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FINRA Targets Variable Annuity Practices

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FINRA's reported enforcement actions as to certain variable annuity practices increased in 2018. For example, FINRA announced more than half a dozen settlements – via Letters of Acceptance, Waiver and Consent (AWCs) – for broker-dealers' failures to meet their obligations in connection with their customers' exchanges from one variable annuity to another.

One such AWC imposed various sanctions on a firm for failing to implement a reasonable supervisory system and procedures to determine if any of its registered representatives had inappropriately high rates of variable annuity exchanges. Specifically, the broker-dealer selected for review only a limited number of its representatives based on criteria unrelated to their volume of variable annuity recommendations and not designed to determine if the representatives had problematic rates of exchanges. Interestingly, the AWC did not indicate that the firm's representatives had, in fact, improperly recommended any exchanges.

Another AWC was based on FINRA's review of a 250-case sample set of a broker-dealer's documentation of the information provided to customers relative to whether a recommended variable annuity exchange would be in the customer's interest. FINRA concluded that, in a high percentage of these samples, material misrepresentations were made to the customers and that, in many cases, they made the recommended exchanges look more favorable to the customer. Accordingly, the AWC imposed various sanctions on the firm for making negligent misstatements and omissions, failing to have a reasonable basis for recommendations, and failure to implement adequate surveillance and supervisory procedures.

In recent months, FINRA has also published several AWCs imposing a range of sanctions on broker-dealers for inadequate supervisory procedures and training for the sale of multi-share class variable annuities. Typically, such AWCs focus on the suitability concerns raised by the sale of L-share annuity contracts that have shorter surrender charge periods and higher ongoing charges than other share classes, if issued under circumstances that include, for example, the presence of certain types of "living benefit" riders, suggesting that the customer has a longer-term orientation.

Accordingly, issuers and distributors should be mindful that FINRA is continuing its historical enforcement focus on variable annuities, particularly as to exchanges and L-share contracts.

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