

ANNUITY CERTIFICATION COURSE

4-HOUR

TEXAS

03-10-2010

Published in the United States of America
By: State Continuing Education, LLC
1.800.994.3040
www.StateCE.com

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INTRODUCTION

TEXAS ANNUITY CERTIFICATION & CONTINUING EDUCATION

Annuity Certification

Life, Accident & Health licensees whose license is issued or renewed on or after April 1, 2010, may not sell, solicit, or negotiate a contract for an annuity or represent an insurer in relation to an annuity in Texas until they have completed a 4-hour Annuity Certification Course that includes the following topics:

- The requirements of the Insurance Code Chapters 1114 & 1115 and the requirements of Chapter 3, Subchapter NN of this title (relating Consumer Notices for Life Insurance Policy & Annuity Contract Replacements)
- the prohibitions specified in the Insurance Code 541.05 – 541.061
- recognition of indicators that a prospective insured may lack the short-term memory or judgment to knowingly purchase an annuity; and
- Practices relating to annuities that are prohibited by the Penal Code Chapter 35.

Course subjects for an annuity certification course outline may include additional topics addressing statutes enacted & rules adopted subsequent to the effective date of this subchapter, provided that the statutes and rules relate specifically to annuities.

Successful completion of this course satisfies the Texas Annuity Certification Course requirement.

Annuity Continuing Education (CE)

Those licensees having taken the 4-hour certification course must complete a 4-hour refresher course that enhances the knowledge, understanding & professional competence of the student with regard to one or more subjects described above. Those licensees completing the certification course prior to the 12th month of that licensing period must complete the continuing education by the end of the expiration of that licensing period. Those licensees completing the certification course after the 12th month of the licensing period must complete the continuing education by the 12th month of the following licensing period.

CHAPTER ONE

SUITABILITY, DISCLOSURE, RECORDKEEPING, AND REPLACEMENT

The Requirements of the Insurance Code Chapters 1115

Suitability

Background

Regulators and Legislators have recently been focusing on the increased vibrancy of sales in annuities, focusing on whether high commissions, rather than investor suitability, drive sales. This resulted in major developments in Texas and nationally. The SEC approved FINRA's (formerly the NASD) new rules relating to variable annuity suitability and the supervision of variable annuity sales. And, a recent statute passed by the Texas Legislature effective January 1, 2008 applied suitability requirements to all individually recommended annuity sales and requires specific disclosures in annuity sales.

Annuity types

As we know, a fixed annuity pays out a defined return on investment for an indefinite period, usually the life of the insured and is not based on the performance of any investments. A variable annuity pays a return on investment based on the performance of subaccounts managed by investment advisers and has multiple other features and benefits. An equity-indexed annuity pays a defined return on investment, but may provide a limited upside based on the performance of an investment index. It has no subaccounts and no selected investments. Variable and equity-indexed annuities are complex contracts that typically require long holding periods for liquidation without penalties. They can also carry higher costs and higher commissions than other investments. Annuities carry tax deferral benefits.

Consumption

In recent years, insurers have sold in excess of \$160 billion of variable annuities and in excess of \$75 billion of fixed annuities. Variable annuities now hold almost \$1.5+ trillion in assets. Variable annuity sales have had periods where they were up more than 35% and where fixed annuity sales were down by more than 25% and vice versa. Equity-indexed annuities have also been growing. In recent years, the ten largest producers of this product sold almost in excess of \$20 billion of equity-indexed annuities.

Regulations

The regulation of the sale of annuities may fall into both securities and insurance regulatory regimes, which are vastly different. Securities regulatory regimes traditionally have imposed investor suitability requirements over the distribution channel and insurance regulatory regimes generally have not had suitability requirements. Further, under federal law, variable annuity sales have fallen under securities regulation while fixed annuity sales have fallen under state insurance regulators. Arguments persist about the appropriate regulatory regime for equity-indexed annuities, and the SEC has not made a final decision about its general jurisdiction over the sale of equity-indexed

annuities. FINRA asked the SEC to evaluate whether equity-indexed annuities are securities. Second, SEC Rule 151 may provide a safe harbor from securities registration for the sale of equity-indexed annuities. That rule exempts from securities regulation those annuities that are 1) registered with a state insurance administrator; 2) have the insurer assume the investment risk; and 3) not primarily marketed as investments. At least one court has ruled that equity-indexed annuities are not securities. Equity-indexed annuities sold by a registered securities broker-dealer would still be subject to suitability evaluations under broker-dealer rules.

Inappropriate Behaviors

One particular suitability concern for annuities involves switching, in which a salesman switches the customer's annuity, gets another large commission, and may cause the customer to pay early liquidation penalties. A second suitability concern involves placing annuities in tax-deferred accounts such as individual retirement accounts. In that case, the annuity's tax deferral benefit would generally be meaningless.

Replacement of Life Insurance and Annuities

Jurisdiction and Enforcement

Under Texas state law all annuities have been governed by the Texas Department of Insurance. The Texas Securities Act specifically excludes registered annuity contracts, thus depriving the Texas Securities Commissioner and courts enforcing the Texas Securities Act from direct authority over annuities.

The Texas Legislature passed two bills impacting the sale of annuity contracts and required suitability in annuity sales for the first time. These bills give enforcement duties to the Texas Department of Insurance.

Annuity Suitability - HB 2761

HB 2761 created a suitability requirement in the sale of annuities made after January 1, 2008. It added Chapter 1115 to the Texas Insurance Code and applied to agent-recommended fixed, variable, and equity-indexed annuities, provided that the annuity was individually solicited. The chapter's applicability does not depend on whether the annuity is a group or individual annuity. *Texas Insurance Code §§1115.002(2) and 1115.003(a)*.

Advertisements Exempted

Chapter 1115 exempts advertisements and other direct responses if no information was collected from the customer, contracts used to fund employee benefit or welfare plans covered by ERISA, 401(k) and similar plans, and government and church plans, nonqualified deferred compensation arrangements by the employer or plan sponsor, litigation or claim settlements, and prepaid funeral benefits. *Texas Insurance Code §1115.003(b)*.

Texas Insurance Code - Chapter 1115 - Suitability

Standards and Procedures Regarding Recommendations

Chapter 1115 was added to the Insurance Code to regulate the standards and procedures regarding recommendations made to a consumer that involve the purchase of an annuity. These

standards and procedures ensure that the insurance needs and financial objectives of the consumer are appropriately addressed.

Reasonable Efforts to Obtain Information

This chapter applies to any recommendation to purchase or exchange an annuity made to a consumer by an agent or insurer, and results in the recommended purchase or exchange of the annuity. Before the consumer's purchase or exchange of an annuity, the agent, or the insurer if an agent is not involved, must make reasonable efforts to obtain information from the consumer concerning the consumer's financial status, the consumer's tax status, the consumer's investment objectives, and other relevant information used or considered to be reasonable in making recommendations to consumers.

Failure to Comply

If the agent or insurance company fails to comply with these requirements, the commissioner may impose sanctions as provided by the Insurance Code. The act does not provide for a private cause of action for a violation.

Obtain Purchaser Information

Chapter 1115 requires that before executing a recommended annuity purchase, the agent (or the insurer in a direct sale) must make reasonable efforts to obtain the purchaser's financial status, tax status, investment objectives, and other relevant information.

Reasonable Grounds

The annuity recommended by the agent (or the insurer in a direct sale) must have "reasonable grounds for believing that the recommendation is suitable" for that purchaser based on the purchaser's other insurance, their investments, and financial situation and needs. *Texas Insurance Code §§1115.051(a) and (b)*. The "reasonable grounds" standard is based on the agent's (or insurer's if direct sold) actual knowledge at the time of the recommendation. *Texas Insurance Code §1115.051(d)*.

Absolved from Responsibility

The agent (or the insurer if direct sold) is absolved from responsibility if the purchaser refused to provide the relevant information, provided incomplete or inaccurate information, or entered into a non-recommended annuity transaction. *Texas Insurance Code §§1115.051(c)*.

Detailed Compliance System

The gathering of information and the reasonable basis for the recommendation will need to be well-documented. In light of this, Chapter 1115 also requires maintaining a detailed compliance system in connection with recommended annuity sales, including written procedures and periodic reviews of the agents' and insurers' records to detect patterns indicating unsuitable annuity sales. *Texas Insurance Code §§1115.052(a) through (c)*. Agents and insurers may contract with third parties to establish and maintain the compliance system, but must reasonably inquire as to whether the third party is fulfilling its duties and take reasonable actions to enforce the third party's contractual compliance duties. These reasonable inquiries requirement can be fulfilled by an annual certification or periodically selecting other third parties to review the first third party's compliance work. *Texas Insurance Code §1115.052(d)*. The review procedures must

be “reasonable under the circumstances” and do not require the review of all agent-solicited transactions or the extension of these compliance controls beyond recommendations of annuity products. *Texas Insurance Code §§1115.052(e) and (f)*. Insurers can request compliance certifications from their agents. *Texas Insurance Code §1115.053*.

Maintaining Records Time Period

Chapter 1115 requires that agents and insurers maintain records of annuity recommendations and the information used as the basis for the recommendations for five years. *Texas Insurance Code §1115.055*.

Private Cause of Action

Chapter 1115 specifically states that it shall not be construed to create a private cause of action. It can only be enforced by the Texas Department of Insurance which can impose administrative sanctions and penalties and require that insurers and agents take specific corrective actions. *Texas Insurance Code §§1115.101 and 1115.102*.

Although Chapter 1115 authorizes no private right of action, the new recordkeeping requirements for the sale of each recommended annuity may provide fodder for those seeking other insurance-related causes of action, including damages actions for “an unfair or deceptive act or practice in the business of insurance.” *Texas Insurance Code §541.151*.

FINRA suitability rules vs. Chapter 1115’s

Finally, compliance with FINRA suitability rules will meet Chapter 1115’s requirements for variable annuity recommendations. *Texas Insurance Code §1115.054*. But, compliance with FINRA record-keeping requirements does not necessarily fulfill the Chapter 1115’s record-keeping requirements.

Suitability and Disclosure Developments in Variable Annuity Sales in Texas

Suitability Concerns

Other suitability concerns involve carrying costs, holding periods, and allocations in variable annuity subaccounts.

For Texas brokers, major developments in annuity sales have occurred. The SEC has approved FINRA’s new sales and supervisory rules for the sale of variable annuities. These rules were effective August 4, 2008. Also, the Texas Legislature for the first time passed suitability rules for all annuity sales. Those laws were effective January 1, 2007.

FINRA’s Annuity Sales and Supervision Rules

FINRA’s variable annuity sales rule, Rule 2821, went into effect on August 4, 2008. Rule 2821 has multiple provisions. It created new suitability obligations, principal review and approval requirements, and supervisory and training requirements tailored specifically to variable annuity transactions that will be in addition to other NASD general rules on these topics.

Rule 2821

Rule 2821 applies to the purchase or exchange of variable annuities and the customer's initial subaccount allocations. It does not generally apply to reallocations or subsequent premium payments, or when the purchase or exchange occurs within a tax-qualified employer-sponsored retirement or benefit plan. But, Rule 2821 does apply if a broker recommends a variable annuity to an individual plan participant.

Rule 2821 requires that a broker have a reasonable basis to believe that the transaction is suitable for the customer in order to recommend a variable annuity purchase or exchange. It also requires principal review and approval before transmitting to the insurer within seven business days of the sale, and require training specifically tailored to variable annuity sales. Finally, the SEC made a technical change to the Net Capital Rule, Rule 15c3-1 which states that during the time the broker-dealer is holding a customer check for a variable annuity purchase pending principal approval and transmission, it will not be deemed to be holding customer funds for the purpose of the net capital rule.

The broker-dealer and the insurer require that all the required information be thoroughly documented and it takes many pages. Also, broker-dealers need to provide extensive training to their sales force to make sure that brokers understand the new rule and the broker-dealers procedures used to comply with the rule.

Rule 2821 is an add-on suitability determination rule. The general suitability requirements of Rule 2310 still apply.

Rule 2821 Broker Requirements

Reasonable Efforts to Obtain Information

Rule 2821 requires that brokers make reasonable efforts to obtain, at a minimum, the following information from the prospective customer before recommending a variable annuity:

- Age;
- Annual Income;
- Financial Situation and Needs;
- Investment experience;
- Investment objectives;
- Intended use of the variable annuity;
- Investment time horizon;
- Existing assets (including investment and life insurance holdings);
- Liquidity needs;
- Liquid net worth;
- Risk Tolerance;
- Tax status; and
- Such other information reasonably used or considered in recommending annuities to customers.

In Writing and in Great Detail

Because brokers need to be able to demonstrate, often years later, to principals, FINRA and SEC examiners, and arbitration panels that there was a reasonable basis for the recommendation, brokers must obtain this information in writing and in great detail. Some of these items may include checking boxes, but other items, such as existing assets, use of a variable annuity, and liquidity needs need more detailed written explanations. Also, there is a provision of the Texas Insurance Code (further explained below) which requires that the broker obtain a detailed list of all of the customers' other life insurance policies and annuities.

Reasonable Efforts

What does "reasonable efforts" mean? It means get it in writing. Principals and compliance departments face personal supervisory liability from FINRA for approving annuity sales and are unlikely to sign off on these sales based on assertion that the customer did not want to provide the requested information but still wanted to purchase an annuity.

Customer Informed VA Features

Once this required information has been obtained, the broker must start making disclosures about the recommended product. Under Rule 2821, the broker and the broker-dealer must have a reasonable basis to believe that the customer has been informed, in general terms, of variable annuities various features, including:

- Potential surrender period;
- Potential surrender charge;
- Potential tax penalty if customers sell or redeem variable annuities before reaching age 59 ½;
- Mortality and expense fees;
- Investment advisory fees;
- Potential charges for and features of riders;
- The insurance and investment components of variable annuities; and
- Market risks.

General and Variable Issues Disclosures

This disclosure requirement combines both general annuity issues and items that are variable depending on the particular annuity recommended. This means that broker-dealers should create their own general annuity features disclosure document and also provide the insurer's disclosure summary. The broker also needs to be able to document that these disclosures were actually delivered with time enough for the customer to review. There is a requirement of these disclosure agreements signed by the customers, but it may also be wise to provide a copy of these disclosures during the initial meeting when the customer information is gathered. Broker dealers should also expect SEC and FINRA examiners to focus on policies and proof relating to delivery of these required variable annuity disclosures.

Suitability Prism Evaluation

After gathering information and providing disclosure, the broker is only one step away from being able to recommend a variable annuity. But, it is a big step. The broker must run all the

customer's needs and the features of the various products through the suitability prism using a detailed list of factors provided by Rule 2821. The general suitability requirements of Rule 2310 also remains in effect. Rule 2821 requires the broker to evaluate if the customer would benefit from at least some of the annuity features, including:

- tax deferred growth;
- annuitization; or
- a death or living benefit.

The reference to tax deferred growth means that brokers should be cautious about recommending variable annuities for qualified accounts.

The next step in the suitability determination is to review the subaccount allocations, riders, and product enhancements to determine if all of these items are consistent with the customers needs as stated in the information gathered from the customer.

Variable Annuity Exchanges have Additional Requirements

Finally, variable annuity exchanges have additional requirements. If the transaction is an annuity exchange, the suitability determination will take into consideration whether:

- The customer would incur a surrender charge;
- The customer would be subject to commencing a new surrender period;
- The customer would lose existing benefits, such as mortality and expense fees, or charges for riders and similar product enhancements;
- The customer would benefit from the product enhancements and improvements; and
- The customer's account had another variable annuity exchange within the preceding 36 months.

Variable Annuity Exchange Within Previous 3 Years

If there was another variable annuity exchange within the previous 3 years, FINRA and SEC examiners will undoubtedly view those transactions as red flags and seek exact details about them. As is standard at many firms today, from a compliance perspective exchanges will require a written acknowledgement of these issues by the customer. Detailed broker notes about the various discussions of these issues will also be a crucial part of the record.

Suitability

Is an Annuity Right for Your Client?

The following scenarios illustrate when an annuity might be – and might not be – a good investment. Sharing these with your client can go a long way in having them informed to be able to make their own suitable annuity and retirement planning and buying choices:

Already Retired

- If you are already retired, an annuity is probably not a good option because it can take many years for the contract to become profitable. Annuities are generally best used to provide for retirement when purchased at least five to 10 years before you retire.

No Other Savings or Investments

- If you do not have any other investments or savings accounts, an annuity is probably not a good place to start. It is generally a good idea for investors to have at least some investments that can be quickly converted to cash in case of an emergency or sudden need. You may have to pay a substantial surrender charge – which can be as high as 25 percent – if you withdraw your money within a certain number of years of purchasing an annuity.

Guaranteed Income Stream

- If your financial goal is to generate a guaranteed income stream for retirement, certain types of annuities that make fixed monthly payments for the remainder of your lifetime can be a good option.

Longer-Term View

- If you have the financial discipline to accumulate and maintain your contract for the long term, an annuity can be a good option. Cashing in an annuity in the short term can result in significant surrender charges and could increase your tax obligations.

Tax Bracket Consideration

- If you're currently in a high-income tax bracket, but expect to be in a lower tax bracket in the future, such as in retirement, an annuity can be a good choice because earnings are tax-deferred. This means an annuity's earnings aren't taxed while they grow, only when you actually make a withdrawal or receive a payment from the contract. If you contribute to an annuity while you're in a high tax bracket and receive payments while you're in a lower one, you will probably pay less in taxes than you would with other types of financial options.
-

Consider Other Financials

- It is also important for you to consider your other debts, i.e., student loans, home equity loans, before purchasing an annuity.

Shopping Smart for Annuities

We need to make sure our clients and customers are smart shoppers when it comes to annuities. If they decide that an annuity might be a good investment option for them, you could educate them on using these tips to help them shop:

Shop Around

- Compare the projected interest rate, whether it is guaranteed or not, the length of time until annuitization or payout, the fees and percent or duration of the surrender charges of multiple annuities contracts. Also, compare an annuity's projected return with other types of investments, such as index funds, mutual funds, and government bonds. Even with an annuity's tax advantages, these other investments may provide an equal or better return while providing less restrictive access to your money.

Time Frame for Payout

- **Make sure the time frame for payout is right for your needs.** Remember that annuities are not short-term financial tools. They frequently take a decade or longer to become profitable.

How Much Risk

- **Know how much risk you want to take on.** It's important to decide the level of risk you're willing to accept before you purchase an annuity. Weigh that against the risk posed by the type of annuity you're considering. Fixed annuities guarantee a minimum rate of return. Variable annuities have the potential to earn significantly more, but you could also lose money. If your primary goal is to keep an existing sum of money roughly in line with inflation, with the possibility of some earnings, consider a fixed annuity. If you're willing to accept the risk of a more aggressive investment, a variable annuity may be a better choice. Remember, annuities are investments and may lose value.

Company's Earnings History

- **Check the company's earnings history.** An agent will likely present you with a chart or other materials projecting an annuity's growth over time. But remember, projections aren't guarantees. An agent may show you a high rate of return for a fixed annuity, but you might only earn the guaranteed minimum rate. Also, if financial conditions change for the worse, your earnings could decline. Ask the agent how well earnings of annuities offered by the company have met projected rates in the past. If earnings are consistently below target, consider shopping for another company.

Verifying Company's Agent and Company Licenses

- **Verify that the agent and company are licensed.** Agents and companies must have a Texas insurance license to legally sell annuities in the state. In addition, agents who sell variable annuities must have a federal securities license. Although it won't avoid every potential problem, verifying the agent or company's license is a good first step toward ensuring that an annuity is legitimate and meets minimum state requirements.

Consumer Help Line

- You can quickly verify licensing status by calling our *Consumer Help Line* or viewing company profiles on our website.

1-800-252-3439
463-6515 in Austin
www.tdi.state.tx.us

Complaint Index

- **Check the company's complaint index.** The complaint index is an indication of a company's customer service record. You can check complaint records by calling the Consumer Help Line or by visiting the website.

Company's Financial

- **Consider the company's financial condition.** Annuities are a long-term financial option. A company that is in solid financial shape is more likely to be around when it is time for you to collect on your contributions. You can learn a company's financial rating from an independent rating organization by calling TDI's Consumer Help Line.

Take Your Time

- **Take your time to consider.** It's probably not a good idea to purchase a contract as complex as an annuity on a first visit with an agent. Take all the time you need to make a decision. If you feel you are being pressured to make a decision quickly, go elsewhere. You may want to bring a trusted family member or friend with you when you meet with the agent. Almost all annuities sold in Texas come with a 10-day "free look" period, and replacement annuities provide a 30-day free look provision. During this period, you can cancel the contract for any reason and get a full refund. Use this time to reread the contract and make sure it meets your financial needs. If the annuity doesn't offer a free look period, use extra caution.

Beware Door to Door

- **Be wary of annuities sold door-to-door or over the telephone.** While most annuities sold door-to-door or over the telephone are legitimate, these sales techniques can lend themselves to fraud operations. If you do buy an annuity in this manner, insist on knowing the company's physical address, and make sure you have a way to contact the agent or company.

Trusted Advisors

- **Consider consulting an accountant, financial adviser, or a trusted family member or friend.** If you purchase an annuity that you don't fully understand, you could be in store for unpleasant surprises down the road. A finance professional should be able to help you understand the annuity and evaluate it in comparison to other investment products. Also, you may want to discuss the annuity with a trusted family member or friend who can assist you with making financial decisions.

Research Options and Ask Questions

- **Research the annuity you're considering.** Ask the agent or company the following questions:
 - What is guaranteed under the annuity, such as interest rates or bonuses?
 - How does the annuity earn excess (non-guaranteed) credits?
 - Can the annuity lose value without surrender?
 - Are there early withdrawal penalties, such as surrender charges or negative adjustments?
 - Is there a free withdrawal provision? If so, what are the terms?
 - What is the death benefit?
 - What is the earliest maturity or annuitization date?

CHAPTER TWO

REPLACEMENT DISCLOSURE

Texas Insurance Code - Chapter 1114 - Replacement Disclosure

Regulating Replacement

Chapter 1114 was added to the Insurance Code regulating the replacement of certain life insurance policies and annuities.

At Application Initiation

When an insurance agent initiates an application for a life insurance policy or annuity, the agent is now required to submit to the insurance company, with or as part of the application, a statement signed by both the applicant and the agent disclosing whether the applicant has existing policies or contracts.

Replacement Notice

If the applicant does have existing policies or contracts, the agent is required to present and read to the applicant a notice regarding replacement of the policy. The notice must include: 1) all life insurance policies or annuities proposed to be replaced, properly identified by the name of the insurer and the company; 2) the name of the insured or annuitant; 3) the policy or contract number, if available; and 4) a statement as to whether each policy or contract will be replaced or if a policy will be used as a source of financing for the new policy or contract.

Right to Return

When the policy is replacing an existing policy, the insurer is required to provide to the policy owner notice of the policy owner's right to return the policy or contract within 30 days of delivery of the policy or contract and receive an unconditional full refund of all premiums or considerations paid on the policy or contract. The failure of an insurer or agent to comply with the requirements of this new Chapter 1114 constitutes a violation of the Unfair Competition Practices Act and subjects the insurer or the agent to the penalties provided therein.

Annuity Disclosures - HB 2762

Detailed Compliance and Disclosure Paperwork

HB 2762 added Chapter 1114 to the Texas Insurance Code. Chapter 1114 generally provides that insurance agents and companies produce detailed compliance and disclosure paperwork to customers considering paying for a new annuity or life insurance policy with financing or

proceeds from a previous annuity or life insurance policy. **Q42** These switching transactions have been a special concern for regulators.

Disclosure-Based Process

Chapter 1114 is a detailed disclosure-based, not a suitability-based regime. It provides that agents must submit a statement signed by both the agent and the applicant as to whether the proposed insured has existing policies or contracts as part of the application for a new life insurance policy or annuity. If the applicant states that there are existing policies or contracts, the agent must present the applicant with a required notice approved by the Insurance Commissioner that lists all the life insurance policies and annuities the applicant proposes replacing, the name of the insured or annuitant, and whether that policy will be used as a financing source for the new policy or contract. The applicant and agent both must sign the notice and attest that the notice was read aloud to the applicant or the applicant waived reading. The notice must be left with the applicant. If the notice is presented to the applicant via the Internet, the insurer must mail the applicant a copy of the notice within three business days of receiving the application. The agent must also leave with the applicant all sales materials used in presenting the new life insurance policy or annuity. *Texas Insurance Code §1114.051.*

Read or Waive Reading

On December 27, 2007, the Texas Insurance Commissioner issued new rules mandating that that an insurance customer be read or waive reading a notice about replacing annuities or life insurance policies. *28 TX Admin Code §3.9504.* The Commissioner also issued a mandatory notice for direct response consumer notices. *28 TX Admin Code §3.9505.* Any variations from these notices must be pre-approved by the Texas Department of Insurance. *28 TX Admin Code §3.9506.* These mandatory notices must be in at least 10 point font and are attached at the end of this article.

Duties of Insurance Companies Selling the Replacement Annuity

Chapter 1114 also imposes duties on insurance companies selling the replacement policy or annuity. The selling insurer must:

- Tell its agents about the Chapter 1114 notice and disclosure requirements and incorporate these requirements into all relevant training manuals;
- Provide each agent with a written statement on the whether and under what circumstances it will accept applications for replacement policies;
- Review the “appropriateness” of each replacement policy;
- Implement procedures to ensure that the insurer meets these provisions;
- Implement procedures to detect replacement transactions involving policies or annuities issued by that insurer in considering new applications, regardless of whether the agent or applicant has disclosed the existence of that previous policy. *Texas Insurance Code §1114.052(a) – (c);* and
- Provide notice of the proposed replacement to the original life insurer. *Texas Insurance Code 1114.053(c).*

Appropriateness

The Texas Department of Insurance has yet to issue regulations defining terms such as “appropriateness.” But, that term may lead to something similar to a suitability review requirement. However, the statute provides a large loophole to the “appropriateness” determination. If the agent tells the insurer that the replacement transaction is consistent with the insurer’s written statement on the circumstances under which it will accept applications for replacement policies, then the insurer need not review the “appropriateness” of the transaction.

The statute appears to say that the insurer can rely entirely upon the agent’s representation. But, the Texas Department of Insurance may require something more than taking the agent’s blanket representation at face value.

Monitoring of Agents’ Sales

Chapter 1114 also requires insurers to generally monitor their agents’ sales of life insurance policies and annuities and be able to produce records detailing:

- Each agent’s life insurance replacements, including financed purchases, as a percentage of the agent’s total annual life insurance sales;
- Each agent’s number of policy lapses by the agent as a percentage of the agent’s total annual life insurance sales;
- Each agent’s annuity replacements, including financed purchases, as a percentage of the agent’s total annual annuity contract sales;
- Number of transactions that are unreported replacements of existing life insurance policies or annuity contracts detected by the insurer’s required monitoring system; and
- Replacement life insurance policies and annuities indexed by agent and previous insurer.

Maintaining Agents’ Records – 5 Years

Chapter 1114 requires that insurers maintain these records for at least five years. *Texas Insurance Code §1114.052(d)*. The new statute also requires that insurers “ascertain” that the sales materials and illustrations used in replacement life insurance policy and annuity sales are “complete and accurate for the proposed policy or contract” and that the insurer maintain these records for five years. *Texas Insurance Code §1114.052(g) and (h)*. The insurer has some further compliance requirements for customers who come from “direct response solicitations” which include endorsers or sponsors and all forms of advertising. *Texas Insurance Code §§1114.002(2) and 1114.055*.

Owner’s Right to Receive Information

Finally, Chapter 1114 imposes certain duties on the insurers who issued the policies or annuities being replaced. Upon receipt of a notice of replacement by the insurer issuing the replacement life insurance policy or annuity, the previous insurer must provide a notice to the policy or contract owner about the owner’s right to receive information about the existing policy and contract values. The notice must include an in force illustration or a policy summary. *Texas Insurance Code §1114.054(c)*.

Notice - Effect of releasing Values

The previous insurer must also provide the customer with a notice stating that “the release of policy values may affect the guaranteed elements, nonguaranteed elements, face amount, or surrender value of the policy from which the values are released.” *Texas Insurance Code §1114.054(d)*.

Maintaining Replacement Records

These previous insurers must also preserve for five years all received replacement notifications received from the insurers issuing the replacement life insurance policies or annuities. *Texas Insurance Code §1114.054(b)*.

Failure to Comply

Chapter 1114 provides that the failure of insurers and agents to comply with its provisions “constitutes a violation of Chapter 541 and is subject to sanctions and penalties as provided by that chapter.” *Texas Insurance Code §1114.101(a)*. Chapter 541 of the Texas Insurance Code provides that the Texas Department of Insurance can bring administrative actions for violations of the Texas Insurance Code’s provisions that can lead to sanctions and penalties. It also provides for a private cause of action for “damages.” *Texas Insurance Code §541.151*. This means that the Chapter 1114 does not create any claims for general damages by reference to Chapter 541. But, in litigation a plaintiff’s attorney could well argue an insurer’s failure to comply with Chapter 1114’s notice requirements is generally indicative of an “unfair method of competition or an unfair or deceptive act or practice in the business of insurance.” *Texas Insurance Code §541.151*.

Chapter 1114 also provides that “if it is determined that the requirements of this chapter have not been met,” the insurer issuing the new life insurance policy or annuity shall provide the policy owner an in force illustration, policy summary, or available disclosure document and the required notice regarding replacements. *Texas Insurance Code §1114.001(c)*. The statute does not say who is required to make that determination. In any event, the only remedy provided for that violation to the policy owner is the requirement that the policy owner receive the required disclosures and notice.

Administrative Remedies for Violations

The Texas Department of Insurance may seek extensive administrative remedies for violations of Chapter 1114. In addition to the penalty and sanction provisions of Chapter 541, the Texas Department of Insurance can seek to revoke or suspend an agent’s license or certificate of authority and forfeit commissions or other compensation paid to an agent. *Texas Insurance Code §1114.102(a)*. Violations that were material to the sale may also lead to an order requiring payment of restitution, restoration of the policy or contract values, and interest payments. *Texas Insurance Code §1114.102(b)*.

In connection with both recommended annuities and life insurance policy and annuity switches, it should be noted that if these activities are done by a FINRA-registered broker-dealer, the purchaser may have claims to enforce under FINRA suitability rules applicable to the broker-dealer.

CHAPTER THREE

REPLACEMENT

TX Insurance Code - Chapter 3 - Subchapter NN.

**Consumer Notices for Life Insurance Policy and Annuity Contract
Replacements**

28 TAC §§3.9501 - 3.9506

Background

The Texas Department of Insurance has a relatively new Subchapter NN, §§3.9501 - 3.9506, relating to the replacement of certain life insurance policies and annuity contracts. This is necessary because of the requirements of HB 2762 to adopt rules to accomplish and enforce the purpose of the Chapter 1114 of the Insurance Code and adopt or approve model documents to be used as consumer notices under the new chapter.

Purpose

As provided in §1114.001, Chapter 1114 was enacted to (i) regulate the activities of insurers and agents with respect to the replacement of existing life insurance and annuities; (ii) protect the interests of purchasers of life insurance or annuities by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions; (iii) ensure that purchasers receive information with which a decision in the purchaser's best interest may be made; (iv) reduce the opportunity for misrepresentation and incomplete disclosure; and (v) establish penalties for failure to comply with the requirements adopted under Chapter 1114.

Consumer Notices

The purpose of the consumer notices proposed in this subchapter is to provide consumers with necessary information regarding potential consequences resulting from the replacement of annuity contract or life insurance policies that will enable them to more likely make a decision that is in their best interest and to reduce the opportunity for misrepresentation and incomplete disclosure.

Examples Shown in This Chapter

Examples shown later in this course chapter. The text in the Example: 28 TAC §3.9504(b) notice for insurers using agents, the proposed Example: 28 TAC §3.9505(a)(1) notice for direct response applicants intending replacement, and the Example: 28 TAC §3.9505(a)(2) notice required for direct response applicants who respond that they do not intend a replacement or who fail to respond to an insurer's inquiry is verbatim from the National Association of Insurance Commissioners Model Number 613, Life Insurance

and Annuities Replacement Model Regulation (NAIC Model). It is the Department's understanding that these NAIC Model notices are currently in widespread use throughout the industry.

The text in both the Example: 28 TAC §3.9504(b) notice required for insurers using agents and the Example: 28 TAC §3.9505(a)(1) notice for direct response applicants intending replacement must be prefaced by the proposed Department consumer advisory in Example: 28 TAC §3.9506(b). The Department advisory is necessary to alert consumers in a succinct manner to the possible negative consequences that may result from life insurance and annuity replacement transactions and to summarize issues explored in further detail in the remainder of the consumer notice.

Adoption of the Model Notices

The adoption of the model notices relating to life insurance and annuity replacement is within the Commissioner's scope of authority under the Insurance Code §§1114.006 and 1114.007. Section 1114.006 requires that the Commissioner by rule adopt or approve model documents to be used for consumer notices under Chapter 1114. Section 1114.007 authorizes the Commissioner to adopt reasonable rules in the manner prescribed by Insurance Code, Subchapter A, Chapter 36, to accomplish and enforce the purpose of Chapter 1114.

Purpose of the Subchapter

§3.9501 states the purpose of the subchapter is to specify the content and procedural requirements for consumer notices for life insurance policy and annuity contract replacements as required by the Insurance Code §1114.006.

Agent and Producer Meanings

§3.9502 specifies that the terms "agent" and "producer" shall have the same meanings when used in the subchapter and defines those terms.

Content and Format Requirements

§3.9503 specifies the content and format requirements for the proposed notices.

§3.9503(a) details the formatting and content requirements for the proposed text in Example: 28 TAC §3.9504(b), in Example: 28 TAC §3.9505(a)(1) and in Example: 28 TAC §3.9505(a)(2) and provides that references that are not applicable to the product being sold or replaced may be omitted from the required text, as provided in §3.9503(c).

§3.9503(b) specifies formatting and content requirements for the proposed text in Example: 28 TAC §3.9506(b) and provides that references that are not applicable to the product being sold or replaced may be omitted from the required text, as provided in §3.9503(c).

§3.9503(c) specifies that a reference in a required notice is presumed applicable if it could be applicable under any circumstances and therefore may not be omitted from the required notice.

§3.9503(d) specifies that an insurer may add a company name and identifying form number to notices required under the subchapter.

§3.9504 addresses the consumer notice regarding life insurance policy and annuity contract replacements that is to be used for insurers using agents.

Submitting Existing Policies Info

§3.9504(a) requires an agent initiating an application for a life insurance policy or annuity contract to submit information to the insurer on whether an applicant for a life insurance policy or annuity contract has existing policies or contracts.

Consumer Notice

§3.9504(b) specifies the conditions that require the use of the consumer notice and the procedures for providing the notice to the applicant. The proposed Example: 28 TAC §3.9504(b) contains the text of the required notice to be used for insurers using agents.

Notices Required in Direct Response Sales

§3.9505 regulates notices required in direct response sales governed by Insurance Code Chapter 1114.

§3.9505(a) requires insurers to inquire whether an applicant applying in response to a direct response solicitation intends to replace, discontinue, or change an existing policy or contract.

§3.9505(a)(1) requires that if the insurer proposed the replacement or if the applicant responds affirmatively that they intend a replacement, the insurer must send to the applicant the notice specified in Example: 28 TAC §3.9505(a)(1). The Example: 28 TAC §3.9505(a)(1) contains the text of the required notice.

§3.9505(a)(2) requires that if the applicant states a replacement is not intended or fails to respond to the insurer's inquiry regarding the applicant's replacement intention, the insurer must send the notice specified in the proposed Example: 28 TAC §3.9505(a)(2). The proposed Example: 28 TAC §3.9505(a)(2) contains the text of the required notice.

Notices Text Specifications

§3.9506(a) requires that the text in Example: 28 TAC §3.9504(b) and Example: 28 TAC §3.9505(a)(1) be prefaced with the text in Example: 28 TAC §3.9506(b).

§3.9506(b) specifies that the text in Example: 28 TAC §3.9506(b) may be printed on a separate piece of paper or printed on the same piece of paper as the text in Example: 28 TAC §3.9504(b) and Example: 28 TAC §3.9505(a)(1), but in either case must meet the formatting and content requirements of §3.9503.

Impact of the regulations

It has also been determined that for each year of the first five years the regulation is in effect, the anticipated public benefit will be that consumers will have more information regarding potential consequences resulting from the replacement of annuity contracts or

life insurance policies, and will therefore be more likely to make a decision that is in their best interest.

It has determined that for each year of the first five years the proposal will be in effect, there will be no fiscal impact to state and local governments as a result of the enforcement or administration of the proposal. There will be no measurable effect on local employment or the local economy as a result of the proposal. The probable costs to insurers required to comply with the proposed rules will result from the printing and mailing of the consumer notices specified in the proposal. The actual total cost to each insurer required to comply with the proposed rules will depend upon the individual insurer's particular costs for each cost component, the number of transactions requiring notices, whether those transactions are agent or direct solicitation sales, the number of pages used in printing the notices and whether the notices are printed one-sided or two-sided.

Purpose of the Statute, Chapter 1114

The purpose of the statute, Chapter 1114, as provided in §1114.001, is to (i) regulate the activities of insurers and agents with respect to the replacement of existing life insurance and annuities; (ii) protect the interests of purchasers of life insurance or annuities by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions; (iii) ensure that purchasers receive information with which a decision in the purchaser's best interest may be made; (iv) reduce the opportunity for misrepresentation and incomplete disclosure; and (v) establish penalties for failure to comply with the requirements adopted under Chapter 1114.

The purpose is to protect the economic welfare of consumers contemplating the purchase of life insurance policies or annuity contracts by providing them with necessary information to enable them to make important financial decisions that are in their best interest. Applicants without this information or with insufficient information may make life insurance or annuity transaction decisions resulting in surrender charges, penalties, tax liabilities, or an inability to access funds without a penalty for substantial periods of time. The consumer notices are consistent with the legislative intent of Chapter 1114 of the Insurance Code that the economic interests of all consumers engaging in life insurance and annuity contract replacement transactions are protected and not just the economic interests of those consumers who engage in such transactions with large insurers.

§3.9503. Consumer Notice Content and Format Requirements

Text Contained in Example: 28 TAC §3.9504(b),

(a) The text contained in Example: 28 TAC §3.9504(b), Example: 28 TAC §3.9505(a)(1) and Example: 28 TAC §3.9505(a)(2) must be in at least 10 point type and presented in the same order as indicated in each figure and without any change to the specified text, including bolding effects, except that references that are not applicable to the product being sold or replaced may be omitted, as provided in subsection (c) of this section.

Text Contained in Example: 28 TAC §3.9506(b)

(b) The text contained in Example: 28 TAC §3.9506(b) must be in at least 12 point type and presented in the same order as indicated in Example: 28 TAC §3.9506(b) and without any change to the specified text, including bolding effects, except that references that are not applicable to the product being sold or replaced may be omitted, as provided in subsection (c) of this section.

(c) For purposes of this subchapter, a reference in any notice required under this subchapter to a product that is being sold or replaced is applicable if the reference could be applicable under any possible circumstances and therefore may not be omitted from the required notice.

(d) An insurer may add a company name and identifying form number to notices specified under this subchapter.

§3.9504.Consumer Notice Regarding Replacement for Insurers Using Agents.

(a) An agent who initiates an application for a life insurance policy or annuity contract must submit to the insurer, with or as part of the application, a statement signed by both the applicant and the agent as to whether the applicant has existing life insurance policies or annuity contracts.

(b) If the applicant states that the applicant does have existing policies or contracts, the agent shall present and read to the applicant, not later than at the time of taking the application, a notice regarding replacement that contains the text contained in Example: 28 TAC §3.9504(b). The notice must be signed by both the applicant and the agent attesting that the notice has been read aloud by the agent or that the applicant did not wish the notice to be read aloud, in which case the agent is not required to read the notice aloud.

Example: 28 TAC §3.9504(b)

**Texas Required Notice for Life Insurance or Annuity Replacements
IMPORTANT NOTICE:
REPLACEMENT OF LIFE INSURANCE OR ANNUITIES**

This document must be signed by the applicant and the producer, if there is one, and a copy left with the applicant.

You are contemplating the purchase of a life insurance policy or annuity contract. In some cases this purchase may involve discontinuing or changing an existing policy or contract. If so, a replacement is occurring. Financed purchases are also considered replacements.

CHAPTER 1: REGULATIONS

A replacement occurs when a new policy or contract is purchased and, in connection with the sale, you discontinue making premium payments on the existing policy or contract, or an existing policy or contract is surrendered, forfeited, assigned to the replacing insurer, or otherwise terminated or used in a financed purchase.

A financed purchase occurs when the purchase of a new life insurance policy involves the use of funds obtained by the withdrawal or surrender of or by borrowing some or all of the policy values, including accumulated dividends, of an existing policy to pay all or part of any premium or payment due on the new policy. A financed purchase is a replacement.

You should carefully consider whether a replacement is in your best interests. You will pay acquisition costs and there may be surrender costs deducted from your policy or contract. You may be able to make changes to your existing policy or contract to meet your insurance needs at less cost. A financed purchase will reduce the value of your existing policy and may reduce the amount paid upon the death of the insured.

We want you to understand the effects of replacements before you make your purchase decision and

ask that you answer the following questions and consider the questions on the back of this form.

1. Are you considering discontinuing making premium payments, surrendering, forfeiting, assigning to the insurer, or otherwise terminating your existing policy or contract? ___ YES ___ NO
2. Are you considering using funds from your existing policies or contracts to pay premiums due on the new policy or contract? ___ YES ___ NO

If you answered "yes" to either of the above questions, list each existing policy or contract you are contemplating replacing (include the name of the insurer, the insured or annuitant, and the policy or contract number if available) and whether each policy or contract will be replaced or used as a source of financing:

INSURER CONTRACT OR INSURED OR REPLACED (R) OR
NAME POLICY # ANNUITANT FINANCING (F)

- 1.
- 2.
- 3.

Make sure you know the facts. Contact your existing company or its agent for information about the old policy or contract. If you request one, an in force illustration, policy summary or available disclosure documents must be sent to you by the existing insurer. Ask for and retain all sales material used by the agent in the sales presentation. Be sure that you are making an informed decision.

The existing policy or contract is being replaced because _____.

CHAPTER 1: REGULATIONS

I certify that the responses herein are, to the best of my knowledge, accurate:

Applicant's Signature and Printed Name Date

Producer's Signature and Printed Name Date

I do not want this notice read aloud to me. ____ (Applicants must initial only if they do not want the notice read aloud.)

A replacement may not be in your best interest, or your decision could be a good one. You should make a careful comparison of the costs and benefits of your existing policy or contract and the proposed policy or contract. One way to do this is to ask the company or agent that sold you your existing policy or contract to provide you with information concerning your existing policy or contract. This may include an illustration of how your existing policy or contract is working now and how it would perform in the future based on certain assumptions. Illustrations should not, however, be used as a sole basis to compare policies or contracts. You should discuss the following with your agent to determine whether replacement or financing your purchase makes sense:

PREMIUMS: Are they affordable?

Could they change?

You're older – are premiums higher for the proposed new policy?

How long will you have to pay premiums on the new policy?

On the old policy?

POLICY VALUES: New policies usually take longer to build cash values and to pay dividends.

Acquisition costs for the old policy may have been paid, you will incur costs for the new one.

What surrender charges do the policies have?

What expense and sales charges will you pay on the new policy?

Does the new policy provide more insurance coverage?

INSURABILITY: If your health has changed since you bought your old policy, the new one could cost you more, or you could be turned down.

You may need a medical exam for a new policy.

Claims on most new policies for up to the first two years can be denied based on inaccurate statements.

Suicide limitations may begin anew on the new coverage.

IF YOU ARE KEEPING THE OLD POLICY AS WELL AS THE NEW POLICY:

How are premiums for both policies being paid?

How will the premiums on your existing policy be affected?

Will a loan be deducted from death benefits?

What values from the old policy are being used to pay premiums?

IF YOU ARE SURRENDERING AN ANNUITY OR INTEREST SENSITIVE LIFE PRODUCT:

Will you pay surrender charges on your old contract?
What are the interest rate guarantees for the new contract?
Have you compared the contract charges or other policy expenses?

OTHER ISSUES TO CONSIDER FOR ALL TRANSACTIONS:

What are the tax consequences of buying the new policy?
Is this a tax free exchange? (See your tax advisor.)
Is there a benefit from favorable "grandfathered" treatment of the old policy under the federal tax code?
Will the existing insurer be willing to modify the old policy?
How does the quality and financial stability of the new company compare with your existing company?

§3.9505.Direct Response Consumer Notices

(a) In the case of a life insurance or annuity application initiated as a result of a direct response solicitation, the insurer shall inquire whether the applicant, by applying for the proposed policy or contract, intends to replace, discontinue, or change an existing life insurance policy or annuity contract. The inquiry may be included with, or submitted as a part of, each completed application for such policy or contract.

(1) If the insurer has proposed the replacement or if the applicant indicates a replacement is intended and the insurer continues with the replacement, the insurer shall send a notice that contains the text in Example: 28 TAC §3.9505(a)(1).

Example : 28 TAC §3.9505(a)(1)

Texas Required Notice for Life Insurance or Annuity Replacements

**IMPORTANT NOTICE:
REPLACEMENT OF LIFE INSURANCE OR ANNUITIES**

You are contemplating the purchase of a life insurance policy or annuity contract. In some cases this purchase may involve discontinuing or changing an existing policy or contract. If so, a replacement is occurring. Financed purchases are also considered replacements.

A replacement occurs when a new policy or contract is purchased and, in connection with the sale, you discontinue making premium payments on the existing policy or contract, or an existing policy or contract is surrendered, forfeited, assigned to the

replacing insurer, or otherwise terminated or used in a financed purchase.

A financed purchase occurs when the purchase of a new life insurance policy involves the use of funds obtained by the withdrawal or surrender of or by borrowing some or all of the policy values, including accumulated dividends, of an existing policy to pay all or part of any premium or payment due on the new policy. A financed purchase is a replacement.

You should carefully consider whether a replacement is in your best interests. You will pay acquisition costs and there may be surrender costs deducted from your policy or contract. You may be able to make changes to your existing policy or contract to meet your insurance needs at less cost. A financed purchase will reduce the value of your existing policy and may reduce the amount paid upon the death of the insured.

We want you to understand the effects of replacements before you make your purchase decision and ask that you answer the following questions and consider the questions on the back of this form.

1. Are you considering discontinuing making premium payments, surrendering, forfeiting, assigning to the insurer, or otherwise terminating your existing policy or contract? ___ YES ___ NO
2. Are you considering using funds from your existing policies or contracts to pay premiums due on the new policy or contract? ___ YES ___ NO

If you answered "yes" to either of the above questions, list each existing policy or contract you are contemplating replacing (include the name of the insurer, the insured or annuitant, and the policy or contract number if available) and whether each policy or contract will be replaced or used as a source of financing:

INSURER CONTRACT OR INSURED OR REPLACED (R) OR
NAME POLICY # ANNUITANT FINANCING (F)

- 1.
- 2.
- 3.

Make sure you know the facts. Contact your existing company or its agent for information about the old policy or contract. If you request one, an in force illustration, policy summary or available disclosure documents must be sent to you by the existing insurer. Ask for and retain all sales material used by the agent in the sales presentation. Be sure that you are making an informed decision.

The existing policy or contract is being replaced because _____.

I certify that the responses herein are, to the best of my knowledge, accurate:

Applicant's Signature and Printed Name Date

Producer's Signature and Printed Name Date

I do not want this notice read aloud to me. ____ (Applicants must initial only if they do not want the notice read aloud.)

A replacement may not be in your best interest, or your decision could be a good one. You should make a careful comparison of the costs and benefits of your existing policy or contract and the proposed policy or contract. One way to do this is to ask the company or agent that sold you your existing policy or contract to provide you with information concerning your existing policy or contract. This may include an illustration of how your existing policy or contract is working now and how it would perform in the future based on certain assumptions. Illustrations should not, however, be used as a sole basis to compare policies or contracts. You should discuss the following with your agent to determine whether replacement or financing your purchase makes sense:

PREMIUMS: Are they affordable?

Could they change?

You're older—are premiums higher for the proposed new policy?

How long will you have to pay premiums on the new policy?

On the old policy?

POLICY VALUES: New policies usually take longer to build cash values and to pay dividends.

Acquisition costs for the old policy may have been paid, you will incur costs for the new one.

What surrender charges do the policies have?

What expense and sales charges will you pay on the new policy?

Does the new policy provide more insurance coverage?

INSURABILITY: If your health has changed since you bought your old policy, the new one could cost you more, or you could be turned down.

You may need a medical exam for a new policy.

Claims on most new policies for up to the first two years can be denied based on inaccurate statements.

Suicide limitations may begin anew on the new coverage.

IF YOU ARE KEEPING THE OLD POLICY AS WELL AS THE NEW POLICY:

How are premiums for both policies being paid?

How will the premiums on your existing policy be affected?

Will a loan be deducted from death benefits?
What values from the old policy are being used to pay premiums?

IF YOU ARE SURRENDERING AN ANNUITY OR INTEREST SENSITIVE LIFE PRODUCT:

Will you pay surrender charges on your old contract?
What are the interest rate guarantees for the new contract?
Have you compared the contract charges or other policy expenses?

OTHER ISSUES TO CONSIDER FOR ALL TRANSACTIONS:

What are the tax consequences of buying the new policy?
Is this a tax free exchange? (See your tax advisor.)
Is there a benefit from favorable “grandfathered” treatment of the old policy under the federal tax code?
Will the existing insurer be willing to modify the old policy?
How does the quality and financial stability of the new company compare with your existing company?

Replacement or Change is Not Intended

(2) If the applicant indicates a replacement or change is not intended or if the applicant fails to respond to the statement, the insurer shall send the applicant, with the policy or contract, a new policy or contract notice that contains the statements in Example: 28 TAC 3.9505(a)(2).

Example : 28 TAC §3.9505(a)(2)

Texas Required Notice for Direct Response Consumer Notices on Replacement of Life Insurance and Annuities

NOTICE REGARDING REPLACEMENT REPLACING YOUR LIFE INSURANCE POLICY OR ANNUITY?

Are you thinking about buying a new life insurance policy or annuity and discontinuing or changing an existing one? If you are, your decision could be a good one—or a mistake. You will not know for sure unless you make a careful comparison of your existing benefits and the proposed policy or contract’s benefits.

Make sure you understand the facts. You should ask the company or agent that sold you your existing policy or contract to give you information about it.

Hear both sides before you decide. This way you can be sure you are making a decision that is in your best interest.

§3.9506. Texas Department of Insurance Consumer Advisory

(a) Effective April 1, 2008, the text in Example: 28 TAC §3.9504(b) and Example: 28 TAC §3.9505(a)(1) must be prefaced with the text in Example: 28 TAC §3.9506(b).

(b) The text in Example: 28 TAC §3.9506(b) may be printed on a separate piece of paper or printed on the same piece of paper as the text in Example: 28 TAC §3.9504(b) or Example: 28 TAC §3.9505(a)(1) of this subchapter, but in either case the text in Example: 28 TAC §3.9506(b) must meet the requirements of §3.9503.

Example : 28 TAC §3.9506(b)

TEXAS DEPARTMENT OF INSURANCE CONSUMER ADVISORY

This transaction may have very serious financial consequences for you. Life insurance policies and annuity contracts provide many consumers with needed financial security. However, please be advised that you may be unable to access your funds in a new policy or contract for many years without incurring charges or penalties. There may be additional tax liabilities if you use funds from an existing policy or contract. Consider consulting a tax advisor. Changing your current policies or contracts may result in additional costs, and you may also lose benefits and coverage. Carefully read all documents provided to you during the sale and when your policy or contract is delivered.

CHAPTER FOUR

PROHIBITIONS

The Prohibitions Specified in the Insurance Code §§541.051 – 541.061;

Purpose

In order to abide by the law and to not be unfair, deceptive, or deceitful as you go about the insurance and annuity business with clients and new customers it is important to be aware of and to understand all items under the Texas Insurance Code § 541.051-§ 541.061. Texas residents deserve our utmost effort to do the right and legal things for them at all times.

Misrepresentation Regarding Policy or Insurer - § 541.051

Do not misrepresent policy details like terms, advantages, surpluses, financials, or legal reserves.

Unfair or Deceptive Acts and Practices

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to:

- make, issue, or circulate or cause to be made, issued, or circulated an estimate, illustration, circular, or *statement misrepresenting a policy* issued or to be issued:
 - the terms of the policy;
 - the benefits or advantages promised by the policy; or
 - the dividends or share of surplus to be received on the policy;
- make a *false or misleading statement* regarding the dividends or share of surplus previously paid on a similar policy;
- make a **misleading representation** or misrepresentation regarding:
 - the financial condition of an insurer; or
 - the legal reserve system on which a life insurer operates;
- use a name or *title of a policy or class of policies that misrepresents the true nature of the policy* or class of policies; or

- make a *misrepresentation to a policyholder* insured by any insurer for the purpose of inducing or that tends to induce the policyholder to allow an existing policy to lapse or to forfeit or surrender the policy.

False Information and Advertising - § 541.052

Marketing and advertising must be truthful and not deceptive, or misleading assertion, representations, or statements.

Untrue Advertisement, Announcement, or Statements

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to make, publish, disseminate, circulate, or place before the public or directly or indirectly cause to be made, published, disseminated, circulated, or placed before the public an advertisement, announcement, or statement containing an untrue, deceptive, or misleading assertion, representation, or statement regarding the business of insurance or a person in the conduct of the person's insurance business.

This section applies to an advertisement, announcement, or statement made, published, disseminated, circulated, or placed before the public:

- in a newspaper, magazine, or other publication;
- in a notice, circular, pamphlet, letter, or poster;
- over a radio or television station; or
- in any other manner.

Defamation of Insurer - § 541.053

Do not misrepresent other companies or other agents and producers.

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to directly or indirectly make, publish, disseminate, or circulate or to aid, abet, or encourage the making, publication, dissemination, or circulation of a statement that:

- is false, maliciously critical of, or derogatory to the financial condition of an insurer; and
- is calculated to injure a person engaged in the business of insurance.

This section applies to any oral or written statement, including a statement in any pamphlet, circular, article, or literature.

Boycott, Coercion, or Intimidation - § 541.054

You must not do anything that that boycotts, provides coercion, or intimidates to result in unreasonable restraint.

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to commit through concerted action or to enter into an agreement

to commit an act of boycott, coercion, or intimidation that results in or tends to result in the unreasonable restraint of or a monopoly in the business of insurance.

False Financial Statement - § 541.055

Do not make false statements to anyone, especially financial ones.

False Financial Statements to the Public

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to, with intent to deceive:

- file with a supervisory or other public official a false statement of financial condition of an insurer; or
- make, publish, disseminate, circulate, deliver to any person, or place before the public or directly or indirectly cause to be made, published, disseminated, circulated, delivered to any person, or placed before the public a false statement of the financial condition of an insurer.

False Entries and Omissions of Financial Information

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to make a false entry in an insurer's book, report, or statement or willfully omit to make a true entry of a material fact relating to the insurer's business in the insurer's book, report, or statement with intent to deceive:

- an agent or examiner lawfully appointed to examine the insurer's condition or affairs; or
- a public official to whom the insurer is required by law to report or who has authority by law to examine the insurer's condition or affairs.

Prohibited Rebates and Inducements - § 541.056

Rebating and providing inducements to get business is unfair and illegal.

Premium Rebating

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to knowingly permit the making of, offer to make, or make a life insurance contract, life annuity contract, or accident and health insurance contract or an agreement regarding the contract, other than as plainly expressed in the issued contract, or directly or indirectly pay, give, or allow or offer to pay, give, or allow as inducement to enter into a life insurance contract, life annuity contract, or accident and health insurance contract a rebate of premiums payable on the contract, a special favor or advantage in the dividends or other benefits of the contract, or a valuable consideration or inducement not specified in the contract, or give, sell, or purchase or offer to give, sell, or purchase in connection with a life insurance, life annuity, or accident and health insurance contract or as inducement to enter into the contract stocks, bonds, or other securities of an insurer or other corporation, association, or partnership, dividends or profits accrued from the stocks, bonds, or securities, or anything of value not specified in the contract.

Non-Cash Rebating

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to issue or deliver or to permit an agent, officer, or employee to issue or deliver as an inducement to insurance:

- company *stock* or other capital stock;
- a benefit *certificate or share* in a corporation;
- *securities*; or
- a special or advisory board contract or any other *contract promising returns or profits*.

Unfair Discrimination in Life Insurance and Annuity Contracts - § 541.057

Everyone must be treated the same when it comes to buying and selling annuities.

Between Individuals

Subject to Section 541.058, it is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to make or permit with respect to a life insurance or life annuity contract an unfair discrimination between individuals of the same class and equal life expectancy regarding:

- the *rates* charged;
- the *dividends* or other benefits payable; or
- any of the *other terms and conditions* of the contract.

Certain Practices not Considered Discrimination or Inducement - § 541.058

There are certain practices that are not considered rebating and inducing.

It is not a rebate or discrimination prohibited by Section 541.056(a) or 541.057:

- for a life insurance or life annuity contract, to *pay a bonus* to a policyholder or otherwise abate the policyholder's premiums in whole or in part *out of surplus* accumulated from nonparticipating insurance policies if the bonus or abatement:
 - is fair and equitable to policyholders; and
 - is in the best interests of the insurer and its policyholders;
- for a life insurance policy issued on the industrial debit plan, to make to a policyholder who has continuously for a specified period made premium payments directly to the insurer's office an allowance in an amount that fairly represents the *saving in collection expenses*;
- for a group insurance policy, to *readjust the rate of premium based on the loss or expense experience* under the policy at the end of a policy year if the adjustment is retroactive for only that policy year; or

- for a life annuity contract, to *waive surrender charges* under the contract when the contract holder exchanges that contract for another annuity contract issued by the same insurer if the waiver and the exchange are fully, fairly, and accurately explained to the contract holder in a manner that is not deceptive or misleading.

Deceptive Name, Word, Symbol, Device, or Slogan - § 541.059

You must not try to trick people by using words, titles, names, and symbols that are close to other companies and people in order to be deceitful of others.

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to use, display, publish, circulate, distribute, or cause to be used, displayed, published, circulated, or distributed in a letter, pamphlet, circular, contract, policy, evidence of coverage, article, poster, or other document, literature, or public media:

- a name as the corporate or business name of a person or entity engaged in the business of insurance or in an insurance-related business in this state that is the same as or deceptively *similar to the name adopted and used by an insurance entity*, health maintenance organization, third-party administrator, or group hospital service corporation authorized to engage in business under the laws of this state; or
- a word, symbol, device, or slogan, either alone or in combination and regardless of whether registered, and including the titles, designations, character names, and distinctive features of broadcast or other advertising, that is the same as or deceptively *similar to a word, symbol, device, or slogan adopted and used by an insurance entity*, health maintenance organization, third-party administrator, or group hospital service corporation to distinguish the entity or the entity's products or services from another entity.

First One In, Wins

If more than one person or entity uses names, words, symbols, devices, or slogans, either alone or in combination, that are the same or deceptively similar and are likely to cause confusion or mistake, the person or entity that demonstrates the first continuous actual use of the name, word, symbol, device, slogan, or combination has not engaged in an unfair method of competition or deceptive act or practice under this section.

Unfair Settlement Practices - § 541.060

Settle claims quickly and do not misrepresent the facts.

Unfair Claims methods

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to engage in the following unfair settlement practices with respect to a claim by an insured or beneficiary:

- misrepresenting to a claimant a material fact or policy provision relating to coverage at issue;
- failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of:
 - a claim with respect to which the insurer's
 - liability has become reasonably clear; or
 - a claim under one portion of a policy with respect to which the insurer's liability has become reasonably clear to influence the claimant to settle another claim under another portion of the coverage unless payment under one portion of the coverage constitutes evidence of liability under another portion;
- failing to promptly provide to a policyholder a reasonable explanation of the basis in the policy, in relation to the facts or applicable law, for the insurer's denial of a claim or offer of a compromise settlement of a claim;
- failing within a reasonable time to:
 - affirm or deny coverage of a claim to a policyholder; or
 - submit a reservation of rights to a policyholder;
- refusing, failing, or unreasonably delaying a settlement offer under applicable first-party coverage on the basis that other coverage may be available or that third parties are responsible for the damages suffered, except as may be specifically provided in the policy;
- undertaking to enforce a full and final release of a claim from a policyholder when only a partial payment has been made, unless the payment is a compromise settlement of a doubtful or disputed claim;
- refusing to pay a claim without conducting a reasonable investigation with respect to the claim;
- with respect to a Texas personal automobile insurance policy, delaying or refusing settlement of a claim solely because there is other insurance of a different kind available to satisfy all or part of the loss forming the basis of that claim; or
- requiring a claimant as a condition of settling a claim to produce the claimant's federal income tax returns for examination or investigation by the person unless:
 - a court orders the claimant to produce those tax returns;
 - the claim involves a fire loss; or
 - the claim involves lost profits or income.
- Subsection (a) does not provide a cause of action to a third party asserting one or more claims against an insured covered under a liability insurance policy.

Misrepresentation of Insurance Policy - § 541.061

Be sure not to make mistakes with material facts, statements, laws, etc.

False and Untrue Statements

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to misrepresent an insurance policy by:

- making an untrue statement of material fact;
- failing to state a material fact necessary to make other statements made not misleading, considering the circumstances under which the statements were made;
- making a statement in a manner that would mislead a reasonably prudent person to a false conclusion of a material fact;
- making a material misstatement of law; or
- failing to disclose a matter required by law to be disclosed, including failing to make a disclosure in accordance with another provision of this code.

CHAPTER FIVE

SHORT TERM MEMORY DEFICIENCY & ANNUITY PURCHASES

Recognition of Indicators that a Prospective Insured May lack the Short-term Memory or Judgment to Knowingly Purchase an Annuity

It is critical for agents and producers to understand and recognize the indicators that a prospective insured may lack the short-term memory or judgment to knowingly purchase an annuity. Neither the senior with memory loss nor the agent wins in a transaction to buy an annuity where the senior does not have the capacity to make an informed decision about suitable financial instrument purchases.

Fees and Unnecessary Losses

The senior may very well end up with a bad situation where there are inappropriate fees, losses, and unnecessary losses that will most often be blamed on the agent who did not recognize the indicators of memory loss and will be seen as taking advantage of the unsuspecting senior. It's a lose-lose situation for everyone.

Causes of Short Term Memory Loss

Short-term memory is the failure of memory and normally results from failure to adequately store, retain and retrieve the information. It is also known as recent or working memory. It is basically a system for temporary storage and management of information, required to carry out simple and complex cognitive tasks. Some of these tasks include learning, reasoning, evaluation and comprehension. Short memory is vulnerable to many obstructions and interferences.

Amnesia and Abnormal Degrees

Believe it or not, all types of memory loss are actually subsets of amnesia. Clinically, memory loss has been defined as "an abnormal degree of forgetfulness and/or inability to recall past events." The key word there is "abnormal" -- a slight decline in memory function is expected with aging, but actual memory loss is something that goes above and beyond that standard. Where the loss in ability is primarily related to recent events, doctors refer to it as short-term memory loss.

Symptoms

The symptoms of short-term memory loss are, not surprisingly, an inability to recall information recently processed by the brain. In order to define short-term memory more accurately, we need to first establish the three types of memory: short, recent long-term, and remote long-term. By defining the term negatively (that is, defining it by first

establishing what short-term memory is not) we can more easily delineate between the three. With that said, recent long-term memory is used to store information that occurred in the close past. Examples would include things such as what one ate for dinner last night, or what movie one watched the past weekend. Remote long-term memory is everything in the extreme past - where one was born, the color of your first house, the name of your best childhood friend. Anything that does not fall into the other two categories is, by exclusion, part of your short-term memory. Any noticeable impairment in your ability to recall those most recent events is a clear indicator of short-term memory loss.

Suspicious Practices Targeting Senior Citizens

In a commissioner's bulletin, the Insurance Department has been informed that suspicious practices targeting senior citizens have been occurring throughout the United States and wants to inform and alert the Texas insurance industry about these transactions. The Department takes allegations of deceptive practices targeting senior citizens very seriously and will prosecute any such violations to the fullest extent possible.

Nursing Home Annuity Sales Practices

The Department has received complaints regarding questionable annuity sales practices directed at seniors residing in nursing homes. Texas agents have purportedly approached nursing home personnel and solicited them to gather information from nursing home residents in an effort to make an annuity sale. The Department has also been notified of agent annuity presentations in nursing homes that it is investigating as deceptive sales practices.

Duty to Report Fraudulent Insurance Acts §701.051

The Department reminds insurers and agents involved in life insurance and annuity sales that new laws relating to suitability. Texas Insurance Code §701.051 gives insurers and agents an affirmative duty to report fraudulent insurance acts to the Department and Insurance Code Chapter 34 provides certain immunities from civil liability for the reporting of fraudulent activities.

Penalties

The Insurance Code also provides for the assessment of various administrative penalties, including the revocation of an insurance agent's license, for failure to comply with any provision of the Insurance Code, including provisions relating to unauthorized insurance; deceptive trade practices; advertising violations; rebating and other prohibited inducements; and fraudulent or dishonest conduct. If warranted, the Department makes referrals to the appropriate criminal authorities for further action.

Longevity, Health, or Behavioral “Studies” or “Surveys”

Questionable “Survey” or “Study” of Senior Citizens

The Department has been notified that insurance agents have been used to facilitate a “survey” or “study” of senior citizens. The survey is designed to elicit sensitive and detailed health and financial information from senior citizens. Although the Department has not yet been able to verify the purpose of these surveys, the information gathered in the surveys may be used for the evaluation, pre-underwriting, and possible solicitation of a life insurance policy that is purchased for the sole purpose of selling the policy to a viatical or life settlement provider.

Viatical and Life Settlements §§3.1701 - 3.1717

The Department has adopted rules (Subchapter R, §§3.1701 - 3.1717, Viatical and Life Settlements) that provide consumer protection to life settlors and viators and require registration of persons involved in the business of viatical or life settlements. The Department is investigating whether the dissemination of the surveys is in violation of these rules. The information contained in the surveys is possibly being sold to persons that may be involved with zero premium life insurance arrangements. Zero premium life insurance arrangements are known by other names including “new issue life settlements,” “high net worth settlements,” “estate maximization plans” or “no cost to the insured plans.”

CHAPTER SIX

PROHIBITED PRACTICES PENAL CODE - CHAPTER 35

Practices Relating to Annuities that are Prohibited by the Penal Code - Chapter 35

Forewarned is to be Fore-armed

Agents must be aware of the penalties for doing wrong and committing unlawful acts. Being forewarned is to be fore-armed. Here are the penalties as they relate to Chapter 35 regarding materiality, fraud, aggregation and multiple offenses, values of claims, and jurisdiction.

Definitions - § 35.01

In this chapter:

- "*Insurance policy*" means a written instrument in which is provided the terms of any certificate of insurance, binder of coverage, contract of insurance, benefit plan, nonprofit hospital service plan, motor club service plan, surety bond, cash bond, or any other alternative to insurance authorized by Chapter 601, Transportation Code. The term includes any instrument authorized to be regulated by the Texas Department of Insurance.
- "*Insurer*" has the meaning assigned by Article 1.02, Insurance Code.
- "*Statement*" means an oral or written communication or a record or documented representation of fact made to an insurer. The term includes computer-generated information.
- "*Value of the claim*" means the total dollar amount of a claim for payment under an insurance policy or, as applicable, the value of the claim determined under Section 35.025.

Materiality - § 35.015

A statement is material for the purposes of this chapter, regardless of the admissibility of the statement at trial, if the statement could have affected:

- the eligibility for coverage or amount of the payment on a claim for payment under an insurance policy; or
- the decision of an insurer whether to issue an insurance policy.

Insurance Fraud - § 35.02

Claims

A person commits an offense if, with intent to defraud or deceive an insurer, the person, in support of a claim for payment under an insurance policy:

- prepares or causes to be prepared a statement that:
 - the person knows contains false or misleading material information; and
 - is presented to an insurer; or
- presents or causes to be presented to an insurer a statement that the person knows contains false or misleading material information.

Statements

A person commits an offense if the person, with intent to defraud or deceive an insurer and in support of an application for an insurance policy:

- prepares or causes to be prepared a statement that:
 - the person knows contains false or misleading material information; and
 - is presented to an insurer; or
 - presents or causes to be presented to an insurer a statement that the person knows contains false or misleading material information.

Rebates and Incentives

A person commits an offense if, with intent to defraud or deceive an insurer, the person solicits, offers, pays, or receives a benefit in connection with the furnishing of goods or services for which a claim for payment is submitted under an insurance policy.

Fines

An offense under Subsection (a) or (b) is:

- a Class C misdemeanor if the value of the claim is less than \$50;
- a Class B misdemeanor if the value of the claim is \$50 or more but less than \$500;
- a Class A misdemeanor if the value of the claim is \$500 or more but less than \$1,500;
- a state jail felony if the value of the claim is \$1,500 or more but less than \$20,000;
- a felony of the third degree if the value of the claim is \$20,000 or more but less than \$100,000;
- a felony of the second degree if the value of the claim is \$100,000 or more but less than \$200,000; or
- a felony of the first degree if:

- the value of the claim is \$200,000 or more; or
- an act committed in connection with the commission of the offense places a person at risk of death or serious bodily injury.

An offense above is a state jail felony.

Variables in Penalties

The court will order a defendant convicted of an offense under this section to pay restitution, including court costs and attorney's fees, to an affected insurer.

If conduct that constitutes an offense under this section also constitutes an offense under any other law, the actor may be prosecuted under this section, the other law, or both.

For purposes of this section, if the actor proves by a preponderance of the evidence that a portion of the claim for payment under an insurance policy resulted from a valid loss, injury, expense, or service covered by the policy, the value of the claim is equal to the difference between the total claim amount and the amount of the valid portion of the claim.

If it is shown on the trial of an offense under this section that the actor submitted a bill for goods or services in support of a claim for payment under an insurance policy to the insurer issuing the policy, a rebuttable presumption exists that the actor caused the claim for payment to be prepared or presented.

Value of Claim - § 35.025

If the value of a claim is not readily ascertainable, the value of the claim is:

- the fair market value, at the time and place of the offense, of the goods or services that are the subject of the claim; or
- the cost of replacing the goods or services that are the subject of the claim within a reasonable time after the claim.

If Claim Cannot be Reasonably Ascertained

If goods or services that are the subject of a claim cannot be reasonably ascertained under Subsection (a), the goods or services are considered to have a value of \$500 or more but less than \$1,500.

Valid Loss

If the actor proves by a preponderance of the evidence that a portion of the claim for payment under an insurance policy resulted from a valid loss, injury, expense, or service covered by the policy, the value of the claim is equal to the difference between the total claim amount and the amount of the valid portion of the claim.

Aggregation and Multiple Offenses - § 35.03

When separate claims in violation of this chapter are communicated to an insurer or group of insurers pursuant to one scheme or continuing course of conduct, the conduct may be considered as one offense and the value of the claims aggregated in determining the classification of the offense. If claims are aggregated under this subsection, Subsection (b) shall not apply.

If Three or More

When three or more separate claims in violation of this chapter are communicated to an insurer or group of insurers pursuant to one scheme or continuing course of conduct, the conduct may be considered as one offense, and the classification of the offense shall be one category higher than the most serious single offense proven from the separate claims, except that if the most serious offense is a felony of the first degree, the offense is a felony of the first degree. This subsection shall not be applied if claims are aggregated under Subsection (a).

Jurisdiction of Attorney General - § 35.04

The attorney general may offer to an attorney representing the state in the prosecution of an offense under Section 35.02 the investigative, technical, and litigation assistance of the attorney general's office.

The attorney general may prosecute or assist in the prosecution of an offense under Section 35.02 on the request of the attorney representing the state.