Assembly Bill No. 689

CHAPTER 295

An act to add Article 9 (commencing with Section 10509.910) to Chapter 5 of Part 2 of Division 2 of the Insurance Code, relating to annuity transactions.

[Approved by Governor September 20, 2011. Filed with Secretary of State September 21, 2011.]

LEGISLATIVE COUNSEL'S DIGEST

AB 689, Blumenfield. Insurance: annuity transactions.

Existing law requires agents and insurers to fulfill certain requirements with regard to the replacement of existing life insurance policies and annuities.

This bill would require insurers and insurance producers, as defined, to comply with specified requirements regarding the purchase, exchange, or replacement of an annuity recommended to a consumer, including, but not limited to, having reasonable grounds for the insurance producer believing the annuity transaction would be suitable for the consumer, as provided. The bill would also prohibit an insurance producer from selling annuities unless he or she has received Insurance Commissioner-approved training, and would authorize the commissioner to require certain actions by, and impose sanctions and penalties on, insurers and their agents for a violation of the bill's provisions.

The bill would further provide that sales by a Financial Industry Regulatory Authority (FINRA) broker-dealer that comply with the suitability and supervision requirements of FINRA shall be deemed to satisfy the suitability and supervision requirements of this bill, as specified.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares all of the following:

(a) The Legislature recognizes that annuities are complex, long-term financial insurance products designed to provide payments to the consumer at specified intervals, usually after retirement.

(b) The Legislature also recognizes that seniors and other California consumers who seek to safeguard funds for retirement and other purposes may be targeted for the sale of unsuitable annuities, resulting in their purchasing annuities that are unsuitable for their financial goals and circumstances, without understanding the complex provisions of the annuities that they purchased.

(c) The Legislature further finds that as a result of purchasing unsuitable annuities without understanding their complex provisions, a consumer who has circumstances arise that require him or her to withdraw funds from the annuity may find himself or herself unable to withdraw significant funds from the annuity without paying expensive charges, large surrender penalties, and the forfeiture of income and other benefits of the insurance, thus making the consumer more dependent on the advice, skill, and training of his or her insurance producer and insurer, hence the concern to strengthen annuity suitability requirements in California.

(d) The Legislature recognizes that President Obama signed the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203), a historic and comprehensive financial regulatory reform bill, which in Section 989J promotes the adoption of laws and regulations based on the National Association of Insurance Commissioners' (NAIC) "Suitability in Annuity Transactions" Model that governs suitability requirements in the sale of annuities in order to preserve the authority for state insurance regulators to oversee the sales practices of these products.

(e) The Legislature further recognizes that the NAIC "Suitability in Annuity Transactions" Model establishes a regulatory framework that requires insurers to establish a system to supervise recommendations so that the insurance needs and financial objectives of consumers are appropriately addressed and that holds insurers responsible for ensuring that annuity transactions are suitable, whether or not the insurer contracts with a third party to supervise or monitor the recommendations made in the marketing and sale of annuities.

(f) The Legislature further recognizes that preservation of the current exemption from federal regulation of fixed annuities is beneficial to both consumers and the insurance businesses of this state.

SEC. 2. Article 9 (commencing with Section 10509.910) is added to Chapter 5 of Part 2 of Division 2 of the Insurance Code, to read:

Article 9. Suitability Requirements for Annuity Transactions

10509.910. The purpose of this article is to require insurers to establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers that result in transactions involving annuity products, so that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed.

10509.911. (a) This article shall apply to any recommendation to purchase, exchange, or replace an annuity made to a consumer that results in the purchase, exchange, or replacement that was recommended.

(b) Nothing in this act shall be interpreted to preclude, preempt, or otherwise interfere with the application of any other laws of this state that may apply in any matter involving the sale of an annuity that is subject to this article.

10509.912. Unless otherwise specifically included, this article shall not apply to transactions involving any of the following:

(a) Direct response solicitations where there is no recommendation based on information collected from the consumer pursuant to this article.

(b) Contracts used to fund any of the following:

(1) An employee pension or welfare benefit plan that is covered by the federal Employee Retirement and Income Security Act (ERISA) (29 U.S.C. Sec. 1001 et seq.).

(2) A plan described by Section 401(a), 401(k), 403(b), 408(k), or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer.

(3) A government or church plan defined in Section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax-exempt organization under Section 457 of the IRC.

(4) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

(5) Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process.

(6) Formal prepaid funeral contracts.

10509.913. (a) "Annuity" means an annuity that is an insurance product under California law that is individually solicited, whether the product is classified as an individual or group annuity.

(b) "Commissioner" means the Insurance Commissioner.

(c) "Continuing education credit" or "CE credit" means one continuing education credit hour as defined in Section 2188.2(i) of Title 10 of the California Code of Regulations.

(d) "Continuing education provider" or "CE provider" means an individual or entity that is certified to offer continuing education courses pursuant to Section 2186.1(b) and Section 2188 of Title 10 of the California Code of Regulations.

(e) "Insurance producer" means a person required to be licensed under California law to sell, solicit, or negotiate insurance, including annuities. An insurance producer is also referred to in this article as a "producer."

(f) "Insurer" means a company required to be licensed or to hold a certificate of authority, or both, under California law to provide insurance products, including annuities.

(g) "Recommendation" means advice or guidance provided or made, by an insurance producer or by an insurer, to an individual consumer that results in a purchase, exchange, or replacement of an annuity in accordance with that advice or guidance.

(h) "Replacement" means a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer, whether or not there is a producer, that by reason of the transaction, an existing policy or contract has been or is to be any of the following:

(1) Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer, or otherwise terminated.

(2) Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values.

(3) Amended so as to effect either a reduction in benefits or a reduction in the term for which coverage would otherwise remain in force or for which benefits would be paid.

(4) Reissued with any reduction in cash value.

(5) Used in a financed purchase.

(i) "Suitability information" means information that is reasonably appropriate to determine the suitability of a recommendation, including all of the following:

(1) Age.

(2) Annual income.

(3) Financial situation and needs, including the financial resources used for the funding of the annuity.

(4) Financial experience.

(5) Financial objectives.

(6) Intended use of the annuity.

(7) Financial time horizon.

(8) Existing assets, including investment and life insurance holdings.

(9) Liquidity needs.

(10) Liquid net worth.

(11) Risk tolerance.

(12) Tax status.

(13) Whether or not the consumer has a reverse mortgage.

10509.914. (a) 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, the insurance producer, or an insurer if no producer is involved, shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to his or her investments and other insurance products and as to his or her financial situation and needs, including the consumer's suitability information, and that there is a reasonable basis to believe all of the following:

(1) The consumer has been reasonably informed of various features of the annuity, such as the potential surrender period and surrender charge, 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.

(2) The consumer would receive a tangible net benefit from the transaction.

(3) The particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of purchase or exchange of the annuity, and riders and similar product enhancements, if any, are suitable, and in the

case of an exchange or replacement, the transaction as a whole is suitable, for the particular consumer based on his or her suitability information.

(4) In the case of an exchange or replacement of an annuity, the exchange or replacement is suitable, including taking into consideration all of the following:

(A) 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 and similar product enhancements.

(B) Whether the consumer would benefit from product enhancements and improvements.

(C) Whether the consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 60 months.

(b) Prior to the execution of a purchase, exchange, or replacement of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain the consumer's suitability information.

(c) Except as permitted under subdivision (d), an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information. The preceding sentence and subdivision (d) notwithstanding, neither a producer nor an insurer shall in any event recommend to a person 65 years of age or older the sale of an annuity to replace an existing annuity that requires the insured to pay a surrender charge for the annuity that is being replaced, where purchase of the annuity does not confer a substantial financial benefit over the life of the policy to the consumer, so that a reasonable person would believe the purchase is unnecessary.

(d) (1) Except as provided under paragraph (2), neither an insurance producer nor an insurer shall have any obligation to a consumer under subdivision (a) or (c) related to an annuity transaction if any of the following occur:

(A) No recommendation is made.

(B) A recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer.

(C) A consumer refuses to provide relevant suitability information and the annuity transaction is not recommended.

(D) A consumer decides to enter into an annuity transaction that is not based on a recommendation of the insurer or the insurance producer.

(2) An insurer's issuance of an annuity subject to paragraph (1) shall be reasonable under all the circumstances which are actually known, or which after reasonable inquiry should be known, to the insurer or the insurance producer at the time the annuity is issued.

(e) An insurance producer or, where no insurance producer is involved, the responsible insurer representative, shall at the time of sale do all of the following:

(1) Make a record of any recommendation subject to subdivision (a).

(2) Obtain a customer-signed statement documenting the customer's refusal to provide suitability information, if any.

(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 insurance producer's or insurer's recommendation.

(f) (1) An insurer shall establish a supervision system that is reasonably designed to achieve the insurer's and its insurance producers' compliance with this article, including, but not limited to, all of the following:

(A) The insurer shall maintain reasonable procedures to inform its insurance producers of the requirements of this article and shall incorporate the requirements of this article into relevant insurance producer training manuals.

(B) The insurer shall establish standards for insurance producer product training and shall maintain reasonable procedures to require its insurance producers to comply with the requirements of Section 10509.915.

(C) The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its insurance producers.

(D) The insurer shall maintain procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable. The review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means, including, but not limited to, physical review. An electronic or other system may be designed to require additional review only of those transactions identified for additional review by the selection criteria.

(E) The insurer shall maintain reasonable procedures to detect recommendations that are not suitable. This may include, but is not limited to, confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters, and programs of internal monitoring. Nothing in this subparagraph prevents an insurer from complying with this subparagraph by applying sampling procedures or by confirming suitability information after issuance or delivery of the annuity.

(F) The insurer shall annually provide a report to its senior management, including to the senior manager responsible for audit functions, which details a review, with appropriate testing, reasonably designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken or recommended, if any.

(2) (A) Nothing in this subdivision restricts an insurer from contracting for performance of a function, including maintenance of procedures, required under paragraph (1). An insurer is responsible for taking appropriate

corrective action, and may be subject to sanctions and penalties pursuant to Section 10509.916 regardless of whether the insurer contracts for performance of a function and regardless of the insurer's compliance with subparagraph (B). An insurer is responsible for the compliance of its insurance producer with the provisions of this article regardless of whether the insurer contracts for performance of a function required under this subdivision and regardless of the insurer's compliance with subparagraph (B).

(B) An insurer's supervision system under paragraph (1) shall include reasonable supervision of contractual performance under this subdivision. This includes, but is not limited to, both of the following:

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

(ii) Annually obtaining a certification from a senior manager who has responsibility for the contracted function that the manager has a reasonable basis to represent, and does represent, that the function is properly performed.

(3) An insurer is not required to include in its system of supervision an insurance producer's recommendations to consumers of products other than the annuities offered by the insurer.

(g) An insurance producer or insurer shall not dissuade, or attempt to dissuade, a consumer from any of the following:

(1) Truthfully responding to an insurer's request for confirmation of suitability information.

(2) Filing a complaint.

(3) Cooperating with the investigation of a complaint.

(h) (1) This subdivision applies to FINRA broker-dealer sales of variable and fixed annuities.

(2) Sales by FINRA broker-dealers that comply with the suitability and supervision system requirements set forth in FINRA Rule 2330, or any successor rule, shall satisfy the suitability and supervision system requirements of this article, provided that the suitability criteria used also include both of the following:

(A) The consumer's income.

(B) The intended use of the annuity.

(3) Except as provided in paragraphs (1) and (2), all other provisions of this article remain applicable to these broker-dealer sales.

(4) Nothing in this subdivision shall limit the commissioner's ability to enforce, including conducting investigations related to, the provisions of this article.

(5) "FINRA" means the Financial Industry Regulatory Authority or a successor agency.

10509.915. (a) An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has adequate knowledge of the product to recommend the annuity and the insurance producer is in compliance with the insurer's standards for product training. An insurance producer may rely on insurer-provided product-specific training standards and materials to comply with this subdivision.

(b) (1) An insurance producer who is otherwise entitled to engage in the sale of annuity products shall complete a one-time eight credit-hour annuity training course approved by the commissioner and provided by a commissioner-approved education provider, prior to commencing the transaction of annuities, pursuant to subdivision (a) of Section 1749.8.

(2) In addition to the requirement set forth in paragraph (1), every producer who engages in this state in the sale of annuity products shall satisfactorily complete four continuing education credits prior to license renewal every two years, pursuant to subdivision (b) of Section 1749.8.

(3) The training required under this subdivision shall include information on all of the following topics:

(A) The types of annuities and various classifications of annuities.

(B) Identification of the parties to an annuity.

(C) How fixed, variable, and indexed annuity contract provisions affect consumers.

(D) The application of income taxation of qualified and nonqualified annuities.

(E) The primary uses of annuities.

(F) Prohibited sales practices, the recognition of indicators that a prospective insured may lack the short-term memory or judgment to knowingly purchase an insurance product, and fraudulent and unfair trade practices, as well as replacement and disclosure requirements for sales of annuities, all as provided under California law, including, but not limited to, this article.

(4) Providers of courses intended to comply with this section shall cover all topics listed in the prescribed outline and shall not present any marketing information or provide training on sales techniques or provide specific information about a particular insurer's products. Additional topics may be offered in conjunction with and in addition to the required outline.

(5) A provider of an annuity training course intended to comply with this section shall register as a CE provider in this state and comply with the rules and guidelines applicable to insurance producer continuing education courses as set forth in Section 1749.8, in subdivisions (d) and (e) of Section 1749.1, and in Sections 2188, 2188.1, 2188.2, 2188.3, 2188.4, 2188.6, 2188.7, 2188.8, 2188.50, and 2188.9 of Title 10 of the California Code of Regulations.

(6) Annuity training courses may be conducted and completed by classroom or self-study methods in accordance with Sections 2188.2 and 2188.3 of Title 10 of the California Code of Regulations.

(7) Providers of annuity training shall comply with the reporting requirements and shall issue certificates of completion in accordance with Section 2188.8 of Title 10 of the California Code of Regulations.

(8) An insurer shall verify that an insurance producer has completed the annuity training required under this section before allowing the producer to sell an annuity product for that insurer. An insurer may satisfy its responsibility under this paragraph by obtaining certificates of completion of the training course or obtaining reports provided by

commissioner-sponsored database systems or vendors or from a reasonably reliable commercial database vendor that has a reporting arrangement with approved insurance education providers.

10509.916. (a) An insurer is responsible for compliance with this article. If a violation occurs, either because of the action or inaction of the insurer or its insurance producer, the commissioner may, in addition to any other available penalties, remedies, or administrative actions, order any or all of the following:

(1) An insurer to take reasonably appropriate corrective action for any consumer harmed by the insurer's, or by its insurance producer's, violation of this article.

(2) A managing general agent or an insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this article.

(3) Penalties and sanctions pursuant to Section 10509.9. For purposes of Section 10509.9, this article shall be deemed to be part of Article 8 (commencing with Section 10509), and the commissioner may in a single enforcement action seek penalties for a first and a second or subsequent violation.

(b) Nothing in this article shall affect any obligation of an insurer for acts of its agents, or any consumer remedy or cause of action that is otherwise provided for.

10509.917. (a) Insurers and insurance producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer and other information used in making the recommendations that were the basis for insurance transactions for five years after the insurance transaction is completed by the insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

(b) Records required to be maintained by this article may be maintained in paper, photographic, microprocess, magnetic, mechanical, or electronic media, or by any process that accurately reproduces the actual document.

10509.918. The commissioner shall, from time to time as conditions warrant, after notice and hearing, adopt reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article. The commissioner may adopt regulations not inconsistent with this article pursuant to Section 989J of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203).

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