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 Banking and Insurance

BILL: SB 166

INTRODUCER: Senator Richter

SUBJECT: Annuities

DATE: February 2, 2013 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Burgess	BI	**Pre-meeting**
2.			JU	
3.			RC	
4.				
5.				
6.				

I. Summary:

Senate Bill 166 substantially revises the Florida consumer protection laws related to sales of annuities by incorporating the 2010 National Association of Insurance Commissioners model regulation on annuity protections. The bill expands the scope of the consumer protection laws to generally include all consumers purchasing annuities; current law applies the protections only to senior 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 are:

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. Additional duties are placed on insurers and insurance agents when a transaction involves the exchange or replacement of an annuity.

Documentation of Sales Transaction – An agent or agent's representative must make a record of any recommendation 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 – Expands from 14 to 21 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charges or deferred sales charges in annuity contracts issued to a senior consumer exceeding 10 percent of the amount withdrawn.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.

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

This bill substantially amends the following sections of the Florida Statutes: 627.4554 and 626.99

II. Present Situation:

Annuities:

An annuity is a contract between a customer and an insurer wherein 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 can be obtained 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 either paid in a lump sum or by 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 to the consumer.

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 on a tax-deferred basis. Both deferred and immediate annuities are long-term contracts that typically restrict investor's ability to access money placed in the annuity. Deferred annuities may be unsuitable investments for some senior consumers because of this fact.

Fixed vs. Variable Annuities

There are two basic annuity types, the fixed annuity and the variable annuity. 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 the periodic payments will be a specified amount per dollar in your account. These periodic payments may last for a definite period, such as 20 years, or an indefinite period, such as your lifetime or the lifetime of you and your spouse. Fixed

annuities are considered insurance products that may be sold by a licensed life insurance and annuity agent.

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, the premium dollars are placed into a variety of investments called subaccounts. The performance of the investments (usually stocks, bonds, or money market instruments) in the subaccounts determines the performance of the annuity. Variable annuities will often offer a wide range of subaccount investment options with varying degrees of risk. 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. Variable annuity sales are subject to the suitability standards contained in Financial Industry Regulatory Authority (FINRA) Rule 2330.

Equity Indexed Annuities

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

Equity indexed annuities are often aggressively marketed 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 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 can contain many detrimental features such as hidden penalties, fees, and large multi-year surrender charges. These annuities are not considered securities and not required to register with the federal Securities and Exchange Commission, as is the case with variable annuities. As a result, the law does not require equity indexed annuities to be accompanied with a prospectus that discloses possible investment risks. Additionally, unlike variable annuity products that may only be sold by agents with securities and insurance licenses, agents that have only an insurance license may sell equity indexed annuities.

Equity based annuities have several unique factors that may affect potential return. The unique factors used to calculate the interest an investor may receive often include:

- 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 – 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 20 percent, the return credited to the equity indexed annuity would be only 14 percent.
- Index Crediting Methods – Permit investors to choose the method by which interest will be 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 – 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 – 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. 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 ch. 626, F.S.

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 their current insurance policy or take out an insurance policy with another insurer.[1] Churning is similar to twisting, but instead involves the surrender or

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

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.

Suitability of Annuity and Life Insurance Products

In Florida, the suitability—the appropriateness of a particular product relative to the consumer's age, investment objectives, and current and future financial needs—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.[3] The 2008 Legislature subsequently passed the John and Patricia Seibel Act, which strengthened Florida's annuity standards and procedures.[4] Those standards were further strengthened by the 2010 Legislature.[5]

Section 627.4554, F.S., provides standards and procedures that must be followed when recommending the purchase of an annuity product to senior consumers (age 65 and older). The section sets forth duties on insurers and insurance agents when recommending the purchase of an annuity by a senior. The agent or insurer must make reasonable efforts to obtain information about the senior's financial status, tax status, and investment objectives prior to completing the sale of an annuity. Additionally, the agent or insurer must have objectively reasonable grounds for recommending the annuity on the basis of the facts disclosed by the senior consumer as to his or her investments, other insurance products, financial situation, and needs.[6] If an agent recommends replacing or exchanging an existing annuity for a new annuity, the agent must provide a written summary detailing the differences between the existing annuity and the new annuity product.[7] The disclosure must provide the benefits, terms, and limitations of each annuity, the fees and charges of each annuity, and the basis for the agent's recommendation, including all relevant information the agent considered in making the recommendation.[8] Insurers and insurance agents are required to develop written procedures designed to ensure compliance with the 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.[9] Senior consumers may obtain such refunds within 21 days. An annuity contract issued to a senior consumer also is prohibited from containing a surrender or deferred sales charge for a withdrawal of money that exceeds 10 percent of the amount withdrawn.[10] Such charges 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.

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

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.[11] 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

The "Unfair Insurance Trade Practices Act" under s. 626.9541, F.S., specifies and prohibits practices which constitute unfair methods of competition or unfair or deceptive acts. Insurers, insurance agents, and any other person involved in the business of insurance can be fined 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 (s. 624.15, F.S.). Each such 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.

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 (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 DFS (s. 626.681, F.S.).

Certain violations such as "twisting" and "churning" are subject to increased penalties.[12] Such violations are first degree misdemeanors. 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 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. Amends s. 627.4554, F.S., which under current law contains standards and procedures for making annuity recommendations to senior consumers. The bill incorporates the 2010 National Association of Insurance Commissioners model regulation on annuity protections, which expands the scope of the section to generally include all annuity transactions and places additional duties on agents and insurers.[13] The bill also retains Florida-specific consumer

[11] Section 627.4554(5), F.S.
[12] Section 626.9521(3), F.S.
[13] Unless stated otherwise, the bill expands the application of the statute to all consumers.

protections that are currently available to senior consumers, often expanding them to all consumers. The major provisions of the bill are as follows:

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 would 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.

Insurance agents, prior to recommending a product to a consumer, 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 – Additional duties are placed on insurers or insurance agents when a transaction involves the exchange or replacement of an annuity. 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 with 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 must make reasonable efforts to obtain a consumer's suitability information. An insurer may not issue an annuity unless there is a reasonable basis 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 its agent.

Documentation of Sales Transaction – An agent or agent's representative must make a record of 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 his or her refusal to provide suitability information. 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 requirements of the statute. The measures include maintaining procedures to inform agents of their legal requirements when selling annuities, providing training and training materials that explain the insurer's annuity products, maintaining procedures for reviewing each recommendation before issuing an annuity, procedures for detecting recommendations that are not suitable, and an annual report to senior managers. Insurers may contract with outside entities to perform these duties, but if an insurer does so, the insurer must supervise contractual performance.

Prohibitions on Agents – The bill prohibits agents from dissuading or attempting to dissuade a consumer from (1) truthfully responding to the insurer's request for suitability information, (2) filing a complaint, or (3) 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 or a full refund of the premiums paid or the accumulation value.

The DFS is authorized to order an insurance agent to take 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 senior 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. Violations under this section do not give rise to a cause of action.

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 contains the following provisions:

- The bill defines "suitability information" as information related to the consumer that is reasonably appropriate to determine the suitability of a recommendation made to the consumer.
- Annuity sales made in compliance with FINRA requirements pertaining to the suitability and supervision of annuity transactions must also comply with the requirements contained in this section. This requirement only applies when (1) the FINRA broker dealer sells an annuity and the suitability and supervision is similar to those applied to variable annuity sales; (2) the insurer monitors the FINRA member broker-dealer; and (3) the insurer provides information to the FINRA member broker-dealer in maintaining its supervision system.
- Insurers and agents must retain records of the annuity transaction for 5 years.
- The DFS has rulemaking authority to adopt rules to administer the section (the bill repeals the rulemaking authority of the Financial Services Commission).

Section 2. Amends s. 626.99, F.S., to apply to all consumers the requirement that annuity policies must provide an unconditional refund for at least 21 days and be equal to the surrender value of the annuity contract. Current law only provides senior consumers with a 21 day unconditional refund period; for other consumers the unconditional refund is available for 14 days. The bill specifies disclosures that must be included within the mandatory cover page that informs the prospective purchaser of the unconditional refund period.

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

Other Potential Implications:

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.

C. Government Sector Impact:

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

VI. Technical Deficiencies:

Staff recommends the following changes:

- On lines 17-19, delete title language that erroneously states the bill deletes caps on surrender or deferred sales charges.
- On line 319, delete the word “senior” to allow the DFS to order restitution for any consumer whose money has been unlawfully misappropriated, converted, or unlawfully withheld by an agent.
- On line 343, reinstate the rulemaking authority of the Financial Services Commission.

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.)

None.

B. Amendments:

None.

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