SEC officials warn insurers on annuity disclosures, VA changes

As complexity grows, so does need for clear language, group told

By **Darla Mercado** and **Mark Schoeff Jr.**
Jun 18, 2013 @ 2:36 pm (Updated 2:46 pm) EST

As insurance products become more complex, the industry needs to redouble its efforts to fully disclose their risks, a federal regulator said today.

Norm Champ, director of the Division of Investment Management at the **Securities and Exchange Commission**, told an Insured Retirement Institute conference in Washington that the agency has been noticing a rise in the number of annuities that are linked to indexes and function like structured notes.

These instruments also can be subject to withdrawal caps, whose rules may confound customers. Mr. Champ pointed to a case the SEC recently brought against **Massachusetts Mutual Life Insurance Co.** for failing to disclose that once investors reach a "cap" on a certain kind of variable annuity, withdrawals can deplete principal. The company removed the cap from the product and paid a $1.625 million penalty last November.

"Your investors' retirement income should not be put at risk because of the complexity of their contracts that are not adequately disclosed," Mr. Champ said.

The SEC wants to see plain-English disclosure on potential investment losses and gains associated with products, as well as the risk of principal loss based on early withdrawals. The agency even has asked insurers to change the names of some new products because they made the offering sound risk-free.

The Division of Investment Management has made a so-called summary prospectus for variable annuities one of its priorities, according to Mr. Champ. That document, which would be subject to the rule-making process, would be modeled after the mutual fund summary prospectus that was approved in 2009.

Separately, staff members at the SEC are taking notice of insurers that are going to extreme measures to curb their variable annuity exposure.

Attempts to limit additions to existing VA contracts and other changes enacted long after clients bought their products are becoming de rigueur for life insurance companies that want to stem VA inflows.

The development is starting to raise eyebrows among regulators.

“One issue that's been in the press is the suspension or limiting of subsequent payments,” said Michael Kosoff, branch chief at the SEC's Office of Insurance Products at the division.

Mr. Kosoff was also speaking at the IRI conference.

SEC staff members have been asking carriers about the number of contracts subject to such changes, as well as the insurers' legal basis for imposing such limits.

“We're still very interested in this,” Mr. Kosoff said. “The concern is whether you are changing the deal on the investor. If someone bought their product 10 or 15 years ago, they received a prospectus that detailed their rights.”

Though variable annuity prospectuses can disclose that a company has the right to limit future payments, carriers can be vague when they make the initial disclosure.

“You see a moving target where the original prospectus might have had a disclosure that says the company reserves the right to limit purchase payments,” said William J. Kotapish, assistant director of the Office of Insurance Products. “It might've been worded in a way that suggested they could reject something that was not in good order.”

A subsequent amendment years down the road that limits additions to a contract “frustrates the Reps responsible for variable annuity guidance: Regulators

Many changes in the pipelines as insurers seek to escape big VA liabilities - Reps responsible for variable annuity guidance: Regulators

By Darla Mercado   Jun 18, 2013 @ 10:54 am (Updated 4:59 pm) EST

As life insurers alter variable annuity contract language and implement other changes to escape from their large VA liabilities, compliance experts and regulators

are stressing that suitability rules apply and reps are ultimately responsible for the guidance they give clients on how to proceed.

Carriers like Axa Equitable Life Insurance Inc., The Hartford Financial Services Group Inc. and Transamerica Life Insurance Co. have instituted programs that allow them to buy out clients' variable annuity benefits in exchange for a higher account value. Others have tried to limit their VA liability by cutting off additional contributions to contracts that have already been purchased or by nudging clients to reallocate their investments to options with less risk and less return.

Though the methods carriers use are the domain of insurance regulators, broker-dealer representatives are on the hook for what they tell clients to do next, panelists said at the Insured Retirement Institute's Government, Legal and Regulatory Conference in Washington yesterday.

The Financial Industry Regulatory Authority Inc.'s Rule 2111, the suitability rule, applies when reps make a recommendation, even after the initial sale of the annuity.

“If the rep says, 'yes, you should take the buyout' or 'no, you shouldn't' or if they suggest that the client put in more money before the insurer cuts off [subsequent premiums] — that brings in suitability,” said Thomas J. Christel, lead senior regulatory specialist of member regulation at Finra.

Indeed, even a suggestion that a client hold on to an old variable annuity contract instead of taking the buyout is technically a suggestion that the client “hold” the investment and that recommendation should be documented, Mr. Christel noted.

To contend with the number of contracts that are going to be subject to buyouts, Jim Shorris, executive vice president and deputy general counsel at LPL Financial LLC, suggested that firms come up with a due diligence process that vets these offers — and does so separately from the rest of the annuity business.

“It shouldn't be exposed to the firm's desire to curry favor with an insurer,” he said. “If a carrier wants to get rid of unprofitable business, use your due diligence team to come up with an internal review.”

On the insurance regulation side, state insurance cops are responsible for examining the buyouts carriers pitch and the notification they give clients. They also can veto these programs.

“We look at the program, the letters [to clients] and the ads,” said James R. Mumford, first deputy commissioner in Iowa's insurance division and securities administrator at the state's securities bureau. “We give a thorough review at the state level on how [the business] is being treated. There are programs that have been proposed that we haven't approved.”