

REGULATION OF ANNUITY SALES

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House Bill 4627 (Substitute H-2 with House floor amendments)

Sponsor: Rep. Bob Constan

Committee: Senior Health, Security and Retirement

Complete to 8-31-10

A SUMMARY OF HOUSE BILL 4627 AS PASSED BY THE HOUSE

Public Act 399 of 2006 added a new Chapter 41A to the Insurance Code to regulate the sale of annuities to consumers. Among other things, the new chapter requires an insurance producer (agent) or an insurance company (if no agent is involved) to have reasonable grounds for believing that an annuity recommendation to a consumer is suitable on the basis of facts disclosed by the consumer about the consumer's investments, other insurance products, and financial situation and needs.

House Bill 4627 would amend Sections 4151, 4153, 4155, and 4165 of Chapter 41A of the Insurance Code and would add new Sections 4158, 4159, 4160, 4161, and 4162 to Chapter 41A. The bill also adds a new Chapter 41B, entitled Annuity Disclosures. Under that chapter, certain disclosures are required to be made to the purchaser of an annuity contract. The bill would take effect nine months after enactment.

[Note: Information in this summary is derived partly from a description of significant changes in the substitute bill as provided by the Office of Financial and Insurance Regulation. The aim of the bill, according to OFIR, is to provide a variety of needed consumer protections.]

The bill would amend Chapter 41A (MCL 500.4151, et al.) in the following ways.

Consumer's Suitability Information and Requirements. Section 4155 would make the suitability requirements apply to the replacement of an annuity contract in addition to the purchase of a contract (as is now required). It also requires that there be a reasonable basis to believe all of the following:

- The consumer has been reasonably informed of various features of the annuity, including surrender periods, surrender charges, potential tax consequences of certain actions, exchanges, annuitizing, fees, charges, limitations and market risks.
- The consumer would benefit from certain features of the annuity such as tax-deferred growth, annuitization, or death or living benefit.
- The annuity as a whole, underlying subaccounts to which funds are allocated, and riders and similar product enhancements, is suitable, and, for an exchange or replacement, the transaction as a whole is suitable for the consumer based on suitability information.

- For an exchange or replacement of an annuity, whether the transaction is suitable for consumer based or whether the consumer would incur a surrender charge, be subject to a new surrender period, lose existing benefits, or be subject to increased fees or charges. The consumer would need to be informed of whether product enhancements would be suitable and whether the consumer has had another annuity exchange or replacement within the preceding 36 months.

In addition, Section 4155 would require a producer (or insurer where no producer is involved in annuity sale) to make reasonable efforts to obtain the consumer's suitability information. An insurer could not issue an annuity recommended to a consumer unless there is a reasonable basis to believe that the annuity is suitable based on the consumer's suitability information. This section would also provide that the issuance of the annuity be reasonable under all circumstances actually known to the insurer at the time the annuity is issued. However, neither the producer nor the insurer would have any obligation to a consumer relative to any annuity transaction if any of the following apply:

- No recommendation is made.
- The recommendation was made and later found to have been prepared based on materially inaccurate information provided by the consumer.
- The consumer refuses to provide relevant suitability information and the annuity transaction is not recommended.
- The consumer decides to enter into an annuity transaction that is not based on a recommendation of the insurer or the insurance producer.

The producer (or the responsible insurance representative if no producer is involved in the transaction) would be required to do all of the following at the time of the sale:

- Make a record of any recommendation for a sale, exchange or replacement of an annuity.
- Obtain a customer-signed statement documenting a customer's refusal to provide suitability information, if any.
- Obtain a customer-signed statement acknowledging that an annuity transaction is not recommended if a customer decides to enter into an annuity transaction that is not based on the producer's or insurer's recommendation.

The bill would define "*suitability information*" to mean information that is reasonably appropriate to determine the suitability of a recommendation including: age, annual income, financial situation and needs, including the financial resources used for the funding of the annuity, financial experience, financial objectives, intended use of the annuity, financial time horizon, existing assets, including investment and life insurance holdings, liquidity needs, liquid net worth, risk tolerance, and tax status.

Supervision System. Under the bill, Section 4158 would require an insurer to establish a supervision system designed to ensure compliance with the chapter. The system would have to include:

- Maintaining reasonable procedures to inform producers of the requirements of the chapter and to incorporate the requirements into relevant producer training manuals.
- Establishing standards for producer product training and training materials.
- Providing product-specific training and training materials that explain all key features of annuity products to producers.
- Maintaining procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable.
- Maintaining procedures to detect recommendations that are not suitable. This could include confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters, and programs of internal monitoring. This section would permit an insurer to apply sampling procedures by confirming suitability information after issuances or delivery of the annuity.
- Providing annually a report to senior management, including the senior manager responsible for audit functions, designed to determine the effectiveness of the supervision system, the exceptions found, and corrective actions taken or recommended.

The section would also permit an insurer to contract the system of supervision to a third party contractor. It would require the insurer to supervise the contractual performance if a third party contractor is providing the supervision of compliance. The supervisory system, whether directly by the insurer or provided through contract is only required when an annuity has been offered to the consumer by the insurer or the insurer's producer.

Producer Prohibition. Section 4159 would prohibit a producer from dissuading, or attempting to dissuade, a consumer from truthfully responding to an insurer's request for confirmation of suitability information, filing a complaint, or cooperating with the investigation of a complaint.

Solicitation of Annuity Product. Under Section 4160, a producer could not solicit the sale of an annuity product unless the producer has adequate knowledge of the product to recommend it and the producer is in compliance with the insured's standard for product training. A producer could rely on insurer-provided product-specific training standards for compliance.

Producer Training Requirement. A producer who engages in the sale of annuity products would be required to complete a one-time four-credit insurance agent training program of study approved by the Commissioner of OFIR. The minimum length of the training could not be less than four hours and could be longer. The training course would need to include all of the following:

- The types and classifications of annuities.
- Identification of the parties to an annuity.
- How fixed, variable, and indexed annuity contract provisions affect consumers.

- The application of income taxation to qualified and non-qualified annuities.
- The primary uses of annuities.
- The appropriate sales practices and replacement and disclosure requirements.

The course could not present any marketing information or provide training on sales techniques or provide specific information about a particular insurer's products.

The insurer would need to verify that the necessary training has been completed by its producer before allowing him or her to sell an annuity product. The satisfaction of the training requirements of another state that are substantially similar to the requirements in this section would satisfy the Michigan requirements. An insurer could satisfy its responsibilities by obtaining certificates of completion of the training course or by obtaining reports provided by the commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with a registered insurance agent program of study.

Consumer Copy of Contract and Right of Cancellation. Under Section 4161, a consumer purchasing an individual annuity contract is to be given a copy of the annuity policy at the time it is accepted and issued. Section 4162 provides the consumer with the right to cancel an annuity within 15 days after its delivery and to have the entire premium refunded if, after examination of the policy, the applicant is not satisfied for any reason. The consumer would need to acknowledge in writing the receipt of the separate right to cancel notice. Cancellation occurs when the consumer mails a written notice of cancellation to the address stated in the notice of cancellation.

Regulatory Authority Over Annuities. The bill would amend Section 4165 to provide that sales made in compliance with financial industry regulatory authority requirements pertaining to suitability and supervision of annuity transactions that are not less stringent than this the requirements of this chapter satisfy the requirements of the chapter. This provision applies to financial industry regulatory authority broker-dealer sales of variable annuities and fixed annuities if the suitability and supervision are similar to those applied to variable annuity sales. For this provision to apply, an insurer would be required to do the following:

- Monitor the financial industry regulatory authority member broker-dealer using information collected in the normal course of an insurer's business.
- Provide to the financial industry regulatory authority member broker-dealer information and reports that are reasonably appropriate to assist the financial industry regulatory authority member broker-dealer to maintain its supervision system.

These provisions would not limit the commissioner's ability to enforce and investigate the chapter.

Chapter 41B. The bill adds Chapter 41B to address annuity disclosures. This chapter defines terms that are commonly used under annuity contracts and outlines annuities that are not subject to the chapter. The chapter would apply to all annuities except registered or nonregistered variable annuities or other registered products, immediate and deferred annuities that contain no nonguaranteed elements, and annuities used to fund the following: an employee pension or welfare benefits plan that is covered by the Employee Retirement Income Security Act (ERISA); a plan described by a 401A, 401K or 403B plan if established or maintained by an employer; a government or church plan defined by a 414 or a deferred compensation plan, or a state or local government or tax-exempt organization under a 457 plan; a non-qualified deferred compensation arrangement established or maintained by an employer or plan sponsor; and structured settlements.

The chapter would also not apply to annuities used to fund a plan or arrangement that is funded solely by contributions an employee elects to make whether on a pretax or after-tax basis, and where the insurer has been notified that plan participants may choose from among two or more fixed annuity providers and there is a direct solicitation or an individual employee by an insurance producer for the purchase of an annuity contract. However, the term "direct solicitation" does not include any meeting held by an insurance producer solely for the purpose of educating or enrolling employees in the plan or arrangement.

Section 4178 of the chapter would require that if an application for an annuity contract is taken in a face-to-face meeting, the applicant be given a disclosure document as well as a buyer's guide at or before the time of application. If the application is taken by means other than a face-to-face meeting, the applicant must be sent both the disclosure document and the buyer's guide by not later than five business days after the completed application is received by the insurer.

If the application has been received through direct solicitation through the mail, providing a buyer's guide and a disclosure document in the mailing inviting prospective applicants satisfies the five-day requirement. If the application is received through an internet solicitation, the disclosure document and the buyers guide must be available through the insurer's website.

All other solicitations other than face-to-face encounters would need to include a statement that the proposed applicant could contact the Office of Financial and Insurance Regulation (OFIR) or the insurer for a free annuity buyer's guide.

Disclosure Document. Under the bill the required disclosure document would need to use terms defined in language that facilitates the understanding by a typical person within the segment of the population to which the document is directed, and must at a minimum contain all of the following information:

- The generic name of the contract, the company product name, if different, and form number and the fact that it is an annuity;
- The insurer's name and address.

- A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate of guaranteed, non-guaranteed, and determinable elements of the contracts, and their limitations, and how these elements operate; an explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate, and the fact that rates may change from time to time and are not guaranteed; periodic income options on a guaranteed and non-guaranteed basis, any value reductions caused by withdrawals; how values in the contract can be assessed; the death benefit, if available, and how it will be calculated; and a summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and the impact of any rider, such as a long term care rider.
- Specific dollar amount or percentage charges and fees with an explanation of how they apply.
- Information about the current guaranteed rate for new contracts and how that rate is subject to change.

Chapter 41B would require the commissioner to prepare and publish a buyer's guide to annuities. The buyer's guide would have to be published as of January 1, 2011, and annually thereafter. The guide would need to be written in plain English and would explain of what an annuity is, the different kinds of annuities, how interest rates are set, charges that may be subtracted from an annuity, the tax treatment of annuities, and how to determine whether an annuity is a right choice.

Under this new chapter, for annuities in the payout period with changes in nonguaranteed elements and for the accumulation period of a deferred annuity, the insurer must provide each contract owner with a report, at least annually, on the status of the contract that contains at least all of the following information:

- The beginning and end date of the current report period.
- The accumulation and cash surrender value, if any, at the end of the previous report period and at the end of the current report period.
- The total amounts, if any, that have been credited, charged to the contract value, or paid during the current report period.
- The amount of outstanding loans, if any as of the end of the current report period.

FISCAL IMPACT:

The bill would have no material fiscal impact on the state or local units of government. The bill would require the Office of Financial and Insurance Regulation (OFIR) to prepare a consumer's guide on annuities. The printing costs of such a guide would likely be no more than \$5,000 and could be met within existing resources. Chapter 2 (The Insurance Commissioner) of the Insurance Code, MCL 500.224, imposes an assessment fee on insurance companies with the total amount of the assessment based on the appropriation made to the Office of Financial and Insurance Regulation related to its regulation of the insurance industry. As such, any additional activities required of OFIR would be reflected in the annual appropriation to the office and would be supported by

assessment fee revenue (i.e., the Insurance Bureau Fund, established in MCL 500.225). There is no GF/GP impact.

POSITIONS:

The Office of Financial and Insurance Regulation testified in support the bill. (6-16-10)

Elder Law of Michigan supports the bill (6-16-10)

The State Bar Elder Law and Disability Rights Section testified in support the bill. (6-16-10)

The American Council of Life Insurance testified in support of the bill with amendments. (6-16-10)

The Teachers Insurance and Annuity Association, College Retirement Equities indicated neutrality at the House committee meeting. (6-16-10)

The Life Insurance Association of Michigan testified that it is opposed to the bill without amendments. (6-16-10)

Legislative Analyst: E. Best
Fiscal Analyst: Mark Wolf

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.