BILL ANALYSIS

H.B. 2762
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Insurance
Committee Report (Unamended)

BACKGROUND AND PURPOSE

In its Biennial Report to the 80th Texas Legislature, the Texas Department of Insurance noted that the replacement of life insurance policies and certain annuity transactions should be examined further. In the United States, the National Association of Insurance Commissioners (NAIC) model regulation serves as a basis for state replacement regulations and is designed to ensure that insurers and agents provide consumers with fair and accurate information about life insurance and annuity products.

In seeking to find a solution for the problem concerning life insurance policies of "twisting" (failing to make complete comparisons of contracts for the purpose of persuading an insured to cancel an existing contract and purchase another contract) or “churning” (persuading a life insurance policyholder through misrepresentation to use the cash value and/or dividends of an existing policy to purchase a higher death benefit policy), the NAIC followed in the path of full disclosure. Full disclosure laws seek to provide the consumer with as much relevant information as possible without interfering with the consumer's right to make the final decision. The NAIC Model Life Insurance Replacement Regulation is a first step toward providing the consumer with clear, relevant information. The Texas legislation, based in part on the model regulation, seeks to provide the consumer with relevant information and adequate protection against a "twist" or “churn” during a replacement. However, the Texas legislation differs from the NAIC model in many aspects. Most important of which is that H.B. 2762 does not mandate Texas carriers to follow the specific forms prescribed in the model act, but instead takes a more moderate approach that is based on disclosure of policy elements. Insurers can develop their own forms with commissioner approval or use pre-approved forms developed by the department.

Nationwide consensus has been growing regarding the expanded adoption of model laws which further protect consumers during the replacement of life insurance policies and annuity products. Individual consumers should have the best possible regulatory environment to plan their financial futures. To date, 44 states have adopted, by rule or statute, replacement guidelines based in whole or in part on the NAIC model regulation.

H.B. 2762 relates to adoption of requirements regarding the replacement of existing life insurance policies and certain annuities; imposing penalties.

RULEMAKING AUTHORITY

It is the committee's opinion that rulemaking authority is expressly granted to the Commissioner of Insurance in SECTION 1 and in SECTION 2 of this bill.

ANALYSIS

SECTION 1 of the bill adds Chapter 1114 to Subchapter A, Title 7, of the Insurance Code.

Section 1114.001 sets for the purpose of the chapter is to protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct by agents and insurers to be observed during the replacement of or financed purchase transactions. Purchasers of such products are to receive clear investment information that also reduces the opportunity for misrepresentation. Failure to comply with provisions may be subject to penalty.

Section 1114.002 set forth definitions of “agent,” “direct response solicitation,” “existing insurer,” “existing policy or contract,” “financed purchase,” “illustration,” “policy summary,” “replacement,” “registered contract,” “replacing insurer,” “and “sales material.”

Section 1114.003 sets forth a "definition of policy summary" to mean a written statement regarding the policy or contract that must contain, at a minimum, certain information including current death benefits, annual contract premiums, cash surrender value, dividends, application of current dividends, and loan balances. There are also specific provisions that apply to universal life policies with similar summaries.

Section 1114.004 sets forth certain exemptions from the act including certain recommendations involving certain 401K type plans, various deferred compensation plans, ERISA plans, settlements, pre-need funeral plans, employee contribution plans, and certain existing life policies and annuities.

Section 1114.005 sets forth the parameters of what is a "financed purchase." "If a withdrawal, surrender, or borrowing involving the policy values of an existing policy is used to pay premiums on a new policy that is owned by the same policyholder and is issued not earlier than four months before the effective date of the new policy or 13 months after the effective date of the new policy, it is deemed prima facie evidence of the policyholder's intent to finance the purchase." This section only applies to a regulatory review of an individual transaction nor does it increase monitoring obligations of insurers that use agents.

Section 1114.006 requires that the commissioner shall adopt or approve model documents to be used for consumer notices. The department may promulgate forms or approve forms approved by insurers.

Sec. 1114.007. RULES. The commissioner may adopt reasonable rules in the manner prescribed by Subchapter A, Chapter 36, to accomplish and enforce the purpose of this chapter.

Section 1114.051 sets forth the duties and responsibilities of the agents. An agent who initiates an application shall submit to the insurer, with or as part of the application, a statement signed by both the applicant and the agent as to whether the applicant has existing policies or contracts. If the answer is "no," the producer's duties with respect to replacement are complete. However, if the answer is "yes," then subsection (b) also sets forth financial disclosure and notice requirements that the agents must explain to the consumer. This notice must list all existing life insurance policies or annuities to be replaced and whether a policy will be used for financing of the new policy. All sales materials must be left in the possession of the consumer.

Section 1114.052 sets forth the duties and responsibilities of insurers that use agents. Insurers must maintain systems of supervision and control to comply with the act by informing agents about the regulations, provide written materials, review replacement transactions, and other safeguards. Subsection (2) requires that insurers maintain the ability to monitor agents' life insurance and annuity replacements for that insurer and be able to provide related information to the Department.

Section 1114.053 sets forth the duties and responsibilities of replacing insurers that use agents. Replacing insurers must also maintain systems of supervision and control of agents to verify the required forms and policies are received and forwarded according to the act. The replacing insurers must also maintain copies for five (5) years any forms or policies used in connection with a replacement, copies of replacement notifications of agents, and allow the consumer a right to refund for 30 days. This subsection also sets forth limitations on transactions wherein the replacing insurer and existing insurer are one and the same and allows for a credit for the period of time that has elapsed under the replaced policy's or contract's incontestability.

Section 1114.054 sets forth the duties and responsibilities of existing insurers. Existing insurers must also maintain systems of supervision and control to verify the replacement records, indexed by agent. Existing insurers are also required to send letters to policy or contract owner regarding the existing policy or contract values with in force illustrations or summaries of that policy being replaced within five (5) business days. Notices must also be sent to policy owners upon receipt of a request to borrow, surrender or withdraw any policy values that outlines how such a transaction may affect the guaranteed elements, non-guaranteed elements, face amounts or surrender value of the policy from which the values are released. This notice must be separate from the check if the check is sent to anyone other than the policy owner.

Section 1114.055 sets forth the duties and responsibilities of insurers with respect to direct response solicitations. In the case of an application that is initiated as a result of a direct response solicitation, the insurer shall require, with or as part of each completed application for a policy or contract, a statement asking whether the applicant, by applying for the proposed policy or contract, intends to replace, discontinue or change an existing policy or contract. If the applicant indicates a replacement or change is not intended or if the applicant fails to respond to the statement, the insurer shall send the applicant, with the policy or contract, a notice regarding replacement in a form approved by the commissioner. However, if a replacement is intended, additional disclosure notices must be submitted to the consumer on a form approved by the commissioner.

Section 1114.056 sets forth that a registered contract is exempt from certain transactions using illustrations or summaries, but must provide other information such as premium or contract contribution amounts and the identification of the appropriate prospectus or offering circular.

Section 1114.101 sets forth enforcement, violations and penalties. Any failure to comply with this regulation shall be considered a violation of Texas Insurance Code Chapter 541. Examples of violations include deceptive or misleading practices, failure to ask pertinent questions to replacements, intentional incorrect recording, asking an applicant to respond negatively to any required questions, or misrepresentations about completing forms. This subsection also outlines repeated conduct by agents may be deemed as *prima facie* evidence of intent to violate the act. Violations of the regulation may result in license revocation or suspension, fines, or penalties.

Section 1114.102. Additional sanctions from Section 1114.101 (Ch. 541) includes other sanction set forth in Chapter 82 including, but not limited to: license revocation or suspension, administrative penalties, commission forfeiture, require restitution, restore policy contract values, and pay interest on the amount refunded.

SECTION 2. The commissioner of insurance shall adopt rules and adopt or approve model documents as necessary to implement Chapter 1114, Insurance Code, as added by this Act, not later than December 1, 2007.

SECTION 3. This Act applies only to replacement of an insurance policy or annuity contract on or after January 1, 2008. Replacement of a policy or annuity contract before January 1, 2008, is governed by the law as it existed immediately before the effective date of this Act, and that law is continued in effect for that purpose.

SECTION 4. This Act takes effect September 1, 2007.

EFFECTIVE DATE

September 1, 2007.