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Senate Bill 777 (as introduced 10-25-11)
Sponsor: Senator Rebekah Warren
Committee: Families, Seniors and Human Services

(as passed by the Senate)

Date Completed: 10-26-11

CONTENT

The bill would add Chapter 41C (Life Insurance and Annuity Replacement) to the Insurance Code to do the following:

- **Establish procedures for insurance producers and insurers to determine whether an applicant for a life insurance policy or contract or annuity had an existing policy.**
- **Prescribe requirements regarding the notification of an applicant or policy or contract owner of his or her rights regarding replacement policies and contracts.**
- **Prescribe requirements regarding the disclosure and documentation of sales materials used by an insurance producer in connection with a replacement.**
- **Require notification of a person's existing insurer in connection with a replacement.**
- **Require an insurer to maintain a system of supervision and control to ensure compliance with Chapter 41C, and monitor each of its producer's existing policy and contract replacements.**
- **Prescribe specific requirements for replacing insurers and existing insurers.**
- **Establish insurer requirements in the case of an application initiated as a result of a direct response solicitation.**
- **Provide that a violation of the chapter would be an unfair trade practice under the Code, and prescribe penalties.**

-- Require the OFIR Commissioner to adopt forms to be used to satisfy the bill's notice requirements.

Proposed Chapter 41C would take effect nine months after the bill's effective date.

Scope of Proposed Chapter 41C

The bill provides that, unless otherwise specifically included, Chapter 41C would not apply to a transaction that involved any of the following:

- Credit life insurance.
- Group life insurance and annuity contracts used to fund prearranged funeral contracts.
- Proposed life insurance that was to replace life insurance under a binding or conditional receipt issued by the same insurer.
- Group life insurance or group annuities if there were no direct solicitation of individuals by a producer.

The chapter also would not apply to a transaction involving an application to the existing insurer if a contractual change or a conversion privilege were being exercised, if the existing policy or contract were being replaced by the same insurer under a program filed with and approved by the Commissioner of the Office of Financial and Insurance Regulation, or if a term conversion privilege were exercised among corporate affiliates.

Direct solicitation would not include a group meeting held by a producer solely for the

purpose of educating or enrolling individuals or, if initiated by an individual member of the group, assisting with the selection of investment options offered by a single insurer in connection with enrolling the individual. Group life insurance or a group annuity certificate marketed through direct-response solicitation would be subject to the bill's provisions regarding direct response solicitation (described below). ("Direct-response solicitation" would mean a solicitation through a sponsoring or endorsing entity or individually solely through mails, telephone, the internet, or other mass communication media.)

Proposed Chapter 41 also would not apply to the following:

- New coverage provided under a life insurance policy or contract whose cost was borne wholly by the insured's employer or by an association of which the insured was a member.
- Existing life insurance that was a nonconvertible term life insurance policy that would expire in five years or less and could not be renewed.
- Structured settlements.
- Immediate annuities that were purchased with proceeds from an existing policy or contract.

Immediate annuities purchased with proceeds from an existing policy or contract would not be exempt from Chapter 41C.

In addition, Chapter 41C would not apply to policies or contracts used to fund any of the following:

- An employee pension or welfare benefit plan covered by the Employee Retirement Income Security act.
- A plan described in Section 401(a), 401(k), or 403(b) of the Internal Revenue Code, if the plan were established or maintained by an employer for purposes of the Employee Retirement Income Security Act.
- A governmental or church plan, or a deferred compensation plan of a state or local government or tax-exempt organization under the Internal Revenue Code.
- A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

Notwithstanding these provisions, Chapter 41C would apply to an existing policy or contract used to fund a plan or arrangement that was funded solely by contributions an employee elected to make, whether on a pretax or after-tax basis, if the insurer were notified that plan participants could choose from among at least two insurers and there were a direct solicitation of an individual employee by a producer for the purchase of a new policy or contract.

A registered contract would be exempt from the bill's requirements pertaining to the notification of existing insurers and policy owners of the right to receive information (described below) with respect to the provision of illustrations or policy summaries. A replacing insurer or existing insurer, as applicable, however, would have to provide premium or contract contribution amounts and identify the appropriate prospectus or offering circular instead.

"Replacement" would mean a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be one of the following:

- Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer, or otherwise terminated.
- Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values.
- Amended so as to effect a reduction either in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid.
- Reissued with any reduction in cash value.
- Used in a financed purchase.

"Existing insurer" would mean the insurer whose existing policy or contract is or will be changed or affected as described above. "Existing policy or contract" would mean an individual life insurance policy or annuity contract in force, including a policy under a binding or conditional receipt or a policy or

contract that is within an unconditional refund period.

"Registered contract" would mean a variable annuity contract or variable life insurance policy subject to the prospectus delivery requirements of the Securities Act. "Illustration" would mean a presentation or depiction that includes nonguaranteed elements of a life insurance policy over a period of years and that is one of the types described in the bill.

The bill also would define "policy summary" with respect to a universal life policy and another type of policy or contract.

Insurance Producer Requirements

A producer who initiated an application would have to submit to the insurer, with or as part of the application, a statement signed by both the applicant and the producer as to whether the applicant had an existing policy or contract. If the statement were that the applicant did not, the producer's duties with respect to replacement would be complete.

If the statement were that the applicant did have an existing policy or contract, the producer would have to present and read to the applicant a notice regarding replacements in the form adopted by the OFIR Commissioner under the bill or in another substantially similar form approved by the Commissioner. Approval by the Commissioner of a substantially similar form would not be required, however, if differences from the notice adopted by the Commissioner were limited to the omission of references not applicable to the policy or contract being sold or replaced.

The notice would have to be signed by both the applicant and the producer, attesting that the producer had read the notice aloud or that the applicant did not wish it to be read aloud, and that the notice had been left with the applicant.

The notice would have to list all existing policies or contracts proposed to be replaced, properly identified by name of insurer, the insured or annuitant, and policy or contract number if available. The notice also would have to include a statement as to whether each policy or contract would be replaced or whether a policy or contract

would be used as a source of financing for the new one. If a policy or contract number had not been issued by the existing insurer, alternative identification, such as an application or receipt number, would have to be listed.

In connection with a replacement, when an application for a new policy or contract was completed, the producer would have to leave with the applicant the original or a copy of all sales material. With respect to electronically presented sales material, it would have to be provided to the policy or contract owner in printed form by the time the policy or contract was delivered.

Except as otherwise provided, in connection with a replacement, the producer would have to submit to the insurer to which an application for a policy or contract was presented a copy of each document required under the bill's statement and notice provisions, a statement identifying any preprinted or electronically presented company-approved sales material used, and copies of any individualized sales material, including any illustration related to the specific policy or contract purchased.

Insurer Requirements

An insurer would have to maintain a system of supervision and control to ensure compliance with proposed Chapter 41C that did at least all of the following:

- Informed its producers of the requirements of the chapter and incorporated the requirements into all relevant producer training manuals prepared by the insurer.
- Gave each producer a written statement of the insurer's position with respect to the acceptability of replacements, providing guidance to the producer as to the appropriateness of these transactions.
- Included a system to review the appropriateness of each replacement that a producer did not indicate was in accord with the insurer's stated position.
- Included procedures to confirm that the requirements of Chapter 41C had been met, including systematic customer surveys, interviews, confirmation letters, or programs of internal monitoring.
- Included procedures to detect transactions that were a replacement of

an existing policy or contract by the existing insurer, but had not been reported as a replacement by the applicant or producer.

An insurer would have to have the capacity to monitor each producer's existing policy and contract replacements for the insurer and, on OFIR's request, produce and make available records of those replacements. The capacity to monitor would have to include the ability to produce records of all of the following for each producer:

- Life insurance policy replacements, including financed purchases, as a percentage of the producer's total annual sales for life insurance.
- The number of lapses of life insurance policies by the producer as a percentage of the producer's total annual sales for life insurance.
- Annuity contract replacements as a percentage of the producer's total annual annuity contract sales.
- The number of transactions that were unreported replacements of existing policies or contracts by the existing insurer detected by the company's monitoring system.
- Replacements, indexed by replacing producer and existing insurer.

In addition, an insurer would have to do all of the following:

- Require with or as part of each application for life insurance or an annuity a statement signed by both the applicant and the producer as to whether the applicant had an existing policy or contract.
- Require with each application for life insurance or an annuity that indicated the applicant had an existing policy or contract a completed notice regarding replacements in the form adopted by the Commissioner.
- Ascertain that the required sales material and illustrations met the requirements of Chapter 41C and were complete and accurate for the new policy or contract.
- If an application did not meet the requirements of Chapter 41C, notify the producer and applicant and fulfill the outstanding requirements.
- Maintain records in paper, photograph, microprocess, magnetic, mechanical, or

electronic media or by any process that accurately reproduced the actual document.

Also, if the applicant had an existing policy or contract, the insurer would have to be able to produce copies of any sales material required by the bill, the basic illustration and any supplemental illustrations related to the specific policy or contract that was purchased, and the producer's and applicant's signed statements with respect to financing and replacement for at least five years after the termination or expiration of the new policy or contract.

Replacing Insurer Requirements

If a transaction involved a replacement, the replacing insurer would have to verify that the required forms were received and complied with proposed Chapter 41C, and be able to produce copies of the required notices regarding replacement, indexed by producer, for at least five years or until the next regular examination by the insurance department of the insurer's state of domicile, whichever was later.

The replacing insurer also would have to notify any other existing insurer that could be affected by the proposed replacement within five business days after receiving a completed application indicating replacement, or after a replacement not indicated on the application was identified, and mail a copy of the available illustration or policy summary for the proposed policy or available disclosure document for the proposed contract within five business days after a request from an existing insurer.

In addition, the replacing insurer would have to give to the new policy or contract owner notice of the right to return the policy or contract within 30 days after delivery and receive an unconditional full refund of all premiums or consideration paid on the policy or contract, including any policy fees or charges or, if the policy or contract were a variable or market value adjustment policy or contract, a payment of the cash surrender value provider under it plus the fees and other charges deducted from the gross premiums or consideration or imposed under the policy or contract.

In a replacement in which the replacing insurer and the existing insurer were the

same or in which one was an affiliate or subsidiary of the other, the replacing insurer would have to allow credit for the period of time that had elapsed under the existing policy's or contract's incontestability and suicide period up to the face amount of the existing policy or contract. With regard to financed purchases, the credit could be limited to the amount the face amount was reduced by the use of existing policy values to fund the new policy or contract.

If an insurer prohibited the use of sales material other than that approved by the insurer, as an alternative to the bill's requirements regarding the submission of sales material to the insurer, the insurer could require with each application a statement signed by the producer that represented that the producer used only company-approved sales material, and stated that copies of all sales material were left with the applicant in accordance with Chapter 41C.

In addition, within 10 days after the issuance of the policy or contract, the insurer could do all of the following:

- Notify the applicant, by letter or verbal communication by a person whose duties were separate from the insurer's marketing area, that the producer had represented that copies of all sales material had been left with the applicant.
- Give the applicant a toll-free telephone number to contact the insurer's personnel who were involved in the compliance function if copies of the sales material had not been left with the applicant as required.
- Stress the importance of retaining copies of the sales material for future reference.

The insurer also would have to be able to produce a copy of the letter sent to the applicant or other verification in the policy file for at least five years after the termination or expiration of the policy or contract.

Existing Insurer Requirements

If a transaction involved a replacement, the existing insurer would have to retain and be able to produce all replacement notifications received, indexed by replacing insurer, for at least five years or until the conclusion of the

next regular examination conducted by the insurance department of the insurer's state of domicile, whichever was later.

The existing insurer also would have to send a letter to the policy or contract owner of the right to receive information regarding the existing policy or contract values including, if available, an in-force illustration or policy summary, if one could not be produced within five business days after the insurer received a notice that an existing policy or contract was being replaced. The insurer would have to provide the information within five business days after receiving the request from the owner.

In addition, upon receiving a request to borrow, surrender, or withdraw any policy values, the existing insurer would have to send a notice advising the policy or contract owner that the release of policy values could affect the guaranteed elements, nonguaranteed elements, face amount, or surrender value of the policy or contract from which the values were released. The notice would have to be sent separately from the check if the check were sent to anyone other than the policy or contract owner. In the case of consecutive automatic premium loans, the insurer would be required to send the notice only at the time of the first loan.

Direct Response Solicitation

If an application were initiated as a result of a direct response solicitation, the insurer would have to require, with or as part of each completed application for a policy or contract, a statement asking whether the applicant, by applying for the proposed policy or contract, intended to replace, discontinue, or change an existing policy or contract. If the applicant indicated a replacement or change was not intended or if he or she failed to respond to the statement, the insurer would have to send to the applicant with the policy or contract a notice regarding replacement adopted by the OFIR Commissioner or other substantially similar form approved by the Commissioner.

If an insurer had proposed a replacement for which an application was initiated as a result of a direct response solicitation or if the applicant indicated that a replacement was intended and the insurer continued with the

replacement, the insurer would have to give the applicant or prospective applicant a notice adopted by the Commissioner or another substantially similar form approved by the Commissioner. In providing the notice, the insurer could delete the reference to the producer, including the producer's signature, and references not applicable to the product being sold or replaced, without having to obtain approval from the Commissioner. The insurer's obligation to obtain the applicant's signature would be satisfied if it could demonstrate that it had made a diligent effort to secure a signed copy of the notice; this requirement would be satisfied if the insurer included in the mailing a self-addressed postage prepaid envelope with instructions for the return of the signed notice.

In addition, the insurer would have to comply with the bill's requirements regarding the notification of existing insurers, if the applicant furnished their names, as well as the requirements regarding producing copies of required notices and the notice of the owner's right to return the policy or contract, and the provisions regarding credit if the existing and replacing insurers were the same.

Violation of Proposed Chapter 41C

A failure to comply with Chapter 41C would be an unfair trade practice for the purposes of Chapter 20 (Unfair and Prohibited Trade Practices and Frauds). Examples of violations would include:

- Deceptive or misleading information contained in sales material.
- Failing to ask the applicant in completing an application the pertinent questions regarding the possibility of financing or replacement.
- The intentional incorrect recording of an answer.
- Advising an applicant to respond negatively to any question regarding replacement to prevent notice to the existing insurer.
- Advising a policy or contract owner to write directly to the company in such a way as to attempt to obscure the identity of the replacing producer or company.

A policy or contract owner would have the right to replace an existing life insurance

policy or annuity contract after indicating in or as part of an application for a new policy or contract that replacement was not his or her intention. Patterns of such action by owners of the same producer, however, would be prima facie evidence of the producer's knowledge that replacement was intended in connection with the identified transactions, and these patterns of action would be prima facie evidence of the producer's intent to violate Chapter 41C.

If it were determined that the requirements of the chapter had not been met, the replacing insurer would have to give to the policy or contract owner an in-force illustration if available or a policy summary for the replacement policy or contract or an available disclosure document for the replacement policy or contract and the appropriate notice regarding replacements adopted by the Commissioner.

A violation of Chapter 41C would subject the violator to penalties that could include the revocation or suspension of a producer's or insurer's license, a monetary fine, and the forfeiture of any commissions or compensation paid to a producer as a result of the transaction in connection with which the violation occurred. In addition, if the OFIR Commissioner determined that the violation was material to the sale, the insurer could be required to make restitution, restore policy or contract values, and pay simple interest at the rate of 12% per year on the amount refunded in cash.

OFIR Commissioner Requirements

The Commissioner would have to adopt forms as follows to be used to satisfy the notice requirements of proposed Chapter 41C:

- A notice regarding the replacement of life insurance or annuities to be signed by the applicant and the producer, if there were a producer, and a copy left with the applicant.
- A shorter notice regarding replacing a life insurance policy or annuity to be given to an applicant who did not indicate that the intended purchase of a new policy or contract was a replacement of an existing one.
- A notice regarding the replacement of life insurance or annuities to be used if the application for a new policy or

contract were initiated as a result of a direct response solicitation.

In adopting the forms, the Commissioner would have to follow substantially the forms published by the National Association of Insurance Commissioners as appendices to the life insurance and annuities replacement model regulation.

Proposed MCL 500.4191-500.4199

Legislative Analyst: Julie Cassidy

FISCAL IMPACT

The bill would have likely have a small fiscal impact on the Department of Licensing and Regulatory Affairs. Under current law, people who engage in unfair practices prohibited under the Insurance Code can be subject to penalties of up to \$500 per violation, for an aggregate total of up to \$5,000. If the violation was willful, the maximum total penalties can add up to \$25,000. Under the bill, insurers or insurance producers who violated the provisions of the bill would be subject to these penalties. To the extent that these new regulations would result in additional violations, the Department could collect additional penalty revenue. Penalty revenue would be credited to the Insurance Licensing and Regulation Fund.

Additionally, the bill would require the Office of Financial and Insurance Regulation to adopt forms to satisfy various notice requirements of the bill. Some small administrative costs could be associated with this, though the bill does mention that the forms "shall substantially follow the forms published by the national association of insurance commissioners", so much of the development cost of the forms could be mitigated.

Fiscal Analyst: Josh Sefton

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.