

BILL ANALYSIS

H.B. 2277
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Insurance
Committee Report (Unamended)

BACKGROUND AND PURPOSE

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

Shortly after that, the U.S. Congress enacted financial reform legislation exempting certain insurance or 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 impose 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.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

H.B. 2277 amends the Insurance Code to require an insurance 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 the following:

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

- in the case of an exchange or replacement of an annuity, the exchange or replacement is suitable, including taking into consideration whether the consumer 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; would benefit from product enhancements and improvements; and has had another annuity exchange or replacement, and in particular, an exchange or replacement in the preceding 36 months.

H.B. 2277 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. The bill prohibits an insurer, except as permitted by the bill's provisions, 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. The bill establishes that an agent or insurer does not have any obligation to a consumer related to an annuity transaction if the consumer refuses to provide suitability information requested by the agent or insurer; the agent or insurer does not make a recommendation; the agent or insurer makes a recommendation later found to have been prepared based on inaccurate material information provided by the consumer; or the consumer decides to enter into a transaction that is not based on a recommendation of the agent or insurer. The bill requires an insurer's issuance of an annuity under those circumstances to be reasonable under all circumstances actually known to the insurer at the time the annuity is issued.

H.B. 2277 requires an agent, or an insurer if an agent is not involved, at the time of sale of an annuity, to make a record of any recommendation made by the agent or insurer regarding the purchase or exchange of an annuity; obtain a customer-signed statement documenting the customer's refusal, if any, to provide suitability information; and 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. The bill removes statutory provisions setting out the requirements that an agent or an insurer must meet before executing a purchase or exchange of an annuity resulting from a recommendation, the conditions that constitute reasonable grounds for the agent or insurer to believe that a recommendation is suitable for a consumer, and the circumstances under which the agent or insurer has no obligation to a consumer related to a recommendation.

H.B. 2277 requires each insurer to establish supervision, rather than operate a system to supervise recommendations, that is reasonably designed to achieve the insurer's and the insurer's agents' compliance with provisions of law governing the suitability of certain annuity transactions. The bill removes provisions of law requiring each agent and independent agency to adopt an insurer's compliance system or to establish and maintain such a system, removes the required components of an established compliance system, and makes conforming changes. The bill removes provisions of law authorizing an agent or insurer to contract with a third party to establish and maintain a compliance system with respect to agents under contract with or employed by the third party and authorizing the agent or insurer to adopt procedures for conducting a third party performance review. The bill specifies that an insurer may comply with the requirement to establish supervision by establishing and maintaining the insurer's own supervision system under which, at a minimum, the insurer does the following:

- maintains reasonable procedures to inform the insurer's agents of the requirements relating to the suitability of annuity transactions and incorporates those requirements into

relevant agent training manuals;

- establishes standards for agent product training and maintains reasonable procedures to require the insurer's agents to comply with agent education requirements;
- provides product-specific training and training materials that explain all material features of the insurer's annuity products to the insurer's agents;
- maintains procedures to review each recommendation electronically, physically, or otherwise before the issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable and that 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;
- 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
- 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.

H.B. 2277 requires an insurer's supervision system to include the supervision of contractual performance that includes, at a minimum, annually obtaining certification from a senior manager who represents that the contracted function is properly performed and monitoring and, as appropriate, conducting audits to ensure that the contracted function is properly performed. The bill establishes that this requirement does not prohibit an insurer from contracting for the performance of a function, including maintenance of procedures, required under the supervision system. The bill establishes that an insurer is not required to include in the supervision system an agent's recommendations to consumers of products other than the annuities offered by the insurer. The bill prohibits an agent from dissuading, or attempting to dissuade, a consumer from truthfully responding to an insurer's request for confirmation or suitability information; filing a complaint; or cooperating with the investigation of a complaint. The bill removes a provision of law establishing that an insurer, agent, or independent agency is not required by provisions of law relating to compliance systems to review, or provide for review of, all agent-solicited transactions.

H.B. 2277 makes provisions of law relating to compliance with certain national standards applicable to Financial Industry Regulatory Authority (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. The bill establishes that provisions of law relating to compliance with national standards do not affect or limit the ability of the commissioner of insurance to investigate under, in addition to enforce, provisions of law relating to the suitability of certain annuity transactions. The bill establishes that the provision of law relating to satisfying annuity transaction suitability requirements through compliance with the conduct rules of FINRA apply only if the insurer monitors the FINRA member broker-dealer using information collected in the normal course of the insurer's business and 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. The bill removes language establishing that compliance with FINRA rules satisfies requirements under provisions of federal law or rules or regulations adopted under the federal law.

H.B. 2277 replaces provisions of law setting out agent education requirements with provisions setting out agent training requirements. The bill 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 and authorizes an agent to rely on insurer-provided, product-specific training standards and materials to comply with those requirements. The bill 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. The bill requires such training to be of a length sufficient to qualify for at least four continuing education credits, as determined by the commissioner in accordance with general agent continuing education requirements under state law and any rules adopted under that law and authorizes the training period to be for a longer period. The bill authorizes the required training to be used to satisfy the general agent continuing education requirements under state law and specifies that the training is not in addition to required general continuing education regarding annuities. The bill requires the required training to include information on the following topics:

- the types of annuities and various 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 of qualified and nonqualified annuities;
- the primary uses of annuities; and
- appropriate sales practices, replacement, and disclosure requirements.

H.B. 2277 requires a provider of a course intended to comply with the required training to cover all of those listed topics and prohibits the provider from presenting any marketing information, providing training on sales techniques, or providing specific information about a particular insurer's products. The bill authorizes additional topics to be offered in conjunction with and in addition to the required topics. The bill requires a provider of a course intended to comply with the training to register as a continuing education provider in Texas and comply with the rules and guidelines applicable to agent continuing education courses prescribed by state law. The bill authorizes an annuity training course to be conducted and completed by classroom or self-study methods in accordance with state law relating to insurance professionals' continuing education and requires a provider of annuity training to comply with the reporting requirements and issue certificates of completion in accordance with that state law.

H.B. 2277 establishes that the satisfaction of the training requirements of another state that are substantially similar to the bill's training requirements is considered to satisfy the bill's training requirements. The bill requires an insurer to verify that an agent has completed the annuity training course required under the bill's provisions before allowing the agent to sell an annuity product for that insurer. The bill authorizes an insurer to satisfy the insurer's responsibility by obtaining a certificate of completion of the training course or obtaining an appropriate report provided by TDI; using a department-sponsored database or vendor; or using a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

H.B. 2277 makes an insurer responsible for compliance with provisions of law relating to the suitability of certain annuity transactions. The bill clarifies that the authorization for the commissioner to take certain corrective actions is contingent on a violation occurring because of the action or inaction of an insurer or the insurer's agent. The bill authorizes the commissioner, if such a violation occurs, to order a general agency or an independent agency, as an alternative to ordering the agent, to take reasonably appropriate corrective action for any consumer harmed by the agent's violation of provisions of law relating to the suitability of certain annuity transactions.

The bill includes among the authorized commissioner actions on a violation the imposition of appropriate sanctions as provided by state law. The bill removes as an authorized commissioner action the ordering of 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. The bill requires, rather than authorizes, the commissioner to reduce or eliminate a sanction for a violation of provisions of law relating to the suitability of certain annuity transactions otherwise applicable if corrective action for the consumer was taken promptly by the agent or insurer after a violation was discovered and adds as an alternative trigger for that requirement that the violation was not part of a pattern or practice.

H.B. 2277 adds as a purpose of statutory provisions governing the suitability of certain annuity transactions the requiring of insurers to establish a system to supervise recommendations made to a consumer that result in a transaction involving annuity products. The bill includes in the applicability of statutory provisions governing the suitability of certain annuity transactions, in addition to recommendations to purchase or exchange an annuity, any recommendation to replace an annuity and specifies that a recommendation made to a consumer by an insurer to which the statutory provisions apply is a recommendation by an insurer if an agent is not involved. The bill exempts from statutory provisions governing the suitability of certain annuity transactions involving certain conditions, rather than recommendations involving those conditions.

H.B. 2277 establishes that it is not a rebate or unfair discrimination prohibited by state law 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, as an alternative to the same insurer, an affiliate of the same insurer that is part of the same holding company group if 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, in a provision added by the bill, the contract holder is given credit for the time that the previous contract was held when determining any surrender charges under the new contract. The bill, in provisions of law exempting transactions involving group life insurance and annuities used to fund prepaid funeral benefits contracts from the applicability of statutory provisions governing the replacement of certain life insurance policies and annuities, makes that exemption apply to transactions involving life insurance and annuities, rather than group life insurance and annuities.

H.B. 2277 requires an insurer that offers to waive surrender charges under a contract when the contract holder exchanges that contract for another annuity contract issued by the same insurer or a certain affiliate of the same insurer, under certain circumstances, to provide reasonable notice of that offer to the insurer's prospective or current contract holders. The bill 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.

H.B. 2277 makes its provisions relating to the suitability of certain annuity transactions apply 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. The bill makes an agent licensed before the bill's effective date not subject to the bill's agent training requirements before March 1, 2012.

H.B. 2277 defines "continuing education provider," "replacement," and "suitability information." The bill redefines "annuity" to remove the specification that the annuity is fixed, variable, or modified and guaranteed and add the specification that the annuity is an insurance product under Texas law. The bill redefines "insurer" to describe an insurer, among other provisions, as a

company, rather than an insurance company. The bill redefines "recommendation" to include advice resulting in a replacement, in addition to a purchase or exchange, of an annuity and to make a conforming change. The bill makes conforming and nonsubstantive changes.

EFFECTIVE DATE

September 1, 2011.