



THE COMPLIANCE & ETHICS FORUM
FOR LIFE INSURERS



2015 CEFLI Annuity Suitability Benchmarking Survey Report Executive Summary



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Introduction

CEFLI is pleased to provide the Executive Summary of the results of its **2015 Annuity Suitability Benchmarking Survey**. As part of CEFLI's mission to serve the needs of the life insurance industry's compliance and ethics professionals, CEFLI has invited compliance and ethics professionals from across the life insurance industry to participate in Surveys over the past several years to allow CEFLI to gauge the current state of practice with respect to specific compliance and ethics issues in the life insurance industry. Given the high level of interest in annuity suitability practices throughout the life insurance industry, CEFLI conducted its 2015 Annuity Suitability Benchmarking Survey. This Executive Summary of the Survey results summarizes the key findings of CEFLI's 2015 Annuity Suitability Benchmarking Survey.

CEFLI would like to extend a special thanks to members of its **Annuity Suitability Issue Forum** for their assistance in the development of this Survey.



Purpose

The purpose of this Survey was to gauge the current state of annuity suitability compliance practices in the life insurance industry. The 2010 revisions to the NAIC Suitability in Annuity Transactions Model Regulation ("Model Regulation") introduced several new requirements that modified annuity suitability practices at life insurers. In light of these developments, this Survey was developed by CEFLI's Annuity Suitability Issue Forum to determine, among other issues, the extent to which these modifications have been implemented within life insurance companies and to review the range of various strategies companies have pursued to comply with these requirements.

To gauge current practice, the Survey asked objective questions designed to identify the nature and scope of the annuity suitability review process at respondent life insurance companies. Areas reviewed included: the organizational structure of annuity suitability review processes, annuity suitability compliance practices with respect to third-party distribution and captive distribution, monitoring and supervision of annuity suitability systems and operational practices associated with annuity suitability analysis.

By evaluating the results of this Survey concerning annuity suitability practices, CEFLI will be able to report on the state of current practices and use this information to serve as a possible benchmark for future analysis of annuity suitability practices across the life insurance industry.



Methodology

To complete its review, CEFLI solicited input from both CEFLI-member life insurance companies as well as non-CEFLI member companies. CEFLI received Survey responses from 82 life insurance companies across a range of company sizes (large, medium and small).

Survey respondents were asked to identify the size of their organization based upon the number of overall employees. For purposes of this Survey, small life insurance companies were characterized as organizations with up to 500 employees, medium companies were characterized as organizations having between 501-10,000 employees and large companies were characterized as organizations having 10,001 or more employees. Survey responses were received from a broad range of companies including large life insurance companies (7%), medium companies (64%) and small companies (29%).

When asked to identify their role within their respective life insurance companies, the majority (63%) of Survey respondents indicated that they have **overall compliance oversight responsibility for annuity suitability** within their respective companies (as opposed to serving in a business management or administrative capacity). A smaller percentage of Survey respondents (9%) indicated that their primary responsibility is to serve as a **reviewer of transactions** to determine annuity suitability.



Key Findings

- The majority (73%) of Survey respondents (regardless of company size) indicated that their company relies upon less than 100 third-party distribution firms to actively sell their annuity products. While reliance upon third-party distribution firms to sell annuity products may be widespread throughout the industry, it appears that most companies have limited the scope of their engagements to a manageable number of relationships which should enhance the ability of life insurers to perform effective annuity suitability compliance oversight.
- While the majority of Survey respondents indicated that they do not provide reports to FINRA broker-dealer firms to assist the firm in its suitability analysis and supervision of fixed annuity sales, several Survey respondent companies that provide reports indicated that they have evidence to suggest that FINRA broker-dealer firms not only acknowledge receipt of the reports from the life insurance company but also use those reports to improve the FINRA broker-dealer firms' practices. Conversely, though the majority (81%) of Survey respondents indicated that their life insurance company does not receive reports from FINRA broker-dealer firms, in those cases in which Survey respondents do receive reports from a FINRA broker-dealer firm, the information contained in the report is not considered effective in assisting the life insurance company with its oversight of fixed annuity sales.
- Survey responses received demonstrate that many life insurers conduct trend analysis to monitor annuity transactions conducted through third-party distribution firms. The percentage of replacement cases transacted through third-party distribution firms is the predominant data point monitored for trend analysis by life insurance companies. It is followed closely by customer complaints.
- A slight majority (58%) of Survey respondent companies indicated that they publish suitability guidelines for their producers. Roughly 2/3 (66%) of those



- companies provide guidelines that take into account the specific features and benefits of each product individually.
- The overwhelming majority (91%) of Survey respondent companies indicated that they have a "heightened review" process for transactions that do not "pass" the standard review process. Compliance generally makes the final determination on which transactions will be subject to "heightened review." Though the nature of the "heightened review" process at companies differs greatly, most companies report that the process often involves a committee with representation from several functional areas across the company including compliance, law, operations and sales and marketing.
 - The majority (79%) of Survey respondent companies indicated that they do not provide customers or producers with the reason why a transaction may have "failed" the company's annuity suitability review process. It was noted that providing such information may offer an opportunity for customers or producers to "game the system" which would be contrary to the goals of seeking suitable annuity transactions.
 - The majority (90%) of Survey respondent companies have a process in place to verify completion of the general and product specific training requirements by a producer before an annuity contract will be issued. If it has been determined that a producer has not met the applicable training requirements, the majority (60%) of Survey respondent companies indicated that they will reject the application until the mandated training requirements are met in the state where the contract is signed and in which it is to be delivered to the contract holder.



Summary

CEFLI's 2015 Annuity Suitability Benchmarking Survey serves as a way to gauge current annuity suitability compliance practices in the life insurance industry. By establishing this benchmark of current practices, this information can be used to analyze possible trends that may occur in annuity suitability compliance in the life insurance industry over the years ahead.

The Survey confirmed that the 2010 revisions to the NAIC Suitability in Annuity Transactions Model Regulation prompted many life insurers to develop annuity suitability review processes that, in some instances, may not have been in place prior to introduction of the Model Regulation. In fact, a significant majority of Survey respondent companies indicated that their company now maintains their own annuity suitability review process. This confirms that the goals of the drafters of the Model Regulation have, in large part, been fulfilled through the dedication of compliance professionals throughout the life insurance industry to establish appropriate strategies to meet these new requirements.

It is recognized that life insurance companies distribute their annuity products through a variety of distribution systems. The Survey explored annuity suitability practices pertaining to third-party distribution firms (including FINRA broker-dealers) as well as captive agent distribution systems. Companies that utilize third-party distribution firms have taken steps to limit the number of firms with whom they enter into agreements as a means to limit the scope of compliance oversight requirements pertaining to annuity suitability. Companies that distribute their annuity products through captive agent field forces rely upon, in many cases, a large number of producers to sell annuity products on their behalf. The Survey results also recognized, however, that life insurers have developed unique annuity suitability review processes tailored uniquely to the different types of distribution systems utilized by the company to distribute their annuity products.



Organizational structures related to annuity suitability review processes vary based upon company size. At many small size life insurers, the annuity suitability review process resides within the compliance or legal department. At many medium size life insurers, the annuity suitability review process is located within their new business processing unit and virtually all life insurance companies responding to the Survey indicated that they have taken the steps to develop a dedicated annuity suitability review unit within their organizational structure.

We were pleased to see that many companies have taken the step to establish the position of Chief Suitability Officer within their organizations. While it may be too soon to determine whether the establishment of this role may constitute a growing trend within the life insurance industry, these companies have demonstrated industry leadership in underscoring the importance of annuity suitability by identifying a senior officer within their organization for responsibility for this important function.

The Survey results also indicated that companies are becoming more selective about the third-party distribution firms with whom they may enter into distribution agreements. In some cases, companies indicated that they will enter into agreements to allow FINRA broker-dealer firms to conduct annuity suitability reviews and supervision of fixed annuity transactions only after an appropriate due diligence review of the FINRA broker-dealer firm's annuity suitability and supervision systems have taken place.

Many life insurers rely upon the "safe harbor" provision of the NAIC Suitability in Annuity Transactions Model Regulation for fixed annuity transactions conducted through a FINRA broker-dealer firm. The Survey results indicated that life insurance and FINRA broker-dealers cooperate to provide reports to assist each other with promoting sound annuity suitability practices. As life insurers and FINRA broker-dealers gain more experience with respect to the operation associated with complying with the requirements of the Model Regulation, there may be additional opportunities to identify ways in which mutual reporting and sharing of transactional information can enhance the annuity suitability practices of life insurers and FINRA broker-dealers.



Though the Model Regulation allows life insurers to rely upon annual suitability certifications as a key element of their monitoring programs of third-party distribution firm supervision systems, many life insurers conduct additional monitoring practices to confirm performance of the supervisory functions. In addition to trend analysis which may include the review of replacement cases and customer complaints, life insurers also follow a range of practices including periodic red flag monitoring, periodic monitoring of random contracts and on-site records reviews and customer service programs to monitor third-party distribution firms' performance of contracted supervisory functions.

Life insurers also have established comprehensive procedures to promote annuity suitability. These procedures include, among other practices, the publication of suitability guidelines to producers, the use of suitability forms designed uniquely for use with a specific life insurance company's products, automated screening processes to evaluate annuity suitability and appropriate procedures for "heightened review" of transactions that fail to meet annuity suitability guidelines. The life insurance industry should be commended for the human and financial resources and innovative creativity that have been dedicated to enhance the overall annuity suitability process at many life insurance companies. Recent discussions with regulators at CEFLI Summit Meetings related to annuity suitability practices have confirmed that the overall marketplace has benefited from these important compliance initiatives at life insurance companies.

One of the key goals of the 2010 revisions to the NAIC Suitability in Annuity Transactions Model Regulation was to require producers to undergo general annuity training and product specific training. As a result, life insurers have developed appropriate systems to ensure that this training has been completed and that, in the event training requirements have not been fulfilled, annuity business will not be issued. The Survey results also indicated, however, that life insurers could benefit from access to a central repository to obtain this type of information to confirm compliance with producer training requirements.



Life insurers also fulfill the compliance requirements of the NAIC Suitability in Annuity Transactions Model Regulation by providing annual reports of annuity suitability practices to senior management within their companies. The Survey results indicated that these reports often identify specific issues and action items that may be used by life insurance companies including their senior management and, in some instances, their Boards of Directors to enhance their existing annuity suitability practices.

Overall, the 2015 Annuity Suitability Benchmarking Survey confirmed that life insurers have taken proactive steps to develop appropriate strategies and systems to meet the compliance requirements of the 2010 revisions to the NAIC Suitability in Annuity Transactions Model Regulation. These initiatives have had a positive impact upon overall annuity suitability practices within the life insurance industry. The Survey results also confirmed that the drafters of the Model Regulation have, in large part, achieved their intended results by encouraging life insurers to develop appropriate annuity suitability review processes and to confirm that applicable training requirements have been completed as part of the annuity sales process. By achieving these results, the life insurance industry has improved the opportunity to provide consumers with the types of annuity products they need to secure their retirement income in a manner that is suitable to meet their needs and financial objectives.

CEFLI would like to thank all compliance and ethics professionals from CEFLI Member Companies as well as non-CEFLI Member Companies who responded to the 2015 CEFLI Annuity Suitability Benchmarking Survey for offering their insights and perspectives. We hope that all Survey respondents find this information to be useful.

CEFLI also would like to thank its Member Companies and Affiliate Members for their financial support of the 2015 CEFLI Annuity Suitability Benchmarking Survey.

THE FORUM THAT CONNECTS.



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