

2011 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1160

2011 HOUSE STANDING COMMITTEE MINUTES

House Industry, Business and Labor Committee Peace Garden Room, State Capitol

HB 1160
February 02, 2011
13893

☐ Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution: Relating to annuity transaction practices; and to provide a penalty.

Minutes:

Chairman Keiser: We will open on HB 1160. I'll introduce HB 1160. Compliments to Commissioner Hamm on the job of looking out for the citizens of North Dakota. We have been talking about annuities for about 2 years but it really came to the forefront about a year ago. The FCC came into the game of annuities and they started to raise significant concerns about whether annuities were an insurance product or an investment product. Historically annuities had always been in the part of the code in every state as an insurance product. It brought in the challenge, and if you think about annuities and the variable rate annuities, there is a continuum of whether it is insurance investment. In the case of annuities that certainly could be an issue. NCOIL and NDNAIC became very engaged. Litigation occurred relative to who had jurisdiction over this issue. At this point it still remains an insurance product however we took notice at the NAIC and at the NCOIL levels that if it is an insurance product are we doing an adequate job. This bill is being brought to you because it is my firm belief that we have not done an adequate job relative to annuities. Annuities are a wonderful product. Like all insurance products there are appropriate applications and there are inappropriate applications. One of my concerns, as in life insurance, is if I have a young person, newly married, and has three kids, should they be buying a whole life policy? Is that appropriate or is it more appropriate that they buy term insurance and maximize the kind of coverage they might have in case they die? Why do you buy life insurance when you are 25 years old with three kids? And what is the purpose of that? What that raises is the question that we always have to deal with and it's referred to as suitability. Is this policy suitable for a particular client in a particular situation? On the annuities side there is a significant incentive from a broker/agent perspective on annuities because typically they are front end loaded, you get a big payment. There certainly is a lot of motivation to suggest to your clients that annuities are a good alternative in your financial planning. That brings the problem to the forefront. Are we doing an adequate job in the area of suitability for the customer and that is really what HB 1160 is all about. It takes our current section of the code that deals with annuities and it is bringing into play suitability. The suitability information means information that is reasonably appropriate to determine the suitability of a recommendation including the following and we have gone through and identified the areas. They should be considered by a broker/agent in terms of addressing with their client if these are suitable criteria. Based on work done at the NAIC specific areas were identified that should be addressed as an agent considers suggesting an annuity

policy. On page 3 line 12 we add "including the consumer's suitability information." We are placing into code the notion of suitability. On page 3 lines 14-31 we talk about the fact that the consumer has been reasonably informed. We are requiring that the agent/broker in fact does have a discussion with the client and present information relative to the plan, what it does, and how it works. On page 6 lines 26-29 we talk about suitability information and now we are saying you can't issue this and when you talk to them you need to talk about what is appropriate and then the insurer has a responsibility to make sure that it is a suitable product for that client. The next page we have some exceptions and then finally on page 12 we have the compliance component. An insurer is responsible for compliance with this chapter. If a violation occurs either because of the action or inaction of the insurer or the insurer's insurance producer, the commissioner may order an insurer to take certain steps. That is what this bill is about.

Representative N Johnson: On page 2 number 8 where it talks about the suitability information, who is a suitable candidate for an annuity based on all that?

Chairman Keiser: It varies. These are the factors that should be taken into consideration. An agent or a producer that is selling someone a policy has or should have suitability requirements for all other insurance products. These elements should really be looked at regardless of the product. As is suggested earlier if you are a young person that is married with three kids and you want to buy just life insurance, personally I don't think a whole life insurance is a suitable product. That includes all of these things as well. We just haven't become involved as well as we should have in the management of annuities through our century code. It is a combination of those variables that would make it appropriate. An annuity might be the perfect product for a young person. Age by itself isn't a determining factor but it is the combination that should be looked at.

Representative Nathe: In regards to suitability information, is it a checklist form that the agent would go through and then have that client sign off that he has been reasonably informed?

Chairman Keiser: There is a requirement I believe on the part of the agent/broker that they have to get a signature from the consumer that they have been instructed on the factors.

Representative Ruby: In the penalties it mentions that the commissioner could take action. It says the appropriate penalties and sanctions. Do we have an idea what those might be?

Chairman Keiser: You should ask the commissioner.

Representative Ruby: Anyone here to speak in support of HB 1160?

Adam Hamm~Commissioner, North Dakota Insurance Department: (see attached testimony 1).

Representative Gruchalla: You singled out one part of the insurance sales. Do we know are there abuses in this area or would your office know if one agent was selling an increased amount of annuities?

Adam Hamm: Thankfully we don't hear a lot of these complaints in North Dakota. Nationally this is a much bigger issue. Are there specific agents or groups in North Dakota we are aware of? The answer is no, but we want to put in safe guards to protect citizens.

Representative Ruby: I see in the area of the training that you are removing some of the training requirements. Who is it that would providing the training and what approval?

Adam Hamm: The fundamental purpose of HB 1160 was to place this responsibility with the insurance companies to make sure that their agent force is being properly trained before they are out there selling annuity products. The amendments we offered clear that up and clarify it and make sure that the administrative burden that flows from 1160 doesn't all of a sudden end up in the insurance department. We do this in other lines of insurance.

Representative Ruby: You feel comfortable that their incentive to get that training right would be the penalty areas?

Adam Hamm: Clearly.

Representative Frantsvog: Your testimony talks about suitability information. What I interpret from this paragraph is that either the agent would have to write a narrative that would be signed out by both the agent and the purchaser or some form that would be filled out so that you would be assured that all the information that needed to be given to the purchaser has been done. Do I understand that correctly?

Adam Hamm: That is right.

Vice Chairman Kasper: On page one of the bill and the definition of annuity would you explain what we are covering under this chapter? What type of annuities are covered and not covered?

Adam Hamm: It would apply to all annuities.

Vice Chairman Kasper: Would it apply to a variable annuity?

Adam Hamm: Yes. If you go to page 9 of the bill, one of the whole points of HB 1160 and the further model that came out of the NAIC was to expand it to cover the entire cross section. What you heard Rep. Keiser talk about in his testimony was the fact that the FCC was looking into these issues. This is part of what led to the further model of the NAIC making sure the entire field was covered. I would imagine people in the securities department are going to be happy with that because we are making sure that those annuity products are covered as well.

Vice Chairman Kasper: You are saying that you see no problem with the securities department or do you think there will be some turf battle?

Adam Hamm: I would hope there is no turf battle because what we are doing is making sure the consumers are protected across the field.

Vice Chairman Kasper: Have you had a conversation with the securities department?

Adam Hamm: I have not.

Vice Chairman Kasper: On page 2, line 19, I read that and there may be something further back in the bill that addresses it, but I want to be sure. For disclosure I sell annuities and I sell variable annuities. When a sale of an annuity is made or when a sale of any insurance product is made, you are looking at the consumer situation at the time of sale.

Adam Hamm: Correct.

Vice Chairman Kasper: 6 months, 3 months, 2 years, or 10 years, circumstances could and most likely do change. How far does the statute for suitability extend after that initial sale or does it very clearly tell us that the suitability must be done at the time of the transaction?

Adam Hamm: At the time the transaction is made.

Vice Chairman Kasper: So therefore even if in two weeks from now the customer's circumstances change the producer would not be in violation because they changed?

Adam Hamm: It is at the time of the transaction, correct.

Vice Chairman Kasper: On page 3, lines 17 & 22, investment advisory fees on 17 and 22 on the underlying sub-accounts that language is there because we are not bringing variable annuities into the equations that would have those types of features?

Adam Hamm: That would be accurate.

Vice Chairman Kasper: On page 6 line 26 how does the insurer get the information? I assume the insurer is the insurance company. How do they receive the information for them to make a judgment about suitability?

Adam Hamm: that would flow from the producer.

Vice Chairman Kasper: Are you requiring the producer to send suitability information to the insurer with the application?

Adam Hamm: If suitability information is obtained from the consumer and they don't decline to provide that then yes.

Vice Chairman Kasper: In all cases if the consumer provides the suitability information it must be forwarded by the producer to the insurance company so they can also look a suitability standard compared to the producer.

Adam Hamm: That's part of the basis for HB 1160 and for the model that flowed from the NAIC was to expand this suitability recommendation and compliance to the insurance company not just the producer.

Vice Chairman Kasper: On page 7, line 11, we are saying an insurer's issuance of an annuity is subject to subdivision A must be reasonable under all the circumstances actually known to the insurer at the time the annuity is issued. So that protects the insurance company as well from circumstances changing or it could fall back to the producer if the producer failed to disclose all the information that producer had to the insurance company. It gives the insurance company the opportunity to say here are our records, we didn't know this, and therefore the liability for the issuance or in inappropriate issuance is at the producer level.

Adam Hamm: I would agree with everything you just said.

Chairman Keiser: Further questions? Anyone else here to testify in support of HB 1160?

Bruce Fergus~Senior VP, American Council of Life Insurers: I think it is 261 ACLI members that are licensed to do business here in North Dakota and account for roughly 90% of the life insurance and annuities in the Peace Garden State and we are in support of HB 1160. Before I go into the reasons I would like to commend & congratulate Chairman Keiser on your presidency of the National Conference of Insurance Legislators and Commissioner Hamm for his leadership at the NAIC level. He chairs the life insurance committee. ACLI worked very extensively with the NAIC throughout the development of the updates to the model act that you have before you in HB 1160. It was a very difficult and challenging exercise. There are many different types of agents and the means in which companies distribute their products is very diverse. Almost all the money coming in these days to a typical life insurance company is from the sale of annuities. The good news is that people are living longer and healthier lives. The bad news is they run the risk of outliving their resources and that is why annuities are becoming more important to people as they plan for retirement security. There was great care taken through the development of the amendments to harmonize the regulation with what exists as Commissioner Hamm explained. We want to make sure that across the board whether you are licensed by the insurance department or you are regulated that the overlay would apply in a consistent way for the benefit of consumers. With respect to where you are with other states, approximately 38 states including North Dakota have an earlier version of the NAIC model on their books. That is something that ACLI had been actively supporting. So far, since the adoption of the revised amendments to NAIC model which you have before you, 6 states have adopted updates based on those revisions and another 6 states have proposed revisions to update their laws. Most states have done this by regulations. A handful of states have done it by statute. I mentioned that we did review the amendments. We are satisfied that the amendments achieve the overall objective of uniformity.

Vice Chairman Kasper: On page 7 the bill is requiring signed statements by the consumer. Do you see that insurance company will be developing master forms that comply with state regulations like this or are the producers going to have to come up with their own forms?

Bruce Fergus: I do believe that the companies themselves will develop the forms and based on information I have it is not very often that a consumer decides the purchase an annuity against the recommendation of the producer. On the other hand, the extent to which forms may be required as checklists where a producer reviews the suitability information with the consumer and the consumer signs that and has record of that, that type of form and checklist would be kept by the insurer and provided to the consumer by the insurer.

Vice Chairman Kasper: What would be the effect on the insurance companies if the bill required the insurance companies to provide these forms to the producer?

Bruce Fergus: I don't know but I would be happy to follow-up on that. There may be instances where the producer develops their own forms that meet with the approval of the commissioner.

Vice Chairman Kasper: Would you see that any suitability form before it is used would need to be approved by the insurance department?

Bruce Fergus: I don't believe that there is a requirement in the act itself to seek prior approval of all the forms by the commissioner. I think to the extent that the commissioner would review a consumer complaint would be did the company and producer and consumer sign off on the fact that they were provided the information.

Vice Chairman Kasper: My concern as a producer is the insurance company or the producer could develop a form that they think addresses all the requirements to prove that the sale was suitable and gather the documentation and then there is a complaint later and you could go to the insurance department they could, after the fact, say that you missed something therefore you are guilty. If we require the department to look at it first and approve it, then there can be no question that we are using the right type of data and gathering the right type.

Bruce Fergus: I understand your concern. To the extent of problems occur and after the fact we understand that there are incomplete forms that might be submitted and that the agent didn't get the information from the consumer or the company didn't verify as they are required to under the law that the information was gathered and we could look at the prior approval requirement. I would hesitate to suggest at this point that some sort of prior approval would be required of the form. The requirements themselves are pretty specific about what information needs to be gathered. To the extent to which information required by the law isn't gathered, I can not only see the company and producer being at risk but that the department having reason to say that the company didn't do their job. If all the information required by this statute is captured then I'm not sure there would be the problem you have outlined.

Vice Chairman Kasper: Does the suitability for annuities, and I'm sure you're familiar with 401K plans and a lot of insurance companies offer group annuities and the employer chooses the plan and then it is offered to the employees. Does this bill require that the

producer obtain a suitability statement from every 401K participant or are we waived in the statute someplace or is this only individual products?

Bruce Fergus: I don't believe that it would apply in the instance of a group annuity where individual certificate holders would need to sign off on the suitability. Much of that would be done at the employer level.

Representative N Johnson: I'm looking at a timeline. Once the agent has got all the information from the individual looking at purchasing, that agent then must make a recommendation, and then what is the timeline from that decision? It has to go all the way up the chain to the insurer which is the insurance company for them to make a call and get back. Is that a very lengthy timeline or is that a matter of a few minutes? How does that work?

Bruce Fergus: One of the things that we expressed concern about during the development of the model was that would these additional requirements, not only that the producer obtain the information and verify that it met the suitability standards and that the company had an obligation not to issue the policy unless it had determined that the sale was suitable would mean that each individual would need to be reviewed by a second set of eyes. That might take time and there might be certain annuity transactions to the point that no one would disagree that they were suitable. For someone that is a little bit older may need to look at the length of the surrender charge period. Those transactions may need more review. It could take extra time but I think it is good business to make sure all that work is done on the front end so that the consumer not only is well served but we are satisfied that the purchase being made is a good one for the time of purchase.

Representative N Johnson: In the language in the proposed legislation it also talks about if the customer signs off saying I still want this annuity even though the suitability is not appropriate for me, and that goes to the insurer, how does the insurer handle that when it is not a recommendation and they get that person that wants the product? But according to all the structure that was put in, it is inappropriate. Do they go ahead and do it or refuse?

Bruce Fergus: Under the law that you would adopt, the sale could continue as long as both the producer and the company have advised against the purchase against the annuity but despite the advice is given to them they choose to purchase the annuity.

Representative Frantsovog: Once an agent and a purchaser agree to the type of annuity and the purchaser signs off on it that would relieve anybody of any liability if something would come up later. Isn't that true?

Bruce Fergus: You're right.

Representative N Johnson: What happens if the insurance agent has studied and has the qualifications and they make a recommendation who says yes I'll go with that and then that goes up the ladder to the insurance company and they say it is not appropriate. Who determines what happens then between the producer and the insurer?

Bruce Fergus: It would be a 2 step process. The producer would gather the information, make an assessment, and send it to the company. What is new about these updates is that the company would be required to have a system for reviewing those recommendations to satisfy itself that the purchase was suitable. There could be instances where the company disagrees based on the information that the product is suitable. They have the ultimate control on whether to issue the annuity. Part of the benefit of the statute is to bring more objectivity to the process by gathering information from the consumer about their tax status, their financial experience, and their age.

Chairman Keiser: The customer could sign or notify that even though it is inappropriate I still want to buy it. And the company could then issue it.

Representative N Johnson: Does the dispute become between the insurer and that producer to determine what is going to happen? That's outside of any legislation. They can have their own contracts and systems set up.

Bruce Fergus: Correct.

Chairman Keiser: Anyone else here in support of HB 1160?

Norbert Mayer~North Dakota Association of Insurance and Financial Advisors: We do support this bill. There was concern with suitability forms. My company provides a suitability form and the majority of the agents are going to be selling securities as well as annuities. The companies provide one suitability form which covers all of the suitability requirements. We also have a compliance officer who comes 1 or 2 times a year and even though we look at this person as a compliance officer, he/she is there to help. They make sure the forms meet adequate records to support the decisions that were made. We ask a lot of the questions outlined in the law in the suitability form. That form is then signed by the client as well as the producer and then it goes to the company. There are times when the company will call back and say based upon the information that has been provided, we are not sure that this is a suitable recommendation. We then have the opportunity to go back and visit with that potential insured to produce some additional information or the company may say this is simply not suitable and we aren't going to issue that particular contract. I think that is covered very well. The requirement that we have to ask those suitability questions actually helps us. For one thing we can say that we are required to gather the suitability information. That is why the law makes a provision where the client can sign off and says I refuse to provide the information but I still want to purchase this particular annuity. That is consistent with the long term care regulations likewise. With regards to the continuing education, I think that is a positive and you are putting the burden back on the company. The only concern I heard from some of our agents is how far is this going to go and they referenced to some states that require term insurance product, whole life, universal life, and so forth. I don't see it going in that direction but I think continuing education related to the product we are selling is always a good idea.

Vice Chairman Kasper: On page 12, line 15, it says the commissioner may evoke appropriate penalties and sanctions. It doesn't say what that is. The word appropriate is a pretty big area. Do you have any idea how broad that reaches?

Norbert Mayer: I don't have that answer.

Adam Hamm: Those would be tied to other penalties and sanctions that exist in the code. I don't have those committed to memory. We can get that for you though.

Chairman Keiser: Anyone else here to testify in support, in opposition, or in neutral to HB 1160? Seeing none we will close the hearing. What are the wishes of the committee?

Vice Chairman Kasper: I move to adopt the amendments.

Representative N Johnson: Second

Chairman Keiser: Further discussion?

Voice vote: Motion carries.

Chairman Keiser: What are the wishes of the committee?

Vice Chairman Kasper: I move a do pass as amended.

Representative Frantsvog: Second.

Chairman Keiser: Further discussion? Prior approval is a good strategy on rates and forms. It is very expensive for companies. You have 50 states and some other political subdivisions that are included in regulation and to go to every state and get prior approval or to go through the compact which a few states belong to, which is a very long time period in some cases, is very difficult. What happens as a company when you want to change your forms slightly? Do you have to go back and get re-prior approval before issuing? It adds a lot of costs. I think the bill is very clear and I think if the company wants to sell the product and wants to protect themselves they are going to provide an appropriate form. We will take the roll on a do pass as amended on HB 1160. We will close on HB 1160.

14 YEAS 0 NAYS 0 ABSENT
CARRIER: Rep. Nathe

DO PASS as Amended

February 02, 2011

VK
2/2/11

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1160

Page 1, line 18, remove ""Continuing education credit" means a continuing education credit as defined under"

Page 1, remove lines lines 19 through 21

Page 1, line 22, remove "4."

Page 2, line 1, replace "5." with "3."

Page 2, line 3, replace "6." with "4."

Page 2, line 6, replace "7." with "5."

Page 2, line 19, replace "8." with "6."

Page 10, line 12, replace "four-credit" with "four-hour"

Page 10, line 12, remove "approved by the insurance"

Page 10, line 13, remove "commissioner and provided by a continuing education provider"

Page 10, line 16, replace "six" with "twelve"

Page 10, remove lines 21 and 22

Page 10, line 23, replace "c." with "b."

Page 11, line 1, replace "d." with "c."

Page 11, remove lines 6 through 11

Page 11, line 12, replace "g." with "d."

Page 11, line 12, remove "shall comply with the reporting requirements and"

Page 11, line 13, remove "in accordance with chapter 26.1-26"

Page 11, line 14, replace "h." with "e."

Page 11, line 17, replace "i." with "f."

Page 11, line 21, remove "provided by commissioner-sponsored"

Page 11, line 22, remove "database systems or vendors or"

Page 11, line 23, remove "approved"

Renumber accordingly

Date: Feb 25, 2011

Roll Call Vote # 1

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES

BILL/RESOLUTION NO. 1160

House House Industry, Business and Labor Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: ☐ Do Pass ☐ Do Not Pass ☐ Amended ☒ Adopt Amendment

Motion Made By Rep Kasper Seconded By REP Johnson

| Representatives | Yes | No | Representatives | Yes | No |
|--------------------------|-----|----|--------------------------|-----|----|
| Chairman Keiser | | | Representative Amerman | | |
| Vice Chairman Kasper | | | Representative Boe | | |
| Representative Clark | | | Representative Gruchalla | | |
| Representative Frantsvog | | | Representative M Nelson | | |
| Representative N Johnson | | | | | |
| Representative Kreun | | | | | |
| Representative Nathe | | | | | |
| Representative Ruby | | | | | |
| Representative Sukut | | | | | |
| Representative Vigesaa | | | | | |
| | | | | | |

voice vote - motion carried

Total Yes _____ No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

Date: Feb 2-2011Roll Call Vote # 2

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES

BILL/RESOLUTION NO. 1160House House Industry, Business and Labor Committee☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: ☒ Do Pass ☐ Do Not Pass ☒ Amended ☐ Adopt AmendmentMotion Made By REP. Kasper Seconded By Rep. Frantsvog

| Representatives | Yes | No | Representatives | Yes | No |
|--------------------------|-----|----|--------------------------|-----|----|
| Chairman Keiser | ✓ | | Representative Amerman | ✓ | |
| Vice Chairman Kasper | ✓ | | Representative Boe | ✓ | |
| Representative Clark | ✓ | | Representative Gruchalla | ✓ | |
| Representative Frantsvog | ✓ | | Representative M Nelson | ✓ | |
| Representative N Johnson | ✓ | | | | |
| Representative Kreun | ✓ | | | | |
| Representative Nathe | ✓ | | | | |
| Representative Ruby | ✓ | | | | |
| Representative Sukut | ✓ | | | | |
| Representative Vigesaa | ✓ | | | | |
| | | | | | |

Total Yes 14 No 0Absent 0Floor Assignment Rep Nathe

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1160: Industry, Business and Labor Committee (Rep. Keiser, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (14 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HB 1160 was placed on the Sixth order on the calendar.

Page 1, line 18, remove ""Continuing education credit" means a continuing education credit as defined under"

Page 1, remove lines 19 through 21

Page 1, line 22, remove "4."

Page 2, line 1, replace "5." with "3."

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Page 11, line 22, remove "database systems or vendors or"

Page 11, line 23, remove "approved"

Re-number accordingly

2011 SENATE INDUSTRY, BUSINESS AND LABOR

HB 1160

2011 SENATE STANDING COMMITTEE MINUTES

Senate Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

HB 1160
March 23, 2011
Job Number 15862

☐ Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

Relating to annuity transaction practices

Minutes:

Testimony Attached

Chairman Klein: Called the hearing to order.

Representative Keiser: Said that this is an important policy bill. The annuity business has become the most significant point of life insurance. He said that approximately sixty five to seventy five percent of dollars collected today are in the form of annuity payments. This is something we have to do a good job on. He said there were many complaints being filed at the federal level to the suitability of annuities and congress began to hear a lot about it and started to raise a lot of questions and we're beginning to involve themselves saying maybe annuities are really investment products and not life insurance products and maybe the SCC should regulate them. There was some legal action taken both inside and outside of the court system but annuities are still in the insurance industry. This bill takes on the insurance industry and says we need to do a better job in terms of the regulation and the communication within the annuity industry. It holds producers, agents and everyone along that stream accountable for communicating what the annuity does what the provisions of the annuity are, what the limitations of the annuity are and what the additional cost of early forfeiture issues.

Senator Murphy: Asked if he would define an annuity.

Representative Keiser: Said it is a product that will provide for a revenue stream and frequently will have a life insurance provision. The industry packages annuities in a lot of forms and you can make a payment and put an infusion of cash on the front end. Typically annuities had a life insurance provision at the end but it would also provide options for a cash payment beginning at a certain time.

Senator Schneider: Asked if this is a product of ENCOIL or any NAIC model legislation or is this North Dakota's own approach or a blend.

Representative Keiser: Said that this model is a NAIC model, it has been adopted in several states and they are working aggressively to get it adopted across the board. He

said Congress gave us a wakeup call and if we want to continue to regulate these things we have to improve the annuity domain relative to who is responsible, accountable and what kind of information has to be provided.

Chairman Klein: Said for the committee's benefit, could you tell us how we are sitting as far as dual regulation, where is the federal government as far as trying to overrun what we as states have been regulating forever.

Representative Keiser: He said that certain segments of the insurance industry about three years ago started pushing the federal government for the development of an alternative regulatory system, a second, similar to the banking industry. They felt an appropriate strategy would be to have the potential for a federal optional charter and or a state charter. There has been a lot of debate a lot of work in that direction. The optional federal charter is not as popular today at the Congressional level as it was initially thought to be by the industry. There is an interim level that is being implemented which is the FIO, Federal Insurance Office, and initially the purpose was because congress did not have the necessary information they would like to have to make informed decisions relative to international issues which they regulate. The FIO which has been implemented to provide insurance related information to congress and it could end up becoming a big bureaucracy and get into the state regulatory issues. The industry sees a dual regulatory system coming that will just add another layer of regulation and the impact will be greater cost to the operation of the company. There has been a shift in company's attitudes to federal regulation.

Adam Hamm, Commissioner of the North Dakota Insurance Department: Testimony Attached.

Senator Schneider: Asked if there were any examples where the 2007 law failed consumers or is just trying to get ahead of the game.

Commissioner Hamm: Said that is right there are some holes they saw as a result of the model legislation that passed in 2007, North Dakota was the first state to adopt it and this is trying to get ahead of the curve, making sure insurers are complying, producers are complying and all annuity transactions are covered.

Senator Laffen: Asked if charitable gift annuities work through an insurance agent and is that how they would be affected by this.

Commissioner Hamm: Said if you go back to page one of engrossed House Bill 1160, you will see the definition section, it makes the definition of annuities much more broad then they use to be. Said he thinks that annuity would be covered here because the intent is to cover all annuity transactions.

Senator Nodland: Asked if most of the annuities were sold through insurance agents or are quite of few of them sold through investment firms.

Bruce Ferguson, Senior Vice President of the American Council of Life Insurers: They are a national trade association; two hundred and eighty two ACLI members are licensed to

do business in North Dakota representing over ninety percent of the life insurance and ninety percent of the annuity sold here in the state. He said this is a NAIC model that was updated; they spent a considerable amount of time working with the regulators on this issue and you can tell it is a very aggressive and comprehensive piece of legislation that requires many new obligations on the part of the company as well as the producer. It represents best practices that occur in the market place. What the regulators did was took the best of the best practices that exist in the marketplace and put them in the form of model legislation. He said it makes sense for the states to adopt it and for it to become the uniform standard across the country. An annuity is the opposite of life insurance, which is the protection against premature death and an annuity is protection against living to long, outliving your resources. These days people are living longer and healthier lives and that means there is a greater chance that people will outlive their resources and that is why annuities have become more popular over the last ten, fifteen, twenty years as a way of protecting individuals of the risk of outliving your resources. The model also accomplishes another objective and that is to harmonize state regulatory requirements regarding suitability with those that exist at the federal level at the SCC and FINRA for the sale of a type of annuity called a variable annuity, where there is an investment risk associated with that product. So the two standards now, if this legislation is adopted would be harmonized in a way that makes sense for consumers as well of customers regardless of where they may live. The question of how annuities are marketed these days, they are marketed through any number of different distribution channels and that is what made the update to this model very challenging and complicated. You have captive agents, some companies have agents that do business just with that company, you have independent agents that may represent any number of companies and you have broker dealers who are registered by the SCC and FINRA to sell variable products and you have banks as a distribution channel for the product. They all have to be licensed by either an insurance department, the SCC, FINRA or both to be able to sell annuities but because of the various ways products are distributed and sold we needed to make sure all those variations were dealt with throughout the country. He said uniformity is a very important consideration for ACLI members and one of the reasons why ACLI have been a proponent of an optional federal charter to try to make sure that the standards are uniform from state to state. Now we are seeing lots of activity and progress in the states on this front and in other areas. We think it is good public policy to make sure this update is in place.

Senator Nodland: Asked the difference between the fixed and variable annuities.

Bruce: A fixed annuity is a product where there is a minimum of a guaranteed fixed interest rate, as much money that is contributed to the annuity it builds up on a tax deferred bases and the interest rate credited grows the value of the annuity with the goal of when the time is that you want to retire you will have the value of that money that has grown over time with a guaranteed rate and be able to use it as a steady stream of income no matter how long you live. A variable annuity has a guaranteed minimum interest rate but it also takes a lot of the money that you contribute to the annuity and invests it in the stock market and the value of the annuity grows depending on how the stock market does. Hopefully it will have a greater amount of accumulation value that you can draw on when you are in your retirement years. He said they don't want customer complaints or people feeling they were led into buying a product that guaranteed income that was never going to be there.

Senator Nodland: Asked where the fixed annuity investments are.

Bruce: Said a fixed annuity the money that is taken in by the company is placed in the company's general account and the investments of the company are regulated by state insurance laws, you can only invest so many of your assets in certain types of securities. It is based on the investment mix of that company. A variable annuity is put into a separate account that has an investment management component to it, you may have an investment advisor that takes that money and invests it in various securities equities to produce a greater yield for the customer than otherwise would be the case if it were put in the company's general account.

Chairman Klein: Closed the hearing.

Senator Nodland: Moved a do pass on engrossed bill 1160

Senator Larsen: Seconded the motion.

Roll Call Vote: Yes-7 No-0

Senator Nodland to carry the bill

Date: 3/23/11
Roll Call Vote # 1

2011 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. Eng. HB 1160

Senate Industry, Business and Labor Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: ☒ Do Pass ☐ Do Not Pass ☐ Amended ☐ Adopt Amendment

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By Senator Nodland Seconded By Senator Larsen

| Senators | Yes | No | Senators | Yes | No |
|--------------------------|-----|----|-----------------------|-----|----|
| Chairman Jerry Klein | ✓ | | Senator Mac Schneider | ✓ | |
| VC George L. Nodland | ✓ | | Senator Philip Murphy | ✓ | |
| Senator John Andrist | ✓ | | | | |
| Senator Lonnie J. Laffen | ✓ | | | | |
| Senator Oley Larsen | ✓ | | | | |
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Total (Yes) 7 No 0

Absent 0

Floor Assignment Senator Nodland

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1160, as engrossed: Industry, Business and Labor Committee (Sen. Klein, Chairman) recommends DO PASS (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). Engrossed HB 1160 was placed on the Fourteenth order on the calendar.

2011 TESTIMONY

HB 1160

HOUSE BILL NO. 1160

Presented by: Adam Hamm
Commissioner
North Dakota Insurance Department

Before: House Industry, Business and Labor Committee
Representative George Keiser, Chairman

Date: February 2, 2011


TESTIMONY

Good morning, Chairman Keiser and members of the committee. My name is Adam Hamm, the North Dakota Insurance Commissioner. I appear before you today in support of House Bill No. 1160.

Background

This bill would amend existing law that was enacted in 2007 which regulates annuity sales. It is designed to enhance the protection of consumers when they buy or exchange an annuity policy. This bill would give further assurance that the insurance needs and financial objectives of consumers are being appropriately considered before an annuity purchase, exchange, or replacement is recommended by an insurer or an insurance producer (agent).

The most basic purpose of the law is to ensure that the annuity being recommended is suitable for the consumer. To accomplish that goal, it requires insurers to establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers in transactions involving annuity products so that consumers are protected from the financial harm that can come with improper sales tactics or improperly trained insurance agents. I believe these protections are important given the increased complexity and variety of annuity contracts being offered.




When is an annuity sale unsuitable? It can happen in multiple ways, such as when there is a failure to get sufficient information to determine the consumer's needs, when there is a failure to take into consideration the consumer's needs, when the consumer will incur substantial tax penalties or early surrender fees from a replaced product, or when a consumer will be subject to a new lengthy surrender charge period.

Section 1

Section 1 clarifies the scope of the law. It provides that the law applies to any recommendation to purchase, exchange, or replace an annuity made to a consumer by an insurance producer (agent), or an insurance company when no producer is involved, that results in the purchase, exchange, or replacement recommended.

Section 2




This section of the bill adds a definition of "replacement" and "suitability information", which I will explain later in my testimony.

Section 3

Section 3 clarifies that the insurance producer or insurer must have reasonable grounds to believe that the annuity is suitable for the consumer's financial situation and need. In order to do so, the insurance producer or insurer must have a reasonable basis to believe all of the following:

That the consumer has been informed of various features of the annuity such as potential surrender periods or charges, tax penalties, fees, and market risk;



That the consumer would benefit from certain features of the annuity, such as tax-deferred growth;

That the annuity is suitable and that transaction as a whole is suitable for the particular consumer based on that consumer's suitability information; and

That an exchange or replacement of an annuity is suitable, taking into consideration whether there will be a surrender charge, loss of existing benefits, or increased fees or charges, whether the consumer would benefit from product enhancements and improvements, and whether the consumer has had another annuity exchange or replacement, and in particular whether any such exchange or replacement has occurred within the preceding 36 months.

This section also requires the producer or insurer to obtain information from the consumer in order to be able to determine suitability. This "suitability information" includes: age, annual income, financial situation and needs, financial experience, financial objectives, intended use of the annuity, financial time horizon, existing assets, liquidity needs, liquid net worth, risk tolerance, and tax status (see definition in § 26.1-34.2-02(8)). There are exemptions from this requirement. An insurance producer and insurer do not have to fulfill these obligations if no recommendation for the purchase of an annuity was made, if the consumer provided materially inaccurate information, if the consumer refused to provide relevant suitability information, or the consumer decides to enter into an annuity transaction that is not based on the recommendation of the insurance producer or insurer. And the reasonableness of the issuance of an annuity is based on the circumstances actually known to the insurer at the time the annuity is issued.

The insurance producer or insurer is responsible for several things at the time of sale, including making a record of any recommendation, obtaining the consumer's signature on a statement documenting his or her refusal to provide suitability information or documenting that an annuity transaction is not recommended but which the consumer wishes to enter into anyway.

An insurer is also responsible for establishing a system to achieve compliance by the insurer and its sales force with the requirements of the bill. An insurer has to establish and maintain procedures to ensure that the insurance producers who sell for that insurer receive the training as set out in this bill. Insurers must also develop procedures to detect recommendations that are not suitable and they must annually provide a report to senior management which details a review, with appropriate testing, designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken. In addition, insurance producers are prohibited from dissuading a consumer from responding to the insurer's request for confirmation of suitability information, filing a complaint, or cooperating with the investigation of a complaint.

Section 4

Section 4 describes the training that insurance producers must get before they attempt to sell annuities. Insurance producers must complete a one-time training course on annuity suitability. Those who are already licensed to sell insurance are given time from the effective date of the bill to complete the required training. The training must cover certain topics designed to educate insurance producers about the purpose and intricacies of annuities, such as: the types of annuities, how fixed, variable, and indexed annuities affect consumers, the application of income taxation of qualified and nonqualified annuities, the primary uses of annuities, and appropriate sales practices and disclosure requirements. This section also requires insurers to verify that their insurance producers have completed the required annuity training course before allowing them to sell an annuity for that insurer.

I would like to address here some proposed amendments. These amendments are designed to relieve some of the administrative burden of tracking the training required in this section. The amendments would give currently licensed insurance producers 12 months, rather than 6 months, in which to secure 4 hours of annuity suitability training. It would also remove any reference to "continuing education credit" and "continuing education provider" so that the training being required would not have to meet

continuing education course requirements or be approved or tracked by the Insurance Department. Insurers providing annuities would be responsible for ensuring that their agents get the required four-hour training. And insurers are responsible for obtaining verification of the training and making it available to the Insurance Commissioner upon request. The training requirements may be approved for continuing education credit in North Dakota if the training has been filed and approved under North Dakota's continuing education laws and rules.

The amendments allow the training requirements to be applied to residents and nonresidents selling this product without requiring changes to the Insurance Department computer systems to track compliance.

It may be helpful to note that this proposed system of requiring the insurer to be responsible for training and maintaining records verifying agents' training is already working in other lines of insurance such as long-term care and flood insurance. We have issued bulletins explaining the requirements in these lines in the last couple of years and have not experienced any problems to date. We also post this information on our website so that new agents and companies doing business in our state are alerted to the requirements.

Section 5

Section 5 clarifies the existing law to provide that an insurer is responsible for compliance with this chapter and that the Commissioner may order an insurer, insurance producer, general agency, or independent agency to take reasonably appropriate corrective action for any consumer harmed by the violation of this chapter and that the Commissioner may impose appropriate penalties and sanctions for those violations.

That concludes my testimony. I would be happy to try to answer any questions you may have. Thank you.

February 2, 2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1160

Page 1, remove lines 18 through 21

Page 1, line 22, replace "4." with "2."

Page 2, line 1, replace "5." with "3."

Page 2, line 3, replace "6." with "4."

Page 2, line 6, replace "7." with "5."

Page 2, line 19, replace "8." with "6."

Page 10, line 12, replace "four-credit" with "four-hour" and remove "approved by the insurance"

Page 10, line 13, remove "commissioner and provided by a continuing education provider"

Page 10, line 16, replace "six" with "twelve"

Page 10, remove lines 21 and 22

Page 10, line 23, replace "c." with "b."

Page 11, line 1, replace "d." with "c."

Page 11, remove lines 6 through 11

Page 11, line 12, replace "g." with "d." and remove "shall comply with the reporting requirements and"

Page 11, line 13, remove "in accordance with chapter 26.1-26"

Page 11, line 14, replace "h." with "e."

Page 11, line 17, replace "i." with "f."

Page 11, line 21, remove "provided by commissioner-sponsored"

Page 11, line 22, remove "database systems or vendors or"

Page 11, line 23, remove "approved"

Renumber accordingly

ENGROSSED HOUSE BILL NO. 1160

Presented by: Adam Hamm
Commissioner
North Dakota Insurance Department

Before: Senate Industry, Business and Labor Committee
Senator Jerry Klein, Chairman

Date: March 23, 2011

TESTIMONY

Good morning, Chairman Klein and members of the committee. My name is Adam Hamm, the North Dakota Insurance Commissioner. I appear before you today in support of Engrossed House Bill No. 1160.

Background

This bill would amend existing law that was enacted in 2007 which regulates annuity sales. It is designed to enhance the protection of consumers when they buy or exchange an annuity policy. This bill would give further assurance that the insurance needs and financial objectives of consumers are being appropriately considered before an annuity purchase, exchange, or replacement is recommended by an insurer or an insurance producer (agent).

The most basic purpose of the law is to ensure that the annuity being recommended is suitable for the consumer. To accomplish that goal, it requires insurers to establish a system to supervise recommendations and to set forth standards and procedures for recommendations to consumers in transactions involving annuity products so that consumers are protected from the financial harm that can come with improper sales tactics or improperly trained insurance agents. I believe these protections are important given the increased complexity and variety of annuity contracts being offered.

When is an annuity sale unsuitable? It can happen in multiple ways, such as when there is a failure to get sufficient information to determine the consumer's needs, when there is a failure to take into consideration the consumer's needs, when the consumer will incur substantial tax penalties or early surrender fees from a replaced product, or when a consumer will be subject to a new lengthy surrender charge period.

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This section of the bill adds a definition of "replacement" and "suitability information", which I will explain later in my testimony.

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The insurance producer or insurer is responsible for several things at the time of sale, including making a record of any recommendation, obtaining the consumer's signature on a statement documenting his or her refusal to provide suitability information or documenting that an annuity transaction is not recommended but which the consumer wishes to enter into anyway.

An insurer is also responsible for establishing a system to achieve compliance by the insurer and its sales force with the requirements of the bill. An insurer has to establish and maintain procedures to ensure that the insurance producers who sell for that insurer receive the training as set out in this bill. Insurers must also develop procedures to detect recommendations that are not suitable and they must annually provide a report to senior management which details a review, with appropriate testing, designed to determine the effectiveness of the supervision system, the exceptions found, and corrective action taken. In addition, insurance producers are prohibited from dissuading a consumer from responding to the insurer's request for confirmation of suitability information, filing a complaint, or cooperating with the investigation of a complaint.

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I would like to explain here the amendments adopted by the House. The amendments relieved some of the administrative burden of tracking the training required in this section. The amendments gave currently licensed insurance producers 12 months, rather than 6 months, in which to secure 4 hours of annuity suitability training. They also removed any reference to "continuing education credit" and "continuing education provider" so that the training required would not have to meet continuing education

course requirements or be approved or tracked by the Insurance Department. Insurers providing annuities are responsible for ensuring that their agents get the required four-hour training. And insurers are responsible for obtaining verification of the training and making it available to the Insurance Commissioner upon request. The training requirements may be approved for continuing education credit in North Dakota if the training has been filed and approved under North Dakota's continuing education laws and rules.

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