

## **BILL ANALYSIS**

Senate Research Center  
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H.B. 2277  
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Engrossed

### **AUTHOR'S / SPONSOR'S STATEMENT OF INTENT**

Several years ago, Texas passed suitability laws based on a nationally recognized insurance association's model law, establishing standards for agents and insurers making recommendations to consumers purchasing annuity products to ensure satisfaction of consumer needs and financial objectives.

Shortly after that, the United States Congress enacted financial reform legislation exempting certain insurance and annuity contracts from federal regulation and subjecting the contracts to state insurance law regulation if the state adopts certain nationally recognized suitability requirements within a certain timeframe.

H.B. 2277 seeks to conform Texas insurance law to the most recently adopted nationally recognized standards regarding suitability in annuity transactions. The legislation seeks to provide stronger protections for consumers and imposes additional duties on insurers and agents to obtain suitability information from consumers before recommending the purchase of a particular annuity. These changes are important to maintain state regulation of certain annuity transactions by the Texas Department of Insurance and allow agents and insurers to avoid the expense of federal regulation for exempted products.

H.B. 2277 amends current law relating to the sale, exchange, or replacement of life insurance and annuity contracts.

### **RULEMAKING AUTHORITY**

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Section 541.058(b), Insurance Code, as follows:

(b) Provides that it is not a rebate or discrimination prohibited by Section 541.056(a) (relating to certain unfair methods of competition or unfair or deceptive acts or practices in the business of insurance) or 541.057 (Unfair Discrimination in Life Insurance and Annuity Contracts):

(1) for a life insurance or life annuity contract, to pay a bonus to a policyholder or otherwise abate the policyholder's premiums in whole or in part out of surplus accumulated from nonparticipating insurance policies if the bonus or abatement:

(A) is fair and equitable to policyholders; and

(B) is in the best interests of the insurer and its policyholders;

(2) for a life insurance policy issued on the industrial debit plan, to make to a policyholder who has continuously for a specified period made premium payments directly to the insurer's office an allowance in an amount that fairly represents the saving in collection expenses;

(3) for a group insurance policy, to readjust the rate of premium based on the loss or expense experience under the policy at the end of a policy year if the adjustment is retroactive for only that policy year;

(4) for a life annuity contract, to waive surrender charges under the contract when the contract holder exchanges that contract for another annuity contract issued by the same insurer or an affiliate of the same insurer that is part of the same holding company group if:

(A) the waiver and the exchange are fully, fairly, and accurately explained to the contract holder in a manner that is not deceptive or misleading; and

(B) the contract holder is given credit for the time that the previous contract was held when determining any surrender charges under the new contract;

(5) in connection with an accident and health insurance policy, to provide to policy or certificate holders, in addition to benefits under the terms of the insurance contract, health-related services or health-related information, or to disclose the availability of those additional services and information to prospective policy or certificate holders; or

(6) in connection with a health maintenance organization evidence of coverage, to provide to enrollees, in addition to benefits under the evidence of coverage, health-related services or health-related information, or to disclose the availability of those additional services and information to prospective enrollees or contract holders.

SECTION 2. Amends Section 1114.004(a), Insurance Code, to provide that, except as otherwise specifically provided by this chapter, this chapter does not apply to certain transactions, including transactions involving life insurance and annuities, rather than group life insurance and annuities, used to fund prepaid funeral benefits contracts, as defined by Chapter 154 (Prepaid Funeral Services), Finance Code.

SECTION 3. Amends Subchapter B, Chapter 1114, Insurance Code, by adding Section 1114.057, as follows:

Sec. 1114.057. DISCLOSURE OF AVAILABILITY OF WAIVER OF SURRENDER CHARGES. Requires an insurer that offers to waive surrender charges as described by Section 541.058(b)(4) to provide reasonable notice of that offer to the insurer's prospective or current contract holders. Authorizes the notice to be provided by any available means, including a disclosure document or by display on a link that is prominently placed on the insurer's Internet website.

SECTION 4. Amends Section 1115.001, Insurance Code, to provide that the purpose of this chapter is to establish standards and procedures regarding recommendations made to a consumer that result in a transaction involving annuity products, and to require insurers to establish a system to supervise those recommendations, to ensure that the insurance needs and financial objectives of the consumer as of the time of the transaction are appropriately addressed.

SECTION 5. Amends Section 1115.002, Insurance Code, by amending Subdivisions (2), (3), and (4) and adding Subdivisions (2-a), (5), and (6), to redefine "annuity," "insurer," and "recommendation" and to define "continuing education provider," "replacement," and "suitability information."

SECTION 6. Amends Section 1115.003, Insurance Code, as follows:

Sec. 1115.003. APPLICABILITY; EXEMPTIONS. (a) Provides that this chapter applies to any recommendation to purchase, replace, or exchange an annuity that is made

to a consumer by an agent, or an insurer if an agent is not involved, and results in the recommended purchase, replacement, or exchange.

(b) Provides that, unless otherwise specifically included, this chapter does not apply to certain transactions, rather than certain recommendations.

SECTION 7. Amends Section 1115.051, Insurance Code, as follows:

Sec. 1115.051. **SUITABILITY OF ANNUITY PRODUCT REQUIRED.** (a) Requires the agent, or the insurer if an agent is not involved, in recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, to have a reasonable basis to believe that:

(1) the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to the consumer's investments and other insurance products and as to the consumer's financial situation and needs, including the consumer's suitability information;

(2) the consumer has been reasonably informed of various features of the annuity, such as the potential surrender period and the surrender charge, any potential tax penalty if the consumer sells, exchanges, surrenders, or annuitizes the annuity, mortality and expense fees, investment advisory fees, potential charges for and features of riders, limitations on interest returns, insurance and investment components, and market risk;

(3) the consumer would benefit from certain features of the annuity, such as tax-deferred growth, annuitization, or a death or living benefit;

(4) the particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the annuity, and any riders or similar product enhancements are suitable, and, in the case of an exchange or replacement, the transaction as a whole is suitable, for the particular consumer based on the consumer's suitability information; and

(5) in the case of an exchange or replacement of an annuity, the exchange or replacement is suitable, including taking into consideration whether the consumer:

(A) will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits such as death, living, or other contractual benefits, or be subject to increased fees, investment advisory fees, or charges for riders or similar product enhancements;

(B) would benefit from product enhancements and improvements; and

(C) has had another annuity exchange or replacement, and in particular, an exchange or replacement in the preceding 36 months.

(b) Requires an agent, or an insurer if an agent is not involved, before the execution of a purchase, exchange, or replacement of an annuity resulting from a recommendation, to make reasonable efforts to obtain the consumer's suitability information.

(c) Prohibits an insurer, except as permitted by Subsection (d), from issuing an annuity recommended to a consumer unless the insurer has a reasonable basis to believe the annuity is suitable based on the consumer's suitability information.

(d) Provides that, subject to Subsection (e), an agent or insurer does not have any obligation to a consumer related to an annuity transaction if:

- (1) the consumer refuses to provide suitability information requested by the agent or insurer;
- (2) the agent or insurer does not make a recommendation;
- (3) the agent or insurer makes a recommendation later found to have been prepared based on inaccurate material information provided by the consumer; or
- (4) the consumer decides to enter into a transaction that is not based on a recommendation of the agent or insurer.

(e) Requires that an insurer's issuance of an annuity under circumstances described by Subsection (d) be reasonable under all circumstances actually known to the insurer at the time the annuity is issued.

(f) Requires an agent, or an insurer if an agent is not involved, at the time of sale of an annuity, to:

- (1) make a record of any recommendation made by the agent or insurer that is subject to Subsection (a);
- (2) obtain a customer-signed statement documenting the customer's refusal, if any, to provide suitability information; and
- (3) obtain a customer-signed statement acknowledging that an annuity transaction is not recommended if the customer decides to enter into an annuity transaction that is not based on the agent's or insurer's recommendation.

Deletes existing text requiring an agent, or the insurer if an agent is not involved, before the execution of a purchase or exchange of an annuity resulting from a recommendation, to make reasonable efforts to obtain information from the consumer concerning the consumer's financial status, the consumer's tax status, and the consumer's investment objectives, and other relevant information used or considered to be reasonable by the agent or that insurer in making recommendations to consumers.

Deletes existing Subsection (b) providing that, in a recommendation to a consumer regarding the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, an agent or the insurer, if an agent is not involved, has reasonable grounds for believing that the recommendation is suitable for that consumer based on the facts disclosed by the consumer regarding the consumer's investments and other insurance products, and financial situation and needs.

Deletes existing Subsection (c) providing that an agent, or an insurer if an agent is not involved, has no obligation to a consumer related to a recommendation if the consumer refuses to provide relevant information requested by the agent or insurer, fails to provide complete or accurate information on the request of the agent or insurer, or decides to enter into a transaction that is not based on a recommendation of the agent or insurer.

Deletes existing Subsection (d) requiring that an agent's or insurer's recommendation subject to Subsection (a) be reasonable under all the circumstances actually known to the agent or insurer at the time of the recommendation.

SECTION 8. Amends Section 1115.052, Insurance Code, as follows:

Sec. 1115.052. New heading: SUPERVISION SYSTEM. (a) Requires each insurer to establish supervision that is reasonably designed to achieve the insurer's and the insurer's agents' compliance with this chapter, rather than requires each insurer to operate a system, that is reasonably designed to achieve compliance with this chapter, to supervise recommendations.

(b) Authorizes an insurer to comply with Subsection (a) by establishing and maintaining the insurer's own supervision system under which, at a minimum, the insurer:

(1) maintains reasonable procedures to inform the insurer's agents of the requirements of this chapter and incorporates the requirements of this chapter into relevant agent training manuals;

(2) establishes standards for agent product training and maintains reasonable procedures to require the insurer's agents to comply with the requirements of Section 1115.056 (Agent Education Requirements);

(3) provides product-specific training and training materials that explain all material features of the insurer's annuity products to the insurer's agents;

(4) maintains procedures to review each recommendation electronically, physically, or otherwise before the issuance of an annuity that:

(A) are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable; and

(B) may include the application of a screening system to identify selected transactions for additional review, and be designed to require additional review only of those transactions identified for additional review by the selection criteria;

(5) maintains reasonable procedures, such as confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters, and programs of internal monitoring, to detect recommendations that are not suitable, which may involve applying sampling procedures or confirming suitability information after the issuance or delivery of the annuity; and

(6) annually provides a report to the insurer's senior management, including to the senior manager responsible for audit functions, that details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and any corrective action taken or recommended.

Deletes existing text authorizing an insurer to comply with Subsection (a) by complying with Subsections (c)-(e) or by establishing and maintaining the insurer's own compliance system that complies with Subsection (c). Deletes existing text requiring each agent and independent agency to adopt an insurer's compliance system or establish and maintain such a system.

(c) Provides that this subsection does not prohibit an insurer from contracting for the performance of a function, including maintenance of procedures, required by Subsection (b). Requires that an insurer's supervision system under Subsection (b) include the supervision of contractual performance under this subsection that includes, at a minimum:

(1) annually obtaining certification that complies with Section 1115.053 from a senior manager who represents that the contracted function is properly performed; and

(2) monitoring and, as appropriate, conducting audits to ensure that the contracted function is properly performed.

(d) Redesignates existing Subsection (f) as Subsection (d). Provides that an insurer, rather than an insurer, agent, or independent agent, is not required by this section to include in the supervision system, rather than compliance system, an agent's recommendations to consumers of products other than the annuities offered by the insurer, rather than offered by the insurer, agent, or independent agency.

(e) Prohibits an agent from dissuading, or attempting to dissuade, a consumer from:

(1) truthfully responding to an insurer's request for confirmation or suitability information;

(2) filing a complaint; or

(3) cooperating with the investigation of a complaint.

Deletes existing Subsection (c) requiring that a compliance system established under Subsection (b) include maintenance of written procedures, and periodic reviews of the insurer's or agent's records in a manner reasonably designed to assist in detecting and preventing violations of this chapter.

Deletes existing Subsection (d) authorizing an agent or insurer may contract with a third party, including an agent or independent agency, to establish and maintain a compliance system with respect to agents under contract with or employed by the third party. Deletes existing text requiring an agent or insurer to make reasonable inquiries sufficient to ensure that the third party is performing the functions required under Subsection (a), and to take any action reasonable under the circumstances to enforce the contractual obligation to perform those functions. Deletes existing text authorizing an agent or insurer to comply with the obligation to make reasonable inquiries by annually obtaining certification from a senior manager of the third party that the third party is performing the required functions, and periodically selecting third parties, based on reasonable selection criteria, for a review to determine whether the third parties are performing the required functions.

Deletes existing Subsection (e) requiring an agent or insurer to adopt procedures for conducting a review under Subsection (d)(2) that are reasonable under the circumstances. Deletes existing text providing that an insurer that contracts with a third party under Subsection (d) and that complies with the requirements to supervise under Subsection (d) is deemed to have complied with the insurer's responsibilities under Subsection (b).

Deletes existing Subsection (f) text providing that an insurer, agent, or independent agency is not required by this section to review, or provide for review of, all agent-solicited transactions.

SECTION 9. Amends Section 1115.053, Insurance Code, as follows:

Sec. 1115.053. CERTIFICATION REQUIREMENTS. Deletes existing Subsection (b) designation. Prohibits a person from providing a certification under Section 1115.052(c)(1), rather than Section 1115.052(d)(1), unless the person is a senior manager

with responsibility for the delegated functions, and has a reasonable basis for making the certification.

Deletes existing Subsection (a) requiring an agent or independent agency that contracts with an insurer under Section 1115.052(d), on request by an insurer, to promptly obtain a certification as described under Section 1115.052(d)(1) or give a clear statement that it is unable to meet the certification criteria.

SECTION 10. Amends Section 1115.054, Insurance Code, as follows:

Sec. 1115.054. COMPLIANCE WITH CERTAIN NATIONAL STANDARDS. (a) Provides that, subject to Subsection (c), sales made in compliance with the conduct rules of the Financial Industry Regulatory Authority (FINRA) relating to suitability and supervision of annuity transactions, or the rules of another national organization recognized by the commissioner of insurance (commissioner), satisfy the requirements of this chapter, rather than the requirements under this chapter for the recommendation of annuities registered under the Securities Act of 1933 (15 U.S.C. Section 77a et seq.) or rules or regulations adopted under that Act. Provides that this section applies to FINRA member broker-dealer sales of variable annuities and fixed annuities if the suitability and supervision conduct rules are similar to those applied to variable annuity sales. Makes nonsubstantive changes.

(b) Provides that this section does not affect or limit the commissioner's ability to enforce or investigate under this chapter.

(c) Provides that Subsection (a) applies only if the insurer:

(1) monitors the FINRA member broker-dealer using information collected in the normal course of the insurer's business; and

(2) provides to the FINRA member broker-dealer information and reports that are reasonably appropriate to assist the broker-dealer to maintain the broker-dealer's supervision system.

SECTION 11. Amends Section 1115.056, Insurance Code, as follows:

Sec. 1115.056. New heading: AGENT TRAINING REQUIREMENTS. (a) Prohibits an agent from soliciting the sale of an annuity product unless the agent has adequate knowledge of the product to recommend the annuity and is in compliance with the insurer's standards for product training. Authorizes an agent to rely on insurer-provided, product-specific training standards and materials to comply with this subsection.

(b) Requires an agent who engages in the sale of annuity products to complete a one-time training course approved by the Texas Department of Insurance (TDI) and provided by a continuing education provider.

(c) Requires that the training required by Subsection (b) be of a length sufficient to qualify for at least four continuing education credits, as determined by the commissioner in accordance with Chapter 4004 (Continuing Education) and any rules adopted under that chapter, but may be longer. Authorizes the training required by Subsection (b) to be used to satisfy the continuing education requirements under Subchapters B (Agent Continuing Education Requirements) and E (Continuing Education Requirements for Sale of Annuities), Chapter 4004, and is not in addition to the continuing education requirements in Section 4004.202 (Required Continuing Education Regarding Annuities).

(d) Requires that the training required by Subsection (b) include information on the following topics:

(1) the types of annuities and various classifications of annuities;

- (2) identification of the parties to an annuity;
- (3) how fixed, variable, and indexed annuity contract provisions affect consumers;
- (4) the application of income taxation of qualified and nonqualified annuities;
- (5) the primary uses of annuities; and
- (6) appropriate sales practices, replacement, and disclosure requirements.

(e) Requires a provider of a course intended to comply with Subsection (b) to cover all topics listed in Subsection (d), and prohibits a provider from presenting any marketing information, providing training on sales techniques, or providing specific information about a particular insurer's products. Authorizes additional topics to be offered in conjunction with and in addition to the required topics.

(f) Requires a provider of a course intended to comply with Subsection (b) to register as a continuing education provider in this state and comply with the rules and guidelines applicable to agent continuing education courses provided by Chapter 4004.

(g) Authorizes an annuity training course to be conducted and completed by classroom or self-study methods in accordance with Chapter 4004.

(h) Requires a provider of annuity training under Subsection (b) to comply with the reporting requirements and issue certificates of completion in accordance with Chapter 4004.

(i) Provides that the satisfaction of the training requirements of another state that are substantially similar to the provisions of this section is considered to satisfy the training requirements of this section.

(j) Requires an insurer to verify that an agent has completed the annuity training course required by this section before allowing the agent to sell an annuity product for that insurer. Authorizes an insurer to satisfy the insurer's responsibility under this section by:

- (1) obtaining a certificate of completion of the training course or obtaining an appropriate report provided by TDI;
- (2) using a TDI-sponsored database or vendor; or
- (3) using a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

Deletes existing text of Subsection (a) requiring a resident agent that intends to sell, solicit, or negotiate a contract for an annuity in this state or to represent an insurer in relation to such an annuity to submit evidence satisfactory to TDI of completion of at least four hours of training relating to annuities before soliciting individual consumers for the purpose of selling annuities.

Deletes existing Subsection (b) authorizing the training required under Subsection (a) to be used to satisfy the continuing education requirements imposed under this code and rules adopted under this code for issuance of a license under this code.

SECTION 12. Amends Section 1115.101, Insurance Code, as follows:



Sec. 1115.101. MITIGATION. Provides that an insurer is responsible for compliance with this chapter. Authorizes the commissioner, if a violation occurs because of the action or inaction of the insurer or the insurer's agent, to:

- (1) order the insurer to take reasonable appropriate corrective action for any consumer harmed by the insurer or by the insurer's agent because of a violation of this chapter, or order a general agency, independent agency, or the agent to take reasonably appropriate corrective action for any consumer harmed by the agent's violation of this chapter; and
- (2) impose appropriate sanctions as provided by Section 1115.102 (Sanctions).

Deletes existing Subdivision (3) relating a managing general agent or independent agency that employs or contracts with an agent to sell, or solicit the sale of, annuities to consumers to take reasonably appropriate corrective action for any consumer harmed by the agent's violation of this chapter. Makes nonsubstantive changes.

SECTION 14. Amends Section 1115.102(b), Insurance Code, to require the commissioner to reduce or eliminate a sanction for a violation of this chapter otherwise applicable if corrective action for the consumer was take promptly by the agent after a violation was discovered, or the violation was not part of a pattern or practice, rather than authorize the commissioner to reduce or eliminate a sanction for a violation of this chapter otherwise applicable if corrective action for the consumer was take promptly by the agent after a violation was discovered.

SECTION 14. (a) Provides that Section 541.058(b), Insurance Code, as amended by this Act, applies only to an exchange of life annuity contracts on or after the effective date of this Act. Provides that an exchange of life annuity contracts before the effective date of this Act is governed by the law in effect immediately before the effective date of this Act, and that law is continued in effect for that purpose.

(b) Provides that Section 1114.004(a), Insurance Code, as amended by this Act, applies only to a transaction involving a life insurance or annuity policy or contract occurring on or after the effective date of this Act. Provides that a transaction involving a policy or contract occurring before the effective date of this Act is governed by the law in effect immediately before the effective date of this Act, and that law is continued in effect for that purpose.

(c) Provides that, except as provided by this section, Chapter 1115, Insurance Code, as amended by this Act, applies only to a recommendation to purchase, exchange, or replace an annuity contract made on or after June 1, 2012, and any transaction arising from that recommendation. Provides that a recommendation made before June 1, 2012, and a transaction arising from that recommendation are governed by the law in effect immediately before the effective date of this Act, and that law is continued in effect for that purpose.

(d) Provides that an insurance agent who becomes licensed under Chapter 4054 (Life, Accident, and Health Agents), Insurance Code, on or after the effective date of this Act is subject to Section 1115.056, Insurance Code, as amended by this Act. Provides that an agent licensed under Chapter 4054, Insurance Code, before the effective date of this Act is not subject to Section 1115.056, Insurance Code, as amended by this Act, before March 1, 2012. Provides that, on and after the effective date of this Act and before March 1, 2012, an insurance agent licensed under Chapter 4054, Insurance Code, before the effective date of this Act is subject to Section 1115.056, Insurance Code, as that section existed immediately before the effective date of this Act, and that law is continued in effect for that purpose.

SECTION 15. Effective date: September 1, 2011.