FLORIDA
SUITABILITY OF LIFE
INSURANCE AND ANNUITY
TRANSACTIONS FOR SENIORS
3 HOUR
The following is required text for all Florida Continuing Education Courses:

THE STATE OF FLORIDA HAS TAKEN A VERY STRONG POSITION ON THE ISSUE OF UNAUTHORIZED ENTITIES. AN UNAUTHORIZED ENTITY IS AN INSURANCE COMPANY THAT IS NOT LICENSED BY THE FLORIDA DEPARTMENT OF FINANCIAL SERVICES. AGENTS AND BROKERS HAVE RESPONSIBILITY FOR CONDUCTING REASONABLE RESEARCH TO ENSURE THAT THEY ARE NOT WRITING POLICIES OR PLACING BUSINESS WITH UNAUTHORIZED ENTITIES. LACK OF CAREFUL SCREENING CAN RESULT IN SIGNIFICANT FINANCIAL LOSS TO FLORIDA RESIDENTS DUE TO UNPAID CLAIMS AND/OR THEFT OF PREMIUMS. AGENTS MAY BE HELD LIABLE WHEN REPRESENTING THESE UNAUTHORIZED ENTITIES. IT IS THE AGENTS AND BROKERS RESPONSIBILITY TO GIVE FAIR AND ACCURATE INFORMATION REGARDING THE COMPANIES THEY REPRESENT. ANY QUESTION ABOUT THE AUTHORIZED STATUS OF A COMPANY CAN BE CHECKED BY CALLING THE FLORIDA DEPARTMENT OF FINANCIAL SERVICES AT 1.877.693.5236 OR 850.413.3089. WE URGE ALL AGENTS AND BROKERS TO ADHERE TO THIS ADMONITION)........SHOULD YOU HAVE QUESTIONS CALL 1.850.413.5465.
TABLE OF CONTENTS

CHAPTER 1 ............................................................................................................ 1

FLORIDA SENATE BILL 2082 ..................................................................................... 1

THE JOHNNY AND PATRICIA SIEBEL ACT ............................................................... 1
PURPOSE OF THE ACT: ............................................................................................ 1
RECOMMENDATIONS NOT COVERED BY F.S. 627-4554............................................. 6
ETHICAL VIOLATIONS: ............................................................................................. 7
COMPLAINTS: ........................................................................................................... 7
DEFINITIONS: ............................................................................................................. 8
ANNuity CONTRACT PER F.S 627.4554 .................................................................... 8
suitABILITY: provided by Florida DFS ....................................................................... 8
AFFILIATED PARTY PER F.S 624.310(1)(A) ............................................................... 8
ETHICAL CONDUCT: ................................................................................................. 8
RECOMMENDATION PER F.S 627.4554: ..................................................................... 9
SENIOR CONSUMER PER F.S 627.4554: ................................................................. 9
RECENT LEGISLATION AFFECTING SALES TO SENIORS ................................................. 9
ANnuity PRODUCTS: ........................................................................................... 14
PRINCIPALS INVOLVED IN AN ANNUITY CONTRACT: ............................................. 14
THE INSURER: ............................................................................................................. 14
CONTRACT OWNER: ................................................................................................. 14
ANNUITANT: .............................................................................................................. 15
BENEFICIARY OR MULTIPLE BENEFICIARIES: ......................................................... 15
SURRENDER CHARGES: .......................................................................................... 15
EXCEPTIONS TO SURRENDER CHARGES: ............................................................... 16
ANNUAL SURRENDER CHARGE EXCEPTION: ......................................................... 16
NURSING HOME CONFINEMENT: ........................................................................... 16
REQUIRED MINIMUM DISTRIBUTION: ..................................................................... 16
DEATH: .................................................................................................................. 17
OTHER EXCEPTIONS TO THE SURRENDER CHARGE: ............................................. 17
ANNUITIZATION OPTIONS: ..................................................................................... 17
OTHER RIDERS AND OPTIONS: ................................................................................ 17
ANNUITY TYPES: .................................................................................................... 17
FIXED ANNUITIES: .................................................................................................. 17
EQUITY INDEXED ANNUITIES: ................................................................................. 18
INDEXING METHOD ............................................................................................... 18
INDEXING PERIOD: ................................................................................................. 18
METHODS FOR MEASURING INDEX CHANGE .............................................................. 19
POINT TO POINT: ..................................................................................................... 19
AVERAGING: ............................................................................................................ 19
HIGH WATER MARK: ............................................................................................... 19
ANNUAL RESET OR RATCHET: ................................................................................ 20
CHAPTER 2 ................................................................. 27

DUTIES OF INSURERS AND AGENTS................................................................. 27

REQUIRED INFORMATION TO COLLECT ...................................................... 27
PERSONAL INFORMATION .............................................................. 27
CURRENT FINANCIAL SITUATION ............................................................. 28
ASSETS ........................................................................ 28
ANNUAL INCOME ........................................................................ 28
TAX STATUS ........................................................................ 28
LIQUID NET WORTH ....................................................................... 29
FUTURE FINANCIAL CONCERNS ......................................................... 29
MEDICAL CARE CONCERNS .............................................................. 29
RETIREMENT AGE ........................................................................ 30
ENDOWMENTS ........................................................................ 30
FINANCIAL SUPPORT OF FAMILY MEMBERS ............................................. 30
INTENDED USE OF ANNUITY .............................................................. 30
SOURCE OF FUNDS ........................................................................ 31
OTHER FINANCIAL NEEDS ................................................................. 31
OTHER INFORMATION OR CONSIDERATIONS USE BY AGENT .................. 31
IF THE CONSUMER CURRENTLY HOLDS AN ANNUITY ............................. 31
INFORMATION TO BE COLLECTED ......................................................... 31
TYPE OF CONTRACT ......................................................................... 31
ISSUE DATE .................................................................................. 32
MATURITY OR ANNUITY DATE ........................................................... 32
ALLOCATION OF VALUES WITHIN THE ANNUITY ................................. 32
Chapter 1

FLORIDA SENATE BILL 2082

THE JOHN AND PATRICIA SIEBEL ACT

In June of 2008 Florida signed into law the “John and Patricia Siebel Act”. This act amends several sections of Florida statute as we will see during the body of this text. The Act was named after an elderly Florida couple (in their 80’s) who were sold $600,000 worth of annuities with very aggressive surrender charges lasting 15 years.

The subject of the suitability of annuity sales to seniors was addressed in 2004 when Florida created FS 627.4554 a version of the National Association of Insurance Commissioner’s (NAIC) “Senior Protection in Annuity Transactions Model Regulation”.

A white paper published by the Florida DFS in March of 2008 basically stated that the 2004 law wasn’t performing as it was intended. This report details that in fiscal year 2006-2007 there were 351 DFS investigations related to annuity transactions which represents a 41% increase over fiscal year 2005-2006. Furthermore in the first eight months of fiscal year 2007-2008 DFS had already opened 260 new annuity investigations which puts Florida on track to see a 58% increase in annuity transaction investigations since the 2004 senior protection law was enacted.

PURPOSE OF THE ACT:

The purpose of this act is to require “objectively reasonable basis” for recommending an annuity and/or life insurance transaction to a senior (65 or older). It is widely viewed that the 2004 NAIC model created a subjective standard for a reasonable basis. Florida law specifies minimum information that must be collected from the consumer and stipulates a form (Annuity Suitability Questionnaire), DFS-H1-1980, developed by the Florida DFS. This form is DFS-H1-1980 and is reproduced beginning on the following page. If the consumer refuses to provide some or all of the information the insurer must use a form (developed by Florida DFS) to evidence the consumer’s refusal prior to the transaction. If the transaction involves an exchange or replacement a detailed comparison is required on a form developed by Florida DFS.
### ANNUITY SUITABILITY QUESTIONNAIRE

#### PROPOSED ANNUITANT’S PERSONAL INFORMATION

Name: Last    First    Middle
Date of Birth    Age    Sex    Tax Status
Number and Age of Dependents:

#### JOINT ANNUITANT INFORMATION

Name: Last    First    Middle
Date of Birth    Age    Sex    Tax Status
Number and Age of Dependents:

#### APPLICANT/OWNER OTHER THAN ANNUITANT/JOINT ANNUITANT

Owner: Last    First    Middle
Date of Birth    Age    Sex
Entity:    Tax Status    Relationship to Annuitant(s):
Form of Ownership:
Supporting documents (list):

<table>
<thead>
<tr>
<th></th>
<th>APPLICANT</th>
<th>JOINT ANNUITANT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Source of Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Household Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Worth</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquid Assets</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Do you currently own any annuities? □ Yes □ No □ Yes □ No

Please list:

Do you currently own life insurance? □ Yes □ No □ Yes □ No

Please list:

---

Applicant’s Signature    Date    Joint Applicant’s Signature    Date

---

DFS-H-1-1980
Pub: 12/25/2003
Page 1 of 4

Adopted in Rule 69B-102.011, F.A.C.
## Does your income cover all your living expenses including medical?

<table>
<thead>
<tr>
<th>APPLICANT</th>
<th>JOINT ANNUITANT</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Yes</td>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
<td>☐ No</td>
</tr>
</tbody>
</table>

**Explain:**

## Do you expect changes to your living expenses?

<table>
<thead>
<tr>
<th>APPLICANT</th>
<th>JOINT ANNUITANT</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Yes</td>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
<td>☐ No</td>
</tr>
</tbody>
</table>

**Explain:**

## Do you anticipate changes in your out-of-pocket medical expenses?

<table>
<thead>
<tr>
<th>APPLICANT</th>
<th>JOINT ANNUITANT</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Yes</td>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
<td>☐ No</td>
</tr>
</tbody>
</table>

**Explain:**

## Is your income sufficient to cover future changes in your living and/or out-of-pocket medical expenses during the surrender charge period?

<table>
<thead>
<tr>
<th>APPLICANT</th>
<th>JOINT ANNUITANT</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Yes</td>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
<td>☐ No</td>
</tr>
</tbody>
</table>

If no, please explain:

## Do you have an emergency fund for unexpected expenses?

<table>
<thead>
<tr>
<th>APPLICANT</th>
<th>JOINT ANNUITANT</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Yes</td>
<td>☐ Yes</td>
</tr>
<tr>
<td>☐ No</td>
<td>☐ No</td>
</tr>
</tbody>
</table>

Please explain:

---

### Why are you purchasing this annuity?

### What are your investment objectives? (Check all that apply)

- ☐ Income
- ☐ Growth (long term)
- ☐ Safety of Principal and Income
- ☐ Safety of Principal and Growth
- ☐ Pass assets to a beneficiary or beneficiaries at death
- ☐ Other:

### Describe your risk tolerance: (Check all that apply)

- ☐ Conservative
- ☐ Moderately conservative
- ☐ Moderate
- ☐ Moderately aggressive
- ☐ Aggressive
- ☐ Other:

**Comments:**

### Describe your investment experience by type and length of time:

### What is the source of the funds for the purchase of the proposed annuity?

### How long do you plan to keep the proposed annuity?

### Will the proposed annuity replace any product?

| ☐ Yes | ☐ No |

### If yes, will you pay a penalty or other charge to obtain these funds?

| ☐ Yes | ☐ No |

If yes, the amount of the charge or penalty $ ___

---

**applicant’s signature** / Date

**Joint applicant’s signature** / Date

---

DFS-H1-1990
Pub. 12/25/2009
Page 2 of 4

Adopted in Rule 89B-182.011, F.A.C
Note:
This section to be completed by the agent, insurer, or Managing General Agent proposing purchase

Advantages of purchasing the proposed annuity:

Disadvantages of purchasing the proposed annuity:

The basis for my recommendation to purchase the proposed annuity or to replace or exchange your existing annuity (ies):

Agent's Signature
Date Signed

Note: No questions or response areas are to be left blank when offered to the Annuitant and/or Applicant for signature. If any information requested is unavailable, not applicable or unknown, the insurance agent or insurer must indicate that.

ACKNOWLEDGEMENTS AND SIGNATURES

I understand that should I decline to provide the requested information or should I provide inaccurate information, I am limiting the protection afforded me by the Florida Statutes regarding the suitability of this purchase.

☐ I have chosen not to provide this information at this time.
☐ I have chosen to provide limited information at this time.

APPLICANT:

DO NOT SIGN THIS FORM IF ANY ITEM HAS BEEN LEFT BLANK, BEFORE CAREFULLY REVIEWING THE INFORMATION RECORDED, OR IF ANY OF THE INFORMATION RECORDED IS NOT TRUE AND CORRECT TO THE BEST OF YOUR KNOWLEDGE.

THE APPLICANT, JOINT APPLICANT AND/OR OWNER MAY SUBSTITUTE THEIR INITIALS FOR SIGNATURES ON ALL FORM PAGES WITH THE EXCEPTION OF THE SIGNATURES BELOW, WHICH ARE REQUIRED.

Applicant or Owner Signature
Date Signed

Joint Applicant or Owner Signature
Date Signed

DFS-H1-1890
Pub. 12/25/2009
Page 3 of 4

Adopted in Rule 69B-192.011, F. A. C.
EXPLANATION OF TERMS

"Age" is the natural person’s attained age on the day the form is completed.

"Tax Status" is the senior consumer’s Federal Income Tax filing status such as "single" or "married filing jointly", if "Exempt", so state.

"Form of Ownership" is the type of entity, other than a natural person, including a corporation, trust, partnership, limited liability company, or other business or not-for-profit entity.

"Supporting documents" are the documents that provide a basis for the relationship between the Proposed Annuitant, Joint Annuitant if applicable, and the Applicant/Owner as it may exist.

"Annual income" is income received during a calendar year, whether earned or unearned.

"Source of annual income" is the income-generating source, such as pension income, dividends, or earned income etc.

"Annual household income" is the combined annual income received by all household members each calendar year.

"Total Net Worth" is the senior consumer’s total assets minus total liabilities or encumbrances applicable to those assets.

"Liquid Assets" are financial holdings that can readily be converted into their cash equivalent, without loss of principal.

"Investment Objectives" are the senior consumer’s stated goals as described to the insurance agent or insurer, if no insurance agent is involved. These may include but are not limited to the following: (1) Income, (2) Growth (long term capital appreciation), (3) Safety of Principal and Income, (4) Safety of Principal and Growth, (5) To pass the investment to a beneficiary or beneficiaries at death.

"Risk Tolerance" means the degree of uncertainty that an investor can reasonably tolerate with regard to a negative change in his or her investments. Examples of risk tolerance levels may include the following: (1) Conservative (prefer little or no risk), (2) Moderately conservative (some risk, reduced safety of principal), (3) Moderate (average risk with potential losses and potentially higher returns), (4) Moderately aggressive (above average risk with potential losses, risk of principal and potentially higher returns), (5) Aggressive (willing to sustain losses or loss of principal in pursuit of higher returns).

"Source of the funds" to be used to purchase the proposed annuity means from where the funds will come to purchase the annuity, and may include but are not limited to: (1) An existing annuity or life insurance contract, (2) Liquid Assets, including but not limited to, cash in bank, maturing certificates of deposit, and money market accounts, (3) Personal Loans, (4) Equity Loans, (5) Mortgages, Reverse Mortgages, (6) Death Benefit Proceeds, (7) Funds received upon retirement from employment, including but not limited to, 401(k) accounts, pensions, and other tax-sheltered funds, (8) Equities, mutual funds, or bonds, (9) Proceeds from real estate transactions.

"Intended use of the annuity" means the purpose for which the senior consumer is considering the recommended purchase or exchange. This may include the following: (1) Immediate income (within 60 days or less), (2) Tax Shelter (protection from taxation of all types while in force), (3) Interest earnings, (4) Income stream at a stated age, (5) Creditor Protection (a desire to protect assets from attachment by any legal process), (6) Other, as stated by the Senior Consumer.

/                                           /
Applicant’s Signature                       Joint Applicant’s Signature

Date                                       Date

DFS-H1-1990
Pub. 12/25/2009
Adopted in Rule 58B-192.011, F.A.C
The John and Patricia Siebel Act also tightens the definition of an annuity to include fixed annuities, variable annuities, equity indexed annuities, and fixed equity indexed annuities.

There are also changes to the “free look” period and penalties for violating certain Florida Statutes and Rules.

The purpose of this legislative action as expressed in F.S. 627-4554 is in quotations below:

“The purpose of this section is to set forth standards and procedures for making recommendations to senior consumers which result in a transaction involving annuity products to appropriately address the insurance needs and financial objectives of senior consumers at the time of the transaction.”

**RECOMMENDATIONS NOT COVERED BY F.S. 627-4554**

*Excerpted from F.S. 627-445*

(7) **EXEMPTIONS.**—Unless otherwise specifically included, this section does not apply to recommendations involving:

(a) Direct-response solicitations where there is no recommendation based on information collected from the senior consumer pursuant to this section.

(b) Contracts used to fund:

1. An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act;

2. A plan described by s. 401(a), s. 401(k), s. 403(b), s. 408(k), or s. 408(p) of the Internal Revenue Code of 1986, as amended, if established or maintained by an employer;

3. A government or church plan defined in s. 414 of the Internal Revenue Code of 1986, as amended, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax-exempt organization under s. 457 of the Internal Revenue Code of 1986, as amended;

4. A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

5. Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; or

6. Prepaid funeral contracts.
**ETHICAL VIOLATIONS:**

An ethical violation (as it related to sales of financial products) is where the producer makes a sale to a consumer that is not beneficial to the consumer. Usually an ethical violation involves the intent to deceive on the part of the producer.

It does not always require the intent to deceive to engage in an ethical violation and a well intentioned producer could unwittingly engage in an ethical violation. If an agent does not possess the knowledge (product knowledge, tax knowledge and other general knowledge) necessary to accurately determine the suitability of a recommendation they may well make an unsuitable (and thus unethical) recommendation.

At the root of determining ethical violations is having an objective standard to measure the suitability of a recommendation. There are many variables to consider when determining suitability. Some of the variables are “soft” in that they are subjective in nature such as the consumers’ risk tolerance, ability to understand complex financial terms and concepts, and ability to express their goals. While other product related variables are hard coded and expressed in very concise terms and could be considered objective variables.

So how do we determine when an ethical violation has occurred? Some transactions are very obviously unethical in that any individual (or group of individuals) knowledgeable of the facts and with no hidden agenda would agree that the transaction was not suitable. However the more challenging determination is when it would depend on the consumers’ intent, goals, understanding of the transaction, and risk tolerance.

What is clear about determining when an ethical violation has occurred is that the more information we have about the consumer (“know thy client”) the less likely we are to make a unsuitable recommendation, provided the intent of the producer is sound.

**COMPLAINTS:**

Many ethical violations are first brought to light when a consumer lodges a complaint about the marketing practices of a producer. This is almost always after the transaction has been executed and sometimes several years afterwards. Florida has seen an escalation of annuity complaints since 2004 (as summarized on page one of this text) and provided some of the motivation for the passage of The John and Patricia Siebel Act in 2008.

One has to wonder how many unsuitable sales are made where the consumer never makes a complaint either because they are not aware that there was a better fit for them or they are embarrassed to admit they were taken advantage of.

Not all complaints result in a finding of ethical violations or indeed of any violations on the part of the producer or insurer. However the number of complaints and facts
discovered during investigation of the complaints does give and indication of the state of market conduct within Florida relative to annuities.

**DEFINITIONS:**

In order to have a frame of reference for the remainder of this text we need to define several key terms. Several of these terms will be definitions straight from Florida Statute.

**ANNUITY CONTRACT PER FS 627.4554**

"Annuity contract" means a fixed annuity, equity indexed annuity, fixed equity indexed annuity, or variable annuity that is individually solicited, whether the product is classified as an individual annuity or a group annuity.

Throughout this text we will reference the annuity as a policy, a contract, or an annuity.

**SUITABILITY: PROVIDED BY FLORIDA DFS**

Suitability - The appropriateness of recommended transactions when considering the risks associated with a transaction relative to a customer’s assets, current insurance holdings, financial situation (income and net worth), financial needs and investment objectives.

**AFFILIATED PARTY PER FS 624.310(1)(A)**

“Affiliated party” means any person who directs or participates in the conduct of the affairs of a licensee and who is:

A third-party marketer who aids or abets a licensee in a violation of the insurance code relating to the sale of an annuity to a person 65 years of age or older.

**ETHICAL CONDUCT:**

Ethical conduct - The traditional definitions of ethical conduct are usually centered on various themes such as: “doing what is right for the client”, “putting the clients’ interests first”, “do no harm”, “always leave them in a better position than where they were”, etc. Another popular definition for ethics is “doing what is right when no one is looking” or in other words doing what is right even when you could do otherwise and most likely not get caught. This definition points out that most consumers will not (at least immediately) be aware that the transaction you recommend is unethical or unsuitable.

Any definition of ethics will contain subjective terms such as “right”, “fair”, “good”, and other terms that are subject to interpretation. Not everyone will agree as to what is right or fair and two sincere, informed individuals can legitimately have different views of whether a particular transaction is right or wrong. While these same two individuals
might agree that they should do “right” by the client they vigorously disagree as to what is “right”.

**RECOMMENDATION PER FS 627.4554:**

"Recommendation" means advice provided by an insurance agent, or an insurer if no insurance agent is involved, to an individual senior consumer which results in a purchase or exchange of an annuity in accordance with that advice.

**SENIOR CONSUMER PER FS 627.4554:**

"Senior consumer" means a person 65 years of age or older. In the event of a joint purchase by more than one party, a purchaser is considered to be a senior consumer if any of the parties is age 65 or older.

**RECENT LEGISLATION AFFECTING SAES TO SENIORS**

In part due to the efforts of the Florida Safeguard our Seniors Task Force, legislation has been passed in Florida that adds to protections put in place by the John and Patricia Siebel Act.

The following pages contain a legislative amendment supplement from the state of Florida that we are required to provide the reader.

As you read the information below please note several things:

- Not all of the legislation is specific to sales to seniors
- The legislative amendments affect several different sections of Florida insurance law

**Safeguard Our Seniors Legislation Amendment Supplement**

A. §624.310(1)(a)5, F.S. – Amends the definition of an ‘affiliated party’ to bring subjected marketers under the regulatory authority of the department.

§624.310(1)(a), F.S. – “Affiliated party” means any person who directs or participates in the conduct of the affairs of a licensee and who is:

5. A third-party marketer who aids or abets a licensee in a violation of the insurance code relating to the sale of an annuity to a person 65 years of age or older.

B. §626.025(13) & §626.798, F.S. - Extends the prohibition on a life insurance agent being the beneficiary of a life insurance policy sold to someone other than the agent’s family member by including the agent’s family members within the prohibition and
by prohibiting the agent, or the agent’s family member, from serving as a guardian, trustee, or having power of attorney over the insured.

§626.025, F.S. - To transact insurance, agents shall comply with consumer protection laws, including the following, as applicable:

(13) The prohibition against the designation of a life insurance agent or his or her family member as the beneficiary of a life insurance policy sold to an individual other than a family member under s. §626.798, F.S.

§626.798, F.S. - No agent shall, with respect to the placement of life insurance coverage with a life insurer covering the life of a person who is not a family member of the agent, handle in his or her capacity as a life agent the placement of such coverage when the agent placing the coverage or a family member of such agent is the named beneficiary under the life insurance policy, unless the life agent or family member has an insurable interest in the life of such person. However, the agent or a family member of such agent may not be designated as a trustee or guardian or be granted power of attorney unless he of she is a family member of the policy owner or insured, or is a bank or trust company duly authorized to act as a fiduciary.

C. §626.2815(3)(k), F.S. - Exempts agents not actively soliciting or servicing insurance or annuity contracts from Senior Suitability CE requirement.

The CE requirement of life agents to complete 3 hours on the subject of Senior Suitability does not apply to an agent who does not have any active life insurance or annuity contracts. In applying this exemption, the department may require the filing of a certification attesting that the agent has not sold life insurance or annuities during the continuing education compliance cycle in question and does not have any active life insurance or annuity contracts.

D. §626.621(13), F.S. - Gives the department authority to take license disciplinary action against an agent who has been disciplined under his or her securities license or a related license.

§626.621, F.S. – The department may, in its discretion, deny an application for, suspend, revoke, or refuse to renew or continue the license or appointment of any applicant, agent, adjuster, customer representative, service representative, or managing general agent, and it may suspend or revoke the eligibility to hold a license or appointment of any such person, if it finds that as to the applicant, licensee, or appointee any one or more of the following applicable grounds exist under circumstances for which such denial, suspension,
revocation, or refusal is not mandatory under s. 626.611, F.S.

(13) Has been the subject of or has had a license, permit, appointment, registration, or other authority to conduct business subject to any decision, finding, injunction, suspension, prohibition, revocation, denial, judgment, final agency action, or administrative order by any court of competent jurisdiction, administrative law proceeding, state agency, federal agency, national securities, commodities, or option exchange, or national securities, commodities, or option association involving a violation of any federal or state securities or commodities law or any rule or regulation adopted thereunder, or a violation of any rule or regulation of any national securities, commodities, or options exchange or national securities, commodities, or options association.

E. §626.641(3)(b), F.S. – Prohibits the department from issuing a license to a former licensee who has had his or her license revoked resulting from the solicitation or sale of an insurance product to a senior consumer.

If a licensee as an agent or customer representative or the eligibility to hold such a license has been revoked resulting from the solicitation or sale of an insurance product to a person 65 years of age or older, the department may not thereafter grant or issue any license under this code to such individual.

F. §626.9521(3)(a)-(b), F.S. - Increases the financial penalty for the willful act of “twisting” or “churning” of an annuity, and fraudulent signatures to a maximum of $75,000.

(3)(a) If a person violates s. 626.9541(1)(l) F.S. the offense known as “twisting,” or violates s. 626.9541(1)(aa) F.S. the offense known as “churning,” the person commits a misdemeanor of the first degree, punishable as provided in s. 775.082, F.S. and an administrative fine not greater than $5,000 shall be imposed for each nonwillful violation or an administrative fine not greater than $75,000 shall be imposed for each willful violation. To impose an administrative fine for a willful violation under this paragraph, the practice of “churning” or “twisting” must involve fraudulent conduct.

(b) If a person violates s. 626.9541(1)(ee), F.S. by willfully submitting fraudulent signatures on an application or policy-related document, the person commits a felony of the third degree, punishable as provided in s. 775.082, F.S. and an administrative fine not greater than $5,000 shall be imposed for each nonwillful violation or an administrative fine not greater than $75,000 shall be imposed for each willful violation.

(4) A licensee must make all reasonable efforts to ascertain the consumer’s age at the time an insurance application is completed.
G. §626.9521(5), F.S. – Allows the use of video depositions in administrative hearings involving a senior consumer and require compliance with the Rules of Civil Procedures.

(5) If a consumer who is a senior citizen is a victim, a video deposition of the victim may be used for any purpose in any administrative proceeding conducted pursuant to chapter 120 if all parties are given proper notice of the deposition in accordance with the Florida Rules of Civil Procedure.

H. §626.99(4)(b), F.S. – Life insurance solicitation; Disclosure Requirements; extends the “free look” period for the purchase of an annuity by a senior consumer from 14 to 21.

(b) With respect to fixed and variable annuities, the policy must provide an unconditional refund for a period of at least 14 days. For fixed annuities, the buyer’s guide shall be in the form as provided by the National Association of Insurance Commissioners (NAIC) Annuity Disclosure Model Regulation, until such time as a buyer’s guide is developed by the department, at which time the department guide must be used. For variable annuities, a policy summary may be used, which may be contained in a prospectus, until such time as a buyer’s guide is developed by NAIC or the department, at which time one of those guides must be used. If the prospective owner of an annuity contract is 65 years of age or older:

1. An unconditional refund of premiums paid for a fixed annuity contract, including any contract fees or charges, must be available for a period of 21 days; and
2. An unconditional refund for variable or market value annuity contracts must be available for a period of 21 days. The unconditional refund shall be equal to the cash surrender value provided in the annuity contract, plus any fees or charges deducted from the premiums or imposed under the contract. This subparagraph does not apply if the prospective owner is an accredited investor, as defined in Regulation D as adopted by the United States Securities and Exchange Commission.

I. §626.99(4)(c), F.S. – Requires an insurer to provide a cover sheet attached to the policy when an annuity is issued informing the purchaser about the free look period and about how to contact the insurer and the department if they have a question about the annuity.

(c) The insurer shall attach a cover page to any annuity policy informing the purchaser of the unconditional refund period prescribed in paragraph (b). The cover page must also provide contact information for the issuing company and the selling agent, the department’s toll-free help line, and any other information required by the department by rule. The cover page is part of the policy and is subject to review by the
office pursuant to s. §627.410, F.S.,

J. §627.4554(3)(b), F.S. – Definitions; Defines ‘Accredited investor’

(b) “Accredited investor” means any person who comes within any of
the following categories, or who the issuer reasonably believes comes
within any of the following categories, at the time of the sale of an
annuity to that person:

1. The person’s net worth or joint net worth with his or her spouse, at the time of the
purchase, exceeds $1 million; or

2. The person had an individual income in excess of $200,000 in each of the 2 most
recent years, or joint income with his or her spouse in excess of $300,000 in each of
those years, and has a reasonable expectation of reaching the same income level in
the current year.

K. §627.4554(5)(b)(c), F.S. – Authorizes the department to require an agent to make
monetary restitution to a senior consumer harmed by a violation of the insurance
code under certain circumstances.

(b) The department may order:

1. An insurance agent to take reasonably appropriate corrective
action, including monetary restitution of penalties or fees incurred by the senior
consumer, for any senior consumer harmed by a violation of this section by the insurance
agent.

2. A managing general agency or insurance agency that employs or contracts with an
insurance agent to sell or solicit the sale of annuities to senior consumers to take
reasonably appropriate corrective action for any senior consumer harmed by a
violation of this section by the insurance agent.

(c) The department shall, in addition to any other penalty authorized
under chapter 626, F.S., order an insurance agent to pay restitution to
any senior consumer who has been deprived of money by the agent’s
misappropriation, conversion, or unlawful withholding of moneys
belonging to the senior consumer in the course of a transaction
involving annuities. The amount of restitution required to be paid
pursuant to this paragraph may not exceed the amount
misappropriated, converted, or unlawfully withheld. This paragraph
does not limit or restrict a person’s right to seek other remedies as
provided by law.

L. §627.4554(9), F.S. – Prohibited Charges; limits the period of a surrender charge for an
annuity sold to a senior consumer to 10 years and limits the surrender charge to 10
percent.
An annuity contract issued to a senior consumer may not contain a surrender or deferred sales charge for a withdrawal of money from an annuity exceeding 10 percent of the amount withdrawn. The charge shall be reduced so that no surrender or deferred sales charge exists after the end of the 10th policy year or 10 years after the premium is paid, whichever is later. This subsection does not apply to annuities purchased by an accredited investor or to those annuities specified in paragraph (7)(b).

ANNUITY PRODUCTS:

Although there exists a wide range of annuities with various options and features, all annuities may be divided into the two basic groups of Fixed and Variable annuities which we will discuss further in this text.

Before discussing the different type of annuities we will discuss what all annuities have in common.

PRINCIPALS INVOLVED IN AN ANNUITY CONTRACT:

The participating parties in the annuity contract are the Insurer (insurance company), the Contract Owner, the Annuitant and the Beneficiary.

THE INSURER:

Since an annuity is an insurance contract it can only be offered by an admitted insurer licensed to do business in the state of Florida. Typically insurers offer several different annuities. While the insurers may only offer fixed annuities or only variable annuities they often will offer several fixed or several variable annuities designed to meet different long term goals with different options, restrictions, and features.

CONTRACT OWNER:

The contract owner has the right to choose and manage the annuity contract including the contractual rights to perform the following functions:

Add additional funds (premiums)
Withdraw any portion of the annuity values
Change contract parties (i.e., annuitant and/or beneficiary)
Surrender the annuity

The contract owner does not have to be one individual, but must be a legal adult. If the contract owner is a minor, the policy must list the minor’s custodian. The contract owner can also be a couple, a partnership, a trust or even a corporation.
ANNUITANT:

Any person who the contract owner chooses to name as the annuitant (i.e., him/herself, family member or friend) must be currently living and must meet the insurance company’s age restrictions for the annuity. Generally, the annuitant must be under age 75 at date of signing, though this may vary depending upon the annuity contract and/or state law. In addition, though the contract owner has the option of changing the annuitant at any time, most annuities require the stipulation that the new annuitant was alive when the original contract was executed.

An annuitant is similar to the insured in a life policy; however, the annuitant cannot:
Control the contract
Make withdrawals
Make deposits
Change the parties to the contract
Surrender the contract

BENEFICIARY OR MULTIPLE BENEFICIARIES:

The beneficiary(ies) of the annuitant are most often family members of the annuitant, individual(s), trusts, a corporation or a partnership. The annuity application has the flexibility of allowing multiple beneficiary designations, at the prior discretion of the contract owner. For example, a beneficiary designation may be apportioned so that the spouse of the contract owner will receive 70% of the annuity, and his three children will receive 10% each.

The contract owner can retain complete control over the annuity during his/her lifetime by naming him/herself as contract owner and annuitant, while naming another as beneficiary(ies).

Most annuity contracts have minimum and maximum age limits for the owner and the annuitant. Since the beneficiary is the one receiving the proceeds of the annuity at death and the contract is terminated at the payout, there are no age limits on the beneficiary. The minimum and maximum age is used to determine the minimum age at which an annuity contract may be issued and the maximum age that the annuity contract may be issued. Some annuity contracts state the minimum and maximum age of both the owner of the annuity contact and the annuitant. Typically the minimum age is 0, but in some cases it is 18. Maximum age depends on the insurer and ranges between 60 and 90 with the majority being 85 or 90.

SURRENDER CHARGES:

Most annuities impose some form of surrender charge. The contract may call it a contingent deferred sales charge or it may be called a withdrawal charge. Surrender charges withhold a portion of the annuity value if the contract owner makes a withdrawal within the surrender charge period. In most annuities, surrender charges are expressed as
a percent of the withdrawn amount. The surrender charge percent typically declines to zero over a 5 to 12 year period. In most cases the surrender charge period expires after 5 to 12 years from the contract issue date; however, some annuities will have a “rolling surrender charge” which applies for a specified period on each separate premium payment and each premium payment has its own surrender charge expiration date.

The percent and duration of a surrender charge can have a significant affect on the contract owners’ ability to access their funds without penalty.

EXCEPTIONS TO SURRENDER CHARGES:

ANNUAL SURRENDER CHARGE EXCEPTION:

Most annuities offer several exceptions to the surrender charge. The most common exception to the surrender charge is the right for the contract owner to withdraw up to 10% of the contract value (or accumulated value) per year after the first contract anniversary. When this surrender charge exception is present it is almost always non cumulative which means that if the owner does not take the allowed withdrawal in a given year it does not accumulate to be withdrawn later (use it or loose it).

NURSING HOME CONFINEMENT:

Another fairly common exception to the surrender charge is confinement in a nursing home. Annuities offering this will allow a withdrawal equal to the cost of confinement without surrender charge. Some annuity contracts will put a cap on this withdrawal expressed as a dollar amount or percent of the annuity value. As a producer you should be very familiar with the wording of the contract(s) you sell and be able to explain in detail the provisions of the contract to the consumer. A good example of this is when the nursing home confinement is offered the triggering event can vary considerably. When reading this exception to the surrender charge it will most often say “if the annuitant is confined to a nursing home” a higher quality variation would say “if the annuitant or their spouse is confined to a nursing home” the highest quality wording would say “if the annuitant and/or their spouse is confined to a nursing home”.

REQUIRED MINIMUM DISTRIBUTION:

If the annuity will be funded with qualified funds (from and IRA, 401(k) or other qualified retirement plan) and the owner will reach their required beginning date, (April 1st of the year following the year they turn age 70½) for required minimum distributions before the end of the surrender charge period they will need an RMD exception to the surrender charge. If the annuity offers a 10% annual withdrawal amount as described above this will most likely (due to the actuarial requirements of RMD) allow sufficient penalty free withdrawals to comply with RMD requirements. Even with the 10% annual exception a consumer in the above situation should not be sold an annuity that does not allow for the RMD to occur penalty free for the reason that they could purchase the annuity with existing qualified funds at an age where they are past their required
beginning date.

**DEATH:**

Many annuities completely waive the surrender charge if the annuitant dies while some companies only waive the surrender charges if the beneficiary takes the annuity proceeds over a 5 year period.

**OTHER EXCEPTIONS TO THE SURRENDER CHARGE:**

Above we have detailed the most common exceptions to surrender charges but we have by no means covered all of the possibilities. A few other surrender charge exceptions are listed below:

- Bailout clause
- Terminal illness waiver
- Disability waiver

**ANNUITIZATION OPTIONS:**

All annuities offer the option to annuitize the contract. While annuitization options can vary significantly from contract to contract they will all offer single life, joint life, and period certain annuitization options. Many will also offer several forms of joint life or joint and survivor annuitization options as well as the ability to combine life annuitization with period certain options of varying length. Fixed annuities and variable annuities will vary as to the level of guarantees during annuitization. The fixed annuity will guarantee a minimum income amount during the annuitization while the variable annuity will guarantee the current value of a certain number of annuity units during annuitization and the value of an annuity unit can vary during the annuitization period. Many variable annuities offer (for a fee) the option of guaranteeing a minimum value of the annuity units during annuitization and thus can guarantee a minimum income benefit during the annuitization period like a fixed annuity.

**OTHER RIDERS AND OPTIONS:**

Most annuities, both fixed and variable offer at least one additional rider or option. These riders or options will vary greatly from one annuity to another and should be examined, disclosed, and evaluated individually.

**ANNUITY TYPES:**

**FIXED ANNUITIES:**

The fixed annuity is the oldest of the types of annuities. With a traditional fixed annuity, the insurance company guarantees the principal, a minimum rate of return (interest rate), and a minimum payout amount. The current credited interest rate for fixed annuities is determined (subject to minimum guarantee requirements) and
declared by the insurance company. If the insurer changes the current credited interest rate it will usually apply to funds received after the change effective date for “new money”. The rate is usually guaranteed for a year at a time for existing annuity values. Some fixed annuities offer a multi year rate guarantee. It is very important for the producer to understand the renewal rate history for the products they recommend.

**EQUITY INDEXED ANNUITIES:**

Equity indexed annuities are a type of fixed annuity that were first market in the mid 90’s and have accounted for a large portion of annuity sales since being introduced. There are several differences between equity indexed annuities and the traditional fixed annuity, most notably the way current interest credits are calculated and what portion of consumer principal is guaranteed. Most equity indexed annuities offer a declared interest rate as an option for the consumer. This interest crediting is the same as the traditional annuity described above.

The first of these differences accounts for a lot of the consumer acceptance of the equity indexed annuities. The current interest is calculated by applying a formula to an external financial index such as the S & P 500®, the Dow Jones Industrial Average®, or the Lehman Aggregate Bond Index®. The formula used to calculate the current credited interest can vary from product to product and there is often the ability to have different portions (buckets) of the annuity values indexed using different indices and formulas within the same annuity. While the various indexes and indexing methods are many we will summarize the most common indexing formulas below. NOTE: The term indexing method as used in this text means the formula for calculating current credited interest.

**INDEXING METHOD**

One of the most confusing aspects of index annuities is the method the company uses to calculate the current credited interest rate that the annuity will earn. The indexing method is the approach used to measure the amount of change, if any, in the index. Some of the most common indexing methods are explained more fully below.

**INDEXING PERIOD:**

All the indexing methods essentially measure the change in the index over some period of time. The time periods that companies use are either the policy year (most common), from the day the policy is issued to one year later or a specific term, a period of one or more years.

For all indexing examples we will use the most common one year indexing term (policy anniversary).
METHODS FOR MEASURING INDEX CHANGE

POINT TO POINT:

With point to point indexing the change in the index value is measured from one point to another. Usually point to point indexing is on an annual basis. The change in the actual index value from the beginning of the policy year to the end of the policy year is expressed as a percentage. If the index value was 500 at the beginning of the policy year and closed at 550 at the end of the policy year, there would have been a 10% increase in the index during the policy year. If during the year the index had been higher than 550 (the ending value) and/or lower than 500 (the beginning value) it would not affect the measurement because the point to point method measures the change in the index value from one date to another. If the index value was 500 on the beginning date and 450 on the policy year ending date point to point indexing would use 0 (zero) as the percent change.

AVERAGING:

With averaging indexing the beginning value for the indexing calculation will be the actual value of the index on the policy year beginning date (assuming policy year as the indexing term). The ending value for the averaging method will be the average of the actual value of the index measured periodically (monthly averaging and daily average being the most common).

If the policy year began on February 8 and the annuity used monthly averaging the beginning value for the calculation would be the actual value of the index on Feb 8 and the ending value for the calculation would be the average of the twelve actual values of the index on March 8, April 8, May 8, June 8, July 8…thru the next Feb 8.

Like point to point indexing if the value of the twelve values (the eighth of each month (March thru next Feb)) was higher than the actual value on the previous Feb 8 (policy year beginning date) then the averaging calculation would show a negative movement in the index and zero (0) would be used as the result.

HIGH WATER MARK:

With high water mark indexing the beginning value for the indexing calculation will be the actual value of the index on the policy year beginning date (assuming policy year as the indexing term). The ending value for the high water mark method will the highest value achieved by the index during the policy year which could be any day during the policy year. Like the above indexing methods if the index value drops below the beginning value (the actual index value on the policy year beginning date) and stays below for the entire year the high water mark method would result in a negative movement in the index value and zero (0) would be used.

The above methods for measuring the percent change in the index are not the only methods used but are the most common.
ANNUAL RESET OR RATCHET:

Now that we have explored the most common methods for measuring the change in the index value lets discuss indexing in successive years. Most equity indexed annuities use annual reset or ratchet as the method to determine the beginning value for index in the ensuing year. This method locks in the gain (if any) for that period which is usually one policy year. Once the interest is credited to their policy it becomes the value on which the next years indexing is calculated. Another way to say this is that indexing for each policy year stands alone.

PARTICIPATION RATE:

Most equity indexed annuities have a participation rate as part of their formula for determining current credited interest. The participation rate determines how much of the increase in the index (as measured by the one of the methods just described above) will be used to calculate index-linked interest to be credited to their policy for that year. For example, if the calculated change in the index is 9% and the participation rate is 70%, the index-linked interest rate for their annuity will be 6.3% (9% x 70% = 6.3%). In most equity indexed annuities that have a participation rate as part of the crediting formula the participation rate is a “moving part” in that it can be changed by the insurance company. There is usually a guarantee as to the lowest the company can set the participation rate (usually 30%) and once the rate is set it is effective and can not be changed until the next indexing term (usually policy year).

INTEREST CAP:

Most equity indexed annuities put an upper limit, or cap, on the index calculated interest rate. This is the maximum rate of interest the annuity will earn. In the example given above, if the contract has a 6% cap rate, 6%, and not 6.3%, would be credited. Not all equity indexed annuities have a cap rate. The cap is often a “moving part” and is usually guaranteed to never go below 3%.

MARGIN, SPREAD, OR ADMINISTRATIVE FEE:

With the margin, spread, or administrative fee approach the change in the index value is calculated using one of the methods described above and the resulting number is reduced by a set predetermined fee percentage. This percentage, usually referred to as the "margin," "spread," or "administrative fee," might be instead of, or in addition to, a participation rate.

For example, if the calculated change in the index is 8%, the annuity might specify that 2.25% will be subtracted from the rate to determine the interest rate credited. In this example, the rate would be 5.75% (8% - 2.25% = 5.75%). In this example, the company subtracts the percentage only if the change in the index produces a positive interest rate.

Equity index annuities that impose a spread, margin, or administrative fee rarely have an interest cap.
SURRENDERS DURING THE INDEXING TERM

If a withdrawal is made during the index term (usually policy year) no index interest will have been credited to the withdrawn funds (since it is always calculated at the end of the index term). This is very important for the producer to understand. Most equity indexed annuities allow the consumer to change their interest calculation methods (within the choices allowed within the annuity) on an annual basis tied to the policy anniversary. If a contract owner is going to need cash from their annuity in the near future (within the policy year) the producer should advise them to move those funds to the declared interest method so that the interest will be credited incrementally during the year.

PRINCIPAL GUARANTEE

It is common for the principal guarantee in an equity indexed annuity to be a guarantee of 90% of the total premiums paid plus guaranteed interest (usually at 3%) less surrender charges if applicable. This principal guarantee is less that is offered by the traditional fixed annuity.

MARKET VALUE ADJUSTED ANNUITIES

Annuities with a market value adjustment are often called CD type annuities because they offer an interest guarantee for a multi year period. A market value adjustment can be found in a traditional fixed annuity or an equity indexed annuity. The market value adjustment is a mechanism that “adjusts” the annuity value to reflect current economic conditions affecting the value of the insurance company’s invested assets when funds are withdrawn from the annuity. The market value adjustment can be very confusing to most people and can result in a positive or a negative adjustment to the annuity contract value. There is a limit to the amount of a negative adjustment allowed in that it can not reduce the annuity below minimum guaranteed values required by state insurance law. This restriction is necessary to maintain the insurance status of the annuity by limiting the consumers’ exposure to investment risk. It is a true statement to say that the annuity owner is subject to some investment risk when a market value adjustment is present in an annuity.

HOW DOES THE MARKET VALUE ADJUSTMENT WORK

Whether the market value adjustment is positive (money is added to the annuity) or negative (money is subtracted from the annuity) depends on whether the interest rates in the market are higher or lower than when the annuity was purchased. If current interest rates are higher than when the annuity was purchased, the adjustment is negative (money is taken away). Similarly, if current interest rates are lower than when the annuity was purchased, the adjustment is positive (money is added).

Example: Assume the annuity is purchased when the interest rate is 6%. During the next year, the current interest rates dropped to 4%. If funds are withdrawn from the annuity (before the MVA period expires), the MVA would be positive. That is, money would be...
added to the withdrawn funds because interest rates were lower than when the annuity was purchased.

It should be noted that the market value adjustment is in addition to a surrender charge and if a withdrawal is taken during the surrender charge period there will be a market value adjustment (positive or negative) in addition to a surrender charge.

With most market value adjustments the interest rate guarantee period and the market value adjustment period expire at the same time. However, some annuities will have a market value adjustment period that runs longer than the interest rate guarantee period.

Obviously when a market value adjustment is present in an annuity it requires considerable disclosure and explanation for the consumer to understand it.

**VARIABLE ANNUITIES**

Excerpted from F.S. 627.4554

(8) APPLICATION TO ANNUITIES.—Any person who is registered with a member of the Financial Industry Regulatory Authority, who is required to make a suitability determination, and who makes and documents such determination is deemed to satisfy the requirements under this section for the recommendation of annuities. This section does not limit the department’s ability to enforce the provisions of this section with respect to insurance agents, insurance agencies, and managing general agents, or the office’s ability to enforce the provisions of this section with respect to insurers.

Variable annuities are securities products and therefore are regulated by state and federal securities laws. Only a insurance producer who is also state and federally securities licensed may sell a variable annuity. The sale of a variable annuity must always be accompanied by the delivery of a prospectus to the applicant.

FINRA, The Financial Industry Regulatory Authority is the non-governmental regulator for all securities firms doing business in the United States and as such serves as the federal level regulator for variable annuity sales. FINRA was created in July 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange.

Variable annuities have evolved into a fairly sophisticated securities vehicle with a combination of security and insurance features. For a number of years regulators have been concerned about the suitability of some variable annuity sales in the face of growing product complexity. FINA has published a new Rule (Rule 2821) dealing with variable annuities. Several sections of this rule became effective in May 5, 2008 and two sections will have delayed implementation.
FINRA RULE 2821 SUMMARY

FINRA adopted Rule 2821 in response to its perception of “numerous instances of questionable sales practices” and inadequate supervision and training procedures regarding variable annuities.

Rule 2821 is focused on four main areas related to variable annuities:

- Suitability
- Principal review and approval
- Supervisory procedures
- Training

In a variable annuity the annuity values are tied to the value of the securities selected within the annuity. Most variable annuities offer a range of investment options within each annuity (called sub accounts) and these investments range from conservative to aggressive. In addition the contract owner can spread their annuity values over several sub accounts. It is common for variable annuities to offer portfolio allocation models designed to automatically keep the investment accounts balanced (based on the goals of the model) as the values fluctuate by transferring amounts among sub accounts to “rebalance” the annuity sub accounts. Variable annuities usually also offer a fixed income account which is guaranteed.

VARIABLE ANNUITY INVESTMENT RISK

Since the variable annuity product consists of securities products the values of the sub accounts is not guaranteed and a consumer can lose principal. Variable annuity companies often offer different forms of guarantees to offset the risk of investment loss. Each of these guarantees has a cost associated with it that will be disclosed in the prospectus.

GUARANTEED MINIMUM DEATH BENEFIT

In an effort to address the downside risks associated with securities the variable annuity companies began to offer a GMDB: Guaranteed Minimum Death Benefit.

The GMDB offers downside market protection at death. In its’ original form the GMDB promised that if the variable annuity owner died the beneficiary would be guaranteed the greater of the account value at death or a return of principal. This basic GMDB covers markets risks associated with equity investing but only did so if the client dies. It should be noted that a GMDB does not protect the owner from market risks but rather protects the beneficiaries.

Some variable annuity companies have enhanced the basic GMDB by stipulating that in addition to a guarantee of a return of principal at death (or account value if higher) they would add an enhanced death benefit.
These enhanced death benefits generally take one of two forms:

**PRINCIPAL COMPOUNDED AT A FIXED RATE GMDB**

This GMDB guarantees a return of all principal plus interest compounded at a specified annual percentage rate. Often this enhanced benefit is not effective until the third or later contract anniversary. The annuity owner is assured that if they die while owning the variable annuity the beneficiary will receive all of the principal invested plus a nominal rate of return if this amount is greater than the actual annuity value at death.

**ANNIVERSARY RATCHET GMDB**

Sometimes called the high-water mark anniversary guarantee this form of enhanced GMDB takes a snapshot of the annuity value at each contract anniversary and guarantees the beneficiary the minimum of the amount invested, actual account value at death, or if greater the highest value of the annuity on any previous contract anniversary date. MAV (prior Maximum Anniversary Value)

**VARIABLE ANNUITY LIVING BENEFITS**

In addition to the GMDB many variable annuities offer other forms of guarantees to offset market risk that are effective while the contract owner is still alive. These guarantees are often called living benefits and take a variety of forms. Living benefits come at a cost to the contract owner and have required holding periods and asset allocation restrictions associated with them that need to be reviewed individually.

**GUARANTEED MINIMUM ACCUMULATION BENEFIT GMAB**

The guaranteed minimum accumulation benefit in its’ most common form guarantees the contract owner that the annuity will grow in value by a minimum stated interest rate and will be available for withdrawal as a “walk away benefit” if the contract holder keeps the contract for a minimum time period (usually 7 to 10 years). Generally speaking the higher the accumulation interest rate guaranteed the longer the required holding period. If the contract owner withdraws or surrenders the contract prior to the end of the required holding period the GMAB is not yet effective. There are other formula driven GMABs that follow a variety of formulas each of which requires understanding and explanation.

**GUARANTEED MINIMUM INCOME BENEFIT GMIB**

This living benefit combines the accumulation guarantees of the GMAB with the contractual annuitization factors to create a guaranteed stream of lifetime income. Like the GMAB there will be a required holding period as well as asset allocation restrictions both during the accumulation and annuitization periods.

**GUARANTEED MINIMUM WITHDRAWAL BENEFIT GMWB**

The guarantee minimum withdrawal benefit GMWB is similar to the GMIB except that the contract does not have to be annuitized. The are a large variety of options offered by
different variable annuity companies under the GMWB. These various GMWBs range from a 5% withdrawal on your account (regardless of market performance) for 20 years with the potential to still have funds left over to a guarantee of 5% for life. One potential advantage of the GMWB over the GMIB is that if the underlying securities perform well the withdrawals could actually increase over time.

Keep in mind, however, what it would take for that to happen. If you are taking withdrawals from the account of 5%, and the annuity itself carries total charges and fees of 2.5% that’s a total of 7.5% coming out of the account value every year. Each year that the investment portfolio produces a gross return of less than 7.5% the account value will decrease and, therefore, gross returns in excess of 7.5% are necessary to grow the account value and produce future increases in withdrawal amounts.

GROUP ANNUITIES

Group annuities are most commonly sold to fund employer provided qualified retirement plans during the accumulation period. There are situations when a group annuity is used to fund the retirement income stream from an employer provided retirement plan when the employer invested in non-annuity assets during the accumulation period (such as in a defined benefit plan). In this situation each employee receives their annuity certificate as they reach retirement and receive all future retirement income from the annuity. Occasionally an employer will employ a group annuity when they terminate a defined benefit retirement plan (sometimes required by the Pension Benefit Guaranty Corporation). In the case of a plan termination there will be employees who receive an annuity well before they reach retirement age.

The sales process for a group annuity usually occurs at the employer level. Group annuities have lower fees and commissions paid therefore they tend to have smaller and shorter surrender periods. If the group annuity is individually solicited it is covered under the definition of annuity under FS 627.4554 and must comply with all of the suitability requirements.

CHAPTER 1 REVIEW QUESTIONS:

*(answers are in the back of the text)*

1. A ___________ is an adjustment which can be positive or negative applied to an annuity when a withdrawal is made, this adjustment may be in addition to a surrender charge.

2. The benefit offered on some variable annuities that guarantees the beneficiary a minimum amount equal to or greater than the total of all premiums paid by the deceased contract owner is called a ____________.

3. In a fixed equity indexed annuity utilizing an indexing option what can be said
about funds that are withdrawn from the annuity during the indexing term?
Chapter 2

DUTIES OF INSURERS AND AGENTS

FS 627.4554 spells out the duties of insurers and agents relative to recommendations to senior consumers relative to annuity transactions (purchase or exchange). It also requires that when an insurance agent is not involved in the transaction (like in the case of direct response sales) the insurer solely is responsible. Before the recommendation is made the agent or the insurer (if no agent is involved) must have an objectively reasonable basis for making the recommendation. The objectively reasonable basis for the recommendation must be based on information disclosed by the senior consumer and consist of very specific information as detailed below.

REQUIRED INFORMATION TO COLLECT

At a minimum the agent must collect the following information:

PERSONAL INFORMATION

Personal information such as name, age, sex, address, marital status and dependents and their ages. This information should be collected for all parties to the annuity including dependents of the annuity parties. Since this rule deals with senior consumers most seniors will not have dependents by the time they reach age 65 and those that do have dependents are more likely to have dependents with special needs that may factor into liquidity requirements and therefore suitability determination.

Investment objectives: The insurer or agent needs to get information from the senior consumer(s) about their investment objectives. Often the consumer needs to be asked numerous follow up questions for them to fully articulate their investment objectives. The timing and amount of future access to the intended funds should be determined to the best of the client’s ability. This is a good time to question about the need for and existence of an emergency fund. It sometimes helps if the insurance agent repeats to the client what they think they heard as the stated investment objective this gives the consumer an additional chance to sharpen their definition of their goals.

Applicant's risk tolerance: Many insurers use some form of questionnaire designed to help determine risk tolerance. This completed questionnaire is often retained by the insurer to show that an attempt was made to determine risk tolerance. Generally speaking the more financial risk the product would expose the client to the more likely the insurer is to require a risk tolerance questionnaire.
Many of these suitability questionnaires are structured so that they can be scored in the field by the agent and result in a numerical score that determines if the consumer’s risk tolerance is within the ranges suitable for the product being recommended. When there is more than one senior purchasing the annuity (such as husband and wife) the risk tolerance of both should be determined.

**CURRENT FINANCIAL SITUATION**

**Current financial situation:** The consumer’s current financial situation includes information related to their current assets income, tax circumstances liquidity needs and resources.

**ASSETS**

**Existing assets:** Information should be collected about all of their investments. For each asset the type of asset, value, original purchase date, intended use, tax status (qualified or non-qualified), type of ownership (single, joint, trust), and current income (if any) provided by the asset.

**ANNUAL INCOME**

**Applicant's annual income:** The consumer’s income and sources of income need to be determined. Some retirement plans and financial institutions will withhold estimated taxes as a convenience for the income recipient. If the income stream has already had estimated taxes withheld then the insurance agent needs to know if the amounts withheld have been adequate in past years. If in the past the consumer has been required to pay additional taxes at year end this will be evidence of an annual need for liquidity. If no taxes are withheld from some or all of the consumer’s income stream then the need for liquidity at tax time will be greater.

The nature of the income is also important as well as past history of the income stream versus inflation. If the income tends to fluctuate this also needs to be known as well as a range of the expected fluctuation. If an income stream has a known ending point that is also important. As an example the consumer might have sold a piece of real estate and owner financed the sale but the payments will end in 5 years because the property will be paid off.

If the client is still working and producing income the intended retirement date is important as well as any predicted changes in future earnings.

**TAX STATUS**

**Tax status:** The insurer and/or agent need to know the consumer’s tax filing status (married, head of household, single, qualifying widow etc) as well as in taxes in arrears. If because of how their income is paid to them they end up having to pay taxes at the end of the year this is important in that it affects liquidity needs.
LIQUID NET WORTH

**Applicant's liquid net worth and liquidity needs:** The consumer’s liquid net worth would include only the net value of assets after converted to liquid cash. Assets such as real estate (including principal residence) should not be included in a liquid net worth calculation. Other assets such as automobiles and household belongings should not be included as liquid assets even if they could be sold with relative ease because these are assets that they utilize in their day to day life. If there exists an asset that imposes a surrender charge or other penalty for liquidation only the net value can be included as a liquid asset. Moreover only the portion of the asset that can be accessed without penalty or surrender charges should be relied on for liquidity. If an asset is exposed to market risks the future amount available for liquidity is hard to gauge. If the one of the consumers is under 59 ½ (where one spouse is 65 or older and the other is younger) their qualified retirement assets should not be counted as liquid due to the 10% early withdrawal penalty. On the other side of this issue if the consumer is already under the required minimum distribution requirement they should have sufficient retirement assets in a position to be liquidated without penalty, surrender charge, or market risk to comply with the required distributions. Laddering of assets is a good strategy to provide future liquidity and involves projecting liquidity needs into the future and determining which assets will provide that liquidity stream without penalty, surrender charge or potential market loss.

FUTURE FINANCIAL CONCERNS

**Future Financial Considerations:** This category of information can involve many consumer goals. It could involve the future purchase of a recreation item (RV or boat), the purchase of real estate, the funding of education for loved ones, providing for potential long term care costs, cessation of employment, future cessation of a current stream of income, caring for a dependent (which could include a parent, child or grandchild), wealth transfer, or many other goals. The time horizon and amount needed to satisfy each of these future considerations will affect future needs for asset growth and liquidity.

MEDICAL CARE CONCERNS

**Medical care concerns:** With health care costs soaring the ability to afford future medical care is a concern for many. Obviously the 65 year old or older consumer can usually rely on Medicare part A & B to form the base of their primary health care delivery strategy. In addition they will need to consider some form of supplementation to the traditional Medicare as well as Medicare part D to gain access to prescription drug coverage. In the case of a couple where one of the consumers is not yet 65 they need to have a strategy to afford health care for the younger spouse until they reach Medicare eligibility. The potential costs of the need for custodial care can not be ignored and is often
addressed through the purchase of a long term care policy. With Florida having a long term care partnership program the senior consumer should investigate the viability of insuring this risk. If a senior consumer needs long term care service sand does not have coverage even the best laid financial plans can be devastated.

**RETIREMENT AGE**

**Retirement age preference:** Retirement is not always a clear line in the sand. Often retirement is partial and involves re-hire-ment where the retiree seeks some form of part time lower level employment to supplement their retirement. The retirement date desired by the consumer will obviously affect their retirement planning and liquidity needs. The anticipated retirement lifestyle and debt structure (if any) at the time of retirement will help determine the income needs at retirement.

**ENDOWMENTS**

**Endowments:** If the consumer is the beneficiary of an endowment the start date (or maturity/endowment date) and form and amount of payment will be important to determining their future financial outlook. Conversely if the consumer wishes to fund an endowment for the benefit of others the desired contribution amount and date of contribution will need to be considered in their overall future financial considerations.

**FINANCIAL SUPPORT OF family members**

**Financial support of family members:** If the consumer is currently or desires in the future to support family members (that weren’t counted when determining dependents earlier) the cost of providing this support needs to be estimated. Often there is a degree of uncertainty as to whether this support will be needed or not. A very common concern in this area is a child who is a single parent and struggling to make ends meet.

**INTENDED USE OF ANNUITY**

**Intended use of the annuity:** The stated goal that the consumer hopes to accomplish by purchasing or exchanging the annuity should be determined. If the consumer states as their goal “to guarantee a stream of income that I can’t outlive” then it appears that the annuity is designed to meet that goal. If however the consumer has non qualified funds and states that their goal is “to invest this money and let it grow and pass to my children upon my death” (which is classified as a wealth transfer goal) then the annuity might not be the best answer. Since annuities are one of the few assets that does not “step up” in cost basis for federal income tax purposes the client needs to be informed of this fact. While the annuity will grow tax deferred while the consumer is alive upon their death all of the growth in the annuity (that was tax deferred during accumulation) will be taxed when withdrawn as ordinary income.
SOURCE OF FUNDS

Source of funds to be used for purchase of annuities: The insurer or insurance agent should determine the source of the funds used to purchase the annuity. If the source of funds would require liquidation and has unrealized capital gains that would be realized the agent should disclose to the consumer that it will be a taxable event when they liquidate the asset to provide the funds to purchase the annuity. Unless the insurance agent is also a CPA they should not give specific tax advice to the consumer nor should they attempt to estimate the amount of taxes that would be due. Many assets when liquidated, surrendered, cancelled, or otherwise converted to cash have fees, penalties, surrender charges and/or tax consequences and the consumer needs to understand these additional costs to the overall transaction.

OTHER FINANCIAL NEEDS

Other financial needs: If the consumer has other financial needs that were not disclosed by them under the previous categories now is the time for them to disclose them. There could be considerable overlap among several of these areas of financial considerations but thorough questioning by the insurance agent can assure that the consumer has had ample opportunity to disclose all foreseeable financial needs, goals, and considerations.

OTHER INFORMATION OR CONSIDERATIONS USE BY AGENT

Any other information used or considered by the agent or insurer in making recommendations to consumers regarding the purchase or exchange of an annuity contract.: If there is any other information that the insurance agent or insurer used in forming their reasonable objective basis for the recommendation they need to document and quantify it to the degree possible.

The Florida DFS will produce an Annuity Suitability Questionnaire to ensure minimum required information is collected. (This questionnaire will be part of FAC 69B-162.011 which is currently under rule development. The questionnaire will be available when the rule development process is complete.)

IF THE CONSUMER CURRENTLY HOLDS AN ANNUITY

If the consumer currently has an annuity (whether it is considered for exchange or not) the following information needs to be collected as part of the suitability determination process.

INFORMATION TO BE COLLECTED

TYPE OF CONTRACT

Type of contract(s): The type(s) of annuity contract(s) currently held by the
consumer needs to be determined. It will be necessary for the insurance agent to actually see the contract to extract much of the required information for proper suitability determination.

ISSUE DATE

Issue date(s): The issue date and amount and frequency of premiums paid into each existing annuity as well as the current value needs to be determined.

MATURITY OR ANNUITY DATE

Maturity date(s) or Annuitization date(s): If the contract(s) have a forced annuitization date that needs to be determined as well as the maturity date for each existing contract. A focus needs to be placed on the annuitization process in the contract paying attention to the assumed interest rate used during annuitization as well as the CSO tables used.

ALLOCATION OF VALUES WITHIN THE ANNUITY

Allocation of funds within contract: If the contract is of a type that allows the consumer to allocate funds within the contract the current allocation as well as other allocations that are not currently utilized needs to be determined. Often the consumer can better achieve their changing goals within an existing annuity by adjusting their current allocation.

SURRENDER CHARGE TERMS

Terms of Surrender Charges: For each existing annuity the surrender charge needs to be explored. If it happens to be a two tier annuity then both surrender charges need to be understood. If the annuity involves bonus amounts the consumer’s entitlement to those amounts needs to be determined. Specifically the details of the surrender charge that are required to be determined are as follows:

- **Dollar Amount and surrender charge percentage:** The percentage of the surrender charge and to what values the percent is applied is important to understand and can be best determined by reading the contract. The actual resulting dollar amount of the surrender charge might need to be calculated if not shown.

- **Number of years in length:** The length of the surrender charge (usually expressed in contract anniversaries or contract years) needs to be determined. Obviously if the contract is old enough so that the surrender charge non longer applies the consumer would need to understand this as well.

COMPARISON OF LIFE EXPECTANCY TO SURRENDER CHARGE PERIOD

Comparison to life expectancy of applicant: The length of the surrender
charge as it relates to the remaining life expectancy of the owner is also important. In the case of John and Patricia Siebel the annuities were sold to them in their 80’s and had surrender charges of 15 years. If the surrender charge exceeds the consumer’s life expectancy then in essence they are making a lifetime commitment to this product because to access funds (in excess of any free withdrawal allowed) at any time during their expected lifespan they will suffer a surrender charge.

**Waiver of surrender charge provision:** Most annuities allow some waivers to their surrender charge. The various waivers and how they work were discussed earlier in this text. The more waivers and the more generously worded they are the less restrictive the surrender charge is viewed. However if the consumer needs access to funds during the surrender charge period and their withdrawal does not fit into one of the waivers they will experience shrinkage of annuity values due to surrender charges.

**RIDERS OR ENDORSEMENTS**

**Contract riders or endorsements:** There are many contract riders and endorsements that can be incorporated into annuities. The more common are a death benefit (life insurance rider), some form of living benefit (discussed earlier), some form of living benefit based on loss of functional capacity or critical illness, or dismemberment, or some form of living benefit based on terminal illness. They may also be loan provisions as part of an endorsement as a qualified retirement plan such as a 403(b) or 401(k). Many of the riders or endorsements are optional and are offered for a fee (usually expressed in basis points), some are hard coded in the product and built in to the guarantees offered by the product. The benefit and costs (if discernable) of each needs to be determined.

**CONTRACT LIQUIDITY**

**Liquidity of Contract:** Should the consumer need access to funds what liquid value can be accessed under the terms of the contract. This determination involves an understanding of surrender charges and/or vesting schedules (if a bonus vesting schedule exists) and/or a market value adjustment as well as other contractual terms placing restrictions on access to funds. For example if a consumer has an annuity that has been annuitized for life with a 10 year period certain it is no longer liquid because it has been annuitized.

**Prior to maturity:** Liquidity prior to maturity is usually influenced by the surrender charge and/or vesting and/or market value adjustment mentioned above. In addition some multi year guaranteed interest annuities (MYGIA) act like a CD in that withdrawals during the multiyear interest guarantee period will forfeit much of the earnings.

**At maturity:** At maturity there are usually various settlement options available to the consumer including annuitization. A walk away benefit is
usually available and if chosen full liquidity is often available. As mentioned above if annuitization is chosen no liquidity remains.

WHEN EXCHANGING OR REPLACING AN ANNUITY

DISCLOSURE AND COMPARISON FORM

If a consumer is exchanging an existing annuity for another contract a comparison between the contracts must be performed. This comparison and disclosure involves disclosing relevant facts about each annuity (current and proposed) and should contrast/compare them item by item. Florida requires the use of a Disclosure and Comparison form that among other things requires:

1. A comparison of the benefits, terms, and limitations between the annuity contracts.

2. A comparison of any fees and charges between the annuity contracts.

3. A written basis for the recommended exchange, including the overall advantages and disadvantages to the consumer if the recommendation is followed.

4. Such other information used or considered to be relevant by the insurance agent or the insurer in making recommendations to the consumer regarding the replacement or exchange of an annuity contract.

(e) Prior to the execution of a purchase or exchange of an annuity contract resulting from a recommendation, an agent shall also disclose to the consumer that such purchase or exchange may have tax consequences and that the applicant should contact his or her tax advisor for more information.

The required Florida DISCLOSURE AND COMPARISON OF ANNUITY CONTRACTS (form DFS-H1-1981 is reproduced beginning on the following page
## DEPARTMENT OF FINANCIAL SERVICES
Division of Agent & Agency Services - Bureau of Investigation

## DISCLOSURE AND COMPARISON OF ANNUITY CONTRACTS

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<th>EXISTING ANNUITY CONTRACT</th>
<th>PROPOSED ANNUITY CONTRACT</th>
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<tr>
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<td>Surrender Charge Period in Years</td>
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<td>Surrender Charge Schedule for Remaining Years</td>
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</tr>
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<td>Annual Free Withdrawal Percentage Rate</td>
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<td>Minimum Guaranteed Interest Rate</td>
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<td>Potential Loss of Bonus if Exchanged?</td>
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<td>Limits and Exclusions for Bonuses that may be Payable</td>
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<td>Participation Rate</td>
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<td>Index Type</td>
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<tr>
<td>Administrative Fees or Margins</td>
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<td>(List limitations, requirements, exclusions of the benefit)</td>
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<tr>
<td>Other</td>
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<th>Applicant Signature</th>
<th>Date</th>
<th>Joint Applicant Signature</th>
<th>Date</th>
</tr>
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</table>

DFS-H1-1981  Page 1 of 4  Adopted in Rule 698-162.01, F.A.C.
Pub. 12/29/2009
DISCLOSURE OF SURRENDER CHARGES IF
EXISTING ANNUITY IS REPLACED OR EXCHANGED

EXISTING ANNUITY CONTRACT NO. ____________________________

Annuity Total Value\(1\) $ __________  Annuity Surrender Value\(2\) $ __________

Surrender Charges\(3\) Applicable at exchange $ __________ ~ this is the estimated amount that will be deducted from the existing annuity’s total value if surrendered, replaced, or exchanged, with an anticipated surrender date of ______ / ______ / ______.

ACKNOWLEDGEMENTS AND SIGNATURES

I acknowledge that I have provided the Applicant with a completed and signed copy of this form.

Agent’s Name (please print) ____________________________  Florida License No. ____________________________

Agent’s Signature ____________________________  Date Signed ______ / ______ / ______

NOTE: NO QUESTIONS OR RESPONSE AREAS ARE TO BE LEFT BLANK WHEN OFFERED TO THE ANNUITANT AND/OR APPLICANT FOR SIGNATURE. IF ANY INFORMATION REQUESTED IS UNAVAILABLE, NOT APPLICABLE OR UNKNOWN, THE INSURANCE AGENT OR INSURER MUST INDICATE THAT.

THE APPLICANT, JOINT APPLICANT AND/OR OWNER MAY SUBSTITUTE THEIR INITIALS FOR SIGNATURES ON ALL FORM PAGES WITH THE EXCEPTION OF THE SIGNATURES BELOW, WHICH ARE REQUIRED.

APPLICANT: DO NOT SIGN THIS FORM IF:

1. ANY ITEM HAS BEEN LEFT BLANK;
2. WITHOUT CAREFULLY REVIEWING THE INFORMATION RECORDED; OR
3. IF ANY OF THE INFORMATION RECORDED IS NOT TRUE AND CORRECT TO THE BEST OF YOUR KNOWLEDGE.

Applicant’s Name (please print) ____________________________  Date Signed ______ / ______ / ______

Applicant’s Signature ____________________________

Joint Applicant’s Name (please print) ____________________________  Date Signed ______ / ______ / ______

Joint Applicant’s Signature ____________________________

DFS-H1-1681  Page 2 of 4  Adopted in Rule 66B-162.011, F.A.C.
EXPLANATION OF TERMS

“Generic Contract Type” is the generic name of the annuity contract form as approved by the Florida Office of Insurance Regulation. Examples of generic annuity contract names are Flexible Premium Equity Indexed Annuity (FPEIDA), Single Premium Immediate Annuity (SPIA), Flexible Premium Variable Deferred Annuity (FPVDA), and Single Premium Deferred Annuity (SPDA).

“Marketing Name” is the name adopted by the insurer to identify the contract form.

“Qualified Contract” means a product used to fund any type of pension plan approved by the Internal Revenue Service.

“Annuity Maturity Date” is the final date of termination of the contract at which time the proceeds of the contract must be paid out.

“Surrender Charge” is the amount deducted from annuity contract values upon surrender of an annuity, or for withdrawals exceeding any free withdrawal provision of the contract, regardless how this charge is titled in the policy, e.g., deferred sales charge.

“Surrender Charge Period” is the number of annuity contract years a surrender charge may be applicable.

“Initial Surrender Charge Percentage Rate” is the original percentage rate that is deducted from annuity values at the inception of the existing annuity contract, or that will be deducted from the recommended replacement contract at its inception if purchased.

“Surrender Charge Percentage Schedule for Remaining Years” the percentage rate that would be deducted from the existing annuity contract if surrendered, or for any withdrawals exceeding the “free withdrawal” limit.

“Minimum Guaranteed Interest Rate” is the minimum interest rate payable under the annuity contract as guaranteed by the insurer in the annuity contract.

“Initial Bonus Percentage or Amount” is a bonus paid by the insurer, generally, at inception of the annuity contract, and may be expressed as a percentage of the initial premium or other amount, or a dollar amount, and must be stated in the annuity contract.

“Potential Loss of Bonus if Exchanged” refers to whether any bonus would be lost if the annuity contract was exchanged or terminated for any reason.

“Interest Rate Cap” is the maximum interest earnings that will be credited to the annuity contract.

/ 
Applicant Signature 
Date 

/ 
Joint Applicant Signature 
Date 

DFS-H1-1681 
Pub. 12/29/2009 
Page 3 of 4 
Adopted in Rule 66B-162.011, F.A.C.
EXPLANATION OF TERMS  
(CONTINUED)

“Participation Rate” is the percentage of the increase or return of the underlying stock market index that will be used to calculate the return.

“Index Type” is the financial measurement used by the insurer to make certain calculations within an annuity contract. Examples of such indices include Standard and Poor’s 500 and the Russell 2000.

“Market Value Adjustment” is the increase or decrease in the surrender value of the contract that is adjusted to reflect market fluctuations.

“Administrative Fees or Margins” are charges that amount to the difference between the percentage gain in the index and the actual amount credited to the annuity contract.

“Asset Fees” are the fees the insurer charges that are a percentage of the value of the annuity contract.

“Death Benefit Amount” is the net amount that would be paid to the annuitant’s designated beneficiary or beneficiaries of an existing annuity, or the death benefit that the proposed replacement policy would pay as of the contract issue date.

“Free Withdrawals” are the withdrawals that may be taken from an annuity’s values that are not subject to surrender or other charges and are a provision of the annuity contract.

“Annual Free Withdrawal Percentage Rate” is the percentage of available funds that may be withdrawn from an annuity contract, generally on an annual basis and is stated in the annuity contract.

“Change of Annuitant upon Death” is a provision that allows another person to become the annuitant upon the death of the original annuitant allowing the contract to remain in force.

“Waiver of Surrender Charge Benefit or Similar Benefit or Provision” is a benefit that is built into individual annuity contracts or added by rider, endorsement or amendment. The benefits are triggered by a qualifying event associated with either the annuitant or owner, as specified in the contract.

---

1 This amount represents the current value of the existing annuity, less any withdrawals or other deductions.
2 This amount represents the surrender value of the existing annuity.
3 Surrender charges or fees that will be deducted from #1 if you exchange or otherwise terminate your existing annuity.

/  /  
Applicant Signature  Date  Joint Applicant Signature  Date

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DFS-H1-1881  Page 4 of 4  Adopted in Rule 68B-162.011, F.A.C.
The areas that are required to be disclosed and compared for both annuities are covered in detail below:

**Note:** When the term exchange is used in reference to annuities it almost always means utilizing internal revenue code section 1035 to effect a tax free exchange of like kind assets. As part of the exchange the consumer transfers their net surrender values from the existing annuity to the new annuity. In this process the income tax cost basis of the old annuity becomes the income tax cost basis of the new annuity and all prior tax deferred growth that occurred in the previous annuity “flows into” the new annuity and continues to be tax deferred until withdrawn. If the exchange is from a qualified annuity (IRA, 401(k), 403(b) etc) to another qualified annuity it also involves other code sections that may be specific to each retirement plan type. For example a plan participant in some retirement plans can not exchange or transfer their retirement funds unless a qualifying event has occurred.

**ANNUITY BENEFITS**

**Benefits:** All benefits including riders, options and endorsements of each annuity should be disclosed and compared. Rarely will any two annuities be identical in benefits so the comparison will not always be symmetrical and by nature will demonstrate benefits in one contract that do not exist in the other and vice-versa.

With many of the benefits offered by annuities it is difficult to quantify (in dollar terms) the value of each benefit and often the consumer has to make a value judgment based on their understanding of the benefit as it applies to them. As an insurance agent you can assist the consumer by disclosing all relevant information in a fair and straightforward manner.

**LIMITATIONS**

**Limitations:** As with most contracts each annuity benefit is designed for a set of circumstances and therefore has limitations built in to more clearly define the intent and parameters of the benefit. Limitations commonly include a required holding period, surrender charge, upward limit on the benefit, or other limiting factors. All limitations for both annuities must be disclosed and compared.

**TERMS**

**Terms:** The nature of contracts (including annuity contracts) is that they usually define terms to be used throughout the contract. These terms have very specific meaning and should be understood by the consumer. The terms used and the definition of these terms can vary from one annuity contract to another. These terms need to be disclosed and compared.
FEES CHARGES

Fees and/or charges: All annuities impose fees and/or charges. A variable annuity (since it is a securities product) is required to disclose fees and/or charges in more detail than a fixed annuity or fixed equity indexed annuity. A good example is premium taxes. The variable annuity will disclose the premium taxes whereas the fixed annuity generally does not. It is not that the fixed annuity is attempting to hide the premium tax it is included in the cost structure of the fixed annuity and affects the guarantees of the product. It would not be a fair comparison to state that the variable annuity has a charge for premium taxes and the fixed annuity does not. While the charge for premium taxes is not disclosed separately in the fixed annuity it is part of the product overall costs. All fees and charges of each annuity need to be disclosed and compared in a fair, and understandable manner.

QUALIFIED OR NON-QUALIFIED

Qualified or Non-Qualified: Whether the annuity is qualified or non qualified is very important. In a fully deductible qualified annuity all proceeds are included in income when withdrawn whereas in a non-qualified annuity only the earnings are taxed when withdrawn. One cannot exchange or transfer a qualified annuity for a non-qualified annuity without first paying taxes on all earnings and previously deducted premiums flowing from the qualified annuity. Also when dealing with qualified annuities (except the Roth) required minimum distributions will be required at some point (earlier discussion) and the presence (or lack thereof) and wording of a waiver of the surrender charge designed to allow required minimum distributions without penalty is very important.

DISCLOSURE

CREDITING METHODS AND TAX IMPLICATIONS

Crediting Methods and Potential Tax Implications: Since all growth or gains inside all annuities grow tax deferred and are taxed as ordinary income when withdrawn there are no potential tax consequences of one interest crediting method versus another within an annuity. That is not to say that the crediting method can not affect the performance of the annuity. There are tax implication to withdrawals or distributions from annuities and these vary depending on whether the annuity is qualified or non qualified and whether the annuity is annuitized or not.

Source of Interest Credits: The source of interest credits must be disclosed.

In a variable annuity the source of interest credits or growth is reflective of the sub accounts where the values are allocated and/or a potential living benefit guarantee within the product.

In a traditional fixed annuity the source of interest credits is the return on invested
assets of the insurer and the determination of the insurer as to what interest will be credited.

The source of interest credits in a fixed equity indexed annuity is the change in the chosen index as measured and applied by the indexing formula. A thorough discussion of this process was covered earlier under the fixed equity indexed annuity.

**Income Taxation of Interest Credits:** Interest credits are taxed when distributed or withdrawn from an annuity. Whether the annuity is variable, fixed, or fixed equity indexed does not affect the taxation method employed. ALL interest credits or growth from ALL annuities is taxed as ordinary income when withdrawn. There are different ways of separating the income or growth from the principal when withdrawn.

**TAXATIONS ON WITHDRAWN INTEREST FOR NON QUALIFIED ANNUITIES**

**ANNUITIZATION OF A NON-QUALIFIED ANNUITY**

If a non qualified annuity is annuitized with a life assumption the growth is recognized (and included in income) as part of every dollar paid to the annuitant until the total cost basis (premiums) has been recovered. Since it not known how long the annuitant will live one must use IRS actuarial tables (in IRS publication 590) to determine life expectancy and “expected return”. Once the expected return on the life based annuitization has been calculated the “exclusion ratio” is calculated by solving the fraction where the numerator of the fraction is the cost basis of the annuity and the denominator is the “expected return” (calculated in the previous step). Luckily the annuity does not have to calculate how much of the annuity proceeds are includible as ordinary income, the tax, Equity and Fiscal Responsibility Act of 1983 (TEFRA) makes the insurer responsible for calculating this and issuing a 1099 each year that a withdrawal or distribution is made.

There is another gain recognition method for annuities issued prior to TEFRA and fully funded prior to 1/1/1986 called the “cost recovery method” which assumes the first monies withdrawn are the cost basis and no interest or growth is recognized until all of the cost basis has been withdrawn.

**TAXATION OF WITHDRAWALS FROM A NON-QUALIFIED ANNUITY OTHER THAN ANNUITIZATIONS**

If money is withdrawn from a non-qualified annuity other than via an annuitization the insurer must assume the first monies withdrawn comes from the interest or growth and is included in income as ordinary income. After all earnings have been withdrawn the cost basis is recovered which is not included in income because it was taxed prior to contribution. This is commonly called the “interest first” method of gain recognition.
TAXATION OF WITHDRAWALS FROM A QUALIFIED ANNUITY

When monies are withdrawn from a fully deductible qualified annuity (except for a Roth annuity) it is included in income as ordinary income regardless of how it is withdrawn (annuitization versus any other method).

When income tax deferral is advantageous: Income tax deferral is always an advantage for the consumer during the accumulation phase of retirement planning.

CREDITING FORMULAS

Crediting Formulas: The crediting formulas of both annuities must be disclosed and compared in a format that can be understood by the consumer. The fixed equity indexed annuity and the variable annuity with living benefits tend to be difficult for the consumer. Each interest crediting formula disclosed should involve when appropriate (and available) which components of the formula can change and the renewal rate history of the product. A reference or reminder of any required holding period, market value adjustment, or surrender charge would also be helpful.

Guaranteed Interest Credits: When a guaranteed or declared interest option is provided in the contract the disclosure should include reference to any required holding period, market value adjustment, or surrender charge.

RISK FACTORS:

Risk factors: when the term risk is used in reference to financial assets most people will equate the term to loss of principal. However, there are risks other than loss of principal.

Loss of principal: If the consumer has a risk for loss of principal in an annuity it should be disclosed. Some fixed equity indexed annuities include the risk for loss of part of the principal where a variable annuity without living benefits can involve the loss of all principal and the traditional fixed annuity guarantees all principal. Even with a guarantee of principal a consumer could suffer loss of principal if they withdraw funds from any annuity during the surrender charge period.

Known versus expected interest: The annuity comparison and disclosure should include information about declared or guaranteed interest versus interest that might be expected based on performance of an index or subaccount.

Reallocation limitations: The annuity comparison and disclosure should include information about the frequency of allocation or reallocation allowed in an annuity as well as the effect of electing a living benefit has on the ability of the consumer to reallocate.

Changes in market or company financial conditions: The consumer can be
exposed to additional risk if the future financial conditions of the company or economy change.

REQUIRED INSURER OVERSIGHT

FS 627-4554 also requires an Insurer, Insurance Agency or Managing General Agent, (collectively called management in this text) to develop supervisory system to ensure that recommendations are appropriate and in accordance with rules set forth in this code section. The supervisory system must be in writing and require periodic reviews.

The insurer can contract with a third party including a managing general agent or insurance agency to perform these supervisory functions. However they will not be deemed to have met the requirements of this section unless they conduct periodic reviews of the third part to ensure they are performing adequate supervision and review.

Written procedures: This required supervisory system must be in writing. Most prudent managers will also institute a training program and require agent acknowledgement of the rules and procedures set out within the written supervisory system. A well written process would probably include standard forms and a system for accurate filing and record retention as well as some form of internal review of sales to verify suitability.

Periodic reviews: In addition to ongoing day to day supervision a periodic review is necessary to view trends and identify overall compliance. Much of this can be accomplished with computerized sales analysis where the more information about the clients and circumstances of each sale that is input the easier it is to uncover trends. For example an agent who has the majority of sales being made to seniors and involving a replacement might warrant closer scrutiny than others.

IF THE INSURER CONTRACTS A THIRD PARTY

An insurer shall make reasonable inquiry to ensure that such third party contracting under subparagraph 3. is performing the functions required under subparagraph 1. and shall take such action as is reasonable under the circumstances to enforce the contractual obligation to perform the functions. An insurer may comply with its obligation to make reasonable inquiry by:

a. Annually obtaining a certification from a third party senior manager who has responsibility for the delegated functions that the manager has a reasonable basis to represent, and does represent, that the third party is performing the required functions.

b. Based on reasonable selection criteria, periodically selecting third parties contracting under subparagraph 3. for a review to determine whether the
third parties are performing the required functions. The insurer shall perform any procedures necessary to conduct the review which are reasonable under the circumstances.

An insurer that contracts with a third party and complies with the annual certification requirements is deemed to have fulfilled its responsibilities.

An insurer, managing general agent, or insurance agency is not required to:

a. Review or provide for review of all transactions solicited by an insurance agent; or

b. Include in its system of supervision an insurance agent’s recommendations to senior consumers of products other than the annuities offered by the insurer, managing general agent, or insurance agency.

A managing general agent or insurance agency contracting with an insurer shall promptly, when requested by the insurer provide a certification as required or provide a clear statement that the managing general agent or insurance agency is unable to meet the certification criteria.

A person may not provide a certification unless the person is a senior manager with responsibility for the delegated functions and has a reasonable basis for making the certification.

AGENT PROCEDURES

In addition to the requirement for written supervisory procedures and period review on the part of management FS 627-4554 also requires that insurance agents, develop procedures to ensure recommendations are appropriate and in accordance with the rules in this code section

Written procedures: The insurance agent must have written procedures designed to ensure suitability and compliance with this law. Most agents will look to their managing general agent or insurer to provide guidance on the written procedures.

Periodic reviews: The insurance agent is also required to perform a periodic review of their written records to ensure compliance. Many agent will be required to undergo a periodic review with their insurer and will document that process to meet this requirement. Otherwise the agent is self regulating.

CHAPTER 2 REVIEW QUESTIONS:

(answers are in the back of the text)
4. When an existing non-qualified annuity is exchanged, replaced, or transferred to another non-qualified annuity this is usually done using Internal Revenue code section ____________.

5. If a consumer currently holds an annuity as an agent making a recommendation you must gather information about the ability of the consumer to access the values within the annuity. This falls under the heading of _________________.

6. When a withdrawal from a non qualified annuity that does not qualify as an annuitization is made the gain is recognized under the ___________ method.
ETHICAL CONSIDERATIONS

There are many ethical considerations that surround the sale of an annuity contract to a senior. Ethics is hard to define and equally hard to enforce because it requires an agreement on what is right and what is fair. While the facts of some situations can be viewed and considered by most to be unethical the real test of defining or enforcing ethics comes in the more grey areas.

Also ethics requires a commitment to a set of values and principles that by nature are vague. Ethics requires each of us to read or hear these principles, interpret them, and incorporate what we think they mean into our daily business practice.

One way to make progress when discussing ethics is to look at published ethical standards, edicts, canons, or requirements. One such published document is the Florida Policy Holders Bill of Rights as contained in FS 626.9641 which is reproduced below.

If you will notice the first point says that these are the standards that will be used by the Florida DFS when exercising discretion of interpreting the law or adopting rules. If you read each of the standards you would be hard pressed to disagree with their content or meaning.

POLICYHOLDERS BILL OF RIGHTS

626.9641 Policyholders, Bill of Rights.--

(1) The principles expressed in the following statements shall serve as standards to be followed by the department, commission, and office in exercising their powers and duties, in exercising administrative discretion, in dispensing administrative interpretations of the law, and in adopting rules:

(a) Policyholders shall have the right to competitive pricing practices and marketing methods that enable them to determine the best value among comparable policies.

(b) Policyholders shall have the right to obtain comprehensive coverage.
(c) Policyholders shall have the right to insurance advertising and other selling approaches that provide accurate and balanced information on the benefits and limitations of a policy.

(d) Policyholders shall have a right to an insurance company that is financially stable.

(e) Policyholders shall have the right to be serviced by a competent, honest insurance agent or broker.

(f) Policyholders shall have the right to a readable policy.

(g) Policyholders shall have the right to an insurance company that provides an economic delivery of coverage and that tries to prevent losses.

(h) Policyholders shall have the right to a balanced and positive regulation by the department, commission, and office.

(2) This section shall not be construed as creating a civil cause of action by any individual policyholder against any individual insurer.

AGENT'S CODE OF ETHICS

Seeing that the Florida DFS has set out their standards a good question would be to ask each agent what standards do they operate by. Do they each have a written code or statement of ethics. The truth is most agents have never reduced their ethical beliefs to writing.

There are numerous professional designations and most have their own code of ethics that all designees must follow at risk of loss of their designation. However agent’s are not required to possess any of these designations.

In addition to professional designation there are industry organizations which have ethical standards. The Florida DFS as part of the course content requirement for this course requires that we show and discuss the code of ethics as published by The National Association of Insurance and Financial Advisors

Similar to the Florida Policy Holders Bill of Rights published above the ethics statements below are very easy to agree with. If you read these ethical statements closely them seem to mirror the Florida Policyholders Bill of Rights, meaning that if an agent complies with the ethical statements of the NAIFA it would go along way towards meeting the test of the Policyholders Bill of Rights.

From: The National Association of Insurance and Financial Advisors

Preamble

Those engaged in offering insurance and other related financial services occupy the
unique position of liaison between the purchasers and the suppliers of insurance and closely related financial products. Inherent in this role is the combination of professional duty to the client and to the company as well. Ethical balance is required to avoid any conflict between these two obligations.

Therefore, I Believe It To Be My Responsibility:

- To hold my profession in high esteem and strive to enhance its prestige.
- To fulfill the needs of my clients to the best of my ability.
- To maintain my clients' confidences.
- To render exemplary service to my clients and their beneficiaries.
- To adhere to professional standards of conduct in helping my clients to protect insurable obligations and attain their financial security objectives.
- To present accurately and honestly all facts essential to my clients' decisions.
- To perfect my skills and increase my knowledge through continuing education.
- To conduct my business in such a way that my example might help raise the professional standards of those in my profession.
- To keep informed with respect to applicable laws and regulations and to observe them in the practice of my profession.
- To cooperate with others whose services are constructively related to meeting the needs of my clients.

AGENT'S FIDUCIARY RESPONSIBILITY TO CONSUMERS

As an insurance professional you owe a fiduciary responsibility to the consumer. You are considerably more knowledgeable about the products and concepts that you offer to the consumer than they are. The consumer must place trust in you to accurately describe the financial product that you offer and to bring them financial solutions that make effective use of their resources.

- **Does applicant understand basic concepts of annuities:** As an agent you need to make sure the client has a firm understanding of how the annuity works including how interest is credited, surrender charges, annuitization options, as well as a good understanding of any riders or options offered.

- **Does applicant have sufficient assets to meet or exceed current financial objectives:** Occasionally a client will have unrealistic objectives and goals (based on their current position and resources including time to meet the objectives). An honest agent will tell the consumer that their current asset base won’t support their goals within the realm of available financial vehicles available. A reasonable amount of education and explanation should help the consumer to understand
what is achievable within their financial parameters.

**Are other financial vehicles more suitable to meet the applicant financial objectives:** If the agent knows that there are better financial vehicles to meet the client’s goals they should disclose this to the consumer. The array of financial vehicles available for the varied financial goals is too great for an insurance agent to try and use the “glass slipper” approach to product suitability.

**Is the sale in the best interest of the client and his family?** The insurance agent should use utmost good faith when making a recommendation. Since the reasonably objective basis for making the recommendation has to be in writing the agent will be forced to put in writing why they thought this transaction was suitable. In essence they are having to defend their recommendation in writing on a contemporary basis (as the recommendation is taking place).

**Does the transaction make sense?** This appears to be redundant considering the above questions about being in the client’s best interest, however, it is possible that a transaction could be in the best interest of the client and still not make sense in which case the agent may want to seek the advice of a valued and trusted mentor or supervisor.

**CASE LAW**

As part of this course content Florida DFS specifies two cases that we should discuss. Following is a brief detail of the facts and court findings in each of the two cases.

**CASE LAW MOSS V APPEL**

*Moss v. Appel, 718 So.2d 199, 201 (Fla. 4th DCA 1998);* This case involves two insurance brokers who were also acting as pension consultants. They sold an annuity to a business owner in 1985. In 1991 while still acting as consultants for the business in relation to the pension plan the insurance brokers learned information about the annuity company indicating the company was having financial difficulties. The insurance brokers did not relate this information to the annuity owners. If they had done so the annuity owners could have surrendered the contract at that time and only experienced a 12% surrender charge. The annuity company ultimately went under and the annuity owners lost their entire investment.

The lawsuit ended up in the Florida 4th District Court of Appeals where it was ruled that a fiduciary relationship existed between the insurance brokers and the business owner. A summary of the findings is below and has some interesting language.

Note the excerpt from the courts ruling (below in italics) it defines an insurance broker. Part of the definition of insurance broker is a contrast to an insurance agent.

*An "insurance broker" is one who acts as middleman between the insured and the insurer, and who solicits insurance from the public under no employment from any
special company, and who, upon securing an order, places it with a company selected by the insured, or, in the absence of such a selection, with a company selected by himself; whereas an "insurance agent" is one who represents an insurer under an employment by it.

The court ruling also cites the next case where the finding was that an insurance broker has a fiduciary relationship with the consumer.

CASE LAW BEARDMORE V ABBOTT

Beardmore v. Abbott, 218 So.2d 807, 808-809 (Fla. 3rd DCA 1969): In this case a Florida insurance counselor sold a policy to an individual for estate planning purposes. The insurance counselor also endorsed a promissory note with the insured so the insured could borrow the first year’s premium. The insured assigned the policy as collateral for the promissory note. The insured did not pay the second year premium and the policy lapsed. The bank applied the cash value of the policy against the promissory note and required the insurance counselor (as endorser) to pay the balance which he did.

The insurance counselor then sued the insured for the payment on the promissory note. The case ended up in the Florida 3rd Distric Court of Appeals.

The court found that a fiduciary relationship did exist but that there was no breach of fiduciary relationship because the insurance counselor was an “endorser of accommodation” since he received no compensation as a direct result of endorsing the promissory note.

The insured was required to pay the insurance counselor the amount he had to pay the bank to satisfy the insured’s promissory note plus attorney costs.

CHAPTER 3 REVIEW QUESTIONS

(answers are in the back of the text)

7. When the Florida DFS exercises their powers and duties, administrative discretion and rulemaking they will follow the _________________.

8. Making sure that the consumer has a basic understanding of how annuities work is discussed as part of the agent’s ________________ to the consumer.
Chapter 4

RESPONSIBILITY, UNFAIR OR DECEPTIVE ACTS, AND PENALTIES

MITIGATION OF RESPONSIBILITY

F S 627.4554 (5) covers mitigation of responsibility and details what actions can be taken by the Florida DFS (office) to make restitution to a senior consumer who has been sold an unsuitable product. It also has provisions to reduce administrative penalties when corrective action is taken soon after the insurer, managing general agent or insurance agency discovers the violation.

AS IT PERTAINS TO INSURER

(a) The office may order an insurer to take reasonably appropriate corrective action, including rescission of the policy or contract and a full refund of the premiums paid or the accumulation value, whichever is greater, for any senior consumer harmed by a violation of this section by the insurer or the insurer's insurance agent.

AS IT PERTAINS TO AN INSURANCE AGENT

(b) The department may order:
1. An insurance agent to take reasonably appropriate corrective action for any senior consumer harmed by a violation of this section by the insurance agent.

(c) The department shall, in addition to any other penalty authorized under chapter 626, order an insurance agent to pay restitution to any senior consumer who has been deprived of money by the agent’s misappropriation, conversion, or unlawful withholding of moneys belonging to the senior consumer in the course of a transaction involving annuities. The amount of restitution required to be paid pursuant to this paragraph may not exceed the amount misappropriated, converted, or unlawfully withheld. This paragraph does not limit or restrict a person’s right to seek other remedies as provided by law.

AS IT PERTAINS TO A MGA OR AGENCY

2. A managing general agency or insurance agency that employs or contracts with an insurance agent to sell or solicit the sale of annuities to senior consumers to take reasonably appropriate corrective action for any senior consumer harmed by a violation
of this section by the insurance agent.

**LOWERING OF PENALTY IF SWIFT CORRECTIVE ACTION IS TAKEN**

(c) Any applicable penalty under the Florida Insurance Code for a violation of paragraph (4)(a), paragraph (4)(b), or subparagraph (4)(c)2. may be reduced or eliminated, according to a schedule adopted by the office or the department, as appropriate, if corrective action for the senior consumer was taken promptly after a violation was discovered.

**WHAT IS CONSIDERED DAMAGE TO A CONSUMER:**

There are many ways that damage to a consumer could be evidenced under this law. Probably the best example is John and Patricia Siebel (the couple after whom the Act is named). The Siebels who were in their 80’s were sold $600,000 worth of annuities that had high surrender charges for 15 years. This effectively locked up the majority of their liquid net worth beyond their life expectancy. Conceivably it could easily be foreseen that the Siebels could not access these funds without penalty for the rest of their lives. This is considered harm to a senior consumer and equates to an unsuitable sale. You will remember earlier in this text that part of the information required to be gathered includes “liquid net worth” and “liquidity requirements”.

**PROHIBITED CHARGES IN AN ANNUITY SOLD TO SENIOR CONSUMER**

2010 amendments to Florida law: §627.4554(9), F.S. –

Prohibited Charges; limits the period of a surrender charge for an annuity sold to a senior consumer to 10 years and limits the surrender charge to 10 percent.

*An annuity contract issued to a senior consumer may not contain a surrender or deferred sales charge for a withdrawal of money from an annuity exceeding 10 percent of the amount withdrawn. The charge shall be reduced so that no surrender or deferred sales charge exists after the end of the 10th policy year or 10 years after the premium is paid, whichever is later. This subsection does not apply to annuities purchased by an accredited investor or to those annuities exempted from this rule.*

**UNFAIR COMPETITION AND UNFAIR OR DECEPTIVE ACTS**

There are many methods and devices of sales and competition within the insurance industry that could be considered as unfair or deceptive. As part of this required course Florida stipulates that we cover several methods or acts that are considered unfair and/or deceptive. In a more lengthy course there are many other forms of unfair and/or deceptive
practices that we could discuss.

As an insurance producer we sell an intangible product that can not be evaluated like a tangible product. The value of what we sell is often not easy for the client to grasp and the contracts by necessity are full of legal terms, exceptions, and contingencies. The average consumer is ill suited to fully understand a life insurance policy or annuity contract so they place much trust in the person selling them the product. Most often this trust is well deserved, but this does create an environment where the consumer can be misled or misinformed to the point that they will enter into a transaction that is not in their best interest.

A common device used to aide the producer engaged in unfair or deceptive practices is an omission. Specifically a deceptive omission where a relevant fact is not disclosed that if known by the consumer might affect their willingness to engage in the transaction.

A good example of a deceptive omission in the sale of an annuity would be to not disclose the surrender charge. If the consumer asked the question “can I still get to my money if I need to” the unscrupulous agent might answer “yes you can”. Clearly the consumer did not get all of the facts in this exchange of words. It is true that the consumer can “get to” their money when they need it, but the short answer of “yes you can” omits a lot of necessary information. The correct answer would involve a discussion of the surrender charge percent, dollar amount, and duration, and possibly the availability of a partial withdrawal (often up to 10% non cumulative annually) without surrender charge. When answering a question the offending producer will rationalize (in their own mind) that if they do not make an overtly untrue statement they are not misrepresenting the transaction and that omitting a fact is not a lie.

Obviously if we used this standard of what is a lie (and therefore a misrepresentation) the consumer would be responsible for knowing the right questions to ask in order to discover the facts they need to have prior to executing a contract. An Omission is cast in a different light if we hold it to the standard of truth required within the oath taken before testifying in court “I swear to tell the truth, the whole truth, and nothing but the truth”.

**CHURNING:**

Churning is an unfair/deceptive process whereby the producer capitalizes on an existing relationship that the victim has with an insurance/annuity company. Since the victim already has a contract with the insurance/annuity company they are easier to approach and often more trusting. The unscrupulous producer will convince the victim (contract holder) to assign the values of the existing contract to fund a new annuity or other insurance product. Sometimes this is done without the contract holders’ knowledge and with the contract holder not having all of the relevant facts disclosed to them. The more egregious case is where the trusting contract holder is unaware that the values from the existing contract will fund the new policy and there have been several class action lawsuits that have gained national exposure in the last decade of just such actions.
The more common form of churning is where the contract holder is aware that the values of the existing contract will be used to fund the new contract but the producer does not disclose all of the relevant facts to the consumer.

**WHAT IS NOT CHURNING:**

There are situations where using the values of one insurance contract to fund another is a legitimate and beneficial transaction for the consumer. However this is not the most common method of sales and accounts for a very small percent of an insurers new sales. This point is mentioned because one way to quickly uncover a developing sales trend involving churning is for the insurer to run periodic reports ranking the producers by percent of new sales financed using the values of an existing contract (often called an in-house sale).

Another way to place additional scrutiny on a sale financed using the values of an existing contract would be to have an additional level of approval for such sales at the insurer level.

If either of these market conduct inspection methods were communicated to all appointed producers it would put them on notice that the insurer is paying close attention while not discouraging beneficial transactions.

To look more closely at the definition of churning we have included below the text of the Florida statute that defines churning. Note the use of the term deceptive omission in the law text. Also note sections 2 and 3 listed below require the insurer to engage in disclosure through the use of a disclosure form and to establish procedures to avoid churning.

**F.S. 626.9541(1)(aa)**

1. *Churning*—Churning is the practice whereby policy values in an existing life insurance policy or annuity contract, including, but not limited to, cash, loan values, or dividend values, and in any riders to that policy or contract, are directly or indirectly used to purchase another insurance policy or annuity contract with that same insurer for the purpose of earning additional premiums, fees, commissions, or other compensation:

   a. Without an objectively reasonable basis for believing that the replacement or extraction will result in an actual and demonstrable benefit to the policyholder;

   b. In a fashion that is fraudulent, deceptive, or otherwise misleading or that involves a deceptive omission;

   c. When the applicant is not informed that the policy values including cash values, dividends, and other assets of the existing policy or contract will be reduced, forfeited, or used in the purchase of the replacing or additional policy or contract, if this is the case; or
d. Without informing the applicant that the replacing or additional policy or contract will not be a paid-up policy or that additional premiums will be due, if this is the case.

Churning by an insurer or an agent is an unfair method of competition and an unfair or deceptive act or practice.

2. Each insurer shall comply with sub-subparagraphs 1.c. and 1.d. by disclosing to the applicant at the time of the offer on a form designed and adopted by rule by the commission if, how, and the extent to which the policy or contract values (including cash value, dividends, and other assets) of a previously issued policy or contract will be used to purchase a replacing or additional policy or contract with the same insurer. The form must include disclosure of the premium, the death benefit of the proposed replacing or additional policy, and the date when the policy values of the existing policy or contract will be insufficient to pay the premiums of the replacing or additional policy or contract.

3. Each insurer shall adopt written procedures to reasonably avoid churning of policies or contracts that it has issued, and failure to adopt written procedures sufficient to reasonably avoid churning shall be an unfair method of competition and an unfair or deceptive act or practice.

End of F.S. 626.9541(1)(aa)

TWISTING:

Another form of unfair and/or deceptive marketing is twisting. Twisting is similar to churning except that the movement from one contract to another also involves moving from the contract of one insurer to the contract of another insurer.

Similar to churning, twisting involves the use of incomplete, misleading, or fraudulent information to encourage the transaction. Since twisting involves moving from one insurer to another often twisting involves making statements about an insurer that are misleading, incomplete, or fraudulent. During the sales process the unscrupulous producer may make untrue statements about the current insurer to encourage the consumer to want to leave the current insurer in favor of the insurer the unscrupulous producer represents.

Since twisting involves the consumer moving from an existing contract in favor of another an incomplete, misleading, or fraudulent comparison is a device often used in the twisting process. Oftentimes the consumer has rights and options existing within their current contract that if exercised would be more beneficial than abandoning it in favor of another contract.

While it is true that often it is in the best interest for a consumer to “replace” a current contract with another from a different insurer twisting circumvents the legitimate replacement process by denying the consumer the accurate information necessary to make an informed decision.
It should be noted that as defined by Florida Statute (F.S. 626-9541(1)(1) below) twisting does not necessarily include the surrender, lapse, forfeit, or cancelling of a current policy. Twisting can occur even if no current policies owned by the consumer are affected. The last section of the last line of the abovementioned and below listed Florida Statute reads “or to take out a policy of insurance in another insurer.”

Let's take a look at the verbiage of the Florida Statute that defines Twisting

F.S. 626.9541(1)(l)
Twisting.--Knowingly making any misleading representations or incomplete or fraudulent comparisons or fraudulent material omissions of or with respect to any insurance policies or insurers for the purpose of inducing, or tending to induce, any person to lapse, forfeit, surrender, terminate, retain, pledge, assign, borrow on, or convert any insurance policy or to take out a policy of insurance in another insurer.
End of F.S. 626.9541(1)(l).

The above wording comes from Florida Statute while below we explore the section of Florida Department of Financial Services (FL DFS) Rule 69B that relates to twisting. You will notice that the FL DFS Rule 69B is very similar to the Florida Statute above.

FL DFS Rule 69B-215.215 Twisting.
Twisting is declared to be unethical. No person shall make any misleading representations or incomplete or fraudulent comparison of any insurance policies or insurers for the purpose of inducing, or tending to induce, any person to lapse, forfeit, surrender, terminate, retain, or convert any insurance policy, or to take out a policy of insurance in another insurer.
End of FL DFS Rule 69B-215.215 Twisting.

You will see later in this text that both churning and twisting are considered first degree misdemeanors under Florida law.

FRAUDULENT SIGNATURES:
In contract law you must have valid signatures of all parties or you have no contract. If an agent knowingly submits fraudulent signatures to the insurer they are committing a 3rd degree felony under Florida law. Another term often used in this area is forgery. There have been numerous cases in the past where an agent will “windowpane” a signature onto a document in order to make a sale. It is very easy to prove intent to deceive when an agent forges a signature, however what if the agent does not commit the forgery. The wording in FS 626.9541 (1)(ee) reproduced below includes the wording “willfully” which would indicate that the insurance agent knew the signature was fraudulent. As an insurance agent one way to assure a valid signature is to be present when all of the documents are signed and insist that the signatures are produced by the intended parties.
Fraudulent signatures on an application or policy-related document.--Willfully submitting to an insurer on behalf of a consumer an insurance application or policy-related document bearing a false or fraudulent signature.

ILLAWFULL OR DECEPTIVE USE OF DESIGNATIONS:

A recent series of news articles in the New York Times and the Wall Street Journal have pointed to problems with the use of professional designations, such as “Certified Senior Adviser,” “Certified Retirement Financial Adviser,” “Chartered Senior Financial Planner” and “Certified Financial Gerontologist,” that imply expertise in providing investment advice to senior citizens. Some claim that, those designations involve very little actual training regarding the needs of this vulnerable population. It appears from these news articles that these designations, which are granted by for-profit entities, serve more as marketing tools than as actual evidence of education or professional development. Most of the problems that have been reported with those using these credentials in marketing materials have dealt with the sale of unsuitable annuities to senior citizens.

There are a number of well established industry designations that have a rigorous training and continuing education requirement and are viewed as valid designations. The Florida statute dealing with this area is reproduced below. Notice in the very last section there is a listing of designations that may be displayed and communicated to the senior consumer. Many insurers have already come to the same conclusion and prohibited their agents from using some of these designations.

F.S. 626 9541 (1)(ff) Unlawful use of designations; misrepresentation of agent qualifications.

1. A licensee may not, in any sales presentation or solicitation for insurance, use a designation or title in such a way as to falsely imply that the licensee:

a. Possesses special financial knowledge or has obtained specialized financial training;
or

b. Is certified or qualified to provide specialized financial advice to senior citizens.

2. A licensee may not use terms such as "financial advisor" in such a way as to falsely imply that the licensee is licensed or qualified to discuss, sell, or recommend financial products other than insurance products.

3. A licensee may not, in any sales presentation or solicitation for insurance, falsely imply that he or she is qualified to discuss, recommend, or sell securities or other investment products in addition to insurance products.

4. A licensee who also holds a designation as a certified financial planner (CFP), chartered life underwriter (CLU), chartered financial consultant (ChFC), life underwriter
training council fellow (LUTC), or the appropriate license to sell securities from the Financial Industry Regulatory Authority (FINRA) may inform the customer of those licenses or designations and make recommendations in accordance with those licenses or designations, and in so doing does not violate this paragraph.

**PENALTIES**

If an agent violates FS 626.9541 Unfair Competition and unfair or deceptive acts by engaging in twisting, churning, submitting false or fraudulent signatures, or the unlawful use of designation or misrepresentation of agent qualifications they face several types of penalties. Note: these penalties are in addition to mitigation of responsibility discussed earlier.

**CRIMINAL PENALTIES:**

They can have criminal penalties imposed under FS 775.082

**FINES:**

They have fines imposed under FS 626.9521

**INTERRUPTION OF LICENSING STATUS:**

They can also have their insurance license suspended or revoked under DFS Rule 69B.

We will discuss each of these acts and summarize the penalties that can be imposed for each. We will follow the above organization scheme in that we will discuss criminal penalties, fines, and interruption of license status in that order.

**TWISTING OR CHURNING**

F.S. 626 (3)(a) If a person violates s. 626.9541(1)(l), the offense known as "twisting," or violates s. 626.9541(1)(aa), the offense known as "churning," the person commits a misdemeanor of the first degree, punishable as provided in s. 775.082, and an administrative fine not greater than $5,000 shall be imposed for each nonwillful violation or an administrative fine not greater than $40,000 shall be imposed for each willful violation. To impose criminal penalties under this paragraph, the practice of "churning" or "twisting" must involve fraudulent conduct.

**Criminal penalties:**

The criminal penalties for twisting or churning can include imprisonment of up to 1 year (see section below)
NOTE: Section 775.082 of Florida Statutes (referenced in FS 626.9521 above) relates to criminal penalties. Section 775.082 (4) (a) states that a person convicted of a first degree misdemeanor (such as twisting or churning) may be sentenced “by a definite term of imprisonment not exceeding 1 year”. According to FS 626.9521 in order for criminal penalties to be imposed the churning or twisting must involve fraudulent conduct.

Fines:
For each nonwillfull violation involving twisting or churning the fine can be as high as $5,000 and balloons to as high as $40,000 for each willfull violation.

Interruption of license status:
DFS Rule 69B provides actions against an agent’s license status. This section stipulates that for the offense of twisting or churning your license can be suspended for 9 months.

FRAUDULENT SIGNATURES:

Criminal penalties:
If an agent willfully submits a fraudulent signature on an application or policy related document they have committed a 3rd degree felony and FS 775.082 provides that they can be sentenced for up to 5 years of imprisonment.

Fines:
Per FS 626.9521 (section reproduced below) for each non willful violation involving fraudulent signatures the fine can be as high as $5,000 and balloons to as high as $40,000 for each willful violation.

Interruption of license status:
DFS Rule 69B provides that for a violation including fraudulent signature your license can be immediately revoked because it involves a third degree felony.

B. Per F. S. 626.9521 (3)(b)

(b) If a person violates s. 626.9541 (1)(ee) by willfully submitting fraudulent signatures on an application or policy-related document, the person commits a felony of the third degree, punishable as provided in s. 775.082, and an administrative fine not greater than $5,000 shall be imposed for each non willful violation or an administrative fine not greater than $40,000 shall be imposed for each willful violation.

NOTE: Section 775.082 of Florida Statutes (referenced earlier ) relates to criminal penalties. Section 775.082 (3) (d) states that a person convicted of a third degree felony (such as willfully submitting false or fraudulent signatures) may be sentenced “by a definite term of imprisonment not exceeding 5 years”.

59
SUITABILITY EDUCATION REQUIREMENTS

In order to ensure that all Florida producers who are licensed to sell annuities are educated about the new suitability requirements FS 626.2815 was amended to require all persons licensed to solicit or sell life insurance to complete 3 hours of coursework approved by the Florida DFS on the subject of suitability in annuity and life insurance transactions. These hours may be used towards the ethics continuing education requirement.

RECORDKEEPING

As part of the suitability process FS 627.4554(6) requires insurers, managing general agents, insurance agencies, and insurance agents to maintain records to support the reasonably objective basis for recommendations for a period of 5 years. These records can be in the form of paper, photographic, microprocess (microfilm), magnetic media, mechanical, or electronic as long as it provides for an accurate reproduction of the document. These records must be made available to The department or office if requested.

Specifically the records maintained must include the following:

- Applications
- Questionnaires
- Illustrations
- Correspondence
- Account review documents
- Account statements

REPRESENTING UNAUTHORIZED ENTITIES

As an insurance agent you are part of the insurance industry and as such you have a responsibility to only transact business with duly licensed insurance companies. Every state (including Florida) has serious problems with unauthorized insurers bilking consumers out of premiums. In many cases these entities are not legitimate insurance companies and are complex fraud schemes. With the state of the art of desktop publishing it is easy to produce documents and brochures that look as if they were produced by a legitimate insurance company.

As premiums increase the prevalence of these fraudulent insurance schemes is increasing especially in the area of health insurance.

If an agent represents an unauthorized insurer they place themselves and their clients at risk. The agent is at risk because they can be help liable for unpaid claims and the consumer is at risk because they can lose premiums and/or suffer unpaid claims.
PROHIBITED ACTS:

F.S. 626.901 prohibits any person (including an insurance agent) from representing or in any way aiding an insurer not authorized to transact such business in Florida.

If an unauthorized insurer fails to pay claims any agent that represented that insurer is liable for the unpaid claims.

PENALTIES FOR REPRESENTING UNAUTHORIZED INSURER:

F.S. 626.902 imposes penalties for representing an unauthorized insurer as follows:

626.902 Penalty for representing unauthorized insurer.

(1) In addition to any other penalties provided in the insurance code:

(a) Any insurance agent licensed in this state who in this state knowingly represents or aids an unauthorized insurer in violation of s. 626.901 commits a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084

NOTE: F.S. 775.082 referenced above in F.S. 626.902 stipulates that a 3rd degree felony (such as knowingly representing an unauthorized insurer) is punishable by imprisonment of up to 5 years.

In addition to being liable for the unpaid claims and potential imprisonment DFS Rule 69B provides that for a violation involving representing an unauthorized insurer your license can be immediately revoked because it involves a third degree felony.

Florida takes this problem so seriously that they require all continuing education providers to include the verbiage below in the course syllabus for all live course offerings.

Unauthorized Entities Updated Verbiage:

The State of Florida has taken a very strong position on the issue of unauthorized entities. An unauthorized entity is an insurance company that is not licensed by the Florida Department of Financial Services. Agents and Brokers have responsibility for conducting reasonable research to ensure that they are not writing policies or placing business with unauthorized entities. Lack of careful screening can result in significant financial loss to Florida residents due to unpaid claims and/or theft of premiums. Agents may be held liable when representing these unauthorized entities. It is the Agents and Brokers responsibility to give fair and accurate information regarding the companies they represent. Any question about the authorized status of a company can be checked by calling the Florida Department of Financial Services at 1.877.693.5236 (inside Florida) or 850.413.3089 (outside of Florida). We urge all Agents and Brokers to adhere to this admonition.
CHAPTER 4 REVIEW QUESTIONS

(answers are in the back of the text)

9. For the purposes of determining criminal penalties submitting fraudulent signatures is considered a _______ and can result in imprisonment for up to _______.

10. If a Florida insurance agent willfully engages in twisting they can have their license suspended for _______ and pay a fine of up to__________.
Answers to Chapter Review Questions

Chapter 1

1. Market Value Adjustment (page 11)
2. Guaranteed Minimum Death Benefit (pages 13 & 14)
3. The withdrawn funds will not include any interest for the current index term because the interest is credited at the end of each index term (page 11)

Chapter 2

4. 1035 (page 23)
5. Contract liquidity and/or surrender charge terms (pages 21 & 22)
6. Interest first (page 26)

Chapter 3

7. Policy Holders Bill of Rights (pages 29 & 30)
8. Fiduciary responsibilities (page 31)

Chapter 4

9. 3rd degree felony, 5 years (pages 41 & 42)
10. 9 months $40,000 (page 41)