

HOUSE BILL REPORT

HB 1563

As Reported by House Committee On:
Financial Institutions & Insurance

Title: An act relating to the suitability of annuities sold in Washington.

Brief Description: Requiring annuities sold in Washington to be suitable to the age and financial situation of the purchaser.

Sponsors: Representatives Kirby, Williams, Hasegawa, Simpson and Morrell; by request of Insurance Commissioner.

Brief History:

Committee Activity:

Financial Institutions & Insurance: 2/3/09, 2/17/09 [DPS].

Brief Summary of Substitute Bill

- Requires insurers and insurance producers to meet suitability standards when recommending the purchase or exchange of an annuity to a consumer.
- Grants the Insurance Commissioner rule-making authority.

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Kirby, Chair; Kelley, Vice Chair; Parker, Assistant Ranking Minority Member; Hurst, McCoy, Nelson, Roach, Santos and Simpson.

Minority Report: Do not pass. Signed by 1 member: Representative Bailey, Ranking Minority Member.

Staff: Jon Hedegard (786-7127)

Background:

The Insurance Commissioner (Commissioner) and the federal and state security regulators all have a role in regulating the sale of annuities in this state.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

The Commissioner oversees insurers and insurance producers and the market practices of those persons and entities in this state. This includes the sale of fixed and variable annuities.

The federal Securities Act of 1933 addresses securities regulation which includes annuities that are classified as securities. The Securities and Exchange Commission (SEC) oversees the Securities Act of 1933 and currently requires registration of variable and indexed (but not fixed) annuities as securities. The Department of Financial Institutions (DFI) also oversees the sale of securities in this state. A security is defined to include annuities but specifically excludes "any insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or some other specified period."

The DFI has a number of requirements for broker-dealers, salespersons, investment advisers, and investment adviser representatives (licensees). One legal requirement is the suitability of a security recommendation made by a licensee. Prior to making a transaction, a licensee must make reasonable efforts to obtain information concerning:

- the customer's financial status;
- the customer's tax status;
- the customer's investment objectives; and
- other information used or considered to be reasonable in making recommendations to the customer.

The licensee must have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts, if any, disclosed by the customer as to his or her other security holdings and as to his or her financial situation and needs.

Both the Insurance Code (Title 48 RCW) and the Securities Act of Washington (chapter 21.20 RCW) recognize this overlap.

The Financial Industry Regulatory Authority (FINRA) is the largest non-governmental regulator for securities firms in the United States. The FINRA was established in 2007 in a merger between the National Association of Securities Dealers and portions of the New York Stock Exchange. As a self-regulatory organization, FINRA must be registered with the Securities and Exchange Commission (SEC). The FINRA rules must be reviewed and approved by the SEC. The FINRA has rules regarding suitability, including the suitability of annuities.

Summary of Substitute Bill:

Before the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurer or insurance producer must make reasonable efforts to obtain information concerning a consumer's financial background, investment goals, and other information used or considered to be reasonable in making recommendations to the consumer. Insurers and insurance producers must have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the

consumer. A recommendation must be reasonable under all circumstances actually known to the insurer or insurance producer at the time.

An insurer or insurance producer does not have an obligation to a consumer if the consumer:

- refuses to provide relevant background;
- fails to provide complete or accurate information; or
- decides to enter into an insurance transaction that is not recommended by the insurer or insurance producer.

Compliance with the FINRA suitability rules satisfies the requirements for the recommendation of annuities registered under the Securities Act of 1933. The Commissioner must notify the appropriate committees of the House of Representatives and Senate if there are changes regarding the registration of annuities under the Securities Act that affect the application of this standard. This does not limit the Commissioner's ability to take enforcement action.

An insurer must establish and maintain a system to supervise recommendations that is reasonably designed to achieve compliance with the suitability requirements. The system must include written procedures and a periodic review of records that are reasonably designed to assist in detecting and preventing violations. An insurer may contract with a third party to establish and maintain the system of supervision. Compliance with specific standards satisfies the insurer's obligations when contracting with a third party.

The Commissioner may order reasonably appropriate corrective action to address any consumer harmed by the insurer's or insurance producer's violation. Any applicable penalty may be reduced or eliminated by the Commissioner if corrective action for the consumer was taken promptly after a violation was discovered.

Insurers and insurance producers must be able to make records regarding the information collected from the consumer and other information used in making the recommendations available to the Commissioner. These records must be available for five years after the insurance transaction or for five years after the annuity begins paying benefits, whichever is longer.

The Commissioner may adopt rules to implement and administer this section.

Exemptions are created for annuity recommendations involving specific factual situations.

Substitute Bill Compared to Original Bill:

The underlying bill is struck including the general grant of authority for the Commissioner to adopt standards for suitability. In the substitute bill, an insurer or insurance producer must make reasonable efforts to obtain a consumer's financial information that will be useful in making recommendations to the consumer. Insurers and insurance producers must have reasonable grounds for believing that the recommendation is suitable for the consumer. A recommendation must be reasonable under circumstances known to the insurer or insurance producer. Compliance with the FINRA suitability rules satisfies requirements for annuities registered under the Securities Act of 1933. An insurer must establish and maintain a system

to supervise suitability recommendations. The Commissioner may order reasonably appropriate corrective action to address any consumer harmed by the insurer's or insurance producer's violation of suitability requirements. Any applicable penalty may be reduced or eliminated by the Commissioner if corrective action for the consumer was taken promptly after the discovery of a violation. Insurers and insurance producers make records and information used in making the recommendations available to the Commissioner. The Commissioner may adopt rules to implement and administer this section. The standards do not apply to recommendations involving specific situations.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) It just makes sense that there are standards to ensure the suitability of a product. A person selling an annuity should not recommend a product unless it is appropriate for the age and financial situation of the customer. This is an interesting area of regulation. There are some shared responsibilities between state and federal regulators and between the Commissioner and the DFI. The Office of the Insurance Commissioner (OIC) regulates insurers and insurance providers, and insurance producers. Currently many people are sold inappropriate products. If it is an insurance product, the Commissioner needs good, clear, and uniform suitability standards. Some people have issues with the bill as drafted. All parties want strong standards but what those standards should be is still an issue. About 39 states have suitability standards. There are national discussions about the suitability standards. This bill gives the Commissioner the authority to adopt a standard that provides solid consumer protections. The Commissioner will review existing standards and adopt a standard for Washington that provides uniformity.

(In support with concerns) Trade associations and regulators have worked on suitability standards nationally and in states across the country. Suitability is very important. The goals behind this bill are very important. The details of the bill are troubling. The National Association of Insurance Commissioners (NAIC) adopted a model on this subject in 2006. The NAIC model has been adopted in 31 states. The NAIC model should be adopted by this state. A standard that seeks uniformity but is not actually uniform increases the cost of compliance. A uniform standard makes sense and that is achieved by adopting the NAIC model. The NAIC model could be wholly adopted in statute or rule.

(Opposed) Broker-dealers oppose the bill in its current form. Suitability regulation is appropriate. Broker-dealers sell securities and are already subject to the FINRA standards which were adopted by the DFI. Broker-dealers are also subject to OIC regulation. The bill as drafted would likely require compliance with two different standards of suitability. The FINRA standards are stringent and are in place today. The current NAIC model provides a

safe harbor for compliance with FINRA. This bill has no such protection. The Commissioner could adopt a conflicting standard and create a compliance nightmare for broker-dealers.

Persons Testifying: (In support) Representative Kirby, prime sponsor; and Mike Kreidler, Washington State Insurance Commissioner.

(In support with concerns) Mel Sorensen, American Council of Life Insurers and National Association of Financial Advisors.

(Opposed) Bill Stauffacher, Securities Industry and Financial Markets.

Persons Signed In To Testify But Not Testifying: None.