

FINRA Fines Firms For Not Supervising L-Share Annuity Sales

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For two years FINRA has made sales and marketing of L-Share variable annuities (VAs) a regulatory and examination priority. Not surprisingly, FINRA in November announced settled actions against eight broker-dealers, alleging failure to supervise sales of L-Share VAs. Without admitting or denying FINRA's findings, the eight firms agreed to pay a collective total of \$6.2 million in fines and more than \$6 million to customers who purchased L-Share VAs. L-Share VAs typically have a shorter surrender charge period (of three to five years) and higher ongoing mortality and expense risk (M&E) charges than a typical B-Share VA. Accordingly, L-Share VAs are generally more suitable for investors with short-term time horizons who want the optionality to be able to surrender the VA sooner than a B-Share VA. On the other hand, certain VA guaranteed income benefit riders, which FINRA dubbed "long-term income riders," are designed primarily for investors with long-term time horizons. FINRA found "the potentially incompatible time horizons" of L-share VAs with long-term income riders "may present a red flag that the purchase may not be suitable for a customer's investment objective and time horizon." Among other things, FINRA determined that the firms did not have and enforce adequate supervisory procedures regarding the sale of multiple-share class VAs, and did not provide adequate training or guidance to registered representatives about the types of customers for whom L-Share VAs would be suitable. Further, FINRA found that five of the firms did not identify or investigate "red flags" of potentially unsuitable sales of L-Share VAs. FINRA's focus on L-Share VAs has contributed to some firms' decisions to cease offering L-share VAs or to ask insurers to redesign VAs to reduce the product's "mortality and expense risk" charge upon completion of the surrender charge period. In this regard, the FINRA actions exclude L-Share VAs with a "persistence credit" that reduces ongoing fees – to a B-Share VA level – after the VA is held for a period of time, generally seven to 10 years.

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