

AMENDED IN SENATE APRIL 25, 2011

AMENDED IN SENATE APRIL 4, 2011

SENATE BILL

No. 715

**Introduced by Senator Calderon
(Coauthors: Senators Anderson, Correa, Gaines, and Wyland)**

February 18, 2011

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.

LEGISLATIVE COUNSEL'S DIGEST

SB 715, as amended, Calderon. 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 system requirements of FINRA shall be

deemed to satisfy the suitability and supervision system requirements of this bill, as specified.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

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

1 SECTION 1. Article 9 (commencing with Section 10509.910)
2 is added to Chapter 5 of Part 2 of Division 2 of the Insurance Code,
3 to read:

4
5 Article 9. Suitability Requirements for Annuity Transactions
6

7 10509.910. The Legislature finds and declares all of the
8 following:

9 (a) The Legislature finds and declares that in 2010 the National
10 Association of Insurance Commissioners (NAIC) adopted a
11 significantly revised Suitability in Annuity Transactions Model
12 Regulation.

13 (b) The Legislature also finds that the revised Suitability in
14 Annuity Transactions Model was adopted by the NAIC to set
15 standards and procedures for suitable annuity recommendations
16 and to require insurers to establish a system to supervise
17 recommendations so that the insurance needs and financial
18 objectives of consumers are appropriately addressed.

19 (c) The Legislature finds that the revised NAIC Suitability in
20 Annuity Transactions Model establishes a regulatory framework
21 that holds insurers responsible for ensuring that annuity transactions
22 are suitable, whether or not the insurer contracts with a third party
23 to supervise or monitor the recommendations made in the
24 marketing and sale of annuities.

25 (d) The Legislature also finds that the 2010 revisions to the
26 NAIC Suitability in Annuity Transactions Model require that
27 producers be trained on the provisions of annuities in general, and
28 the specific products they are selling.

29 (e) The Legislature finds that the adoption last year of the
30 Dodd-Frank Wall Street Reform and Consumer Protection Act
31 (Public Law 111-203) provides, under Title IX, Subtitle I, Section
32 989A, relating to senior investment protections, that a state's
33 adherence to *at least the minimum requirements of the NAIC's*

Suitability in Annuity Transactions Model is ~~required~~ *a required element* for a state or other eligible entities to participate in a program of grants to support enhanced protections of seniors against misleading marketing practices.

(f) Finally, the Legislature finds that adoption in this state of *at least the minimum requirements of* the NAIC Suitability in Annuity Transactions Model affects California's continued jurisdiction over indexed securities under Title IX, Subtitle I, Section 989J of the Dodd-Frank Act.

10509.911. 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.

10509.912. (a) This article shall apply to any recommendation to purchase, exchange, or replace an annuity made to a consumer ~~by an insurance producer, or an insurer where no insurance producer is involved~~, 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.*

10509.913. 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 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, if established or maintained by an employer.

(3) A government or church plan defined in Section 414 of the Internal Revenue Code, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government

1 or tax exempt organization under Section 457 of the Internal
2 Revenue Code.

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

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

7 (6) Formal prepaid funeral contracts.

8 10509.914. For the purposes of this article, the following terms
9 have the following definitions:

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

13 (b) "Commissioner" means the Insurance Commissioner.

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

17 (d) "Continuing education provider" or "CE provider" means
18 an individual or entity that is certified to offer continuing education
19 courses pursuant to Section 2186.1(b) and Section 2188 of Title
20 10 of the California Code of Regulations.

21 (e) "FINRA" means the Financial Industry Regulatory Authority
22 or a succeeding agency.

23 (f) "Insurance producer" means a person required to be licensed
24 under ~~the laws of this state~~ *California law* to sell, solicit, or
25 negotiate insurance, including annuities.

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

29 (h) "Recommendation" means ~~advice provided or other~~
30 ~~communication provided or made~~ by an insurance producer, ~~or an~~
31 ~~insurer where no insurance producer is involved, or by an insurer~~
32 to an individual consumer that results in a purchase, exchange, or
33 replacement of an annuity in accordance with that advice *or*
34 *communication*.

35 (i) "Replacement" has the same definition as in Section 10509.2,
36 *except that for the purposes of this section, the term "surrendered,"*
37 *as used in Section 10509.2, shall include partial surrenders.*

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

- 1 (1) Age.
- 2 (2) Annual income.
- 3 (3) Financial situation and needs, including the financial
- 4 resources used for the funding of the annuity.
- 5 (4) Financial experience.
- 6 (5) Financial objectives.
- 7 (6) Intended use of the annuity.
- 8 (7) Financial time horizon.
- 9 (8) Existing assets, including investment and life insurance
- 10 holdings.
- 11 (9) Liquidity needs.
- 12 (10) Liquid net worth.
- 13 (11) Risk tolerance.
- 14 (12) Tax status.
- 15 (13) *Whether or not the consumer has a reverse mortgage.*

16 10509.915. (a) In recommending to a consumer the purchase
17 of an annuity or the exchange of an annuity that results in another
18 insurance transaction or series of insurance transactions, the
19 insurance producer, ~~or the insurer where no insurance producer is~~
20 ~~involved~~, and the insurer shall have reasonable grounds for
21 believing that the recommendation is suitable for the consumer on
22 the basis of the facts disclosed by the consumer as to his or her
23 investments and other insurance products and as to his or her
24 financial situation and needs, including the consumer's suitability
25 information, and that there is a reasonable basis to believe all of
26 the following:

27 (1) The consumer has been reasonably informed of various
28 features of the annuity, such as the potential surrender period and
29 surrender charge, potential tax penalty if the consumer sells,
30 exchanges, surrenders, or annuitizes the annuity, mortality and
31 expense fees, investment advisory fees, potential charges for and
32 features of riders, limitations on interest returns, insurance and
33 investment components, and market risk.

34 (2) The consumer would ~~benefit from certain features of the~~
35 ~~annuity, such as tax-deferred growth, annuitization, or death or~~
36 ~~living benefit.~~ *receive a tangible net benefit from the transaction.*

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

1 or replacement, the transaction as a whole is suitable, for the
2 particular consumer, based on his or her suitability information.

3 (4) In the case of an exchange or replacement of an annuity, the
4 exchange or replacement is suitable, including taking into
5 consideration ~~whether any of the following are applicable~~ *all of*
6 *the following*:

7 (A) The consumer will incur a surrender charge, be subject to
8 the commencement of a new surrender period, lose existing
9 benefits, such as death, living, or other contractual benefits, or be
10 subject to increased fees, investment advisory fees, or charges for
11 riders and similar product enhancements.

12 (B) The consumer would benefit from product enhancements
13 and improvements.

14 (C) The consumer has had another annuity exchange or
15 replacement and, in particular, an exchange or replacement within
16 the preceding ~~36~~ 60 months.

17 (D) The exchange or replacement of that annuity would not be
18 an “unnecessary replacement” as that term is used in subdivision
19 (b) of Section 10509.8.

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

25 (c) Except as permitted pursuant to subdivision (d), an insurer
26 shall not issue an annuity recommended to a consumer unless there
27 is a reasonable basis to believe the annuity is suitable based on the
28 consumer’s suitability information and applicable California law.

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

33 (A) No recommendation is made.

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

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

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

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

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

12 (1) Make a record of any recommendation subject to subdivision
13 (a) of this section.

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

16 (3) Obtain a customer signed statement acknowledging that an
17 annuity transaction is not recommended if a customer decides to
18 enter into an annuity transaction that is not based on the insurance
19 producer's or insurer's recommendation.

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

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

28 (B) The insurer shall establish standards for insurance producer
29 product training and shall maintain reasonable procedures to require
30 its insurance producers to comply with the requirements of Section
31 10509.916.

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

35 (D) The insurer shall maintain procedures for review of each
36 recommendation; prior to issuance of an annuity; that are designed
37 to ensure that there is a reasonable basis to determine that a
38 recommendation is suitable. The review procedures may apply a
39 screening system for the purpose of identifying selected
40 transactions for additional review, and may be accomplished

1 electronically or through other means, including, but not limited
2 to, physical review. An electronic or other system may be designed
3 to require additional review only of those transactions identified
4 for additional review by the selection criteria.

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

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

19 (2) (A) Nothing in this subdivision restricts an insurer from
20 contracting for performance of a function, including maintenance
21 of procedures, required under paragraph (1). An insurer is
22 responsible for taking appropriate corrective action and may be
23 subject to sanctions and penalties pursuant to Section 10509.917
24 regardless of whether the insurer contracts for performance of a
25 function and regardless of the insurer's compliance with
26 subparagraph (B). *An insurer is responsible for the compliance of*
27 *its insurance producer with the provisions of this article regardless*
28 *of whether the insurer contracts for performance of a function*
29 *required under this subdivision and regardless of the insurer's*
30 *compliance with subparagraph (B).*

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

35 (i) Monitoring and, as appropriate, conducting audits to assure
36 that the contracted function is properly performed.

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

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

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

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

9 (2) Filing a complaint.

10 (3) Cooperating with the investigation of a complaint.

11 ~~(h) (1) Sales made in compliance with FINRA requirements~~
12 ~~pertaining to suitability and supervision of annuity transactions~~
13 ~~shall satisfy the requirements under this article. This subdivision~~
14 ~~applies to FINRA broker-dealer sales of variable annuities and~~
15 ~~fixed annuities if the suitability and supervision is similar to those~~
16 ~~applied to variable annuity sales. However, nothing in this~~
17 ~~subdivision shall limit the commissioner's ability to enforce,~~
18 ~~including conducting investigations related to, the provisions of~~
19 ~~this article.~~

20 ~~(2) For paragraph (1) to apply, an insurer shall do both of the~~
21 ~~following:~~

22 ~~(A) Monitor the FINRA member broker-dealer using~~
23 ~~information collected in the normal course of an insurer's business.~~

24 ~~(B) Provide to the FINRA member broker-dealer information~~
25 ~~and reports that are reasonably appropriate to assist the FINRA~~
26 ~~member broker-dealer to maintain its supervision system.~~

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

29 ~~(2) Sales by FINRA broker-dealers that comply with the~~
30 ~~suitability and supervision system requirements set forth in FINRA~~
31 ~~Rule 2111, or any successor rule, shall satisfy the suitability and~~
32 ~~supervision system requirements of this article, provided that the~~
33 ~~suitability criteria used also include both of the following:~~

34 ~~(A) The consumer's income.~~

35 ~~(B) The intended use of the annuity.~~

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

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

4 10509.916. (a) An insurance producer shall not solicit the sale
5 of an annuity product unless the insurance producer has adequate
6 knowledge of the product to recommend the annuity, and the
7 insurance producer is in compliance with the insurer's standards
8 for product training. An insurance producer may rely on
9 insurer-provided product-specific training standards and materials
10 to comply with this subdivision.

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

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

22 ~~(C) Insurance producers who hold a life insurance line of~~
23 ~~authority on the effective date of this article and who desire to sell~~
24 ~~annuities shall complete the requirements of this subdivision within~~
25 ~~six months after the effective date of this article. Individuals who~~
26 ~~obtain a life insurance line of authority on or after the effective~~
27 ~~date of this article may not engage in the sale of annuities until the~~
28 ~~annuity training course required under this subdivision has been~~
29 ~~completed.~~

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

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

34 (B) Identification of the parties to an annuity.

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

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

39 (E) The primary uses of annuities.

1 (F) Appropriate sales practices, replacement, and disclosure
2 requirements.

3 (G) Other topics required for training in selling annuities under
4 subdivision (c) of Section 1749.8.

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

11 (4) A provider of an annuity training course intended to comply
12 with this section shall register as a CE provider in this state and
13 comply with the rules and guidelines applicable to insurance
14 producer continuing education courses as set forth in Section
15 1749.8, in subdivisions (d) and (e) of Section 1749.1, and in
16 Sections 2188, 2188.1, 2188.2, 2188.3, 2188.4, 2188.6, 2188.7,
17 2188.8, 2188.50 and 2188.9 of Title 10 of the California Code of
18 Regulations.

19 (5) Annuity training courses may be conducted and completed
20 by classroom or self-study methods in accordance with Sections
21 2188.2 and 2188.3 of Title 10 of the California Code of
22 Regulations.

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

27 ~~(7) The satisfaction of the training requirements of another state~~
28 ~~that are substantially similar to the provisions of this subdivision~~
29 ~~shall be deemed to satisfy the training requirements of this~~
30 ~~subdivision in this state.~~

31 ~~(8)~~

32 (7) An insurer shall verify that an insurance producer has
33 completed the annuity training course required under this
34 subdivision before allowing the insurance producer to sell an
35 annuity product for that insurer. An insurer may satisfy its
36 responsibility under this subdivision by obtaining certificates of
37 completion of the training course or obtaining reports provided by
38 commissioner-sponsored database systems or vendors or from a
39 reasonably reliable commercial database vendor that has a reporting
40 arrangement with approved insurance education providers.

1 10509.917. (a) An insurer is responsible for compliance with
2 this article. If a violation occurs, either because of the action or
3 inaction of the insurer or its insurance producer, the commissioner
4 ~~may order any~~, *in addition to any other available penalties,*
5 *remedies, or administrative actions, order any or all of the*
6 *following:*

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

10 (2) A general insurance agency, independent agency, or the
11 insurance producer to take reasonably appropriate corrective action
12 for any consumer harmed by the insurance producer's violation
13 of this article.

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

19 (b) Any applicable penalty under Section 10509.9 for a violation
20 of this article may be reduced or eliminated if corrective action
21 for the consumer was taken promptly after a violation was
22 discovered or the violation was not part of a pattern or practice.

23 (c) *Nothing in this article shall affect any other obligation of*
24 *an insurer for acts of its agents, or any other consumer remedy or*
25 *cause of action otherwise provided by law.*

26 10509.918. (a) Insurers, general agents, independent insurance
27 agencies, and insurance producers shall maintain or be able to
28 make available to the commissioner records of the information
29 collected from the consumer and other information used in making
30 the recommendations that were the basis for insurance transactions
31 for five years after the insurance transaction is completed by the
32 insurer. An insurer is permitted, but shall not be required, to
33 maintain documentation on behalf of an insurance producer.

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