SUBCHAPTER PP. Annuity Disclosures
28 TAC §§3.9701 - 3.9712

1. INTRODUCTION. The Texas Department of Insurance (Department) proposes new Subchapter PP, §§3.9701 – 3.9712, concerning disclosures pertaining to annuities. These rules are proposed to require insurers to provide annuity applicants and contract owners with necessary information regarding annuities. The purpose of the disclosures proposed in this subchapter is to provide consumers with educational and identifying information regarding annuities that will enable them to make a decision that is more likely in their best interest and to reduce the opportunity for misrepresentation and incomplete disclosure. On April 15, 2010, the Department made an informal posting on its website of proposed rule text and cost note estimates. On April 26, 2010, the Department held a public meeting to receive comments relating to the informal rule text and cost note estimates. The proposed subchapter is based on the National Association of Insurance Commissioners (NAIC) Annuity Disclosure Model Regulation.

The proposed sections apply to all group and individual annuity contracts and certificates unless specifically excepted by the rules. The proposed rules require that insurers provide specific disclosures to both annuity applicants and annuity contract owners. The disclosures required under the proposed sections consist of a report to contract owners on at least an annual basis and a disclosure document and a buyer's guide for annuity applicants. The report to contract owners provides consumers with information regarding the current status of their contract and changes that have occurred to their account since the inception of their contract or their last report. The buyer's guide provides annuity applicants with educational information regarding annuity types and features. The disclosure document provides annuity applicants with information regarding the features and restrictions of a particular annuity product. The proposed rules specify that if the required buyer's guide and disclosure document are not provided to an applicant at or before the time of application, a free look period of at least 15 calendar days beginning upon contract receipt must be provided during which the applicant may return the contract without penalty.

The following statutes provide the authority for the proposed new subchapter. The Insurance Code §1108.002 provides that for the purpose of regulation under the Insurance Code, an annuity contract is considered an insurance policy or contract if the annuity contract is issued by a life, health, or accident insurance company, including a mutual company or fraternal benefit society, or issued under an annuity or benefit plan used by an employer or individual. Under the Insurance Code §101.051(b)(1), an insurer that makes or proposes to make an insurance contract is engaging in the business of insurance in this state. The Insurance Code §101.051(b)(3) specifies that taking or receiving an insurance application constitutes the business of insurance in this state. The Insurance Code §101.051(b)(5)(A) specifies that issuing or delivering a contract to a resident of this state constitutes the business of insurance. The Insurance Code §31.002 specifies in pertinent part that in addition to other required duties, the Department shall regulate the business of insurance in this state and ensure that the Insurance Code and other laws regarding insurance and insurance companies are executed. The Insurance Code §36.001 authorizes the Commissioner of Insurance to adopt any rules necessary and appropriate to implement the powers and duties of the

Texas Department of Insurance under the Insurance Code and other laws of this state. Because the proposed new subchapter applies to annuities issued by life, health, or accident insurance companies, including a mutual company or fraternal benefit society, or issued under an annuity or benefit plan used by an employer or individual, the subchapter regulates annuities that are considered insurance contracts for the purpose of regulation under the Insurance Code pursuant to the Insurance Code §1108.002. The acts that trigger the requirements of the proposed new subchapter are the taking of an annuity application and an insurer's issuance of an annuity contract. Both of these acts are expressly listed among the acts that constitute the business of insurance under the Insurance Code §101.051(b). Therefore, because the proposed new subchapter applies to annuities that constitute insurance contracts for the purpose of the Insurance Code, and because the acts that trigger the requirements of the proposed new subchapter are expressly listed in the Insurance Code as acts constituting the business of insurance, the Department has the authority to propose the new subchapter pursuant to the Insurance Code §§31.002 and 36.001. Sections 1108.002, 101.051(b)(1), 101.051(b)(3) and 101(b)(5)(A) specify business transactions and subject matters for which the Commissioner is authorized pursuant to the Insurance Code §36.001 to adopt necessary and appropriate rules. It is the Department's position that the provision of basic educational and identifying information relating to annuities is necessary to effectively regulate the sale of annuities in this state.

In addition to this generally applicable authority, §§1152.005 and 1114.007 provide rulemaking authority for certain transactions that will be regulated under the proposed new rules and specific types of annuities that will be subject to the proposed new rule requirements and procedures. The Insurance Code §1152.005 specifies that the Commissioner may adopt rules that are fair, reasonable, and appropriate to augment and implement the Insurance Code Chapter 1152, relating to separate accounts and variable annuity contracts, including rules establishing agent licensing, standard policy provisions, and disclosures. Although the proposed new rules will apply to all types of annuities and not just variable annuity contracts, §1152.005 expressly authorizes the Commissioner to adopt rules relating to disclosures for variable annuities. Additionally, in the context of annuity replacement transactions, the Commissioner has specific authority to promulgate rules pertaining to (i) regulating the actions of insurers and agents concerning annuity replacement transactions; (ii) ensuring that purchasers receive information with which a decision in the purchaser's best interest may be made; and (iii) reducing the opportunity for misrepresentation and incomplete disclosure. The Insurance Code §1114.007 specifies that the Commissioner may adopt reasonable rules in the manner prescribed by Subchapter A, Chapter 36, to accomplish and enforce the purpose of Chapter 1114. The Insurance Code §1114.001 in pertinent part states that the purpose of Chapter 1114 is to regulate the activities of insurers and agents with respect to the replacement of existing annuities; protect the interests of purchasers of annuities by establishing minimum standards of conduct to be observed in certain transactions; ensure that purchasers receive information with which a decision in the purchaser's best interest may be made; reduce the opportunity for misrepresentation and incomplete disclosure; and establish penalties for failure to comply with the requirements adopted under Chapter 1114. The Insurance Code §36.001 provides that the Commissioner of Insurance may adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of this state.

Proposed §3.9701 specifies that the purpose of the subchapter is to provide standards for the disclosure of certain minimum information about annuity contracts and to assist purchasers of annuity contracts to understand basic features of annuity contracts.

Proposed §3.9702 specifies the applicability and scope of the subchapter. Proposed §3.9702(a) specifies that the subchapter applies to all group and individual annuity contracts and certificates, except as provided in §3.9702(b). Proposed §3.9702(b) specifies that except as provided in §3.9702(c), the subchapter does not apply to certain annuity products. Proposed §3.9702(b)(1) specifies that the subchapter does not apply to immediate and deferred annuities that contain only guaranteed elements. Proposed §3.9702(b)(2) specifies that the subchapter does not apply to annuities used to fund: (i) an employee pension plan subject to the Employee Retirement Income Security Act of 1974 (29 U.S.C. Section 1001 et seq.); (ii) a plan described by the Internal Revenue Code of 1986 §§401(a), 401(k), or 403(b), in which the plan, for purposes of the Employee Retirement Income Security Act of 1974 (29 U.S.C. Section 1001 et seq.), is established or maintained by an employer; (iii) a governmental or church plan as defined by the Internal Revenue Code of 1986 §414, or a deferred compensation plan of a state or local government or a tax-exempt organization under the Internal Revenue Code of 1986 §457; (iv) a nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor; or (v) prepaid funeral benefits, as defined by the Finance Code Chapter 154.

Proposed §3.9702(b)(3) specifies that the proposed subchapter does not apply to a structured settlement annuity. Proposed §3.9702(b)(4) specifies that the proposed subchapter does not apply to a charitable gift annuity qualified under the Insurance Code Chapter 102. Proposed §3.9702(b)(5) specifies that the proposed subchapter does not apply to a funding agreement. Proposed §3.9702(c) specifies that notwithstanding the exemptions specified in §3.9702(b), the subchapter applies to an annuity used to fund a plan or arrangement that is funded solely by contributions an employee elects to make, whether on a pre-tax or after-tax basis, if the insurer has been notified that plan participants may choose from among two or more fixed annuity providers and there is a direct solicitation of an individual employee by an agent for the purchase of an annuity contract. As used in this subsection, "direct solicitation" does not include a meeting held by an agent solely for the purpose of educating or enrolling employees in the plan or arrangement.

Proposed §3.9703 specifies that the subchapter shall apply only to annuity transactions subject to regulation under the subchapter that occur on or after the effective date of the subchapter.

Proposed §3.9704 specifies that words and terms defined in the Insurance Code Chapter 102 shall have the same meaning when used in the subchapter. The proposed section defines the terms *agent*, *buyer's guide*, *contract owner*, *disclosure document*, *funding agreement*, *generic name*, *and structured settlement annuity*. The proposed section defines *agent* as an individual who holds a license under the Insurance Code Chapter 4054 and who sells, solicits, or negotiates annuities in this state. The proposed section defines *buyer's guide* as a document specified as a buyer's guide and adopted by the NAIC to be used in implementation of the NAIC Annuity Disclosure Model Regulation. The proposed section defines *contract owner* to be the owner named in the annuity contract or, in the case of a group annuity contract, the certificate holder. The proposed section defines *disclosure document* as a document intended for consumers that provides information regarding the features and restrictions of a specific annuity product and that satisfies the requirements of §3.9709 of the subchapter. The proposed section defines *funding agreement* as an agreement for an insurer to accept and accumulate funds and to make one or more payments at future dates in amounts that are not based on mortality or morbidity contingencies. The proposed section defines *generic name* as a short title descriptive of the annuity contract being illustrated or for which an applicant is applying, such as "single premium deferred annuity." The proposed section defines *structured settlement annuity* as a "qualified funding asset," as defined by the Internal Revenue Code of 1986 §130(d), or an annuity that would be a qualified funding asset but for the fact that the annuity is not owned by an assignee under a qualified assignment.

Proposed §3.9705 defines and gives example of the term *determinable elements*. Proposed subsection 3.9705(a) specifies that for the purpose of the subchapter, the phrase means elements derived from processes or methods that are guaranteed at issue and are not subject to company discretion, but for which the values or amounts cannot be determined until some point after issue. The proposed section specifies that the term includes: (i) premiums; (ii) credited interest rates, including any bonus; (iii) benefits; (iv) values; (v) non-interest based credits; (vi) charges; and (vii) elements of formulas used to determine any element described by paragraphs (1) - (6)

of this subsection. Proposed subsection 3.9705(b) specifies that determinable elements may be described as guaranteed but not determined at issue, and that an element is considered determinable if the element was computed from only underlying determinable elements, or from both determinable and guaranteed elements.

Proposed §3.9706 defines the terms *guaranteed element* and *non-guaranteed element.* Proposed subsection 3.9706(a) specifies that for the purposes of the subchapter, *guaranteed element* means an element listed in subsections §3.9705(a)(1) - (7) that is guaranteed and determined at issue. The proposed subsection specifies that an element is considered guaranteed if all of the underlying elements used in its computation are guaranteed. Proposed subsection 3.9706(b) specifies that for the purposes of the subchapter, "non-guaranteed element" means an element listed in subsections §3.9705(a)(1) - (7) that is subject to the insurer's discretion and is not guaranteed at issue, and that an element is considered non-guaranteed if any underlying elements used in its computation is non-guaranteed.

Proposed §3.9707 specifies that compliance with the subchapter is not a defense in any action brought by or for the Department alleging a violation of the Insurance Code, or, except for this subchapter, any rule adopted pursuant to the Insurance Code.

Proposed §3.9708 specifies certain consumer notices required under the subchapter. Proposed §3.9708(a) specifies that if an application for an annuity contract or certificate is taken in a face-to-face meeting, the applicant shall be given at or before the time of application both a disclosure document and the appropriate buyer's guide specified in §3.9710 of the subchapter. Proposed §3.9708(b) specifies that if the application is taken by means other than in a face-to-face meeting the applicant shall be sent not later than the fifth business day after the date on which the completed application is received by the insurer both a disclosure document and the appropriate buyer's guide specified in §3.9710 of the subchapter. Proposed §3.9708(c) specifies that if the insurer receives the application as a result of a direct solicitation through the mail, the insurer providing the appropriate buyer's guide and a disclosure document in a mailing inviting prospective applicants to apply for an annuity contract or certificate is considered to satisfy the requirement in §3.9708(b) that the appropriate buyer's guide and the disclosure document be provided not later than the fifth business day after the date of receipt of the application. Proposed §3.9708(d) specifies that if the application is received through the Internet, the insurer must take reasonable steps to ensure that the appropriate buyer's guide and a disclosure document are available for viewing and printing on the insurer's website and opened or acknowledged by the prospective applicant in order to satisfy the requirement that the appropriate buyer's guide and the disclosure document be provided not later than the fifth business day after the date of receipt of the application. Proposed §3.9708(e) specifies that a solicitation for an annuity contract that is provided in a manner other than a face-to-face meeting must include a statement that the proposed applicant may contact the insurer for a free annuity buyer’s guide.

Proposed §3.9709 specifies the minimum requirements for the disclosure document required under the subchapter. Proposed §3.9709(a) specifies that the following minimum information must be included in the required disclosure document: (i) the generic name of the contract, the insurer product name, if different from the generic name, the product’s form number, and a statement of the fact that the contract is an annuity; (ii) the insurer's name and address; (iii) a description of the contract and the benefits provided under the contract that emphasizes the long-term nature of the contract and includes examples of the long-term nature as appropriate; (iv) the guaranteed, non-guaranteed, and determinable elements of the contract, any limitations of those elements, and an explanation of how those elements operate; (v) an explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the initial crediting rate, and the fact that rates may change from time to time and are not guaranteed; (vi) periodic income options, both on a guaranteed and non-guaranteed basis; (vii) any value reductions caused by withdrawals from or surrender of the contract; (viii) how values in the contract can be accessed; (ix) the death benefit, if available, and how the death benefit is computed; (x) a summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; (xi) the impact of any rider, such as a long-term care rider; (xii) a list of the specific dollar amount or percentage charges and fees, with an explanation of how those charges and fees apply; and (xiii) information about the current guaranteed rate for new contracts that contains a clear notice that is reasonably intelligible to the average consumer that the rate is subject to change. Proposed §3.9709(b) specifies that an insurer shall define terms used in the disclosure document in language that facilitates the understanding by a typical person within the segment of the public to which the disclosure document is directed. This provision is intended to require insurers to craft disclosures relevant to the intended market for the particular product discussed in the disclosure. For example, a product intended for senior citizens or retirees may have a disclosure document printed in larger font to facilitate easier reading. Proposed

§3.9709(c) specifies that a disclosure document that complies with the Financial Industry Regulatory Authority (FINRA) Conduct Rules and the United States Securities and Exchange Commission (SEC) prospectus requirements satisfies the requirements of this section for disclosure documents. Proposed §3.9709(c) further specifies that the subsection does not limit the commissioner's ability to enforce the provisions of this section or require the use of a FINRA-approved disclosure document. The subsection specifies that it provides a safe harbor under this subchapter for an annuity contract that is regulated by, and complies with, the FINRA Conduct Rules and the SEC prospectus requirements pertaining to disclosure.

Proposed §3.9710 specifies that for the purposes of the subchapter, an appropriate buyer’s guide is the latest version of the buyer’s guide adopted by the NAIC that applies to the particular type of annuity (such as fixed deferred annuity, equity-indexed annuity, or variable annuity) that is the subject of the transaction. The subsection specifies that if the NAIC has not adopted a buyer’s guide for the particular type of annuity that is the subject of the transaction, then the appropriate buyer’s guide is Buyer’s Guide to Fixed Deferred Annuities that has been most recently adopted by the NAIC.

Proposed §3.9711 specifies the provisions relating to the free look period required in certain circumstances. Proposed §3.9711(a) specifies that if the buyer's guide and the disclosure document required by the subchapter are not provided at or before the time of application, a free look period of at least 15 calendar days must be provided during which the applicant may return the contract without penalty. Proposed §3.9711(b) specifies that notice of the free look period required under this section must be provided to consumers in a notice that is included on or attached to the cover page of the delivered annuity contract, and that the notice must prominently disclose the 15 day free-look period. Proposed §3.9711(c) specifies that the free look period begins the date the consumer receives the contract and shall run concurrently with any other free look period required under the Texas Administrative Code, the Texas Insurance Code, or another law of this state. Proposed §3.9711(d) specifies that an unconditional refund without penalty for purposes of the section for variable or modified guaranteed annuity contracts shall mean a refund 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. Proposed §3.9711(e) specifies that the refund and free look period requirements in this subsection do 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.

Proposed §3.9712 specifies the provisions relating to the report to contract owners. Proposed §3.9712(a) specifies that for annuities in the payout period with changes in non-guaranteed elements and for the accumulation period of a deferred annuity, the insurer shall provide each contract owner with a report, at least annually, on the status of the contract. Proposed §3.9712(b) specifies that report must contain: (i) the beginning and ending dates of the current reporting period; (ii) the accumulation and cash surrender value, if any, at the end of the previous reporting period and the current reporting period; (iii) the total amounts, if any, that have been credited, charged to the contract or certificate value, or paid during the current reporting period; and (iv) the amount of any outstanding loans as of the end of the current reporting period.

2. FISCAL NOTE. Doug Danzeiser, Deputy Commissioner for the Life, Health & Licensing Division, has determined that for each year of the first five years the proposed sections are in effect, there will be no fiscal implications to state or local government as a result of the enforcement or administration of the proposal. There will be no measurable effect on local employment or the local economy as a result of the proposal.

3. PUBLIC BENEFIT/COST NOTE. Mr. Danzeiser also has determined that for each year of the first five years the proposal is in effect, there is an anticipated public benefit of increased economic welfare of insurance consumers, as well as potential costs for persons required to comply with the proposal. The Department, however, drafted the proposed rules to maximize public benefits while mitigating costs. Annuities are complex insurance products with numerous features and restrictions that vary between annuity type, product, and issuer. The purchase of an inappropriate or unsuitable annuity product can lead to severe adverse financial consequences for consumers. The Department has determined that the buyer's guide, disclosure document, and report to contract owners are necessary to decrease the likelihood of consumer financial harm resulting from inappropriate annuity contract purchases. The buyer's guide informs annuity applicants of common features and varieties of annuity contracts so that they may make a decision most appropriate for their specific financial needs. The disclosure document provides annuity applicants with basic identifying information regarding a specific annuity product so that they can compare the product being offered with their needs. The report to contract owners gives annuity purchasers information regarding the performance and operation of their annuity contract so that they may make informed choices regarding continuation, surrender, exchange, or replacement of that contract. Therefore, the requirements of the proposed subchapter will substantially contribute to the economic welfare of insurance consumers by providing them with specific information that will assist them in making financial decisions in their best interest. Some companies currently provide Texas applicants with buyer's guides and disclosure documents on a voluntary basis, and other companies have implemented the documents as part of a company-wide compliance effort resulting from similar requirements in other states. The current industry standard practice is to provide contract owners with the report required by the proposed subchapter or a similar report. Further, since 2000, the Department's product checklists for individual and group deferred annuities have contained an item regarding annuity issuers providing annual status reports to its customers. Product checklists are documents issued by the Department to facilitate company filings by notifying companies of provisions that Department reviewers analyze upon filing receipt. Therefore, to the extent that companies issuing annuities in Texas are already providing annual status reports to customers, the requirement in the rule will not represent an additional cost. It is not anticipated that the rule will result in any costs to companies that currently provide annuity applicants with buyer's guides and disclosure documents and contract holders with reports. However, companies that do not currently provide these documents to applicants and contract owners will incur costs as a result of the compliance with the rule. The costs incurred will depend on the number of annuity contracts offered for sale or sold by a particular company. Therefore, because the costs are related to the number of sales or sales offers, large insurers may incur more expenses than smaller insurers. The Department anticipates that the following cost components will result from compliance with the rule: (1) initial implementation costs; (2) costs specific to buyer's guides; (3) printing costs for disclosure documents and annual reports; (4) distribution costs; and (5) costs relating to the free look period.

1. Initial Implementation Costs. The Department anticipates that initial implementation cost estimates range from $7,500 to $10,000. These costs will be incurred only once and relate to computer system programming, website redesign, agent training, changes in form ordering procedure, and direct solicitation marketing. For the purpose of this cost note, the Department assumes that the majority of direct solicitation business done by annuity insurers is conducted though a insurer's internet website. This cost estimate of $7,500 to $10,000 is based on information received from an insurer that has implemented distribution of the buyer's guides, disclosure documents, and annual status reports to contract owners in states other than Texas.

2. Costs Specific to Buyer's Guides. The buyer's guides currently adopted by the NAIC include the *Buyer's Guide to Fixed Deferred Annuities* and the *Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities*. Insurers have three options for implementing the requirements relating to buyer's guides: (i) they may purchase printed copies from the NAIC; (ii) they may print copies themselves; or (iii) they may offer electronic access to consumers on their websites. The NAIC supplies insurers with printed copies of these buyer's guides and charges $0.60 per copy for the 12 page *Buyer's Guide to Fixed Deferred Annuities* and $0.63 per copy for the 20 page *Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities*.

However, this cost may vary depending on these factors: (1) the NAIC offers volume discounts for insurers ordering in large quantities; (2) the cost per copy does not include shipping charges; and (3) the NAIC may require an additional charge for customization or artwork printed on the buyer's guides. The volume discount pricing structure for the *Buyer's Guide to Fixed Deferred Annuities* is as follows: $0.60 for 999 or fewer copies; $0.56 for 1,000 to 9,999 copies; $0.53 for 10,000 to 49,999 copies; $0.48 for 50,000 to 74,999 copies; $0.44 for 75,000 to 99,999 copies; and $0.40 for 100,000 to 10,000,000 copies. The NAIC has not established sales volume discount prices for the purchase of more than 10,000,000 copies of the *Buyer's Guide to Fixed Deferred Annuities* in a year. The volume discount price printing costs for the *Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities* are as follows: $0.63 for 999 or fewer copies; $0.58 for 1,000 to 9,999 copies; $0.55 for 10,000 to 49,999 copies; $0.50 for 50,000 to 74,999 copies; $0.45 for 75,000 to 99,000 copies; and $0.43 for 100,000 to 10,000,000 copies. The NAIC has not established sales volume discount prices for the purchase of more than 10,000,000 copies of the *Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities* in a year.

An insurer may also contractually agree with the NAIC to reprint or provide electronic access to the buyer's guides. The contractual agreement requires insurers to pay the NAIC a reprinting or viewing fee on an annual basis and a royalty for electronic viewing or each copy of the buyer's guide the insurer prints. The NAIC charges the same amount for each insurer-printed copies as they do for a viewing of an electronic version on the insurer's website. The NAIC charges insurers a base standard licensing fee of $3,500, and a tiered royalty fee based on the number of copies printed by the insurer or website views the insurer receives during the year. According to the NAIC, the costs for viewings of the electronic version or insurer-printed copies of the online buyer's guides are as follows: $500.00 for one to 999 views or reprintings; $1,075 for 1,000 to 4,999 views or reprintings; $1,900 for 5,000 to 9,999 views or reprintings; $4,375 for 10,000 to 24,999 views or reprintings; and $8,500 for 25,000 or more views or reprintings. These costs are the same for both the *Buyer's Guide to Fixed Deferred Annuities* and the *Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities.*

3. Printing costs for Disclosure Documents and Annual Reports. Insurers will incur costs in printing the disclosure documents. The proposed rule requires distribution of a disclosure document which the Department estimates will be two pages in length. The Department assumes disclosure documents will be two pages in length based upon information contained in the publication *Improving Annuity Disclosure* written by the American Council of Life Insurers, the National Association of Variable Annuities, and the National Association of Insurance and Financial Advisors. This publication provides disclosure document templates and guidance for insurers on compliance with the NAIC Annuity Disclosure Model Regulation on which the proposed rule is based. The Department estimates the cost of printing a disclosure document to be $0.16 based on its cost estimate for a printed page of $0.08.

The proposed rule also requires that insurers provide annuity owners with a report, at least annually, on the status of an in-force annuity contract. Based upon the amount and type of information required, the Department estimates that the annual status reports will be two pages in length. The Department estimates the cost of printing a report to contract owners to be $0.16 based on its cost estimate for a printed page of $0.08. The Department assumes that the information required in the reports is readily available, easily compiled, and will not impose additional costs for insurers to prepare. The Department has been informed by insurance industry representatives that the current industry standard practice is to provide this report or a similar report. Further, since 2000, the Department's product checklists for individual and group deferred annuities have contained an item regarding annuity issuers providing annual status reports to its customers. Product checklists are documents issued by the Department to facilitate company filings by notifying companies of provisions that Department reviewers analyze upon filing receipt. Therefore, to the extent that companies issuing annuities in Texas are already providing annual status reports to its customers, the requirement in the rule will not represent an additional cost.

4. Distribution costs. The Department does not anticipate any costs relating to distribution of the buyer's guides or disclosure documents by agent or internet website distribution additional to those previously discussed. The Department does anticipate costs relating to sending these documents in the mail. Assuming the disclosure document and buyer's guides are sent in a single mailing, the anticipated cost estimates for such a mailing range from $1.06 to $1.87. This estimate is based on United State Postal Service first class mail costs. This estimate assumes that the 14 pages of the disclosure document and *Buyer's Guide to Fixed Deferred Annuities* weigh no more than five ounces, and that the 22 pages for the disclosure document and *Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities* weigh no more than eight ounces. The Department anticipates that costs associated with mailing these documents may be less if mailed together with documents that are already being provided to consumers.

5. Free Look Period. The proposed rule requires that if an insurer does not provide the buyer's guide and the disclosure document, the insurer must provide a free look period of at least 15 days beginning on the date the consumer receives the contract and during which the applicant may return the contract without penalty. Notice of the free look period must be provided to the consumers in a notice included on or attached to the cover page of the delivered annuity contract. The Department anticipates that if not included on the cover page, this notice will be a single page in length and estimates a cost for the notice to be $0.08. The Department assumes that all carriers will provide the required buyer's guide and disclosure documents and that applicants will thus not be entitled to the free look required under the proposed rule. Thus, the Department does not anticipate any costs associated with the return of contracts without penalty.

The cost elements and estimates identified in this cost note are based upon the April 15, 2010 informal posting on the Department's website. The April 15, 2010 informal cost estimate also noted that insurer staff time would be required to comply with the proposed rule text, but that insurers would be able to absorb additional staff time requirements with their existing resources. In its April 15, 2010 posting, the Department sought additional information on the above cost estimates and components. The Department did not receive any information additional to or conflicting with these cost estimates.

All of the analyses in this cost note are equally applicable to and do not vary for small or micro businesses.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS FOR SMALL AND MICRO BUSINESSES. The Government Code §2006.002(c) requires that if a proposed rule may have an economic impact on small businesses, state agencies must prepare as part of the rulemaking process an economic impact statement that assesses the potential impact of the proposed rule on small businesses and a regulatory flexibility analysis that considers alternative methods of achieving the purpose of the rule. The Government Code §2006.001(2) defines "small business" as a legal entity, including a corporation, partnership, or sole proprietorship, that is formed for the purpose of making a profit, is independently owned and operated, and has fewer than 100 employees or less than $6 million in annual gross receipts. The Government Code §2006.001(1) defines "micro business" similarly to "small business" but specifies that such a business may not have more than 20 employees. The Government Code §2006.002(f) requires a state agency to adopt provisions concerning micro businesses that are uniform with those provisions outlined in the Government Code §2006.002(b) - (d) for small businesses.

As required by the Government Code §2006.002(c), the Department has determined that the proposal may have an adverse economic effect on approximately 31 to 47 small or micro-businesses that are required to comply with the proposed rules. The Department does not have precise information regarding the number of small or micro insurers administering or offering annuity contracts for sale in Texas. However, for the purpose of this estimate, the Department assumes that between 10 to 15 percent of the 312 licensed companies doing annuity business in Texas as of December 31, 2009, are small or micro-businesses. The cost of compliance with the proposal will not vary between large businesses and small or micro-businesses, and the Department's cost analysis and resulting estimated costs for insurers in the Public Benefit/Cost Note portion of this proposal is equally applicable to small or micro-businesses. However, as noted in the Public Benefit/Cost Note portion of this proposal, the costs associated with the proposed subchapter depend upon the number of annuity contracts sold or offered for sale. Therefore, to the extent that a small or micro business sells or offers for sale fewer annuity contracts, these costs are expected to be lower than they would be for a larger insurer.

In accordance with the Government Code §2006.002(c-1), the Department has determined that even though the proposal may have an adverse economic effect on small or micro-businesses that are required to comply with the proposal, the proposal does not require a regulatory flexibility analysis that is mandated by §2006.002(c)(2) of the Government Code. Section 2006.002(c)(2) requires that a state agency, before adopting a rule that may have an adverse economic effect on small businesses, prepare a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. Section 2006.002(c-1) of the Government Code requires that the regulatory flexibility analysis "consider, if consistent with the health, safety, and environmental and economic welfare of the state, using regulatory methods that will accomplish the objectives of applicable rules while minimizing adverse impacts on small businesses." Therefore, an agency is not required to consider alternatives that, while possibly minimizing adverse impacts on small and micro-businesses, would not be protective of the health, safety, and environmental and economic welfare of the state.

The purpose of this proposal is to protect the economic welfare of Texas annuity applicants and contract owners by providing them with educational and identifying information regarding annuities that will enable them to more likely make a decision in their best interest and reduce the opportunity for misrepresentation and incomplete disclosure. The severe adverse financial consequences that can result from the uninformed purchase of an annuity product can be significantly mitigated through the use of the disclosures required by the proposed subchapter. The buyer's guide informs annuity applicants of common features and varieties of annuity contracts so that they may choose a product and features most appropriate for their specific situation. The disclosure document provides annuity applicants with basic identifying information regarding a specific annuity product so that they can compare the product being offered with their needs. The report to contract owners gives annuity purchasers information regarding the performance and operation of their annuity contract so that they may make informed choices regarding continuation, surrender, exchange, or replacement of that contract. Therefore, the proposed subchapter will substantially contribute to the economic welfare of insurance consumers by allowing them to make more informed decisions regarding annuities.

Therefore, the Department has determined in accordance with §2006.002(c-1) of the Government Code, that because the purpose of the proposal is to protect consumer economic interests, there are no regulatory alternatives to the required notices in this proposal that will sufficiently protect the economic interests of consumers purchasing insurance from small or micro-business insurers.

5. TAKINGS IMPACT ASSESSMENT. The Department has determined that no private real property interests are affected by this proposal and that this proposal does not restrict or limit an owner's right to property that would otherwise exist in the absence of government action and, therefore, does not constitute a taking or require a takings impact assessment under the Government Code §2007.043.

6. REQUEST FOR PUBLIC COMMENT. To be considered, written comments on the proposal must be submitted no later than 5:00 p.m. on September 13, 2010, to Gene C. Jarmon, General Counsel and Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comments must be simultaneously submitted to Doug Danzeiser, Deputy Commissioner for the Life, Health & Licensing Division, Mail Code 107-2A, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104. Any request for a public hearing should be submitted separately to the Office of the Chief Clerk before the close of the public comment period. If a hearing is held, written and oral comments presented at the hearing will be considered.

7. STATUTORY AUTHORITY. The new subchapter is proposed under the Insurance Code §§1108.002, 31.002, 101.051(b)(1), (b)(3), and (b)(5)(A), 1152.002, 1114.007, 1114.001, and 36.001. Section 1108.002 specifies that for the purpose of regulation under the Insurance Code, an annuity contract is considered an insurance policy or contract if the annuity contract is issued by a life, health, or accident insurance company, including a mutual company or fraternal benefit society or issued under an annuity or benefit plan used by an employer or individual. Section 31.002 specifies that in addition to other required duties, the Department shall regulate the business of insurance in this state; administer the workers' compensation system of this state as provided by the Labor Code Title 5; and ensure that the Insurance Code and other laws regarding insurance and insurance companies are executed. Section 101.051(b)(1) specifies that the making or proposing to make, as an insurer, an insurance contract constitutes the business of insurance in this state. Section 101.051(b)(3) specifies that taking or receiving an insurance application constitutes the business of insurance in this state. Section 101.051(b)(5)(A) specifies that issuing or delivering a contract to a resident of this state constitutes the business of insurance. Section 1152.005 specifies that the Commissioner may adopt rules that are fair, reasonable, and appropriate to augment and implement the Insurance Code Chapter 1152, relating to separate accounts and variable annuity contracts, including rules establishing agent licensing, standard policy provisions, and disclosure. Section 1114.007 specifies that the Commissioner may adopt reasonable rules in the manner prescribed by Subchapter A, Chapter 36, to accomplish and enforce the purpose of Chapter 1114. Section 1114.001 states that the purpose of Chapter 1114 is to regulate the activities of insurers and agents with respect to the replacement of existing life insurance and annuities; protect the interests of purchasers of life insurance or annuities by establishing minimum standards of conduct to be observed in certain transactions; ensure that purchasers receive information with which a decision in the purchaser's best interest may be made; reduce the opportunity for misrepresentation and incomplete disclosure; and establish penalties for failure to comply with the requirements adopted under Chapter 1114. Section 36.001 provides that the Commissioner of Insurance may adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of this state.

8. CROSS REFERENCE TO STATUTE. The following statutes are affected by this proposal:

Rule	Statute
§§3.9701 - 3.9712	Insurance Code §§101.051(b),(1) 101.051(b)(3), 101.051(b)(5)(A), 1152.005, and 1114.007

9. TEXT.

SUBCHAPTER PP. Annuity Disclosures
28 TAC §§3.9701 - 3.9712

§3.9701. Purpose. The purpose of this subchapter is to:

(1) provide standards for the disclosure of certain minimum information about annuity contracts; and

(2) assist purchasers of annuity contracts to understand certain basic features of annuity contracts.

§3.9702. Applicability and Scope.

(a) This subchapter applies to all group and individual annuity contracts and certificates except as provided by subsection (b) of this section.

(b) This subchapter does not apply to the following annuity products except as provided in subsection (c) of this section:

(1) immediate and deferred annuities that contain only guaranteed elements;

(2) annuities used to fund:

(A) an employee pension plan subject to the Employee Retirement Income Security Act of 1974 (29 U.S.C. Section 1001 et seq.);

(B) a plan described by the Internal Revenue Code of 1986 §§401(a), 401(k), or 403(b), in which the plan, for purposes of the Employee Retirement Income Security Act of 1974 (29 U.S.C. Section 1001 et seq.), is established or maintained by an employer;

(C) a governmental or church plan as defined by the Internal Revenue Code of 1986 §414, or a deferred compensation plan of a state or local government or a tax-exempt organization under the Internal Revenue Code of 1986 §457;

(D) a nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor; or

(E) prepaid funeral benefits, as defined by the Finance Code Chapter 154;

(3) a structured settlement annuity;

(4) a charitable gift annuity qualified under the Insurance Code Chapter 102; or

(5) a funding agreement.

(c) Notwithstanding the exemptions specified in subsection (b) of this section, this subchapter applies to an annuity used to fund a plan or arrangement that is funded solely by contributions an employee elects to make, whether on a pre-tax or after-tax basis, if the insurer has been notified that plan participants may choose from among two or more fixed annuity providers and there is a direct solicitation of an individual employee by an agent for the purchase of an annuity contract. As used in this subsection, "direct solicitation" does not include a meeting held by an agent solely for the purpose of educating or enrolling employees in the plan or arrangement.

§3.9703. Effective Date. This subchapter shall apply only to annuity transactions subject to regulation under this subchapter that occur on or after the effective date of this subchapter.

§3.9704. Definitions.

(a) Words and terms defined in the Insurance Code Chapter 102 shall have the same meaning when used in this subchapter.

(b) The following words and terms, when used in this subchapter, shall have the following meanings unless the context clearly indicates otherwise.

(1) Agent--An individual who holds a license under the Insurance Code Chapter 4054 and who sells, solicits, or negotiates annuities in this state.

(2) Buyer's guide--A document specified as a buyer’s guide and adopted by the National Association of Insurance Commissioners (NAIC) to be used in implementation of the NAIC Annuity Disclosure Model Regulation.

(3) Contract owner--The owner named in the annuity contract or, in the case of a group annuity contract, the certificate holder.

(4) Disclosure document--A document intended for consumers that provides information regarding the features and restrictions of a specific annuity product and that satisfies the requirements of §3.9709 of this subchapter (relating to Disclosure Document).

(5) Funding agreement--An agreement for an insurer to accept and accumulate funds and to make one or more payments at future dates in amounts that are not based on mortality or morbidity contingencies.

(6) Generic name--A short title descriptive of the annuity contract being illustrated or for which an applicant is applying, such as "single premium deferred annuity."

(7) Structured settlement annuity--A "qualified funding asset," as defined by the Internal Revenue Code of 1986 §130(d), or an annuity that would be a qualified funding asset but for the fact that the annuity is not owned by an assignee under a qualified assignment.

§3.9705. Determinable Elements.

(a) For the purposes of this subchapter, "determinable elements" means elements derived from processes or methods that are guaranteed at issue and are not subject to company discretion, but for which the values or amounts cannot be determined until some point after issue. The term includes:

(1) premiums;

(2) credited interest rates, including any bonus;

(3) benefits;

(4) values;

(5) non-interest based credits;

(6) charges; and

(7) elements of formulas used to determine any element described by paragraphs (1) - (6) of this subsection.

(b) Determinable elements may be described as guaranteed but not determined at issue. An element is considered determinable if the element was computed from only underlying determinable elements, or from both determinable and guaranteed elements.

§3.9706. Guaranteed and Non-guaranteed Elements.

(a) For the purposes of this chapter, "guaranteed element" means an element listed in subsection §3.9705(a)(1) - (7) of this subchapter (relating to Determinable Elements) that is guaranteed and determined at issue. An element is considered guaranteed if all of the underlying elements used in its computation are guaranteed.

(b) For the purposes of this subchapter, "non-guaranteed element" means an element listed in subsections §3.9705(a)(1) - (7) of this subchapter that is subject to the insurer's discretion and is not guaranteed at issue. An element is considered non-guaranteed if any underlying element used in its computation is non-guaranteed.

§3.9707. Effect on Other Law. Compliance with this subchapter is not a defense in any action brought by or for the department alleging a violation of the Insurance Code, or, except for this subchapter, any rule adopted pursuant to the Insurance Code.

§3.9708. Required Consumer Notices.

(a) If an application for an annuity contract or certificate is taken in a face-to-face meeting, the applicant shall be given at or before the time of application both a disclosure document and the appropriate buyer's guide specified in §3.9710 of this subchapter (relating to Buyer's Guide).

(b) If the application is taken by means other than in a face-to-face meeting the applicant shall be sent not later than the fifth business day after the date on which the completed application is received by the insurer both a disclosure document and the appropriate buyer's guide specified in §3.9710 of this subchapter.

(c) If the insurer receives the application as a result of a direct solicitation through the mail, the insurer's providing the appropriate buyer's guide and a disclosure document in a mailing inviting prospective applicants to apply for an annuity contract or certificate satisfies the requirement in subsection (b) of this section that the appropriate buyer's guide and the disclosure document be provided not later than the fifth business day after the date of receipt of the application.

(d) If the application is received through the Internet, the insurer must take reasonable steps to ensure that the appropriate buyer's guide and a disclosure document are available for viewing and printing on the insurer's website and opened or acknowledged by the prospective applicant in order to satisfy the requirement that the appropriate buyer's guide and the disclosure document be provided not later than the fifth business day after the date of receipt of the application.

(e) A solicitation for an annuity contract that is provided in a manner other than a face-to-face meeting must include a statement that the proposed applicant may contact the insurer for a free annuity buyer's guide.

§3.9709. Disclosure Document.

(a) At a minimum, the following information must be included in the disclosure document required to be provided under this subchapter:

(1) the generic name of the contract, the insurer product name, if different from the generic name, the product's form number, and a statement of the fact that the contract is an annuity;

(2) the insurer's name and address;

(3) a description of the contract and the benefits provided under the contract; the description must emphasize the long-term nature of the contract and include examples of the long-term nature as appropriate;

(4) the guaranteed, non-guaranteed, and determinable elements of the contract, any limitations of those elements, and an explanation of how those elements operate;

(5) an explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the initial crediting rate, and the fact that rates may change from time to time and are not guaranteed;

(6) periodic income options, both on a guaranteed and non-guaranteed basis;

(7) any value reductions caused by withdrawals from or surrender of the contract;

(8) how values in the contract can be accessed;

(9) the death benefit, if available, and how the death benefit is computed;

(10) a summary of:

(A) the federal tax status of the contract; and

(B) any penalties applicable on withdrawal of values from the contract;

(11) the impact of any rider, such as a long-term care rider;

(12) a list of the specific dollar amount or percentage charges and fees, with an explanation of how those charges and fees apply; and

(13) information about the current guaranteed rate for new contracts that contains a clear notice that is reasonably intelligible to the average consumer that the rate is subject to change.

(b) An insurer shall define terms used in the disclosure document in language that facilitates the understanding by a typical person within the segment of the public to which the disclosure document is directed.

(c) A disclosure document that complies with the Financial Industry Regulatory Authority (FINRA) Conduct Rules and the United States Securities and Exchange Commission (SEC) prospectus requirements satisfies the requirements of this section for disclosure documents. This subsection does not limit the commissioner's ability to enforce the provisions of this section or require the use of a FINRA-approved disclosure document. This subsection provides a safe harbor under this subchapter for an annuity contract that is regulated by, and complies with, the FINRA Conduct Rules and the SEC prospectus requirements pertaining to disclosure.

§3.9710. Buyer's Guide. For the purposes of this subchapter, an appropriate buyer's guide is the latest version of the buyer's guide adopted by the NAIC that applies to the particular type of annuity (such as fixed deferred annuity, equity-indexed annuity, or variable annuity) that is the subject of the transaction. If the NAIC has not adopted a buyer's guide for the particular type of annuity that is the subject of the transaction, then the appropriate buyer's guide is Buyer's Guide to Fixed Deferred Annuities that has been most recently adopted by the NAIC.

§3.9711. Free Look Period.

(a) If the buyer's guide and the disclosure document required by this subchapter are not provided at or before the time of application, a free look period of at least 15 calendar days must be provided during which the applicant may return the contract without penalty.

(b) Notice of the free look period required under this section must be provided to consumers in a notice that is included on or attached to the cover page of the delivered annuity contract. The notice must prominently disclose the 15 day free-look period.

(c) The free look period shall begin on the date the consumer receives the annuity contract and shall run concurrently with any other free look period required under the Texas Administrative Code, the Texas Insurance Code, or another law of this state.

(d) An unconditional refund without penalty for purposes of this section for variable or modified guaranteed annuity contracts shall mean a refund 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.

(e) The refund and free look period requirements in this subsection do 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.

§3.9712. Report to Contract Owners.

(a) For annuities in the payout period with changes in non-guaranteed elements and for the accumulation period of a deferred annuity, the insurer shall provide each contract owner with a report, at least annually, on the status of the contract.

(b) The report must contain at least the following information:

(1) the beginning and ending dates of the current reporting period;

(2) the accumulation and cash surrender value, if any, at the end of:

(A) the previous reporting period; and

(B) the current reporting period;

(3) the total amounts, if any, that have been credited, charged to the contract or certificate value, or paid during the current reporting period; and

(4) the amount of any outstanding loans as of the end of the current reporting period.

10. CERTIFICATION. This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's authority to adopt.

Issued at Austin, Texas, on ____________________, 2010.

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Gene C. Jarmon
General Counsel and Chief Clerk
Texas Department of Insurance