

Variable Annuity Replacements In Finra's Crosshairs

JANUARY 11, 2023 • [TRACEY LONGO](#)

FA Financial Advisor

Variable annuity contract replacements are now obviously on the radar of the Financial Industry Regulatory Authority, as [a new report](#) by Finra on its 2022 exam findings shows a significant number of product switches have not been in customers' best interests.

While there can be good reasons for a rep to sell a customer a replacement variable annuity—including better investment options, higher payouts and lower expenses—Finra examiners are finding that a number of the replacements recommended by reps aren't providing customers with a better deal, but rather serve solely to generate fresh commissions for the rep and broker-dealer and additional fees such as surrender charges for the insurer, all of which the customer pays.

“In particular, replacements or switching one annuity for another continues to be the highest risk area in the annuity space and is where the majority of our findings are where investors may be losing valuable benefits in that switch or incurring surrender fees that they're not adequately aware of,” said Michael Solomon, Finra's senior vice president of examinations, in a new podcast on the exam findings.

Solomon said the findings are important “given variable annuities' complexity, their high fees to the investor and the high levels of remuneration to advisors.” Given advisors' significant incentives to swap contracts, these transactions have to be “monitored carefully and supervised carefully,” he said.

Finra's report said firms were not adequately supervising their advisors' product exchange recommendations, and that the replacement annuities could likely run afoul of the customer's investment objectives and time horizon, and thus result in, among other things, increased fees “or the loss of material, paid-for accrued benefits.”

Both Finra Rule 2330 and Regulation Best Interest require that reps and advisors make sure that the purchase or replacement of a variable annuity be in their customers' best interest and that customers are informed about the various features of the products, including the potential tax penalties, various fees and costs and market risk. Any switch must also align with a customer's particular goals, risk tolerance, cash-flow needs and time horizon.

Reps are also supposed to consider “reasonably available alternatives” to the contracts they are selling, according to Reg BI. Yet, according to Finra's exam findings, that hasn't been the case: The reps have actually given “insufficient consideration of

reasonably available alternatives to the recommended VA purchase, surrender or exchange,” Finra said.

Finra rules further require that a registered principal review and determine whether to approve a customer’s application for a deferred variable annuity. This must be done before they send the application to the issuing insurance company.

Firms themselves are required to have surveillance in place to help identify misconduct and ways of addressing any inappropriate exchanges. Firms must also create training programs for registered representatives who make recommendations and registered principals who review the transactions.

But that isn’t always happening, Solomon said. “We’ve seen some deficiencies in firms’ surveillance ... with respect to the rates of VA exchanges, to see if there are advisors who are outside the norm in terms of their exchange rates.

“Also,” he added, “when we ask for information and documentation on VA switches, we’ve seen too many instances where firms aren’t collecting or retaining adequately the information that they’re required to maintain to surveil and supervise and also to provide to us for our examination processes.”

Reps and broker-dealers are also failing to evaluate and supervise additional deposits that are made by investors into a VA to make sure they are in the customers’ best interest, he added.

Finra examiners found that advisors and reps were insufficiently trained on these matters. According to the report, firms “are not conducting training for registered representatives and supervisors regarding how to assess and compare costs and fees, surrender charges and long-term income riders to determine whether exchanges complied with regulations.”

“We continue to see instances where brokers are recommending products that they don’t understand,” said Bill St. Louis, executive vice president and head of Finra’s National Cause and Financial Crimes Detection Program (NCFC) during the podcast.

“Obviously the duty of care requires reasonable due diligence, skill and care. And if you don’t understand core components of the product, that’s going to be a Reg BI problem. The first thing we do when we see an issue with a complex product is ask the broker, ‘Tell me how this product works,’” St. Louis added.