FLORIDA TIGHTENS LAWS ON SUITABILITY OF ANNUITY SALES TO SENIORS

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On June 30, 2008, Florida Governor Charlie Crist signed into law as Chapter 2008-237, Laws of Florida (CS/CS/SB 2082), the "John and Patricia Seibel Act." Named after a Venice, Florida couple in their 80s who were sold $600,000 worth of annuities that could not be touched without large penalties for 15 years,[1] the new law significantly modifies the Florida Insurance Code with regard to sales of life insurance and annuities.

THE "FREE LOOK" PROVISION

An early version of the Seibel Act would have expanded the "free look" provision of Section 626.99(4)(a), Fla. Stat., for purchasers of annuities who are 75 or older, from the current 10 days to one year. Industry opposition defeated this proposal.[2] Because an annuity contract cannot be provided prior to its purchase, the "free look" is intended to avoid requiring purchasers

[1] J. Liberto, *State CFO Wants Tougher Rules on Annuities*, St. Petersburg Times, April 18, 2008.

[2] Florida Securities Dealers Association, *Florida Review* (May 12, 2008) at 3.

to rely solely on agents' representations about the contract's terms. Florida formerly required that consumers be allowed to read and review such contracts and to cancel the purchase for an unconditional refund within 10 days after receiving the contract. The final version of the bill, which is effective January 1, 2009, dropped the age requirement and expanded the free look period in all cases from 10 to 14 days.[3]

Life insurance policies can avoid the "free look" requirement if prospective purchasers are given "a buyer's guide and a policy summary" prior to the insurer's acceptance of an initial premium or premium deposit. Prospective purchasers of all annuities, no longer just fixed annuities, must be given the buyer's guide and contract summary required by the NAIC.[4] In addition, all annuity purchasers must have the right to an unconditional refund "for a period of at least 14 days."

AGENT REGULATION

Persons licensed to solicit or sell life insurance in Florida on and after January 1, 2009, must complete a minimum of three hours continuing education in life insurance and annuity suitability.[5] Licensees are also required to inform the regulator of their telephone number or e-mail address and to keep this information current or face a $500 fine.[6]

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[3] Ch. 2008-237, Fla. Laws, Section 8.

[4] National Association of Insurance Commissioners

[5] Ch. 2008-237, Fla. Laws, Section 3.

[6] Ch. 2008-237, Fla. Laws, Section 4.

(footnote cont'd)

Although it has not been a matter of doubt in Florida, Section 11 of the Seibel Act amends Section 627.805, Fla. Stat., to provide that Florida's securities regulator, namely the Office of Financial Regulation ("OFR"), "shall regulate the sale of variable and indeterminate value contracts" as securities. As a result, life insurance agents in Florida must be registered as associated persons of a securities dealer in order to sell variable annuities (or any other insurance product deemed a "security") "in or from offices in this state."[7]

UNFAIR INSURANCE TRADE PRACTICES

Florida Chief Financial Officer Alex Sink, head of the Florida Department of Financial Services ("DFS"), of which OFR and the Office of Insurance Regulation ("OIR") are autonomous units, expressed disappointment that the legislation failed "to make it a felony to intentionally deceive a senior into an inappropriate annuity product."[8] In a press release commending passage of the bill, she pledged not to rest "until we are able to put unscrupulous agents that prey on our seniors behind bars."[9] CFO Sink wanted to designate certain violations of the insurance code to be felonies because DFS claimed Florida state attorneys are reluctant to

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[7] Section 517.12(1), Fla. Stat. Notably offers and sales of equity indexed annuities would receive similar treatment should Florida adopt the approach proposed by the U. S. Securities and Exchange Commission in its Release No. 33-8933 (June 25, 2008), which denies classification of most such annuity contracts as insurance.

[8] Press Release: Statement by CFO Sink on the Legislature's Passage of The Annuity Fraud Bill (May 2, 2008). <http://www.myfloridacfo.com/PressOffice/ViewMediaRelease.asp?ID=2930>

[9] *Ibid.*

initiate criminal prosecutions of misdemeanor offenses.[10] This fails to recognize, however, that fraudulent sales of variable annuities and any other insurance products deemed "securities or investments" are already felonies under Section 517.302(1), Fla. Stat. in the Florida Securities and Investor Protection Act. Moreover, under current law such crimes are predicate offenses under RICO[11] and subject to the highly punitive "alternative fine" provision of Section 517.302(3), Fla. Stat.

Furthermore, by this enactment, especially in combination with Chapter 2008-66, Laws of Florida (CS/CS/SB 2860), the "Homeowner's Bill of Rights Act," Florida has significantly increased penalties for violations of the Florida Unfair Insurance Trade Practices Act.[12] For example, an insurer can now face an administrative fine of $40,000 for a single willful violation up to an aggregate fine of a quarter of a million dollars, instead of $20,000 and $100,000 respectively under current law. After the effective date of the Seibel Act, insurers might face even greater administrative penalties for offenses against senior consumers under new powers granted OIR to order rescission.[13]

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[10] Florida Senate Bill Analysis and Fiscal Impact Statement for CS/SB 2082, prepared by staff of Banking and Insurance Committee (March 19, 2008) (hereafter "Staff Analysis") at 6.

[11] Racketeer Influenced and Corrupt Organizations Act, Sections 895.01-895.08, Fla. Stat.

[12] Section 626.9521, Fla. Stat.

[13] Ch. 2008-237, Fla. Laws, Section 9, amending Section 626.5445(5)(a), Fla. Stat. *See* Note 30 *infra*.

Agents are also subject to increased fines for specified violations: $5,000 for each non-willful violation (increased from $2,500), up to a maximum aggregate amount of $50,000 (increased from $10,000).[14] Willful violations can be punished administratively by a fine of $30,000 for each offense (increased from $20,000), up to a maximum aggregate amount of $250,000 (increased from $100,000).[15] The disparity between insurers and agents is caused by Section 6 of the Seibel Act, which provides that if another law is enacted in the 2008 legislative session that creates greater fines in Section 626.9521, Fla. Stat., the greater fines will supersede increases made in this law. Although judicial construction may be required, this section appears to be triggered only with regard to insurers subject to the Homeowner's Bill of Rights Act (Chapter 2008-66, Laws of Florida, CS/CS/SB 2860).[16]

The prohibited practices punishable by these enhanced penalties are "twisting," "churning" and two new offenses created by the Seibel Act.[17] "Twisting" is prohibited by Section 626.9541(1)(l), Fla. Stat. It involves use of misrepresentations, incomplete or fraudulent comparisons or material omissions to sell insurance or to induce other actions. "Churning" is prohibited by Section 626.9541(1)(aa), Fla. Stat. It occurs when a policyholder is fraudulently induced to use the value of existing insurance to purchase another product from the same insurer, when this increases compensation of the agent, but does not benefit the policyholder. The definition of "twisting" is unchanged by this law, but the definition of "churning" at Section

[14] Ch. 2008-237, Fla. Laws, Section 5.

[15] *Ibid.*

[16] Ch. 2008-237, Fla. Laws, Section 7.

[17] Ch. 2008-237, Fla. Laws, Section 5.

626.9541(1)(aa), Fla. Stat. is amended to prohibit specifically "indirect churning." This occurs when a policy is surrendered and the resulting funds are used to purchase both an immediate and a deferred annuity, thus creating a double commission for the agent.[18]

The two new offenses are, first, unlawful use of designations. A new subsubsection (ff) of Section 626.9541(1), Fla. Stat. prohibits agents from falsely implying they possess special skills or qualifications through use of titles and bogus designations.[19] Use of bona fide licenses and designations is permitted. Submission of false signatures on an application or policy-related document is prohibited in new subsubsection (ee).[20] Because the practice of submitting false signatures to an insurer is already illegal as forgery, which is punishable as a felony,[21] this new offense is punishable as a third degree felony. Twisting, churning and the other new offense are first degree misdemeanors.[22]

SENIOR SUITABILITY

[18] Staff Analysis at 7.

[19] Ch. 2008-237, Fla. Laws, Section 7. This law should be considered in conjunction with OFR's proposed Rule 69W-600.0133, Florida Administrative Code, restricting use of "senior-specific certifications and professional designations" in securities transactions. Florida Administrative Weekly, Vol. 34, No. 25 (June 20, 2008).

[20] *Ibid.*

[21] Sections 831.01 and 831.02, Fla. Stat.

[22] Ch. 2008-237, Fla. Laws, Section 5

Section 626.4554, Fla. Stat. was created in 2004 as Florida's enactment of the NAIC "Senior Protection in Annuity Transactions Model Regulation."[23] A "White Paper on Annuities" prepared by DFS on March 5, 2008,[24] strongly implied that enactment was ineffective. It reports that during fiscal year 2006-2007, DFS opened 351 investigations related to annuity transactions, a 41% increase over the 2005-2006 period. The White Paper further reports 260 new annuity-related investigations opened in the first eight months of fiscal year 2007-2008, a projected cumulative increase of 58% since the senior suitability statute took effect on July 1, 2004.

The NAIC model enacted in Florida was intended to create standards for recommending the purchase or exchange of annuities to consumers who are 65 or older. The thrust of the Seibel Act is to replace a subjective standard, namely that agents and insurers must have "reasonable grounds" for recommending annuities to seniors, with an objective standard. The former law was asserted to thwart prosecution because clear and convincing evidence was required, not to prove that a particular transaction was suitable for a senior consumer, but whether the agent reasonably believed it was.[25] To accomplish replacement of the subjective standard with an objective one, the Seibel Act amends Section 626.5445(4)(a), Fla. Stat. to state that an insurer or agent must, in recommending purchase or exchange of an annuity to a senior consumer, have "an objectively reasonable basis for believing the recommendation is suitable." The new law also specifies the minimum information that must be obtained from the consumer and requires use of a form to be promulgated by the regulator. Should the consumer refuse to provide the required

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[23] Section 146, Ch. 2004-390, Fla. Laws

[24] Florida Department of Financial Services 2008 White Paper on Annuities (March 5, 2008) by Roxanne Rehm, Assistant General Counsel.

[25] Staff Analysis at 5.

information, the agent or insurer must, before execution of a transaction, obtain verification of such refusal from the consumer, again on a form to be promulgated by the regulator. In transactions concerning replacement or exchange of an annuity, a comparison must be provided on a prescribed form, including a written statement of the basis for the recommendation, disclosure of the possibility of tax consequences and other "overall advantages and disadvantages to the consumer if the recommendation is followed."[26]

An effort was made in the 2008 legislative session to expand application of the senior suitability statute to all life insurance products. That effort failed, but some language of the Seibel Act retains traces of the effort. A few references to "policies" appear among descriptions of annuity contracts. A definition of "annuity contract," once intended to complement a definition of "life insurance contact," has been added to the statute, but appears to have no effect. Former law defined "annuity" as a fixed annuity or a variable annuity. The new law replaces this definition with "annuity contract," defined as a fixed annuity, a variable annuity or an "equity indexed annuity."[27] Because equity indexed annuities are fixed annuities, it is unclear how the Legislature intended this amendment to change the law.

The Florida Governor and Cabinet, sitting as the Florida Financial Services Commission, are authorized to begin rulemaking to implement the Seibel Act, including to promulgate the statutory forms, on June 30, 2008. The senior suitability provisions, Section 9 of the law, will

[26] Ch. 2008-237, Fla. Laws, Section 9.

[27] *Ibid*.

become effective 60 days after the last such rule is adopted or on January 1, 2009, whichever is later.[28]

SENIOR SUITABILITY SAFE HARBORS

Like the former senior suitability statute, the new law contains a specific disclaimer of any private right of action to enforce its provisions.[29] In addition, the following language was enacted as a new subsubsection (c) in Section 626.5445(1), Fla. Stat.:

> Nothing in this section shall subject an insurer to criminal or civil liability for the acts of independent individuals not affiliated with that insurer for selling its products, when such sales are made in a way not authorized by the insurer.[30]

This may be a significant safe harbor, but the Legislature's intent in its enactment is unclear. Does it mean Florida intends to relieve insurers of their obligation at Section 626.5445(4)(d), Fla. Stat. to "ensure that a system to supervise recommendations . . . is established and maintained?" Does the "criminal or civil liability" from which insurers are protected by this language include administrative enforcement by OIR? How, for example, is this safe harbor to be read in conjunction with the simultaneously enacted new power of OIR at Section

[28] Ch. 2008-237, Fla. Laws, Section 12.

[29] Ch. 2008-237, Fla. Laws, Section 9.

[30] *Ibid.*

626.5445(5)(a), Fla. Stat., to order rescission when "any senior consumer [is] harmed by a violation of this section by the insurer or the insurer's insurance agent?" The constitutionality of this new power of OIR will need to be tested. Without question, it exceeds any administrative authority given the regulator under Florida's securities laws. Section 517.191(3), Fla. Stat. only authorizes OFR to seek a similar remedy in securities cases from a court.

Another safe harbor is provided at Section 626.5445(8), Fla. Stat. for agents who are registered associated persons of members of FINRA.[31] Unfortunately, this provision is also unclear. The former law did not refer to membership in FINRA or registration in the securities industry. Anyone who could demonstrate compliance with NASD rules as they existed on January 1, 2004, was deemed to have satisfied the senior suitability statute with regard to variable annuities. Nevertheless, the Seibel Act does not change current law, which preserves the authority of DFS to discipline insurance agents and agencies and that of OIR to discipline insurers "to enforce the provisions of this section." Presumably, this means persons charged with having violated the senior suitability statute, with regard to variable annuities, can defend by asserting their compliance with the applicable FINRA rule, but the regulator can rebut such a defense.

Application of the safe harbor provision at Section 626.5445(8), Fla. Stat. is expanded in the Seibel Act from variable annuities to all annuities. At the same time, however, the new provision is available only to persons "registered with a member of [FINRA]." Such persons may also be insurance agents, but it seems unlikely this immunity could ever be available to an

[31] Financial Industry Regulatory Authority (formerly National Association of Securities Dealers or NASD); Ch. 2008-237, Fla. Laws, Section 9.

insurance agency or to an insurer. Of course, agents who are not also registered to sell securities can no longer avail themselves of this provision. Also, because the suitability determination required by FINRA does not apply to products that are not securities, it is unclear whether the attempt to expand the safe harbor beyond variable annuities has any effect. Combining this new language with the existing "saving clause" for jurisdiction of DFS and OIR suggests Florida has significantly restricted availability of this safe harbor.

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