HOUSE BILL REPORT
HB 1120

As Reported by House Committee On:
Consumer Protection & Business

Title: An act relating to the best interest standard for annuities in Washington.

Brief Description: Concerning the best interest standard for annuity transactions.

Sponsors: Representatives Reeves, Corry and Ryu.

Brief History:

Committee Activity:

Consumer Protection & Business: 1/17/23, 1/20/23 [DP].

Brief Summary of Bill

- Adopts a best interest standard of conduct for producers and insurers recommending and selling annuities based on model guidelines adopted by the National Association of Insurance Commissioners.
- Requires producers recommending and selling annuities to act in the best interest of the consumer, to not place their financial interest ahead of the consumer's interest, and act with reasonable diligence, care, and skill in making recommendations.
- Includes four areas of obligation that are owed to consumers and sets forth regulations for each: care, disclosure, conflict of interest, and documentation.
- Expands safe harbor provisions to any producer that is regulated as a broker-dealer, investment advisor, or plan fiduciary.

HOUSE COMMITTEE ON CONSUMER PROTECTION & BUSINESS

Majority Report: Do pass. Signed by 11 members: Representatives Walen, Chair; Reeves, Vice Chair; Corry, Ranking Minority Member; McClintock, Assistant Ranking

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

Minority Member; Chapman, Cheney, Connors, Donaghy, Hackney, Ryu and Sandlin.

Minority Report: Without recommendation. Signed by 1 member: Representative Santos.

Staff: Megan Mulvihill (786-7304).

Background:

The Insurance Commissioner (the Commissioner) oversees insurers, insurance producers, insurance solicitors and adjusters, and the market practices of those persons and entities. This includes the sale of fixed and variable annuities.

Insurers and producers recommending or selling annuities must comply with a number of requirements. They must have reasonable grounds to believe the recommendation is suitable for the consumer, must make reasonable efforts to obtain relevant information from the consumer, and must make recommendations that are reasonable in light of all circumstances actually known to the insurer and producer. An insurer must assure that a system to supervise recommendations is established and maintained. Insurers and producers must maintain and make available records used in making recommendations that were the basis for insurance transactions for five years after the transaction or five years after the annuity begins paying benefits, whichever is longer.

In 2018 the US Securities and Exchange Commission (SEC) adopted a rule change which included a best interest standard of conduct for broker-dealers. This rule requires broker-dealers to only recommend financial products to their consumers that are in the consumer's best interests and to clearly identify potential conflicts of interests and financial incentives the broker-dealer may receive. In addition, the National Association of Insurance Commissioner's (NAIC) "Suitability in Annuity Transactions Model Regulation" was revised in 2020 and sets forth a best interest standard of conduct for producers and insurers. Under the NAIC revisions, producers and insurers making recommendations for annuities must act in the best interest of the consumer under the circumstances known at the time the recommendation is made.

Summary of Bill:

A producer must act in the best interest of the consumer when making a recommendation of an annuity without placing the producer's or the insurer's financial interests ahead of the consumer. A producer has acted in the consumer's best interest if they have satisfied the obligations regarding care, disclosure, conflict of interest, and documentation.

Care Obligation.
When making a recommendation, the producer must exercise reasonable diligence, care,

and skill to:
- know the consumer's financial situation, insurance needs, and financial objectives;
- understand the available recommendation options after making a reasonable inquiry into options available to the producer;
- have a reasonable basis to believe the recommended option effectively addresses the consumer's financial situation, insurance needs, and financial objectives over the life of the product, as evaluated based on the consumer profile information; and
- communicate the basis or bases of the recommendation.

The producer must make reasonable efforts to obtain consumer profile information prior to recommending an annuity. The producer must consider the types of products the producer is authorized and licensed to recommend or sell that address the consumer's financial information, insurance needs, and financial objectives. Producers must be held to standards applicable to producers with similar authority and licensure. These requirements only create a regulatory obligation, not fiduciary, and do not mean the producer has ongoing monitoring obligations.

The consumer profile information, characteristics of the insurer and product costs, rates, benefits, and features are those factors generally relevant in determining whether an annuity effectively addresses the consumer's financial situation, insurance needs, and financial objectives. The importance of each factor may vary depending on the facts and circumstances of a particular case, but each factor may not be considered in isolation.

Care obligation requirements include having a reasonable basis to believe the consumer would benefit from certain features of an annuity. These requirements apply to the particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of purchase or exchange of an annuity, and riders and similar product enhancements, if any. The requirements do not mean the annuity with the lowest one-time or multiple occurrence compensation structure must be recommended. In the case of an annuity exchange or replacement, the producer must consider the whole transaction, which includes whether:
- the consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits, or be subject to increased fees, investment advisory fees, or charges for riders and similar product enhancements;
- the replacing product would substantially benefit the consumer in comparison to the replaced product over the product's life; and
- the consumer has had another annuity exchange or replacement, particularly within the preceding 60 months.

Nothing in the care obligation requirements should be construed to require a producer to obtain any license other than a producer license with the appropriate line of authority to sell, solicit, or negotiate insurance.

<u>Disclosure Obligation</u>.

Prior to the recommendation or sale of an annuity, the producer must prominently disclose to the consumer:

- a description of the scope and terms of the relationship with the consumer, and the producer's role in the transaction;
- an affirmative statement on whether the producer is licensed and authorized to sell fixed annuities, fixed indexed annuities, variable annuities, life insurance, mutual funds, stocks and bonds, and certificates of deposit;
- an affirmative statement describing the insurers the producer is authorized, contracted, appointed, or otherwise able to sell insurance products for, using the following descriptions: (1) from one insurer; (2) from two or more insurers; or (3) from two or more insurers although primarily contracted with one insurer;
- a description of the sources and types of cash compensation and noncash compensation the producer will receive, including whether the producer is to be compensated as part of the premium or other remuneration received from the insurer, intermediary, or other producer, or by fee as a result of a contract for advice or consulting services; and
- a notice of the consumer's right to request additional information regarding the producer's cash compensation.

Upon the consumer's request, the producer must disclose a reasonable estimate of the producer's cash compensation and whether the cash compensation is a one-time or multiple occurrence amount, and if a multiple occurrence amount, the frequency and amount of the occurrence, which may be stated as a range or percentages.

Prior to, or at the time of the recommendation or sale of an annuity, the producer must have a reasonable basis to believe the consumer has been informed of various features of the annuity.

<u>Conflict of Interest Obligation</u>.
A producer must identify and avoid, or reasonably manage and disclose, material conflicts of interest.

<u>Documentation Obligation</u>.
A producer must, at the time of recommendation or sale:

- make a written record of any recommendation and the basis for the recommendation;
- obtain a consumer-signed statement documenting: (1) a customer's refusal to provide the consumer profile information, if any; and (2) a customer's understanding of the ramifications of not providing, or providing insufficient, consumer profile information; and
- obtain a consumer-signed statement acknowledging that the customer decided to enter into an annuity transaction that is not based on a producer's recommendation.

<u>Application of the Best Interest Obligation</u>.
The best interest requirements apply to every producer who has exercised material control

or influence in the making of a recommendation or sale, regardless of whether the producer has had any direct contact with the consumer. Activities such as delivering marketing or educational materials or back office support do not constitute material control or influence.

A producer has no obligation to a consumer if: (1) no recommendation is made; (2) a recommendation was made and was later found to have been prepared based on materially inaccurate information provided by the consumer; (3) a consumer refused to provide relevant consumer profile information and the annuity transaction is not recommended; or (4) a consumer decides to enter into an annuity transaction that is not based on a producer's recommendation.

Supervision System.
An insurer may not issue an annuity recommended to a consumer unless there is reasonable basis to believe the annuity would effectively address the particular consumer's financial situation, insurance needs, and the financial objectives based on the consumer profile information. An insurer may base its analysis on information received from either the financial professional or their supervisor. An insurer must establish and maintain a supervision system that is designed to ensure compliance.

Safe Harbor.
Recommendations and sales of annuities made in compliance with comparable standards satisfy requirements. "Comparable standards" means:
- with respect to broker-dealers and registered representatives of broker-dealers, applicable SEC and Financial Industry Regulatory Authority (FINRA) rules pertaining to best interest obligations and supervision of annuity recommendations and sales;
- with respect to investment advisors registered under federal or state securities laws or investment adviser representatives, the Investment Advisers Act of 1940 or applicable state securities law; and
- with respect to plan fiduciaries, the duties and other requirements under the Employee Retirement Income Security Act of 1974 or the Internal Revenue Code and any amendments or successor statutes thereto.

These requirements apply to recommendations and sales of annuities made by broker-dealers, investment advisors, and plan fiduciaries in compliance with business rules, controls, and procedures that satisfy a comparable standard, even if such a standard would not otherwise apply to the product or recommendation at issue. However, the requirements do no limit the Commissioner's ability to investigate and enforce regulations for annuities.

For the comparable standard to apply, the insurer must monitor the relevant conduct of the financial professional or their supervisor using information collected during the normal course of business and provide to the supervisor information and reports that are reasonably appropriate to assist with maintaining its supervision system.

Violations.

The insurer is responsible for compliance, but the authority to enforce compliance is vested exclusively with the Commissioner. If a violation occurs, either because of the action or inaction of the insurer or its producer, the Commissioner may order:

- an insurer to take reasonably appropriate corrective action for any consumer harmed by an insurer's failure to comply with best interest regulations, an entity contracted to perform the insurer's supervisory duties, or the producer;
- a general agency, independent agency, or the producer to take reasonably appropriate corrective action for any consumer harmed by the producer's violation; and
- appropriate penalties and sanctions.

An applicable penalty may be reduced or eliminated by the Commissioner if corrective action was taken promptly after a violation was discovered, or the violation was not part of a pattern or practice.

Insurers, general agents, independent agencies, and producers must maintain or be able to make available records of the information collected from the consumer; disclosures made to the consumer, including summaries of oral disclosures; and other information used in the making of recommendations that were the basis for an insurance transaction for five years. Records may be maintained in paper, photographic, microprocess, magnetic, mechanical, electronic media, or by any process that accurately reproduces the actual document.

The best interest requirements must not be construed to create or imply a private cause of action for a violation, or subject a producer to civil liability under the best interest standard of care or under standards governing the conduct of a fiduciary or a fiduciary relationship.

Definitions.

Definitions for the following terms are added: cash compensation, consumer profile information, financial professional, FINRA, insurer, intermediary, material conflict of interest, noncash compensation, nonguaranteed elements, producer, replacement, and SEC. The definition for "recommendation" is modified and does not include general communication to the public, generalized customer services assistance or administrative support, general educational information and tools, prospectuses, or other product and sales material.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect on January 1, 2024.

Staff Summary of Public Testimony:

(In support) The problem this legislation is attempting to solve is accessibility to financial support and guidance for people looking to retire, especially disproportionately impacted populations. An annuity is like a personal pension, and it can guarantee income for the length of a person's life. An annuity is like insurance against outliving your savings, and the new standards cover both fixed and variable annuities. The median household income is around $70,000 for people buying annuities, so these changes are geared toward providing protections for middle-income people. Those with annuities are less dependent on family members and government programs in retirement.

The current statute uses the suitability standard. This raises the standard of conduct by replacing Washington's law with the NAIC model, which has been adopted by 27 other states. The best interest standard of conduct requires insurers and producers to act in the best interest of the consumer, without placing their own interests ahead of the consumer. This applies to all recommendations made, and it establishes clear and enhanced standards so consumers better understand what they are purchasing.

(Opposed) None.

Persons Testifying: Representative Kristine Reeves, prime sponsor; Michael Walker, Office of the Insurance Commissioner; and John Mangan, American Council of Life Insurers.

Persons Signed In To Testify But Not Testifying: None.