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BILL ANALYSIS

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Senate Bill 467 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Rick Jones
Committee: Families, Seniors, and Human Services

Date Completed: 1-5-12

CONTENT

The bill would amend Chapter 41a (Annuity Recommendation to Consumers) of the Insurance Code to do the following:

- **Extend the chapter to recommendations to replace an annuity.**
- **Require an insurance producer's or insurer's belief that a recommendation is suitable to be based on "suitability information", and require there to be a reasonable basis for certain beliefs.**
- **Expand the circumstances under which a producer or insurer does not have an obligation to a consumer.**
- **Require a consumer purchasing an individual annuity to be given a copy of the policy within a reasonable time after the annuity was accepted and issued.**
- **Repeal and replace a section requiring an insurer to establish and maintain a supervision system or to contract for that function.**
- **Require a producer to complete a training course in order to sell annuities, and prescribe course requirements.**
- **Provide that a sale made in compliance with financial industry regulatory authority requirements pertaining to suitability and supervision of annuity transactions would satisfy the requirements of Chapter 41a.**

The bill would take effect nine months after it was enacted.

Replacement Annuities

Chapter 41a applies to any recommendation to purchase or exchange an annuity made to a consumer by an insurance producer, or by an insurer if no producer is involved, that results in the purchase or exchange recommended. Under the bill, Chapter 41a also would apply to any recommendation to replace an annuity made to a consumer by an insurance producer or insurer, that resulted in the replacement recommended.

The bill would define "replacement" or "replace" as a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be one of the following:

- Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer, or otherwise terminated.
- Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values.
- Amended so as to effect a reduction either in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid.
- Reissued with any reduction in cash value.
- Used in a financed purchase.

Suitability of Recommendation

Under Chapter 41a, in recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or a series of transactions, the insurance producer or insurer must have reasonable grounds to believe that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to his or her investments and other insurance products, and as to his or her financial needs.

Under the bill, the insurance producer's or insurer's reasonable grounds to believe that the recommendation was suitable also would have to be based on the consumer's suitability information. In addition, there would have to be a reasonable basis to believe that the consumer had been reasonably informed of various features of the annuity and would benefit from certain features of the annuity.

There also would have to be a reasonable basis to believe that the particular annuity as a whole, the underlying subaccounts to which funds were allocated at the time of purchase or exchange, and riders and similar product enhancements, if any, were suitable, and for an exchange or replacement, the transaction as a whole was suitable, for the particular consumer based on his or her suitability information.

In addition, for an exchange or replacement of an annuity, there would have to be a reasonable basis to believe that the exchange or replacement was suitable, taking into consideration all of the following:

-- Whether the consumer would incur a surrender change, be subject to the commencement of a new surrender period, lose existing benefits, or be subject to increased fees, investment advisory fees, or charges for riders and similar product enhancements.
-- Whether the consumer would benefit from product enhancements and improvements.
-- Whether the consumer had had another annuity exchange or replacement, particularly within the preceding 36 months.

Currently, before the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurance producer or insurer must make reasonable efforts to obtain the consumer's financial status, tax status, and investment objectives, and other information used or considered reasonable by the producer or insurer.

Under the bill, instead, before the execution of a purchase, exchange, or replacement of an annuity resulting from a recommendation, an insurance producer or insurer would have to make reasonable efforts to obtain the consumer's suitability information.

The bill would define "suitability information" as information that is reasonably appropriate to determine the suitability of a recommendation, including all of the following:

-- Age.
-- Annual income.
-- Financial situation and needs, including the resources used for funding 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.
-- Tax status.

Except as permitted under the following provisions, an insurer could not issue an annuity recommended to a consumer unless there were a reasonable basis to believe that the annuity was suitable based on the consumer's suitability information.

Obligation to Consumer

Currently, neither an insurance producer nor an insurer has any obligation to a consumer related to any recommendation if a consumer does any of the following:

-- Refuses to provide relevant information requested by the producer or insurer.
-- Decides to enter into an insurance transaction that is not based on a recommendation of the producer or insurer.

-- Fails to provide complete or accurate information.

Under the bill, instead, neither a producer nor an insurer would have any obligation to a consumer related to an annuity transaction if any of the following applied:

-- A recommendation was not made.
-- A recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer.
-- A consumer refused to provide relevant suitability information and the annuity transaction was not recommended.
-- A consumer decided to enter into an annuity transaction that was not based on a recommendation of the producer or the insurer.

The bill would require a producer, or the responsible insurer representative if no producer were involved, to do all of the following at the time of sale:

-- Make a record of any recommendation subject to the requirement that there be reasonable grounds to believe a recommendation is suitable.
-- 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 was not recommended, if a customer decided to enter into a transaction not based on the producer's or insurer's recommendation.

<u>Supervision System</u>

The bill would repeal Section 4157 of the Code, which requires an insurer either to establish and maintain a system to supervise recommendations that is reasonably designed to achieve compliance with Chapter 41a, or to assure that such a system is established and maintained by contracting with a third party to establish and maintain the system and taking actions to enforce the third party's contractual obligation to perform the required functions.

The bill would add Section 4158 to require an insurer to establish a supervision system that was reasonably designed to achieve the insurer's and its producers' compliance with Chapter 41a, including all of the following:

-- Maintaining reasonable procedures to inform its producers of the requirements of the chapter and incorporate them into relevant producer training manuals.
-- Establishing standards for producer product training and maintaining reasonable procedures to require its producers to comply with training requirements.
-- Providing product-specific training and training materials explaining all material features of its annuity products to its producers.
-- Maintaining procedures for review of each recommendation before issuance of an annuity that were designed to ensure that there was a reasonable basis to determine that a recommendation was suitable.
-- Maintaining reasonable procedures to detect recommendations that were not suitable.
-- Annually giving senior management a report detailing a review designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.

The bill specifies that Section 4158 would not restrict an insurer from contracting for performance of a function, including maintenance of procedures, described above. An insurer would have to take appropriate corrective action and could be subject to sanctions and penalties under the Code regardless of whether the insurer contracted for performance of a function and regardless of the insurer's compliance with the following requirement.

An insurer's supervision system would have to include supervision of contractual performance. This would include monitoring and, as appropriate, conducting audits to assure that the contracted function was properly performed. It also would include annually obtaining a certification from a senior manager who had responsibility for the contracted function that the manager had a reasonable basis to represent, and did represent, that the function was properly performed.

An insurer would not have to include in its system of supervision a producer's recommendation to consumers of products other than the annuities offered by the insurer.

Prohibited Activities

The bill would prohibit a producer from dissuading, or attempting to dissuade, a consumer from any of the following:

-- Truthfully responding to an insurer's request for confirmation of suitability information.
-- Filing a complaint.
-- Cooperating with the investigation of a complaint.

The bill also would prohibit a producer from soliciting the sale of an annuity unless the producer had adequate knowledge of the product to recommend the annuity and the producer were in compliance with the insurer's standards for product training.

Training Course

A producer who engaged in the sale of annuities would have to complete a one-time, four-credit training course approved by the Commissioner of Financial and Insurance Regulation and provided by an insurance producer program of study registered under Chapter 12 of the Code. Insurance producers who held a life insurance line of authority on the bill's effective date and wanted to sell annuities would have to comply with these requirements within six months after that date. Individuals obtaining a life insurance line of authority on or after that date could not engage in the sale of annuities until they had completed the annuity training course.

The training course would be at least four hours' long and include information on all of the following:

-- The types and various classifications of annuities.
-- Identification of the parties to an annuity.
-- How fixed, variable, and indexed annuity contract provisions affect consumers.
-- The income taxation of qualified and nonqualified annuities.
-- The primary uses of annuities.
-- Appropriate sales practices and replacement and disclosure requirements.

Registered insurance producer programs of study could not present any marketing information or provide training on sales techniques or provide specific information about a particular insurer's products.

A provider of an annuity training course intended to comply with these requirements would have to register with the Commissioner as a continuing education provider in Michigan and comply with any applicable requirements.

An annuity training course could be conducted and completed by classroom or self-study methods in accordance with requirements of the Commissioner.

Providers of annuity training would have to comply with any reporting requirements imposed by the Commissioner and issue certificates of completion according to his or her requirements.

Satisfaction of the training requirements of another state that the Commissioner determined to be substantially similar to the requirements of the bill would satisfy these training requirements.

An insurer would have to verify that an insurance producer had completed the annuity training course before allowing the producer to sell an annuity for that insurer. An insurer could satisfy its responsibility by obtaining certificates of completion of the training course or obtaining reports provided by Commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that had a reporting arrangement with a registered insurance producer program of study.

Industry Regulatory Requirements

Currently, an insurer or producer that complies with the National Association of Securities Dealers rules cited in Chapter 41a, or rules as least as stringent pertaining to suitability, satisfies the chapter's requirements for the recommendation of variable annuities. The bill would delete this provision.

Under the bill, subject to the following provision, a sale made in compliance with financial industry regulatory authority requirements pertaining to suitability and supervision of annuity transactions would satisfy the requirements of Chapter 41a. This would apply to a financial industry regulatory authority broker-dealer sale of a variable annuity or fixed annuity if the suitability and supervision were similar to those applied to variable annuity sales, but would not limit the Commissioner's ability to enforce and investigate Chapter 41a.

The provision above would apply if the insurer did both of the following:

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

MCL 500.4151 et al.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would introduce some new, likely small, administrative costs to the Office of Financial and Insurance Regulation (OFIR). The bill would require the Commissioner of OFIR to approve annuity training courses and potentially review training programs from other states. Additionally, OFIR would have to maintain a registry of training course providers. Since the bill would provide no additional funding for OFIR, these requirements would be fulfilled using existing resources of the Department of Licensing and Regulatory Affairs.

Fiscal Analyst: Josh Sefton

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