Legislative Analysis

Mitchell Bean, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

ANNUITY SALES: SUITABILITY REQUIREMENTS

Senate Bill 880 (Substitute H-3)
Sponsor: Sen. Gerald Van Woerkom
House Committee: Insurance
Senate Committee: Banking and Financial Institutions

First Analysis (6-29-06)

BRIEF SUMMARY: The bill would regulate the sale of annuities; it would require 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.

FISCAL IMPACT: There is no fiscal impact on the State of Michigan or its local units of government.

THE APPARENT PROBLEM:

Annuities, including variable annuities whose value is tied to an underlying securities portfolio, are a popular investment vehicle. The Office of Financial and Insurance Services (OFIS) has pointed out, however, that:

Unfortunately, some insurance companies and their appointed producers have taken advantage of the growing popularity to market and sell products that are not "suitable" for the individual purchasing the product based on his or her financial situation. This is particularly troublesome when elderly or other vulnerable consumers are the target of the unscrupulous activity.

As a long-term investment, variable annuities are often not suitable for elderly consumers, because they tie up cash that might be needed; a senior might even die before the product's term is up. OFIS says, "Seniors are particularly vulnerable to abuse from unscrupulous sales tactics since they may not fully understand the variable annuity product as it relates to their own circumstances." Legislation has been introduced that would provide consumer protections related to the sale of annuities; the legislation is said to be based on a model developed by the National Association of Insurance Commissioners (NAIC).

THE CONTENT OF THE BILL:

The bill would add a new Chapter 41A to the Insurance Code (MCL 500.4151, et al.) to regulate the sale of annuities to consumers.

Under the bill, an insurance producer (agent)—or an insurance company if no agent is involved—would need to **have reasonable grounds for believing that an annuity**

recommendation to a consumer is suitable on the basis of facts disclosed by the consumer regarding his or her investments, other insurance products, and financial situation and needs. This would apply to the recommendation that a consumer purchase or exchange an annuity.

Before the execution of a purchase or exchange, an agent or company would have to make reasonable efforts to obtain information about the consumer's financial status, tax status, and investment objectives, along with other information for making recommendations.

However, an agent or company would have no obligation to a consumer when the consumer refused to provide relevant information; decided to enter into a transaction not based on a recommendation; or failed to provide complete or accurate information. A recommendation would be required to be reasonable "under all the circumstances actually known . . . at the time of the recommendation."

An insurance company would be required to establish and maintain a system to comply with the new chapter and could contract with a third party, including an insurance producer, to establish and maintain a system of supervision. A company using a third party would have to make reasonable inquiries to assure that the functions were being performed.

An insurance producer would have to either adopt a system of supervision recommendations established by an insurance company or establish and maintain its own system. If an insurance producer developed its own system, that system would have to maintain written procedures and conduct periodic reviews of records reasonably designed to assist in detecting and preventing violations of the new chapter.

An insurance company or insurance producer would not be required either (1) to review all insurance producer-solicited transactions, or (2) to include in its system of supervision an agent's recommendations to consumers of products other than the annuities offered by the company or producer.

Information collected from a consumer and other information used in making recommendations that were the basis for insurance transactions would have to be maintained for five years and would have to be available to the commissioner of OFIS.

An insurance company that complied with the National Association of Securities Dealers rules on suitability would satisfy the requirements of the new chapter for the recommendation of variable annuities.

The bill would not apply to certain specified transactions, including direct response solicitations where no recommendation is based on information from a senior consumer; employee pension or welfare benefit plans covered by the Employee Retirement and Income Security Act (ERISA); employer profit sharing and pension plans and government and private employer deferred compensation plans covered under the

Internal Revenue Code; settlements of personal injury litigation or any dispute or claim resolution process; and formal prepaid funeral contracts.

HOUSE COMMITTEE ACTION:

The House Insurance Committee reported a Substitute H-3 for the Senate-passed bill. The substitute makes the bill apply to all consumers rather than to consumers 65 years of age or older ("senior consumers"). The substitute also removes provisions that allow OFIS to take reasonably appropriate corrective action when harmful violations occur (in addition to existing penalties in the Insurance Code).

ARGUMENTS:

For:

The Office of Financial and Insurance Services has said about this bill:

This new chapter would provide vital tools for the protection of consumers who find themselves victims of insurers and producers who do not have the best interest of the consumer at heart. Under the language of the bill, the burden would be on the insurer or producer to determine the suitability of the product before the sale occurred. If that provision is violated, the Commissioner can impose any of the penalties and fines available . . .under the Insurance Code.

State regulators point out that while they currently have the ability to enforce laws on sales of annuities, the burden currently is on purchasers to show that the producer or insurance company acted improperly, made misrepresentations, or sold them a product that was not in their best interest. This is difficult for consumers, particularly some older consumers. The bill puts the onus on producers and insurers to gather information from the consumer and make a judgment about the suitability of an annuity product based on that information. OFIS points out that about half the states have adopted the NAIC model on annuity consumer protections; this bill is based on that model. The bill, furthermore, has been amended to go beyond providing protections to senior consumers and now applies to consumers of annuities of any age.

Against:

AARP Michigan has criticized the bill on a number of grounds. AARP believes that variable annuities should be regulated as securities products and supports legislation that would treat them that way. This bill does not require those who sell annuities to be licensed and registered as securities dealers. The bill also contains no private right of action for consumers. Further, it places the burden of proof on the consumer to provide all necessary information to the seller; there appears to be no liability for the seller for recommendations made in the absence of information the seller should have solicited.

AARP points out that commissions on annuity products earned by sellers are very high, and the penalties to consumers who wish to borrow in advance of maturity are steep. (Senior consumers may die before the annuity matures.) Yet, the bill does not require that sellers disclose the size of the commission or penalties on an annuity product. AARP also points out that supervision of annuity accounts can be delegated to third parties with questionable credentials, and that agents and insurers are given the latitude to develop their own oversight procedures with overly broad parameters. Although information provided by consumers must be kept for five years, there is no requirement that the annuity recommendation or supporting documentation be maintained.

AARP says the penalties are not sufficient to deter fraud and says, generally, that the bill provides more protection to insurers than to consumers.

POSITIONS:

The Office of Financial and Insurance Services supports the bill. (6-28-06)

Citigroup indicated support for the bill. (6-28-06)

The National Association for Variable Annuities indicated support for the bill. (6-28-06)

The American Council of Life Insurance indicated support for the substitute bill. (6-28-06)

The Life Insurance Association of Michigan indicated support for the substitute bill. (6-28-06)

The Association of Insurance and Financial Advisors indicated support for the substitute bill. (6-28-06)

AARP Michigan is opposed to the bill. (6-28-06)

Legislative Analyst: Chris Couch
Fiscal Analyst: Richard Child

■ 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.