrective action for a senior consumer harmed by an agent's noncompliance.

Unfair Insurance Trade Practices Act

Part IX of chapter 626, the Unfair Insurance Trade Practices Act specifies and prohibits practices that constitute unfair methods of competition or unfair or deceptive acts. The DFS can fine insurers, insurance agents, and any other person involved in the business of insurance for violating the act, up to $5,000 for each non-willful violation up to an aggregate $20,000 fine, and up to $40,000 for each willful violation up to an aggregate $200,000 fine. Willful violations of these provisions are also subject to criminal prosecution as a second degree misdemeanor.[14] Each act is a third degree felony if committed by a person who is not licensed, authorized, or eligible to engage in business under the Florida Insurance Code.[15]

Further, the unfair trade practice laws authorize the OIR or the DFS to issue cease and desist orders against insurers and agents that violate those provisions.[16] Violation of a cease and desist order is subject to a penalty of up to $50,000.[17] The DFS and the OIR can also suspend or revoke the license of an insurance agent that violates this section and impose an administrative penalty of up to $500 or, for willful violations, up to $3,500.[18]

Certain violations such as "twisting" and "churning" are subject to increased penalties.[19] Violators can be criminally charged with first degree misdemeanors.[20] Each non-willful violation is subject to a $5,000 fine up to an aggregate $50,000 fine, while each willful violation is subject to a $75,000 fine up to an aggregate $250,000 fine. Willfully submitting fraudulent signatures on an application or policy-related document is a third degree felony, and is subject to an administrative fine not greater than $5,000 for each nonwillful violation up to an aggregate fine

[12] Section 627.4554(9), F.S.
[13] Section 627.4554(5), F.S.
[14] Section 624.15(1), F.S. Section 775.082(4)(b), F.S., provides for a term of imprisonment for up to 60 days for a second-degree misdemeanor
[15] Section 775.082(3)(d), F.S., provides for a term of imprisonment for up to 5 years for a third-degree felony.
[16] Section 626.9581(1), F.S.
[17] Section 626.9601(1), F.S.
[18] Section 626.681(1), F.S.
[19] Section 626.9521(3), F.S.
[20] Section 775.082(4)(a), F.S., provides for a term of imprisonment for up to 1 year for a first-degree misdemeanor.

of $50,000, while each willful violation is subject to an administrative fine not greater than $75,000 up to an aggregate fine of $250,000.

III. Effect of Proposed Changes:

Section 1. Expands the annuity recommendation standards provided in s. 627.4554, F.S., for the protection of senior consumers to apply to all consumers. The bill incorporates the 2010 National Association of Insurance Commissioners model regulation on annuity protections, to broaden the scope of coverage to generally include all annuity transactions. Bill language also imposes additional duties on agents and insurers.[21] The bill also retains Florida-specific consumer protections that are currently available to senior consumers, often expanding them to all consumers.

Major provisions of this section address:

Duties of Insurers and Agents

Suitability of Annuities – The bill requires an insurer or insurance agent recommending the purchase or exchange of an annuity that results in an insurance transaction to have reasonable grounds for believing the recommendation is suitable for the consumer, based on the consumer's suitability information. The insurer or agent must also have a reasonable basis to believe that:

- The consumer has been reasonably informed of:
  - The annuity's features such as the potential surrender period and surrender charge;
  - Potential tax penalties if the consumer sells, exchanges, surrenders, or annuitizes the annuity;
  - Mortality and expense fees;
  - Investment advisory fees;
  - Riders, their features, and potential charges;
  - Limits on interest returns;
  - Insurance and investment components; and
  - Market risk.
- The consumer will benefit from certain features of the annuity such as tax-deferred growth, annuitization, or the death or living benefit.
- The annuity and any associated subaccounts, riders, and product enhancements are suitable. If the annuity is being exchanged or replaced, the annuity must be suitable for the particular consumer based on his or her suitability information.

Before recommending products, insurance agents must obtain specified personal and financial information from the consumer relevant to the suitability of the recommendation on a form promulgated by the DFS (DFS-H1-1980).

Suitability of the Exchange or Replacement of an Annuity – The bill imposes additional duties on insurers or insurance agents if a transaction involves the exchange or replacement of an annuity.

[21] Unless stated otherwise, the bill expands the application of the statute to all consumers.

The bill provides criteria for determining whether the new annuity is suitable for a particular consumer. The insurer or agent must consider whether the consumer:

- Will incur a surrender charge; be subject to commencement of a new surrender period; lose existing benefits (death, living, or other contractual benefits), or be subject to increased fees (including investment advisory fees or charges for riders or other similar product enhancements).
- Will benefit from product enhancements and improvements; and
- Has had another annuity exchange or replacement, in particular within the past 36 months.

The insurer or agent must provide the consumer specified information on a DFS form (DFS-H1-1981) concerning differences between the annuity being recommended for purchase and the existing annuity that would be surrendered or replaced. Under current law, this only applies to transactions involving a senior consumer.

Requirement to Obtain Suitability Information – The bill retains the requirement in current law that the insurer or its agent use reasonable efforts to obtain a consumer's suitability information. An insurer may not issue an annuity unless a reasonable basis exists to believe the annuity is suitable based on the consumer's suitability information. However, the insurer or its agent are not obliged to have a reasonable basis for believing the annuity is suitable if no recommendation has been made, the recommendation was based on materially inaccurate information, the consumer refuses to provide relevant suitability information and the annuity transaction is not recommended, or the consumer decides to enter into an annuity transaction not based on a recommendation of an insurer or an agent.

Documentation of Sales Transaction – An agent or agent's representative must record any recommendation made to a consumer. If the consumer refuses to provide suitability information, the agent or representative must obtain a signed statement from the consumer documenting the refusal. If the consumer enters into an annuity transaction that is not based on the recommendation of the insurer or insurance agent, the agent or representative must obtain a signed statement from the consumer acknowledging that the annuity transaction is not recommended.

Compliance Measures – As under current law, insurers must establish a supervision system designed to ensure insurer and agent compliance with the statute. Measures include maintaining procedures to inform agents of their legal requirements when selling annuities, providing training and training materials on annuity products, maintaining procedures for reviewing each recommendation before issuing an annuity and procedures for detecting recommendations that are not suitable, and providing an annual report to senior managers.

This bill subjects insurers to liability for violations made by contract workers. Insurers may contract with outside entities to sell products, but if an insurer does so, insurers remain subject to sanctions and penalties and must supervise the contract performance. This appears to depart from current law, which provides: "Nothing in this section shall subject an insurer to criminal or civil

liability for the acts of independent individuals not affiliated with that insurer for selling its products, when such sales are made in a way not authorized by the insurer."[22]

Prohibitions on Agents – The bill prohibits agents from dissuading or attempting to dissuade a consumer from truthfully responding to the insurer's request for suitability information, filing a complaint, or cooperating with the investigation of a complaint.

Compliance and Penalties – Insurers are responsible for compliance with this section, both with regard to the insurer and its agents. The OIR may order an insurer to take reasonably appropriate corrective action for a consumer harmed by the actions of the insurer or an insurer's agent. The bill removes language specifying that the OIR may require the rescission of the policy, a full refund of the premiums paid, or a refund of the accumulation value. Rescission is still, however, and option available to the OIR. The DFS may order reasonably appropriate corrective action, including monetary restitution of penalties or fees incurred by the consumer. The DFS must order an insurance agent to pay restitution to a consumer who is deprived of money due to the agent's misappropriation, conversion, or unlawful withholding of moneys belonging to a consumer. The DFS also may order a managing general agency or insurance agency to take corrective action.

Insurance code penalties must be reduced or eliminated by the OIR or the DFS if corrective action for the consumer is promptly taken after the discovery of a violation.

A violation of the consumer protection standards in the bill does not create or imply the existence of a private cause of action. This limit on the effect of the bill is identical to limits on the effect of existing law.

Prohibited Sales and Surrender Charges on Senior Consumers – The bill retains the requirement in current law that an annuity contract issued to a senior consumer may not contain a surrender charge or deferred sales charge for a withdrawal of money from an annuity exceeding 10 percent of the amount withdrawn. The charge must be reduced so that no surrender or deferred sales charge exists after the end of the 10th policy year or 10 years after the premium is paid, whichever is later. The provision contains exceptions for purchases by accredited investors and contracts used to fund specified benefit plans, personal injury litigation settlements, or prepaid funeral contracts.

Other Provisions – The bill also:

- Defines "suitability information" as information related to the consumer which is reasonably appropriate to determine the suitability of a recommendation made to the consumer.
- Requires that annuity sales made in compliance with FINRA requirements pertaining to the suitability and supervision of annuity transactions also comply with the consumer protection requirements in the bill. This requirement only applies if the FINRA broker dealer sells an annuity and the suitability and supervision is similar to those applied to variable annuity sales; the insurer monitors the FINRA member broker-dealer; and the insurer provides information to the FINRA member broker-dealer in maintaining its supervision system.

[22] Section 627.4554(1)(c), F.S.

- Requires insurers and agents to retain records an annuity transaction for 5 years.
- Grants rulemaking authority to the Department of Financial Services and the Financial Services Commission to adopt rules to administer the section.

Section 2. Amends s. 626.99, F.S., to apply to all consumers the requirement that annuity policies provide an unconditional refund for at least 21 days and be equal to the surrender value of the annuity contract. Current law provides only senior consumers with a 21 day unconditional refund period; for other consumers, the unconditional refund is available for 14 days. The bill specifies disclosures required on the mandatory cover page of an annuity contract to inform consumers of the bonus feature in the contract; that purchase of a contract may restrict access to money; that interest rates may be variable; and that the insurer is required to provide a prospectus.

Section 3. The bill has an effective date of October 1, 2013.

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 consumer protections of s. 627.4554, F.S., will generally apply to all consumers purchasing annuities. To the extent that the protections provide greater transparency and protection against fraud and misrepresentation, consumers who purchase annuities should realize cost savings.

C. Government Sector Impact:

The Office of Insurance Regulation (OIR) indicates that insurers will need to file revised contract forms for approval by the OIR. The OIR can absorb the increase in workload within current resources.

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.)

CS/CS by Judiciary on March 6, 2013:
The CS revises the disclosure statement required on the cover page of an annuity contract to inform purchasers that the interest rates that apply to the annuity contract may change periodically.

CS by Banking and Insurance on February 6, 2013:

- Clarifies DFS authority to order restitution for any consumer whose money has been unlawfully misappropriated, converted, or unlawfully withheld by an agent.
- Reinstates the rulemaking authority of the Financial Services Commission.

B. Amendments:

None.

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