BEFORE THE OFFICE OF ADMINISTRATIVE HEARINGS
STATE OF OREGON
for the
DEPARTMENT OF CONSUMER AND BUSINESS SERVICES
INSURANCE DIVISION

In the Matter of	)	
	)	**OAH Case No. 1005008**
EDMUND R. KNOWLES	)	**Agency Case No: INS 10-05-008**
	)	
	)	**PROPOSED ORDER**
	)	

HISTORY OF CASE

On June 29, 2010, the Administrator of the Department of Consumer and Business Services Insurance Division issued a Notice of Proposed Action (Notice) proposing to suspend the Oregon resident individual insurance producer license of Edmund R. Knowles for 30 days pursuant to ORS 744.074(1). Mr. Knowles timely requested a hearing challenging the proposed action. On July 14, 2010, the Division referred this matter to the Office of Administrative Hearings (OAH) for hearing. The OAH assigned the matter to Senior Administrative Law Judge (ALJ) John Mann.

ALJ Mann held a telephone prehearing conference on September 20, 2010. Assistant Attorney General Judith Anderson represented the Division. Mr. Knowles participated in the conference and represented himself.

ALJ Mann presided over a hearing on November 8, 2010 at the OAH offices in Tualatin, Oregon. Ms. Anderson represented the Division. Mr. Knowles represented himself and testified. The Division also presented testimony from Clifford Cummins. Mr. Knowles presented testimony from Gary Hoag. The record closed on November 8, 2010 at the conclusion of the hearing.

ISSUES

1. Whether Licensee violated OAR 836-080-0090 by recommending an annuity to Norman Schuh without reasonable grounds to believe that the annuity was not unsuitable.

2. If Licensee violated OAR 836-080-0090 on one or more occasions, what is the appropriate sanction?

EVIDENTIARY RULINGS

The Division's Exhibits A1 through A6, and Mr. Knowles's Exhibits R1 and R4 through R8, were admitted into the record without objection. Exhibit R2 was excluded because it

contained information concerning a possible settlement of the issues alleged in the Division's Notice. Exhibit R3, a copy of Mr. Knowles' witness list, was excluded as irrelevant. Mr. Knowles withdrew Exhibit R9 which was a duplicate of a previous version of the Division's Exhibit A5. The Division withdrew that previous version at the beginning of the hearing and substituted it with the current Exhibit A5.

FINDINGS OF FACT

1. Edmund R. Knowles has been licensed by the Division as an Oregon resident insurance producer since August 2003. (Ex. A1.) From January 2004 through October 2007 Mr. Knowles worked under contract with Bankers Life and Casualty Company (Bankers Life) as an insurance sales representative in its Eugene Branch Office. Under the terms of the contract, Mr. Knowles was considered an independent contractor. (Test. of Knowles and Hoag.)

2. On January 1, 2005, the Division adopted a rule, OAR 836-080-0090, which required insurance producers in Oregon who sold annuities to make a reasonable inquiry into whether the annuity was suitable in light of a consumer's insurance objectives, age, and financial situation and needs. The rule also required producers to consider "other relevant information" that bore on suitability. The Division interprets the phrase "other relevant information" to include such things as the consumer's health and life expectancy, the consumer's liquid assets and cash reserves, the tax consequences of the proposed transaction, and any penalties or fees that could be incurred as a result of the transaction. (Test. of Cummins.)

3. The Division adopted OAR 836-080-0090 out of a nationally emerging concern about abuse in the sale of annuities. Prior to the effective date of the rule, the Division posted information about the new requirements on its website and in a newsletter sent to producers. (Test. of Cummins.) Bankers Life created a form Annuity Suitability Questionnaire to be used by its sales representatives when they sold annuities. Managers at the Bankers Life Eugene Branch Office gave minimal training about the requirements of the new rule, but instructed its representatives that they would need to complete the form. Managers gave very little guidance as to why the form was necessary or the purpose of the questions. In general, the culture of the office favored selling fixed annuity products unless there was a good reason not to do so. (Test. of Hoag.)

4. In November or December 2004, Mr. Knowles met with Norman Schuh and his wife, Beverly Schuh at their home in Albany, Oregon. Mr. Schuh, who was 71 years old, had submitted a card to Bankers Life requesting information on long term care and home health care insurance coverage. Mr. Knowles discussed various options available to the Schuhs, but did not recommend any particular products at that meeting. However, the Schuhs agreed to set up another meeting in early 2005. (Test. of Knowles.)

5. Mr. Knowles again met with the Schuhs, at their home, in January or February 2005. During their conversation, Mr. Knowles asked Mr. Schuh about the couple's assets. Mr. Schuh stated that their main asset was their home and that he had an annuity with ING that had been provided by a prior employer. Mr. Schuh stated that he was not happy with ING because of poor customer service. He told Mr. Knowles that he had trouble contacting people at ING and that he

could not understand statements that the company sent to him. Mr. Knowles told Mr. Schuh that Bankers Life had a fixed annuity that paid 5.5 percent during the first year and a guarantee of 2.5 percent for the remainder of the term. Mr. Knowles also told Mr. Schuh that the annuity had been paying more than the guaranteed rate and was averaging 5.0 percent per year. (Test. of Knowles.)

6. Mr. Knowles asked Mr. Schuh for a copy of a statement from ING, and Mr. Schuh gave him some paperwork. Mr. Knowles is not sure whether it was an account statement or some other document. Because Mr. Knowles had limited experience with annuities, he took the paperwork back to the branch office to discuss it with his manager, Dick Bidwell. Mr. Bidwell reviewed the documents and told Mr. Knowles that he should recommend that Mr. Schuh withdraw his money from the ING annuity and purchase one from Bankers Life. (Test. of Knowles.)

7. Mr. Knowles assumed that the ING annuity was variable, which meant that the rate of return would fluctuate with the market with no guaranteed minimum. (Test. of Knowles.) That was incorrect. The ING annuity was for a ten year term beginning in October 2002. The ING annuity paid 6.0 percent the first year with a guarantee of 4.0 percent each year thereafter. Mr. Schuh paid $18,654.66 for the annuity. (Test. of Cummins; Ex. A4 at 3.)

8. Mr. Knowles again met with the Schuhs on March 23, 2005. During that meeting, following Mr. Knowles' recommendation, Mr. Schuh signed an Application for Insurance in order to purchase an annuity from Bankers Life. (Ex. A2 at 9-16.) Mr. Knowles also completed an Annuity Suitability Questionnaire for Mr. Schuh which disclosed that he had an existing IRA (the ING annuity) worth $20,736.89 and a monthly income of $2,300. In response to a question that asked the purpose for buying the annuity, Mr. Knowles checked a box marked "Retirement" and wrote "Better interest rate" next to a box marked "Other." Question 3 on the form asked if Mr. Schuh would incur penalties or charges by withdrawing from the annuity. Mr. Knowles answered yes, but left the line for the amount of charges and penalties blank. (Ex. A2 at 17.) Mr. Schuh also signed a document labeled Important Notice: Replacement of Life Insurance of Annuities. "Better Interest Rate" is listed as the reason for replacing the existing annuity. (Ex. A2 at 20.)

9. Also on March 23, 2005, Mr. Schuh executed a document authorizing Bankers Life to request that ING transfer the proceeds from the ING annuity to Bankers Life as a total surrender and IRA rollover to Bankers Life. (Ex. A2 at 19.) Mr. Knowles forwarded that request to ING the following day. (*Id.* at 21.)

10. ING transferred the funds to Bankers on May 6, 2005. The value of the annuity was $20,209.44. However, pursuant to the terms of the annuity, ING charged Mr. Schuh a "surrender charge" of $1,405.78 and a "market value adjustment" of $936.91 leaving a balance of $17,866.75. (Test. of Cummins; Ex. A4 at 3.) The market value adjustment was intended to revise the value of the annuity to reflect actual market conditions rather than the 4.0 percent guaranteed rate of return. In Mr. Schuh's case, that adjustment reflected a lower yield than the 4.0 percent guarantee. The surrender charge was based on a percentage of the value of the annuity at the time of surrender. The percentage declined over time which meant that the

surrender charge during later years would be based on a lower percentage than one done during the early years of the annuity term. (Test. of Cummins.)

11. Bankers Life issued Mr. Schuh an annuity on May 11, 2005 with an initial investment of $17,866.75 from the proceeds from the surrender of the ING annuity. It provided a 5.5 percent guaranteed interest rate the first year, a guarantee of 2.5 percent for years 2 through 10, and 3.0 percent per year for each year thereafter. The Bankers Life annuity also charged a withdrawal charge for early surrender. The withdrawal charge was 8.0 percent of the first two years then declined one percent each year thereafter. (Ex. A2 at 3-8.) By rolling over his annuity, Mr. Schuh made the value of the annuity less liquid because he would be subject to a withdrawal penalty for three years longer than if he had left the money in the ING annuity. (Test. of Cummins.)

12. As a result of the rollover to the Bankers Life annuity, Mr. Schuh incurred charges of $2,342.69, thereby reducing the value of his annuity to less than his original investment. His guaranteed rate of return was reduced from 4.0 percent to 2.5 percent. The effective rate of return (averaging the rate over a ten year period) was 2.8 percent per year for the Bankers Life annuity versus an effective rate of 4.2 percent per year for the ING annuity. If Mr. Schuh holds the Bankers Life annuity for ten years, the value of the annuity at the end of that period will be $23,540. If he had not surrendered the ING annuity, it would have been worth $28,131 at the end of ten years. (Ex. A5; test. of Cummins.)

13. Mr. Schuh's rollover of the ING annuity to the Bankers Life annuity left him in an economically worse condition than he would have been had he left the money with ING. (Test. of Knowles; test. of Cummins.) It reduced his net worth and imposed additional economic penalties for withdrawal over the next ten years. (Test. of Cummins.) Mr. Knowles believes that Mr. Schuh was primarily interested in customer service and did not focus on the economic consequences of the rollover. Mr. Knowles also believes that Mr. Schuh was not concerned with liquidity because he did not intend to use the money from the annuity, but wanted it to go to his wife and sons. (Test. of Knowles.)

14. At the time of the March 23, 2005 rollover, Mr. Knowles did not know the terms of the ING annuity. Mr. Knowles knew the account number and the total value of the ING annuity, but nothing more. Based upon his limited experience in working with employer-provided annuities, Mr. Knowles assumed that the ING annuity had a variable interest rate. He assumed that Mr. Schuh would benefit by transferring to a fixed annuity from Bankers Life which he believed was a safe investment. Mr. Knowles did not learn the terms of the ING annuity until a board investigator contacted him in 2010. (Test. of Knowles.)

15. Mr. Knowles did not attempt to determine Mr. Schuh's life expectancy in March 2005 and did not understand that it was necessary to do so. (Test. of Knowles.) The Social Security Administration's Period Life Table for 2005 shows that a 71 year old man in 2005 had a life expectancy of 12.66 years. (Ex. A6 at 3; test. of Cummins.)

16. On November 29, 2005, Allen Brooks, M.D., formally diagnosed Mr. Schuh with dementia. Dr. Brooks believes that the onset of dementia pre-dated the date of diagnosis, but he

cannot determine when it first began. (Ex. R5.) Mr. Knowles believed that Mr. Schuh was cogent and able to understand their conversations. He believed that Mr. Schuh's memory was good and saw no signs of mental impairment. (Test. of Knowles.)

17. Although Mr. Knowles understood that he was responsible for complying with the law, Mr. Knowles relied heavily on the advice and training he received from the Branch Manager and from Allen Towne, a more experienced producer at the Bankers Life Eugene Branch Office. (Test. of Knowles.)

CONCLUSIONS OF LAW

1. Licensee violated OAR 836-080-0090 by recommending an annuity to Norman Schuh without reasonable grounds to believe that the annuity was not unsuitable.

2. The appropriate sanction is a 30 day suspension.

OPINION

1. Violation of OAR 836-080-0090

The Division seeks to suspend Mr. Knowles' insurance producer license based on his alleged violation of OAR 836-080-0090. The Division alleges that Mr. Knowles violated the rule in 2005 when he recommended that Norman Schuh roll over funds from an annuity issued by ING to one issued by Bankers Life. The Division has the burden of proving the allegations. *See* ORS 183.450(2) and (5); *Harris v. SAIF*, 292 Or 683, 690 (1982) (general rule regarding allocation of burden of proof is that the burden is on the proponent of the fact or position.). The Division must prove the allegations by a preponderance of the evidence. *Sobel v. Board of Pharmacy*, 130 Or App 374, 379 (1994), rev den 320 Or 588 (1995) (standard of proof under the Administrative Procedures Act is preponderance of evidence absent legislation adopting a different standard). Proof by a preponderance of the evidence means that the fact finder is persuaded that the facts asserted are more likely true than not true. *Riley Hill General Contractor v. Tandy Corp.*, 303 Or 390 (1987).

OAR 836-080-0090 requires Oregon insurance producers to conduct a reasonable inquiry into a consumer's needs and objectives in recommending a life insurance policy or annuity to the consumer. The rule also requires that the producer recommend only suitable products that are suitable for that consumer. Specifically, OAR 836-080-0090 provides:

> *A person may not recommend* to a consumer the purchase, sale or replacement of a life insurance policy or annuity, or any rider, endorsement or amendment to the policy or annuity, *without reasonable grounds to believe that the recommendation or transaction is not unsuitable* for the consumer based upon reasonable inquiry concerning the consumer's insurance objectives, financial situation and needs, age and other relevant information known by the person. For the purpose of this rule, when a person recommends a group life insurance policy or annuity, "consumer" refers to the intended group policyholder.

(Emphasis added.)

The parties did not dispute the material facts in this case. In March 2005, Licensee recommended to Norman Schuh that he withdraw funds from his ING annuity and deposit the proceeds into a Bankers Life annuity. At the time, Mr. Knowles had minimal information regarding the ING annuity. He knew the amount of the annuity and the account number. He did not know the terms of the annuity, the amount of any surrender penalty, the possible loss occasioned by a market value adjustment, nor the interest to be paid under the ING annuity. Indeed, he did not even know that the ING product was a fixed annuity, but simply assumed that it was variable. Because of a lack of any understanding of the annuity that was being replaced, Mr. Knowles could not have known the financial impact of the action he recommended.

The evidence established that Mr. Knowles failed to conduct a reasonable inquiry and did not have reasonable grounds to believe that the annuity he Mr. Schuh was suitable for him. Because Mr. Knowles was representing the replacement of one annuity with another, a reasonable inquiry, at a minimum, required Mr. Knowles to investigate the terms of the existing annuity to see if the rollover was economically prudent. Mr. Knowles did not conduct such an inquiry. Instead, he relied on assumptions and sparse information regarding the nature of Mr. Schuh's largest investment other than his home. Had he taken the simple step of requesting a copy of the annuity contract from ING, he would have easily discovered that the transaction he was recommending was not financially prudent. It resulted in an immediate loss of $2,342.69 in the value of the annuity, and a loss of $4,591 in earnings over the life of the annuity. Furthermore, because the rollover occurred three years into the term of the ING annuity, the rollover resulted in a three year extension of the period in which Mr. Schuh would have limited access to his funds.

Mr. Knowles asserted that Mr. Schuh was not concerned about his access to funds in his annuity and that he was primarily concerned with poor customer service from ING. However, because Mr. Knowles had no information concerning the terms of the ING annuity, it was impossible for him to advise Mr. Schuh of the economic consequences of the transaction. Whether or not Mr. Schuh would be willing to sacrifice $4,591 over the life of the annuity simply to address his customer service concerns is a matter of pure speculation because Mr. Schuh was never informed that this was the cost he would incur. Furthermore, in his application materials, Mr. Schuh did not indicate that he was replacing the ING annuity because of a concern about customer service; he wrote that he was replacing it to get a better interest rate. He got precisely the opposite. He sacrificed an annuity with an annual effective interest rate of 4.2 percent for one with an annual effective interest rate of 2.8 percent.

Mr. Knowles also asserted that he relied heavily on managers and senior producers at Bankers Life in making his recommendation to Mr. Schuh. Mr. Knowle's former supervisor, Gary Hoag, provided credible testimony that corroborated that contention. The evidence established, more likely than not, that Mr. Knowles' conduct was consistent with the culture of the Bankers Life Eugene Branch Office and that he relied on advice given to him by managers and senior producers. Nevertheless, Mr. Knowles, as licensed insurance producer, had an independent duty to comply with the law. The fact that he relied on the advice of others in the office does not excuse his failure to comply with OAR 836-080-0090.

2. Sanction

The Division proposed to suspend Mr. Knowles' resident individual insurance producer license for 30 days. ORS 744.074(1) provides, in relevant part:

> The Director of the Department of Consumer and Business Services may place a licensee on probation or suspend, revoke or refuse to issue or renew an insurance producer license and may take other actions authorized by the Insurance Code in lieu thereof or in addition thereto, for any one or more of the following causes:
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> * * * * *
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> (b) Violating any insurance laws, or violating any rule, subpoena or order of the director or of the insurance commissioner of another state or Mexico or Canada.

Mr. Knowles did not specifically address the sanction, but appeared to argue that it should be mitigated because he relied on his manager and senior producers in his office. He also asserted that he got little to no guidance from Bankers Life regarding his obligations under OAR 836-080-0090. While this is understandable, and provides some explanation for Mr. Knowles' conduct, it does not excuse the violation or provide a basis for reducing the sanction. Due to his lack of experience and his reliance on others, Mr. Knowles failed to perform his legal duty to make a reasonable inquiry into the suitability of the transaction he recommended to Mr. Schuh. Under these circumstances and in accordance with the Division's authority, a 30 day suspension of Mr. Knowles' license is reasonable.

ORDER

I propose that the Division issue a final order affirming the June 29, 2010 Notice of Proposed Action suspending Edmund R. Knowles' Oregon resident insurance producer license for a period of 30 days pursuant to ORS 774.074(1).



John Mann
Senior Administrative Law Judge
Office of Administrative Hearings

Notice of Right to File Exception to Proposed Order

If the proposed order is adverse to a party, then the party has the right to file written exceptions to the order and present written argument concerning those exceptions pursuant to ORS 183.460. A party may file the exceptions and argument by sending them to the Insurance Division by delivering them to the Labor and Industries Building, 350Winter Street NE, Room 440 (4th Floor), Salem, Oregon; or mailing them to P.O. Box 14480, Salem, Oregon 97309-0405; or faxing them to503-378-4351; or e-mailing them to mitchel.d.curzon@state.or.us. The Insurance Division must receive the exceptions and argument within 30days from the date this order was sent to the party.

CERTIFICATE OF SERVICE

On 3rd day of January 2011, I mailed the foregoing Proposed Order in Reference No. **1005008.**

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