

## **BILL ANALYSIS**

C.S.H.B. 1777  
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Insurance  
Committee Report (Substituted)

### **BACKGROUND AND PURPOSE**

Annuities provide protected lifetime income through retirement. At a time when many consumers are feeling uncertain about their futures and market swings are putting pressure on retirees invested in stocks and bonds, the guaranteed income provided by annuities appeals to consumers. In 2007, the Texas Legislature enacted legislation requiring agents to determine the suitability of a particular annuity product for the individual consumer before it is sold. Recently, the federal Securities and Exchange Commission adopted a "best interest" standard of care for the sale of securities to consumers. Because variable annuities contain securities, under current Texas law there is a disparity in the standards of care for the sale of different annuities. Annuities that contain securities operate under this new federal standard while those that do not operate under the state's outdated standard of suitability. C.S.H.B. 1777 seeks to update state law to enhance consumer protections and provide consistency in how the state regulates the sale of all annuity products by bringing state law more into line with these federal standards.

### **CRIMINAL JUSTICE IMPACT**

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

### **RULEMAKING AUTHORITY**

It is the committee's opinion that rulemaking authority is expressly granted to the commissioner of insurance in SECTION 9 of this bill.

### **ANALYSIS**

C.S.H.B. 1777 amends the Insurance Code to decrease the minimum permissible interest rate used in determining minimum nonforfeiture amounts for a paid-up annuity, cash surrender, or death benefit from one percent to 0.15 percent. This change applies only to an annuity contract delivered, issued for delivery, or renewed on or after January 1, 2022.

C.S.H.B. 1777 also revises provisions establishing the standards for life insurance annuity transactions as provided below.

#### **Applicability and Purpose of Chapter**

C.S.H.B. 1777 makes provisions governing recommendations by an insurance agent or insurer to a consumer to purchase, replace, or exchange a life insurance annuity that results in the recommended purchase, replacement, or exchange applicable instead to any sale of an annuity, while retaining existing exemptions. The bill establishes as the new purpose of these provisions requiring an agent to act in a consumer's best interest when making a recommendation of an annuity and requiring insurers to establish and maintain a system to supervise those

recommendations so that the consumer's insurance needs and financial objectives as of the time of the transaction are effectively addressed.

C.S.H.B. 1777 prohibits the provisions from being construed to create or imply a private cause of action against an agent or insurer or to subject an agent or insurer to civil liability for a violation of the provisions, a rule adopted thereunder, or a standard governing the conduct of a fiduciary or a fiduciary relationship.

C.S.H.B. 1777 adds certain new definitions and revises existing definitions as follows:

- revises the definition of "recommendation" to include advice that is intended to result in a purchase, exchange, or replacement of an annuity and to exclude a general communication to the public, any generalized customer service assistance or administrative support, any general educational information or tools, a prospectus, or any other product or sales material;
- clarifies the definition of "replacement"; and
- includes a fraternal benefit society in the definition of "insurer."

## **Duties of Insurers and Agents**

### General Provisions

C.S.H.B. 1777 makes provisions establishing the duties of insurers and agents with respect to life insurance annuity transactions applicable to each agent who exercises material control or influence in making a recommendation or sale and receives direct compensation as a result of the recommendation or sale, regardless of whether the agent has direct contact with the consumer. The bill establishes that the provisions may not be construed to require an agent to obtain a license other than their agent license and specifies that activities that do not constitute material control or influence include providing or delivering marketing or educational materials, product wholesaling or other back office product support, general supervision of an agent, and similar activities.

### Obligations to Consumers

C.S.H.B. 1777 removes and repeals provisions establishing certain obligations on the part of an agent or insurer with respect to determining the suitability of an annuity product when recommending a purchase, exchange, or replacement of an annuity. The bill instead establishes the following obligations to consumers to ensure that recommendations are in a consumer's best interest.

#### *Agent's Care Obligation*

C.S.H.B. 1777 requires an insurance agent to exercise reasonable diligence, care, and skill to do the following in making a recommendation of an annuity:

- obtain consumer profile information, as defined by the bill, from the consumer before making the recommendation;
- know the consumer's financial situation, insurance needs, and financial objectives;
- understand the available recommendation options available to the agent;
- consider the types of products the agent is authorized and licensed to recommend or sell that address the consumer's financial situation, insurance needs, and financial objectives;
- have a reasonable basis to believe the recommendation addresses the consumer's financial situation, insurance needs, and financial objectives over the life of the product, in light of the consumer profile information;
- have a reasonable basis to believe the consumer would benefit from certain features of the annuity, such as annuitization, a death or living benefit, or other insurance-related feature; and
- communicate the basis of the recommendation.

The bill requires the agent to consider consumer profile information; characteristics of the insurer; and product costs, rates, benefits, and features in determining whether an annuity effectively addresses the consumer's financial situation, insurance needs, and financial objectives. The bill authorizes the agent to place varying levels of importance on each of those factors based on the facts and circumstances of a particular case but prohibits the insurer from considering one factor in isolation.

C.S.H.B. 1777 specifies that this obligation of care does not require any of the following:

- analysis or consideration of a product outside the agent's authority and license;
- analysis or consideration of a product or strategy that is an alternative to an annuity;
- recommendation of the annuity with the lowest one-time or multiple occurrence compensation structure; or
- ongoing monitoring of the consumer's financial situation.

C.S.H.B. 1777 requires an agent, in the case of an exchange or replacement of an annuity, to consider the whole transaction, including whether:

- the consumer will incur or face certain fees or charges, lose their benefits, or be subjected to the commencement of a new surrender period;
- the replacing product would substantially benefit the consumer in comparison to the replaced product over the life of the product; and
- the consumer has had an annuity exchange or replacement in the preceding 60 months.

C.S.H.B. 1777 provides the following with respect to these provisions establishing an obligation of care:

- the provisions apply to an annuity as a whole, including applicable subaccounts, riders, and similar product enhancements;
- an agent is held to standards applicable to an agent with similar authority and licensure with respect to the obligation of care requirements;
- the provisions do not create a fiduciary obligation or relationship and only create a regulatory obligation; and
- the provisions do not affect any ongoing monitoring obligation an agent may have under a fiduciary, consulting, investment advising, or financial planning agreement between the consumer and the agent.

C.S.H.B. 1777 exempts an agent from their obligation of care for a consumer under any of the following circumstances:

- the agent does not make a recommendation;
- the agent makes a recommendation based on materially inaccurate information provided by the consumer;
- the consumer refuses to provide consumer profile information; or
- the consumer enters into an annuity transaction that is not based on the recommendation from the agent or insurer.

#### *Agent's Disclosure Obligation*

C.S.H.B. 1777 requires an agent, before the recommendation or sale of an annuity, to provide a disclosure to the consumer on a form prescribed by the commissioner of insurance by rule. The bill requires that the form be substantially similar to a specified form adopted by the National Association of Insurance Commissioners (NAIC) and include the following:

- a description of the scope and terms of the agent's relationship with the consumer and role in the transaction;
- an affirmative statement on whether the agent is licensed and authorized to sell certain specified products;
- a statement describing the number of insurers for whom the agent is authorized, contracted or appointed, or otherwise able to sell insurance products;

- a description of the sources and types of cash compensation and noncash compensation to be received by the agent; and
- a notice of the consumer's right to request additional information regarding cash compensation.

The bill requires an agent, on request of the consumer or the consumer's designated representative, to disclose a reasonable estimate of the amount of cash compensation to be received by the agent, which may be stated as a range of amounts or percentages, and whether the cash compensation is a one-time or multiple occurrence amount. If the cash compensation is a multiple occurrence amount, the agent must disclose the frequency and amount of occurrence, which may be stated as a range of amounts or percentages.

C.S.H.B. 1777 requires that an agent have a reasonable basis to believe the consumer has been informed of the features of an annuity prior to or at the time of the recommendation or sale of the annuity, including certain features specified by the bill.

#### *Agent's Conflict of Interest Obligation*

C.S.H.B. 1777 requires an agent to take reasonable steps to discover a material conflict of interest, including a material conflict of interest related to an ownership interest, and requires the agent to identify and avoid a material conflict of interest or reasonably manage and disclose the conflict. The bill specifies what constitutes a material conflict of interest.

#### *Agent's Documentation Obligation*

C.S.H.B. 1777 requires an agent, at the time of the recommendation or sale of an annuity, to do the following:

- make a written record of the recommendation and the basis for the recommendation;
- if applicable, obtain a statement signed by the commissioner on a form prescribed by the commissioner by rule, which must be substantially similar to a related NAIC form, documenting a consumer's refusal to provide consumer profile information and a consumer's understanding of the ramifications of failing to provide that information or providing insufficient information; and
- if a consumer decides to enter into an annuity transaction that is not based on the agent's recommendation, obtain a statement signed by the consumer on a form prescribed by the commissioner by rule, which must be substantially similar to a related NAIC form, acknowledging that the annuity transaction is not recommended.

#### *Agent's Best-Interest Obligation*

C.S.H.B. 1777 requires an agent making a recommendation of an annuity to act in the consumer's best interest under the circumstances known to the agent at the time the recommendation is made, without placing the agent's or the insurer's financial interest ahead of the consumer's interest. An agent is presumed to act in the consumer's best interest if the agent satisfies the care, disclosure, conflict of interest, and documentation obligations.

#### *Insurer Obligations*

C.S.H.B. 1777 establishes that an insurer's issuance of an annuity must be reasonable under the circumstances known to the insurer at the time the annuity is issued. If there is no agent involved in an annuity transaction, the obligations established for an agent apply to the insurer that recommends or sells the annuity in the same way those obligations would apply to an agent.

### **Supervision System**

C.S.H.B. 1777 prohibits an insurer from issuing an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity would effectively address the consumer's

financial situation, insurance needs, and financial objectives based on their consumer profile information, except in circumstances where an agent is exempted from their obligation of care. The bill makes it mandatory for an insurer to establish and maintain a supervision system that is reasonably designed to achieve the insurer's and the insurer's agent's compliance with statutory provisions governing the suitability of annuity transactions. The bill retains and revises the existing minimum requirements of such a system and adds certain new requirements, including a requirement to establish and maintain reasonable procedures to identify and eliminate sales contests, sales quotas, bonuses, or noncash compensation that are based on the sale of specific annuities within a limited period of time. That requirement expressly does not prohibit the receipt by employees of health insurance, office rent, office support, retirement benefits, or other employee benefits so long as those benefits are not based on the volume of sales of a specific annuity within a limited period of time.

C.S.H.B. 1777 establishes that an insurer is not required to include in the supervision system consideration of or comparison to options available to the agent or compensation relating to those options other than annuities or other products offered by the insurer.

C.S.H.B. 1777 establishes that an insurer is responsible for taking appropriate corrective action and may be subject to sanctions and penalties regardless of whether the insurer contracts for performance of a function related to its supervision system and regardless of whether the insurer complies with contractual performance supervision standards.

### **Prohibited Practices**

C.S.H.B. 1777 prohibits an agent or insurer from dissuading or attempting to dissuade a consumer from truthfully responding to the insurer's request for confirmation of consumer profile information, filing a complaint, or cooperating with the investigation of a complaint. The bill repeals a similar prohibition applicable only to an agent.

### **Safe Harbor**

C.S.H.B. 1777 establishes that recommendations and sales of annuities made in compliance with comparable standards satisfy statutory requirements for the suitability of an annuity transaction. These safe harbor provisions apply to recommendations and sales of annuities made by a financial professional, as defined by the bill, in compliance with business rules, controls, and procedures that satisfy a comparable standard even if such standard would not otherwise apply to the product or recommendation at issue.

C.S.H.B. 1777 establishes that the above provisions regarding safe harbor apply only if the insurer does the following:

- using information collected in the normal course of the insurer's business, monitors the relevant conduct of the financial professional or the entity responsible for supervising the financial professional, such as the financial professional's broker-dealer or an investment adviser registered under federal or state securities laws; and
- provides to the supervising entity information and reports that are reasonably appropriate to assist the entity in maintaining its supervision system.

C.S.H.B. 1777 establishes what constitutes a qualifying comparable standard. These safe harbor provisions expressly do not limit the insurer's obligation to comply with the prohibition against issuing an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity would effectively address the consumer's financial situation, insurance needs, and financial objectives based on their consumer profile information, although the insurer may base its analysis on information received from either the financial professional or the entity supervising the financial professional.

### **Recordkeeping Requirements**

C.S.H.B. 1777 extends the applicability of existing recordkeeping requirements for agents, independent agencies, and insurers to general agents and revises those requirements so as to require each applicable entity to be able to make available to the commissioner disclosures made to the consumer, including summaries of oral disclosures.

### **Agent Training Requirements**

C.S.H.B. 1777 requires that the one-time training course for agents who engage in the sale of annuity products be four credits. The bill revises the required content of the course and establishes that a course that is substantially similar to such a course satisfies the training requirement.

C.S.H.B. 1777 requires the Texas Department of Insurance (TDI) to approve a compliant training course not later than December 1, 2021. The bill's training course changes apply only with respect to the sale of an annuity on or after January 1, 2022, and the bill establishes that an agent who has completed a training course before that date may comply with the bill's revised training requirements by completing either a new four-credit training course approved by TDI or an additional one-time one-credit training course approved by TDI and provided by a continuing education provider on appropriate sales practices, replacement, and disclosure requirements.

### **Mitigation**

C.S.H.B. 1777 clarifies the commissioner's authority to issue orders to mitigate a violation of provisions governing the suitability of annuity transactions.

### **Repealers**

C.S.H.B. 1777 repeals the following provisions of the Insurance Code:

- Section 1115.002(6);
- Sections 1115.051(c), (d), (e), and (f); and
- Section 1115.052(e).

### **EFFECTIVE DATE**

September 1, 2021.

### **COMPARISON OF ORIGINAL AND SUBSTITUTE**

While C.S.H.B. 1777 may differ from the original in minor or nonsubstantive ways, the following summarizes the substantial differences between the introduced and committee substitute versions of the bill.

The substitute includes a provision decreasing the minimum permissible interest rate in determining nonforfeiture amounts from one percent to 0.15 percent for contracts delivered, issued for delivery, or renewed on or after January 1, 2022.

The substitute makes certain changes to the revised provisions governing annuity transactions, including changes that do the following:

- prohibit the provisions from being construed to subject an agent or insurer to civil liability for certain violations;
- specify that an agent must take steps to discover a material conflict of interest related to an ownership interest;

- specify that the sales contests and sales quotas that an insurer is required to identify and eliminate under the supervision system are those that are based on the sale of specific annuities within a limited period of time; and
- replace the requirement for the training course to include information on how fixed, variable, and indexed annuity contract provisions affect consumers with a requirement for that course to include information on how product-specific annuity features affect consumers.

The substitute does not include a provision authorizing the commissioner of insurance by rule to adopt disclosure requirements for an agent in addition to those established by the bill.