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BILL ANALYSIS

BILL NUMBER:	House Bill 4627 (H-1)
TOPIC:	Suitability Standards for the Sale of Annuity Products
SPONSOR:	Rep. Bob Constan
CO-SPONSORS:	Rep. Polidori, Clemente, and Kandrevas
COMMITTEE:	Committee on Senior Health, Security, and Retirement
Analysis Done:	June 14, 2010

POSITION

The Office of Financial and Insurance Regulation (OFIR) supports this legislation.

PROBLEM/BACKGROUND

Between January 1, 2007 and December 31, 2009, OFIR received 435 consumer complaints involving annuities. Of these, 348 (or 80%) were based on the marketing and sales of annuity products. These complaint statistics highlight the need for suitability standards and enhanced disclosures associated with marketing and sale of these complex financial instruments.

DESCRIPTION OF BILL

House Bill 4627 amends sections 4151, 4153, 4155, and 4165 of chapter 41A of the Michigan Insurance Code; adds new sections 4158, 4159, 4160, 4161 and 4162 to chapter 41A and adds chapter 41B. The legislation requires an insurer or producer, as applicable, to apply suitability standards prior to and during the sale of annuity contracts. Under the new chapter, 41B, certain disclosures are required to be made to the purchaser of an annuity contract.

Section 4151 revises the definition of annuity to include only those contracts that are considered an insurance product under state law. It provides a definition for a "replacement" transaction involving an annuity, as well as what is meant by "suitability information."

Section 4153 adds replacement transactions of annuity contracts to the existing language which was formerly applicable only to the purchase or exchange of annuities.

Section 4155 is being amended to include the replacement of an annuity as well as provides the following requirements relative to the use of suitability information to be considered in recommending the purchase of an annuity:

- The consumer has been reasonably informed of various features of the annuity, including; surrender periods, surrender charges, potential tax consequences of certain actions, exchanges, annuitizing, fees, charges, limitations, and market risks.
- The benefit to the consumer from certain features of the annuity.
- The annuity as a whole, including allocation of funds, product enhancements, subjective suitability information.
- For an exchange or replacement of an annuity, whether the transaction is suitable for the consumer based on whether the consumer will incur a surrender charge, be subject to a new surrender period, lose existing benefits, or be subject to increased fees or charges. The consumer must be informed of whether product enhancements would be suitable for them. Whether the consumer has had another annuity exchange or replacement within the preceding 36 months must also be taken into consideration for the suitability determination.

Section 4155 also requires a producer or insurer where no producer is involved in the annuity sale to have a reasonable basis to believe that the annuity is suitable based on information provided by the consumer. Furthermore, it provides that the issuance of the annuity be reasonable under all circumstances actually known to the insurer at the time the annuity is issued. If any of the following circumstances exists, neither the producer nor the insurer shall have any obligation to a consumer relative to suitability:

- No recommendation is made.
- The recommendation was based on materially inaccurate information provided by the consumer.
- The consumer refuses to provide relevant suitability information and the annuity transaction is not recommended.
- The consumer decides to enter into an annuity transaction that is not based on the producer or insurer's recommendation.

Finally, section 4155 requires the producer or insurer if no producer is involved in the transaction to do the following: make a record of any recommendation for the sale, exchange, or replacement of an annuity; obtain a signed statement from the consumer that the consumer refused to provide suitability information; and, obtain a signed statement from the consumer that an annuity transaction is not recommended if a consumer decides to enter into an annuity transaction that is not based on the producer or insurer's recommendation.

Section 4158(1)(A) through (F) requires an insurer to establish a system of supervision to ensure compliance with the chapter. The supervisory tasks include: maintaining reasonable procedures to assure compliance and to incorporate the requirements into relevant producer training manuals; establish standards for producer product training and training materials; maintain procedures for review of each recommendation prior to the issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable; maintain reasonable procedures to detect recommendations that are not suitable; annual reports to senior management evaluating the effectiveness of the supervision system, with details of the review, testing, exceptions found, and corrective action taken.

Subsection 4158 permits an insurer to contract the system of supervision to a third party contractor. It requires the insurer to supervise the contractual performance if a third party contractor is providing the supervision of compliance. The supervisory system, whether directly by the insurer or provided through contract is only required when an annuity has been offered to the consumer by the insurer or the insurer's producer.

Section 4159 prohibits a producer from dissuading a consumer from truthfully responding to an insurer's request for confirmation of suitability information, filing a complaint, or cooperating with the investigation of a complaint.

Section 4160 ensures that the producer selling the annuity product has adequate knowledge of the product, including having had a 1-time, 4-credit training course approved by the Commissioner. The training course must include information on: the types and classifications of annuities; identification of the parties to an annuity; how fixed, variable, and indexed annuity contract provisions affect consumers; the tax implications of annuities; the primary uses of annuities; and the appropriate sales practices and replacement and disclosure requirements. The course may not include any marketing or sales training techniques. The producer may not engage in the sale of annuities until the annuity training course has been completed. The satisfaction of the training requirements of another state that are substantially similar to the requirements in section 4160 satisfies the Michigan requirements. The insurer must verify that the necessary training has been completed by its producer.

Under section 4161, the consumer must be given a copy of the annuity contract at the time the annuity is accepted and issued.

Section 4162 provides the consumer with the right to cancel an annuity within 15 days after its delivery and to have the entire premium refunded if the consumer is not satisfied for any reason. The notice of the right to cancel the contract must be prominently printed in not less than 14 point type on the first page of the contract and on the summary of coverage page. The consumer must also be provided with a separate notice entitled "Right to Cancel."

Section 4165 addresses the regulatory authority over annuities and the cooperative regulation under other laws, both federal and state, governing the business of annuities.

Chapter 41B entitled Annuity Disclosures has been added to HB 4627. This chapter includes definitions of terms that are commonly used under annuity contracts and outlines annuities that are not subject to the chapter.

Chapter 41B requires that, at the time of a face-to-face application for an annuity, the applicant must be given a disclosure document as well as a buyer's guide. If the application has been received through direct response solicitation, the disclosure document and the buyers guide must be provided no later than five business days after the receipt of the application. If the application is received through an Internet solicitation, the disclosure document and the buyers guide must be available through the insurer's website. All solicitations, other than face-to-face encounters, must include a statement that the proposed applicant may contact OFIR or the insurer for a free annuity buyer's guide.

The required disclosure document must include terms that facilitate the understanding of an annuity by a typical person within the segment of the public to which the document is directed and must include the following elements:

- The generic name of the contract.
- The insurer's name and address.
- A description of the contract and its benefits, emphasizing its long-term nature, including guaranteed, nonguaranteed, and determinable elements of the contracts, and their limitations, and how these elements operate; an explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate, and the fact that rates may change from time to time and are not guaranteed; periodic income options on a guaranteed and nonguaranteed basis; any value reductions caused by withdrawals; how values in the contract can be accessed; the death benefit, if available, and how it will be calculated; a summary of the federal tax status and any penalties applicable on withdrawal of values from the contract; the impact of any rider, such as a long term care rider.
- Specific dollar amount or percentage charges and fees with an explanation of how they apply.
- Information about the current guaranteed rate for new contracts and how that rate is subject to change.

The new chapter requires the Commissioner to prepare and publish a buyer's guide to annuities. The Guide must be written in plain English and must explain what an annuity is, as well as identify the different kinds of annuities.

Finally, Chapter 41B requires an insurer to provide each contract owner, who is in a payout period that have changes in the nonguaranteed elements for the accumulation period of a deferred annuity, an annual report with at the following information:

- The beginning and end date of the current report period.
- The accumulation and cash surrender value, if any, at the end of the previous report period and at the end of the current report period.
- The total amounts, if any, that have been credited, charged to the contract value, or paid during the current report period.
- The amount of outstanding loans, if any, as of the end of the current report period.

SUMMARY OF ARGUMENTS

Pro

The bills provide a variety of necessary consumer protections for Michigan residents, and these protections would apply to all Michigan residents, not just senior citizens.

Extending the right to cancel the annuity contract from 10 days to 15 days is a valuable consumer protection. Having the consumer sign a form acknowledging receipt of the right to cancel notice will provide protection for the consumer and the producer involved in the annuity sale. In addition to the signed notice of the right to cancel, OFIR would like to see a requirement for a signed proof that the policy was received since consumers often complain that the contract was never received.

Con

While this legislation requires the Commissioner to annually prepare and publish a consumer guide on annuities, the National Association of Insurance Commissioners (NAIC) currently publishes such a guide. OFIR recommends that section 4158 be amended to require OFIR to provide, but not to create, a consumer guide on annuities.

FISCAL/ECONOMIC IMPACT

OFIR has identified the following revenue or budgetary implications in this bill:

(a) To the Office of Financial and Insurance Regulation:

Budgetary: Developing, printing, and distributing the consumer buyer's guide will have a budgetary impact on the agency. The costs are unknown at this time.

Revenue:

Comments:

(b) To the Department of Energy, Labor & Economic Growth: None Known

Budgetary:

Revenue:

Comments:

(c) To the State of Michigan: None Known

Budgetary:

Revenue:

Comments:

(d) To Local Governments within this State: None Known

Comments:

OTHER STATE DEPARTMENTS

None

ANY OTHER PERTINENT INFORMATION

Similar legislation was introduced in House Bill 6523 during the 2007-2008 legislative session.

Section 4157 of the Insurance Code is being repealed.

This legislation, with slight changes, would provide critical consumer protections in connection with the sale of annuity products. OFIR suggests that Administrative Rules be promulgated for variable annuities, similar to those promulgated for variable life contracts in Administrative Rules 500.841 – 500.866.

Section 500.4073 currently requires insurers to provide consumers with a 10 day right to cancel and will have to be amended to be consistent with the 30 day requirement proposed in section 4159.

The legislation tracks closely with the April 2010 NAIC "Suitability in Annuity Transactions" Model Regulation. However, HB 4627(H-1) does not include compliance language that is in the Model. To date, the majority of states have not adopted the 2010 version of the Model.

The amendatory act takes effect 9 months after the date it is enacted into law.

KR

Ken Ross
Commissioner

6/15/10

Date