FINAL BILL REPORT
HB 1120

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Synopsis as Enacted

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

Sponsors: Representatives Reeves, Corry and Ryu.

House Committee on Consumer Protection & Business
Senate Committee on Business, Financial Services, Gaming & Trade

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, make reasonable efforts to obtain relevant information from the consumer, and make recommendations that are reasonable in light of all circumstances actually known to the insurer and producer. An insurer must ensure 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 United States 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 that are in the consumer's best interest 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

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must act in the best interest of the consumer under the circumstances known at the time the recommendation is made.

Summary:

A producer must act in the consumer's best interest 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.

<u>Care Obligation</u>.
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 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, insurer's characteristics, 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 their 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 by fee; and
- a notice of the consumer's right to request additional information regarding the producer's cash compensation and if requested, disclosure of an estimate of the producer's compensation and the occurrence and frequency.

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.

Application of the Best Interest Obligation.
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 had 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 consumer's financial situation, insurance needs, and financial objectives. 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.

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.

Votes on Final Passage:

House	97	0
Senate	49	0

Effective: January 1, 2024