SENATE COMMITTEE ON INSURANCE
Senator Susan Rubio, Chair
2023 - 2024 Regular

Bill No:	SB 263	**Hearing Date:**	April 26, 2023
Author:	Dodd		
Version:	April 17, 2023		
Urgency:	No	**Fiscal:**	Yes
Consultant:	Erin Ryan		

SUBJECT: Insurance: annuities and life insurance policies

DIGEST: Revises the Suitability Requirements for Annuity Transactions in California law to generally reflect changes made by the National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions Model Regulation #275 of 2020, with some changes, as specified; and adds additional training requirements for those licensed or seeking a license to sell life insurance or annuities.

ANALYSIS:

Existing law:

1) Prohibits any unfair or deceptive practice in the business of insurance.

2) Generally speaking, grants the Insurance Commissioner (IC) broad powers to determine if annuities and life insurance products are fair to the public.

3) Requires that all annuity and life insurance forms be filed with the IC before being used in the market, but specifies that prior approval by the IC before marketing or use is not required.

4) Requires all individual life insurance policies to include a right to return of not less than 10 days nor more than 30 days, specifies that return of the policy within the "free look" period voids the policy and requires all premiums and fees paid to be refunded; and requires a notice of that right be printed on the policy or attached to it.

5) Generally speaking regards senior citizens a protected class in the sale of life insurance and annuities, specifies that all insurance agents and brokers owe a senior 65 and older a duty of honesty, good faith and fair dealing, and requires every individual life insurance or individual annuity contract issued to a senior to include a right of return of no less than 30 days.

6) Broadly regulates the sale of replacement life insurance and annuities, and imposes penalties for violation of those provisions.

7) Defines replacement of a life insurance or annuity to include products that are lapsed, forfeited, surrendered, or otherwise terminated, or other methods that generally reduce the benefits due to the consumer under the existing product.

8) Imposes specified duties on insurance agents and brokers (producers) who accept an application for life insurance or an annuity, including a signed statement

indicating whether the agent knows replacement is or may be involved in the transaction, and if a replacement is involved, provide a specified notice to the applicant regarding decisions about replacement that must be signed by both the producer and applicant.

9) Requires the insurer to ensure its producers or other personnel responsible in the application process comply with this requirement, and requires each completed application for life insurance or an annuity to include a statement signed by the applicant on whether the product will replace an existing life insurance policy or annuity and that recommends the consumer seek more information about the implications of such a decision.

10) Creates a rebuttable presumption of a violation of the statute if a producer or insurer recommends the replacement of a policy by presenting materially inaccurate information in the comparison of the existing policy's premiums and benefits or dividends and values, or if recommends a senior purchase an unnecessary replacement annuity.

11) Requires insurers to have a system to supervise recommendations and establish standards and procedures for the sale of annuity products, whether purchase, exchange or replacement, so that the needs and financial objectives of consumers at the time of the transaction are appropriately addressed.

12) Before recommending an annuity product to a consumer, requires the producer, or insurer if no producer is involved, to have reasonable grounds to believe the annuity is suitable, as specified.

13) Defines "suitability information" to include all of the following information from the consumer:

    a) Age

    b) Annual income

    c) Financial situation of needs, including the financial resources used for funding the annuity

    d) Financial experience

    e) Financial objectives

    f) Intended use of the annuity

    g) Financial time horizon

    h) Existing assets, including investment and life insurance holdings

    i) Liquidity needs

    j) Liquid net worth

    k) Risk tolerance

l) Tax status

m) Whether consumer has a reverse mortgage

n) Whether the consumer intends to apply for means tested government benefits, including Medi-Cal.

14) Requires the producer, or insurer if no producer is involved, to have a reasonable basis to believe that the consumer has been informed of the features of the annuity and the consumer would receive a tangible net benefit from the transaction.

15) Prohibits an insurer from issuing 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, as specified.

16) Provides that no violation has occurred if no recommendation has been made or if the recommendation was made based on materially inaccurate information provided by the consumer or if the consumer refuses to provide relevant suitability information and no recommendation is made.

17) Provides that if no recommendation is made, or if the consumer proceeds without providing all suitability information and an annuity transaction is not recommended, the producer shall obtain a customer signed statement documenting the consumer's refusal to provide suitability information and acknowledging that an annuity transaction is not recommended.

18) Requires a minimum of 20 hours of pre-licensing study to qualify for a life insurance agent license, and an additional 12 hours of study on ethics and the Insurance Code.

19) Requires a life insurance agent to complete 24 hour hours of continuing education, including 3 hours of ethics training prior to license renewal.

20) Requires any life insurance agent who sells annuities to complete 8 hours of training prior to soliciting individual consumers to sell annuities, and requires 4 hours of training prior to each license renewal, as specified.

21) Requires an insurer to verify that a producer has completed the required training prior to selling any annuity products for the insurer.

22) Specifies that an insurer is responsible for compliance with the above provisions, and if a violation occurs the IC may impose penalties, remedies, or administrative actions, as specified.

This bill:

1) Requires a life insurance agent to complete 4 hours of training before soliciting individual consumers to sell life insurance policies and 2 hours prior to each license renewal, in addition to existing training requirements, as specified.

2) States the bill's purpose as ensuring insurance producers, as defined, act in the best interest of the consumer when making a recommendation of an annuity product, and requiring insurers to supervise such recommendations by producers.

3) Expressly states that no private cause of action is created by the best interest standard of care.

4) Adds or changes several definitions, including:

   a) Defines "compensation" as anything of value, if paid as commission, or otherwise and if paid in cash or some other means received by a producer in connection with the recommendation or sale of an annuity, and includes health insurance, office rent, office support, and retirement benefits, but excludes products with the insurer name or logo with an aggregate value of $150 per year.

   b) Defines "material conflict of interest" as a financial interest of the producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation.

   c) Defines "producer" as someone licensed to sell or negotiate insurance, including annuities, and if no agent is involved, the insurer is the producer.

   d) Defines "recommendation" as advice or guidance made by a producer to an individual consumer that was intended to result or does result in the purchase, exchange or replacement of an annuity.

5) Broadly establishes duties for producers to ensure that annuities are in the consumer's best interest, including:

   a) Prohibits the producer from placing the producer's or insurer's financial interest ahead of the consumer's interest when recommending an annuity.

   b) Requires the producer to exercise reasonable diligence, care and skill to know the consumer's financial situation, financial needs, insurance needs and financial objectives, and have a reasonable basis to believe that the consumer would receive a tangible net benefit from the transaction over the life of the product.

   c) Requires the producer to communicate the bases of the recommendation to the consumer both orally and in writing, and to the insurer in writing.

   d) Requires the producer's recommendation to be based on the consumer's relevant profile information, and reflect the care, skill, prudence and diligence that a prudent person acting in a like capacity would use under similar circumstances.

6) Requires the producer to make reasonable efforts to obtain consumer profile information from the consumer prior to making a recommendation.

7) Specifically states it does not require the producer to analyze or consider any products outside the authority and license of the producer, and does not create a fiduciary obligation or relationship between the producer and the consumer.

8) States that the best interest of the consumer standard does not necessarily mean that the annuity with the lowest producer compensation is in the consumer's best interest; and the standard of care does not mean the producer has an ongoing monitoring obligation to the consumer, unless such an obligation separately owed under the terms of a fiduciary, consulting, investment advisor, or financial planning agreement between the producer and consumer.

9) Specifies additional factors to be considered if the annuity is an exchange or replacement of an annuity.

10) Requires the producer to prominently disclose specified information to the consumer, including a description of the scope and terms of the relationship with the consumer, a description of the products the producer is licensed and authorized to sell, a description of the sources and types of compensation and non-cash compensation to be received by the producer as a result of the sale of an annuity, a reasonable estimate of the amount of cash compensation to be received, and a notice of the customer's right to request more information regarding the producer's compensation.

11) Requires the producer, prior to or at the time of recommendation of an annuity, to inform the consumer of various features of the annuity, including potential surrender period and surrender charges, potential tax penalty if the consumer sells, exchanges or surrenders the annuity, associated fees, potential charges, and any market risk associated with the annuity.

12) Requires a producer to identify and avoid or reasonably manage, and prominently disclose to the consumer any material conflicts of interest, including any ownership interest in the insurer.

13) Requires a producer, at the time of recommendation sale, to provide the consumer with a written record of any recommendation and the basis for the recommendation.

14) Specifies that the best interest obligation applies to every producer who has exercised material control or influence in the making of the recommendation and received direct compensation as a result of the recommendation or sale, regardless of whether the producer has direct contact with the consumer.

15) Provides that a producer has no obligation to a consumer if no recommendation is made, if a recommendation is made but was based on materially inaccurate information provided by the consumer, if a consumer refuses to provide relevant consumer profile information and no recommendation is made, or if a consumer decides to enter into an annuity transaction that is not based on a recommendation of the producer.

16) Requires an insurer's issuance of an annuity under (15) above to be reasonable under all circumstances that are actually, or that after reasonable inquiry should be known to the insurer at the time the annuity is issued.

17) Requires the producer, or the responsible insurer representative if no producer is involved, to make a record of any recommendation; obtain a customer signed statement documenting a customer's refusal 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 producer's or insurer's recommendation.

18) Provides that, except as specifically permitted, an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity would effectively address the consumer's needs based on the consumer's consumer profile information.

19) Requires an insurer to establish, maintain and utilize a supervision system that is reasonably designed to ensure the insurer's and its producers' compliance with these requirements, as specified.

20) Requires the insurer to incorporate the requirements under this article into producer training manuals, provide product specific training and training materials that explain all material features of its annuity products to its producers, and maintain and utilize procedures to require its producers to comply with producer annuity training requirements.

21) Requires the insurer to have reasonable procedure in place to detect recommendations that are not in compliance with the producer requirements of the statute before or upon issuance or delivery of an annuity.

22) Requires the insurer to establish and maintain reasonable procedures to identify and eliminate any sales contests, bonuses, and non-cash compensation that are based on the sales of specific annuities within a limited period of time.

23) Allows an insurer to contract with a third party to perform specified supervision functions, but requires the insurer to reasonably monitor those contracted functions.

24) Provides that the insurer is responsible for taking appropriate corrective action, and may be subject to sanctions and penalties for actions of its third party contractors and producers.

25) Prohibits an insurer or producer from dissuading, or attempting to dissuade a consumer from truthfully responding to a request for consumer profile information, filing a complaint, or cooperating with the investigation of a complaint.

26) Provides a "safe harbor" for recommendation and sales of annuities by financial professionals (broker-dealer, investment adviser) made in compliance with comparable business rules, controls and procedures that satisfy a comparable standard, even if the producer also holds a life agent license, but specifies the IC retains authority to enforce, and conduct investigations related to, the requirements in the statute.

27) Requires the insurer to monitor the conduct of the financial professional seeking to utilize the safe harbor, as specified.

28) Requires life insurance agents to complete additional annuity product training requirements, as specified.

29) Requires a life insurer to provide all consumers who purchase an annuity an NAIC approved annuity buyer's guide as a standalone document with the annuity or prior to delivery of the annuity.

30) Grants the IC authority to adopt reasonable rules and regulations to implement these provisions.

Background

Section 989J of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act confirms state authority to regulate the sale of fixed and fixed indexed annuities and provides an exemption for such annuities from federal securities regulation when certain conditions are met, including when the state in which the contract is issued or the state in which the insurer issuing the contract is domiciled: 1) has adopted requirements that "substantially meet or exceed the minimum requirements" established by the 2010 version of the NAIC Suitability in Annuity Transactions Model Regulation (#275); and 2) "adopts rules that substantially meet or exceed the minimum requirements of any successor modifications to the model regulation" within 5 years of the adoption by the NAIC. NAIC Model #275 was updated in 2020. Therefore, by 2025, California needs to adopt the updates to California law which contain consumer protections that are at least as stringent as NAIC Model #275 to avoid dual regulation of fixed annuities by the California Department of Insurance (CDI) and the federal government.

The NAIC's Model #275 was created in 2003 in response to increasingly egregious and numerous financial abuses occurring in the annuity market throughout the United States. Seven years later in 2010, the NAIC updated Model #275 again as overly aggressive tactics utilized by insurance companies and their agents to sell annuities to seniors and other consumers remained prevalent. AB 689 (Blumenfield, Ch. 295, Stat. of 2011) was the first to implement the NAIC Suitability in Annuity Transactions Model Regulation in California, with some changes to enhance consumer protections. That bill required insurers to establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers for the sale of annuities to ensure that the financial and insurance needs and objectives of the consumer purchasing the annuity are appropriately addressed.

Annuities are specialized contracts sold by an insurance company which are designed to provide payments to the holder at specified intervals, usually after retirement. For insurers, producers and consumers, annuities are appealing because they require no individual underwriting for insurers, they are easily marketed as a guarantee of adequate income for life for seniors, and are often accompanied by high commissions for producers. Annuities can be valuable and appropriate investment products when sold by responsible insurers and agents and purchased by suitable consumers who understand their features.

With the purchase of an annuity, the insurance company accepts payment from the buyer and then, at a contracted future time, a stream of payments to the individual begins. They are often used to secure a steady cash flow during retirement. Annuities can be structured according to a wide array of details and factors, such as the how long annuity payments can be guaranteed to continue. Annuities can also be structured to provide either fixed or variable payments. Variable annuities let an annuitant receive greater payments if investments of the annuity fund do well and smaller payments if its investments do poorly. While this provides for a less stable cash flow than a fixed annuity, it allows annuitants to reap a benefit when returns are strong. While the variety of annuities give buyers flexibility to pick one that fits their situation, it also makes buyers more dependent on the skill and training of their agent or financial advisor, hence the concern to strengthen suitability and training requirements.

Annuities require a greater level of sophistication and education by the consumer than other insurance products they might be familiar with. Many people do not understand some of the basic features of annuities, and particularly deferred annuities. Most deferred annuities are back-end loaded, which means that they contain surrender charges. These charges are imposed if the money is withdrawn, and can be substantial. They usually decrease over time but can last many years, even 20 or more in some cases. Customers who purchase a back-end loaded deferred annuity and then change their mind are essentially locked in—they cannot get their money out without paying a surrender charge. The consumer may believe that they are getting a better return on an annuity, for instance, versus a certificate of deposit. What they may not understand is that while the early surrender on a CD may result in a subtraction from the interest, early surrender of a deferred annuity may cause a deduction from the principal.

Seniors sometimes are persuaded invest their entire life savings in these types of products, leaving them with no liquid assets or income for years. The upfront premium monies invested are unavailable for many years and the withdrawal of funds from annuities frequently involves the payment of large penalties. Interestingly, although abuses still occur, complaints about annuities have fallen. The NAIC has yet to tackle the problem of abuses in the broader life insurance industry, however, where more and more complex products are being marketed to consumers who do not fully understand the products and risks involved.

Recent amendments to the bill deleted a specific disclosure form and product comparison form that were different than the NAIC Model and required significantly more information be provided to the consumer about the nature of the producer's relationship with the consumer and the nature and amount of compensation to be received by the producer as a result of a recommendation or sale of an annuity. The bill still describes information that must be provided to the consumer at or before a recommendation of an annuity, both orally and in writing. Proposed amendments include the NAIC disclosure form by reference, and require the disclosure form used to be "substantially similar" to that form.

Questions

1) Is it possible to "avoid or reasonably manage" a material conflict of interest created by the receipt of compensation by a producer resulting from the recommendation or sale of an annuity? In the NAIC Model Act compensation is not considered a material conflict of interest. Should compensation be removed

from qualifying as a material conflict of interest? See arguments in opposition, below.

   a. Possible amendment: on page 8, line 24, ADD: <u>“material conflict of interest” does not include cash compensation or non-cash compensation.”</u>

2) The NAIC producer disclosure form being incorporated into the bill by reference does not require the producer to disclose an estimate of the amount of compensation the producer will receive as a result of the recommendation or sale of an annuity. The required disclosures currently in the bill do require such information to be disclosed. Should this requirement be stricken from the bill?

   a. Possible amendment: on page 21, <u>DELETE lines 31-33</u>.

3) Should a life agent producer who also holds a broker dealer license be able to avail themselves of the safe harbor and choose which “comparable” standards apply to the recommendation or sale of an annuity? Shouldn’t they be held to the highest standard? If the annuity does not qualify as a security, are securities laws and standards the appropriate standards to apply?

   a. Possible amendment: on page 32, line 31, after “and sales of annuities” ADD <u>“that also qualify as securities</u>”

Suggested Amendments

1. On page 5, DELETE lines 13-23 after (b) (definition of compensation (1 and 2))

2. On page 5, line 13 ADD <u>(1) “Cash compensation” means any discount, concession, fee, service fee, commission, sales charges, loan, override, or cash benefit received by a producer in connection with the recommendation or sale of an annuity from an insurer, intermediary, or directly from a consumer.</u>

3. On page 5, line 24, CHANGE (3) to (2)

4. On page 8, line 25 ADD <u>(j) “Non-cash compensation” means any form of compensation that is not cash compensation, including, but not limited to, health insurance, office rent, office support and retirement benefits</u>

5. On page 8, line 26, CHANGE (j) to (k)

6. On page 9, line 8, CHANGE (k) to (l)

7. On page 9, line 13, CHANGE (l) to (m)

8. On page 9, line 23, CHANGE (m) to (n)

9. On page 10, line 1, CHANGE (n) to (o)

10. On page 13, lines 7-9 Amend to read the following “The requirements under paragraph (1) include having a reasonable basis to believe the consumer would benefit from <u>certain features of the annuity, such as annuitization, death or living benefit, or other insurance related features”</u>

11. On page 15, REPLACE lines 9-17 with the following: Before or at the time of recommendation or sale of an annuity, the producer shall prominently disclose all of the following information to the consumer on a form substantially similar to the "Insurance Agent (Producer) Disclosure for Annuities" form in Appendix A of the 2020 National Association of Insurance Commissioners' Suitability in Annuity Transactions Model Regulation.

12. On page 21, line 14, ADD a new (v) "Other life and annuity products, as specified" and renumber subsequent subparagraphs.

13. On page 28, lines 21-22 DELETE this subparagraph (drafting error)

14. On page 30, lines 33-36 AMEND as follows: after "identify and address" "suspicious consumer refusals to provide complete consumer profile information."

15. On page 39, amend to correct operational issue involving the deletion and replacement of existing code sections so that there is no gap in statutory operation (per Legislative Counsel)

Related/Prior Legislation

AB 689 (Blumenfield, Ch. 295, Stat. or 2011) enacted the 2010 NAIC Suitability in Annuity Transactions Model Regulation in California.

SB 927 (Archuleta, 2022) would have extended the "free look" period for life insurance policies and annuities to at least 30 days; provided that a policy owner, in deciding whether to cancel a life insurance policy or annuity is entitled to rely on any information received regardless of whether the information was received before or after the policy was delivered to the policy owner; allowed an insurance agent to receive compensation incentives related to the sale of a life insurance policy or annuity if the amount did not influence the recommendation to the consumer; required several new disclosures to the consumer regarding agent compensation, potential tax benefits, all fees and charges under the policy, and crediting rates and surrender charges, as specified.

ARGUMENTS IN SUPPORT:

The Insurance Commissioner has sponsored SB 263 because despite the numerous improvements made by the NAIC Model as adopted in California in 2011 setting forth standards and procedures for insurance producers recommending annuity products to consumers, unsuitable annuity sales have continued to occur. The NAIC updated Model #275 in 2020 to once again attempt to improve the standards of conduct governing the sale of annuity products. The California Department of Insurance continues to see numerous complaints and cases which have the ability to ruin consumers' lives. For example, a recent case involved a 94-year-old consumer who was persuaded to liquidate their existing annuity policy and use their inheritance to buy new policies which were later deemed unsuitable, causing a monetary loss of $220,000 and consequences to their income tax and social security benefits. Another recent example involved an agent using high-pressure tactics, manipulation, misrepresentation, fraud, and false impersonation to induce the consumer to use their savings and move them out of their existing annuity contracts and investments in order to sell them new annuities. This scheme generated commissions of approximately $500,000 for the agent. The updates contained in this bill notably require all recommendations by agents and insurers to be in the best interest of the consumer and the producer may not place their financial interest ahead of the consumers' interest in making a recommendation. I believe that California can and should do more to stop financial abuse of our seniors and other citizens.

The California Commission on Aging supports SB 263 because they stand in support of legislation which protects older adults' financial futures and ensures insurance producers are acting in the best interest of consumers. Financial instruments are often complex with many requiring expertise in finance just to understand what they do. Most consumers do not have the specified knowledge to understand the complexities of annuities. They must rely on those who are selling them the product to act in their best interest. Thus, it is necessary that those who are entrusted with providing guidance on a person's financial future are legally obligated to do so in a manner that puts the consumer first

ARGUMENTS IN OPPOSITION:

The Independent Insurance Agents and Brokers of California (IIABCal) and National Association of Insurance and Financial Advisors (NAIFA) oppose the bill unless it is amended to more closely reflect provisions in the NAIC Annuity Suitability Model that impose on insurance agents certain obligations and certain disclosures prior to the sale of an annuity to a consumer. The Model Act requires the producer to identify and manage any conflicts of interest, including material conflict related to an ownership interest. The most recent amendments to SB 263 requires the producer to *avoid or reasonably manage* material conflicts of interest. Both SB 263 and the Model Act define a conflict of interest as: "a financial interest of the producer in the sale of an annuity that a reasonable person would expect to influence the impartiality of a recommendation." However, the Model Act further states that "Material conflict of interest" does not include cash compensation or non-cash compensation. Without the modifying language indicating that compensation paid to the producer is not a material conflict of interest, every sale of an annuity by a producer appointed by an insurer would qualify as a material conflict of interest and thus require the producer to somehow deal with that conflict. Under the Model Act, the mere payment of compensation would not be a material conflict of interest and it would not be a material conflict of interest because the Model already requires the producer to disclose that he or she is an appointed agent of the insurer, being paid compensation by the insurer, and whether that compensation is a commission as part of premium or other remuneration received by the insurer. As such, the intent of the Model Act was that a material conflict of interest be something other than compensation, such as a significant ownership interest in the insurer whose product the producer is recommending. The producer is already obligated to disclose such compensation and the agency relationship with the insurer as part of the other provisions in SB 263.

SUPPORT:

California Advocates for Nursing Home Reform (March 7, 2023 version)
California Commission on Aging
California Department of Insurance (sponsor)
Legal Assistance for Seniors (March 7, 2023 version)

403bwise.org (March 7, 2023 version)

OPPOSITION:

Insurance Retirement Institute

OPPOSE UNLESS AMENDED:

American Council of Life Insurers
Association of California Life and Health Insurance Companies
Center for Economic Justice
Consumer Federation of America
Consumer Federation of California
Federation of Americans for Consumer Choice
Finseca
Independent Insurance Agents and Brokers of California
Life Insurance Consumer Advocacy Center
LPL Financial
National Association of Insurance and Financial Advisors
United Policyholders

-- END --