



THE COMPLIANCE & ETHICS FORUM  
FOR LIFE INSURERS



# 2016 CEFLI Annuity Suitability Benchmarking Survey Report



## 2016 CEFLI Annuity Suitability Benchmarking Survey Report

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## 2016 CEFLI Annuity Suitability Benchmarking Survey Report

### Introduction

CEFLI is pleased to report the results of its 2016 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 continued high level of interest in annuity suitability practices throughout the life insurance industry, CEFLI conducted its 2016 Annuity Suitability Benchmarking Survey. This Report summarizes the key findings of CEFLI's 2016 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.



## 2016 CEFLI Annuity Suitability Benchmarking Survey Report

### 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 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 of different annuity types, monitoring and supervision of annuity suitability systems, operational practices associated with annuity suitability analysis, and reports to senior management.

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.



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### Methodology

To complete its review, CEFLI solicited input from both CEFLI member life insurance companies as well as non-CEFLI life insurance companies. CEFLI received Survey responses from 62 life insurance companies across a range of company sizes (small, medium and large).

### Characteristics of Respondents

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 small life insurance companies (28%), medium companies (68%) and large companies (4%).

### Roles

When asked to identify their role within their respective life insurance companies, the majority (70%) of Survey respondents indicated that they have overall compliance oversight responsibility within their respective companies (as opposed to serving in a business management or administrative capacity). A smaller percentage of Survey respondents (7%) indicated that their primary responsibility is to serve as a reviewer of transactions to determine annuity suitability.

*The majority of Survey respondents indicated that they have overall compliance oversight responsibility for annuity suitability within their company.*



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### Organizational Structure

When asked to identify the department or division in which they work within a life insurance company, the majority of Survey respondents (71%) reported that they reside within the compliance department at their life insurance company. Other Survey respondents (9%) indicated that they reside within the law department, others (5%) reported they reside within the sales/marketing department and still others (4%) indicated they work in a standalone suitability department within their company.

### Annuity Product Types

When asked to identify the types of annuities sold by their companies, the Survey results indicated that more than half (55%) of all companies responding to the Survey sell both fixed and variable annuities, which was true of all large company respondents. While other companies (43%) indicated that they sell only fixed annuities, only some small companies (2%) indicated they sell variable annuities only.

For those companies who indicated they sell fixed annuities, the majority (59%) offer both traditional fixed and fixed indexed products, while the remainder (41%) offer only traditional fixed annuities.



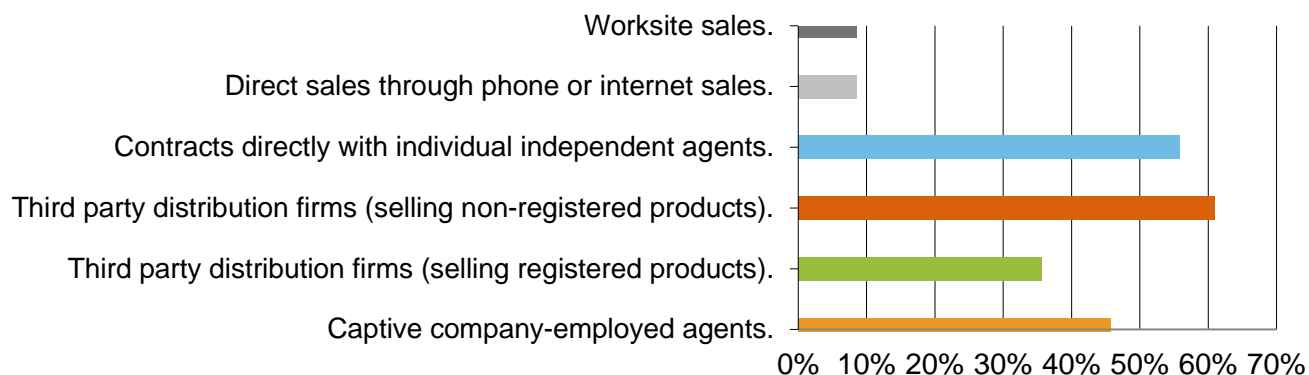
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### Distribution Systems

The Survey also sought to identify the various types of distribution systems used by companies in selling their annuity products. The Survey results confirmed that most companies use a range of distribution systems to sell their annuity products.

Respondents representing small companies indicated that their primary modes of annuity product distribution included third-party distribution firms (such as independent marketing organizations (IMOs), banks and broker-dealers) and direct engagements with individual independent agents. Respondents representing some medium and large companies also indicated that they primarily use third-party distribution firms, but many also identified direct engagements with individual independent agents and captive agents as a significant source of annuity distribution.

**What Forms of Distribution Systems Does Your Company Use (select all that apply)?**



### Third-Party Distribution

The Survey also sought to gauge the number of distribution system relationships utilized by life insurers according to company size. While some larger companies may engage between 751-1,000+ third-party distribution firms to distribute their annuity products, the majority (78%) of Survey respondents indicated that their company relies upon fewer than 250 third-party distributors firms, with most small companies relying on fewer than 100 third-party distributors to actively sell their annuity products.





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This data may be important from an annuity suitability compliance oversight perspective. These findings suggest that while reliance upon third-party distribution firms to sell annuity products may be widespread throughout the industry, it appears that most companies limit the scope of their engagements to a smaller number of relationships which could enhance the ability of life insurers to perform effective annuity suitability compliance oversight. It is also recognized, however, that these third-party distribution firms often have many producer relationships which can introduce additional layers of complexity into the design of annuity suitability review processes at life insurance companies.

*Most companies limit the scope of their engagements with TPDs to a smaller number of relationships, which could enhance the ability of life insurers to perform effective annuity suitability compliance oversight.*

### Captive Distribution

For those companies that use captive agents to distribute their annuity products, almost half (48%) of all Survey respondents, representing companies of all sizes, indicate the size of their captive sales force to be between 1,001 and 10,000 captive agents. An equal number (17%) of medium company Survey respondents reported having a captive annuity sales force in the 101 - 500 or 501 - 1,000 range, and a slightly smaller percentage of Survey respondents (14%), including all small companies, indicated they had captive sales forces of fewer than 100 agents.

While the primary mode of annuity product distribution may be third-party distribution firms, these Survey responses indicate that a significant number of captive agents are used to sell annuity products on behalf of life insurance companies and this method of distribution may afford a higher degree of control by the insurer (e.g., company employed captive agents) over annuity suitability recommendations.



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### The Annuity Suitability Review Process

#### Background

The Model Regulation requires insurers to “maintain procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable.”<sup>1</sup>

Though many insurers already had these types of annuity suitability review processes in place prior to development of the Model Regulation, the drafters of the Model Regulation included this requirement to compel insurers to establish annuity suitability review processes more broadly throughout the life insurance industry. Therefore, the Survey sought to determine the extent to which life insurers have developed these types of annuity suitability review processes.

#### Overview

As anticipated, a significant majority (93%) of Survey respondent companies indicated that their company now maintains their own annuity suitability review process.

#### Organizational Structure

The Survey sought to determine the organizational structure associated with the annuity suitability review process at life insurance companies. While the Compliance or Legal Department was most likely to be responsible for this function at small companies, Survey respondents representing medium and large companies were most likely to report that their organization’s annuity suitability review process is located within their New Business Processing Unit.

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<sup>1</sup> Section 6, F. (d). NAIC Suitability in Annuity Transactions Model Regulation.



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### Reporting Relationships

When asked to identify the reporting relationships for individuals completing the annuity suitability review process, most Survey respondents representing small companies indicated that their annuity suitability reviewers report to Compliance/Legal. Survey respondents representing medium companies mostly indicated that their annuity suitability reviewers either report to Compliance/Legal or New Business and most Survey respondents representing large companies indicated that their annuity suitability reviewers report to New Business processing.

### Chief Suitability Officer

The Survey also sought to determine the extent to which life insurance companies have established the position of Chief Suitability Officer. Though previous Survey results indicated that only a very few life insurance companies had established the position of Chief Suitability Officer, now nearly 20% of respondents (mostly at medium and large companies) reported their companies have identified an individual to serve in this capacity since the introduction of the Model Regulation.



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### Types of Business Reviewed

When asked to identify what types of annuity cases would be reviewed under a company's annuity suitability review process, the majority (63%) of all Survey respondents, regardless of company size, indicated that they subject all annuity transactions, regardless of the method of distribution, to their company's internal annuity suitability review process.

Other companies indicated a variety of practices with respect to the review of annuity transactions. Many reported that they forego an internal review of transactions where the suitability review function has been contracted out to a third-party distribution firm, though some companies would only do so for select (e.g. having met certain due diligence criteria) third-party distributor firms. Perhaps not surprisingly, variable annuities sold by third party distributors were least likely to be subjected to an internal suitability review.



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### Third-Party Distribution Firm Practices

Life insurance companies continue to use a wide variety of distribution systems to sell their annuity products. Section 6, F. (2) (a) of the Model Regulation allows an insurer to contract a third-party distribution firm to perform functions associated with the insurer's supervision system, including oversight of annuity sales suitability. The Survey attempted to gauge practices of third-party distribution firms with respect to their roles regarding these contracted functions.

#### FINRA Broker-Dealer Firms

Variable annuity products distributed by life insurers through FINRA broker-dealer firms are subject to FINRA requirements for suitability and supervision of annuity transactions. When fixed annuity products are distributed through a FINRA broker-dealer firm, however, it is recognized that strategies to conduct annuity suitability reviews and supervision of these fixed annuity transactions may vary.

It may be interesting to note that when analyzed by company size and annuity type there was virtually no variance between small, medium and large companies with respect to current practices for contracting with FINRA member broker-dealers for sales of fixed indexed, traditional fixed or even variable annuities.

Even though there is no requirement to subject sales of fixed annuities to the FINRA requirements for suitability and supervision of annuity transactions, the majority (57%) of Survey respondents indicated that they maintain a written agreement with their FINRA member broker-dealers requiring the FINRA member firm to perform annuity suitability reviews and supervision of fixed annuity sales.

*The majority of Survey respondents indicated that they maintain a written agreement with their FINRA member broker-dealers requiring the FINRA member firm to perform annuity suitability reviews and supervision of fixed annuity sales.*



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Moreover, many Survey respondent companies indicated that they will only enter into an agreement with a FINRA member broker-dealer firm to conduct annuity suitability reviews and supervision of annuity transactions after the life insurance company has had an opportunity to conduct a “due diligence review” of the FINRA broker-dealer firm's annuity suitability and supervision systems.



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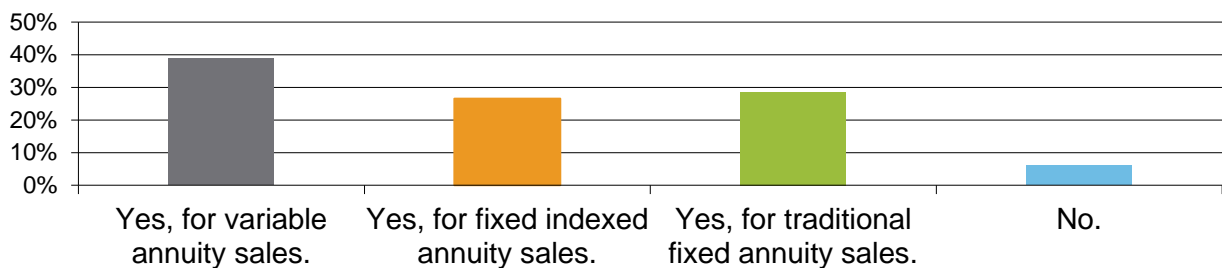
### The “Safe Harbor” Provision

Section 6, H. of the Model Regulation recognizes that sales made in compliance with FINRA requirements pertaining to suitability and supervision of annuity transactions will satisfy the requirements of the Model Regulation. This provision has often been referred to as the “safe harbor” within the Model Regulation as it suggests that, to the extent that a transaction complies with FINRA rules pertaining to suitability and supervision, it need not be subject to further review by state insurance regulatory authorities for compliance with the Model Regulation. The Survey gathered information concerning life insurance company practices with respect to the “safe harbor” provision within the Model Regulation.

The Survey results indicated that approximately 73% of life insurance companies, including all large companies responding to the Survey indicated that they rely upon the “safe harbor” provision of the Model Regulation for variable annuity sales conducted through a FINRA member broker-dealer. When asked the same question about fixed indexed and traditional fixed annuity transactions by a FINRA member broker-dealer, approximately half (50%) of Survey respondents indicated they rely on the “safe harbor” for fixed indexed sales, while slightly more (54%) indicated they rely on the “safe harbor” for sales of traditional fixed annuities.

*Approximately three quarters of life insurance companies indicated that they rely upon the “safe harbor” provision of the Model Regulation for variable annuity sales conducted through a FINRA member broker-dealer.*

**Does Your Company Rely On The FINRA “Safe Harbor” Provision For Annuity Sales Conducted Through A FINRA Member TPD (select all that apply)?**





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### Reports to Distribution Partners

To the extent that a life insurance company may rely upon the "safe harbor" provision of the Model Regulation for annuity transactions conducted through a FINRA broker-dealer firm, the Survey sought to determine whether those life insurance companies routinely provide reports to the FINRA broker-dealer firm to assist the firm in its suitability analysis and supervision of annuity sales.

A majority (58%) of Survey respondent companies that indicated that they rely upon the "safe harbor" provision of the Model Regulation reported that they routinely provide reports to the FINRA broker-dealer firm to assist the firm in its suitability analysis and supervision of the company's fixed annuity sales. When compared to data received during the 2015 CEFLI Annuity Suitability Benchmarking Survey, these new findings indicate that this practice is growing throughout the life insurance industry.

In instances in which these reports are provided, the Survey asked respondents to indicate the degree of cooperation and action undertaken by the FINRA broker-dealer firm regarding the reports. In all cases Survey respondents indicated that the FINRA broker-dealer firm will acknowledge receipt of the reports from the life insurer, and in some cases the broker-dealer may even follow-up with evidence that the firm used the report to improve their suitability practices.

Conversely, the Survey also asked respondents to indicate whether FINRA broker-dealer firms provide reports to life insurance companies to assist in oversight of annuity sales. While only a minority of Survey respondents indicated that their life insurance company receives reports from FINRA broker-dealer firms, those that received these reports find that they are effective in assisting the life insurance company with its oversight of annuity sales.

*58% of Survey respondent companies indicated that they routinely provide reports to FINRA broker-dealer firms to assist the firm in its suitability analysis and supervision of the company's fixed annuity sales.*





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When asked what type of information is received from FINRA member firms that assists their company in its oversight of annuity sales, Survey respondents receiving such reports indicated that receiving details about the applicant's suitability information (e.g., income, net worth, age, investment objectives) as well as information pertaining to the number of replacements were the most important reporting metrics. Some companies also indicated that receiving reports pertaining to the number of applications rejected by the firm and the reasons for rejection were also helpful to their company in its review of annuity sales.

### Non-FINRA Member Third-Party Distributors

The Survey also sought to determine the extent to which companies may enter into agreements for annuity suitability review and supervision with non-FINRA member third-party distributors. While the majority of companies Surveyed indicated that they enter into such agreements with FINRA member broker-dealers, only 23% enter into agreements with non-FINRA member third-party distributors to perform suitability review and supervision functions.

### Monitoring

Section 6, F. (2) (b) of the Model Regulation requires a life insurer that contracts for performance of supervision by a third-party distributor to monitor and, as appropriate, conduct audits to ensure that the contracted supervision function is properly performed.

Therefore, the Survey sought to gather life insurance company practices with respect to monitoring performance of the contracted supervision function with non-FINRA member third-party distribution firms.



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The majority (77%) of Survey respondents rely upon annual suitability certifications as a key element of their monitoring programs of third-party distribution firm supervision systems. Year-to-year analysis of prior Survey data suggests that this practice is growing throughout the life insurance industry.

However, a range of additional monitoring practices also exist among life insurance companies. These practices include periodic monitoring of random contracts (62%), periodic red flag monitoring of business intelligence data (54%), requesting copies of the third-party distribution firm's written supervisory procedures (54%), review of the terms of the contractual agreement (39%), customer survey programs (46%) and onsite records reviews (15%). Many Survey respondent companies reported that they use one or more of these elements as key components of their overall monitoring programs.

*77% of Survey respondents rely upon annual suitability certifications as a key element of their monitoring of TPDs.*

### Trend Analysis

Many life insurers conduct trend analysis to monitor annuity transactions. The Survey attempted to identify several common trend categories utilized by life insurers to monitor annuity transactions conducted through non-FINRA member third-party distribution firms.

The Survey results indicated that 92% of life insurance companies review customer complaints as the top suitability trend category for monitoring purposes. It is followed closely by the percentage of replacement cases transacted (85%) as well as patterns of replacement activity (77%).



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Many companies also conduct sophisticated trend analysis utilizing a wide range of additional data for monitoring purposes. Other areas for trend analysis identified through the Survey results included: age-based patterns of sale (i.e., senior sales), surrender activity soon after purchase, suitability review not addressed, volume and percentage of "free looks", lack of understanding of the product by the customer, appropriate disclosures not provided, opt outs/waiver of recommendation and sales patterns by the third-party distributor reflecting benefit election, share class/product concentrations or asset allocation.

*92% of life insurance companies review customer complaints as the top suitability trend category for monitoring purposes.*

### Timing of Periodic Monitoring and Auditing.

The Survey also sought to obtain information regarding the timing of periodic monitoring and auditing activities by life insurance companies regarding the supervision system functions performed by third-party distribution organizations. Survey respondent companies indicated that they perform periodic monitoring of their third-party distribution partners either annually (46%) or quarterly (46%), while some life insurance companies perform periodic monitoring as frequently as monthly (8%).

In instances in which life insurance companies conduct a periodic audit of a third-party distribution firm, the majority of Survey respondents indicated that they would provide the results of the periodic audit to the third-party distributor only if issues arose or if the results were outside the "norm." While this was the predominant practice at both small and large companies, medium companies are more likely to provide results of periodic audits and trend analysis reports on a routine basis.



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### Captive Agent Practices

#### Monitoring and Trend Analysis

As indicated earlier, a significant number of life insurance companies distribute annuity products through captive agents. The Survey sought to gather information concerning company practices regarding monitoring of captive agents and identifying the types of information that may be subject to trend analysis.

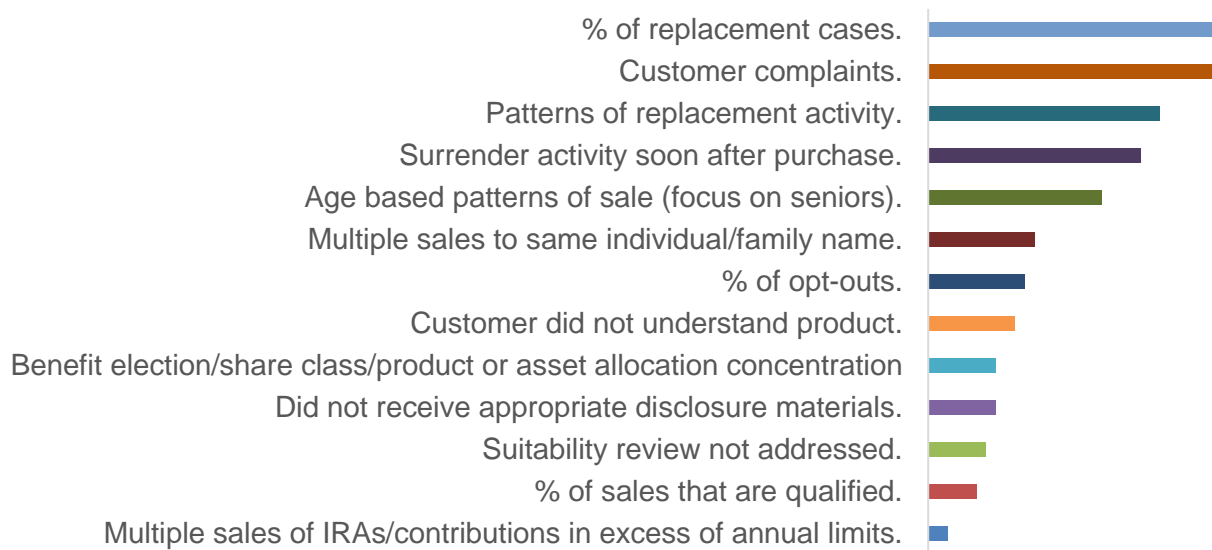
Companies that conduct trend analysis for monitoring their captive agents most often rely upon the percentage of replacement cases in a producer's business and customer complaints as the most common trend analysis points for monitoring purposes. This was true for a majority of companies (83%) regardless of company size were identified as the predominant areas for trend analysis (at 83% of companies of all sizes) when monitoring captive agent activity for annuity suitability purposes. Other points of indicia for trend monitoring of captive agent activity (in priority order) included:

- Patterns of replacement activity;
- Surrender activity soon after purchase;
- Age based patterns of sales (focus on seniors); and
- Multiple sales to same individual/family name.



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### Which Suitability Trend Categories Do You Monitor?





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### Annuity Suitability Review Procedures

#### Secondary Review

The Survey asked respondents to indicate whether their company requires every annuity transaction to be subject to some type of "secondary review" by the company or the third-party distribution firm (for purposes of this Survey, "secondary review" was defined as a suitability review after the initial suitability review was conducted by the selling producer or third-party distribution firm.) The Survey results indicated that approximately half (51%) of Survey respondent companies indicated that their companies require every annuity transaction be subject to some type of "secondary review."

#### Suitability Guidelines

The Survey also asked whether companies publish specific suitability guidelines for producers. A majority (61%) of Survey respondent companies indicated that they do publish suitability guidelines for their producers, and this is the case at insurers of all

*A majority of Survey respondent companies indicated that they publish suitability guidelines for their producers.*

sizes. Moreover, of those companies that publish suitability guidelines for their producers, over half (56%) of those companies provide guidelines that take into account the specific features and benefits of each product individually.

#### Florida Annuity Suitability Questionnaire

The Survey gathered information concerning whether companies use the Florida Annuity Suitability Questionnaire or whether they have elected to file a company specific form in the state of Florida. The majority of Survey respondents (69%), regardless of company size, indicated that they use the Florida Annuity Suitability Questionnaire for this purpose.



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### Reverse Mortgages

The State of California requires insurers to collect information concerning whether the purchaser of an annuity may have a reverse mortgage. Accordingly, the Survey asked respondents to indicate whether their company would accept business if an owner has a reverse mortgage.

A significant number of Survey respondent companies (41%) indicated a willingness to accept the transaction if the financial impact of the reverse mortgage was considered as part of the annuity suitability review.

### Suitability Forms

The Survey also included several questions regarding the use of suitability forms by life insurance companies. Most companies (98%) indicated that they require the use of a suitability form for all transactions in which their company will be completing the annuity suitability review, and similarly most of those companies (98%) require producers to use a suitability form designed exclusively for use with their respective companies.

*Nearly all life insurers indicated that they require the use of a proprietary suitability form for all transactions in which their company will be completing the annuity suitability review.*



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### Failure to Provide Information

It is recognized that some annuity customers may be unwilling to provide information necessary to conduct an annuity suitability analysis. Therefore, the Survey attempted to gauge company practices when these instances arise.

The Survey asked respondents to indicate how their companies handle the situation in which a client provides limited or no suitability information. As anticipated, company practices in this area vary.

Some companies (37%) take the position that, if all of the information requested is not provided by the customer, then the application will be rejected. Other companies (57%) take the position that, if not all of the information requested is provided by the customer, then the company will request additional information and/or make a determination of suitability based on the information submitted originally provided the case fits within the company's annuity suitability guidelines.

Companies also encounter situations in which a customer may choose to "opt out" of providing suitability information. In those cases in which a customer chooses to "opt out" of providing suitability information, an increasing majority (64%) of Survey respondent companies indicated that the case will be rejected. However, some companies (14%) will accept these types of "opt out" transactions if the customer signs an "opt out" form, and others (6%) will accept the case if certain information is determined to be within company suitability guidelines (e.g. age, net income and liquid net worth). Still other companies indicated they will accept "opt out" transactions, but will undertake efforts to contact the customer to provide the outstanding information.





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### Automated Screening

Since the adoption of the most recent revisions to the Model Regulation in 2010, a growing number of companies have developed automated screening as part of their annuity suitability review process and the Survey sought to determine the range and scope of industry practices with respect to automated screening techniques.

Overall Survey respondents were evenly divided on whether their companies maintain an automated screening process for annuity suitability purposes. While automated screening processes are more often in place at medium and large life insurance companies, this year's survey data indicates that this practice is growing even among small companies.

The Survey then asked respondents whose companies maintain automated screening processes to indicate the primary method for detecting cases that may require "heightened review." The Survey results indicated that the automated screening process is designed to "flag" certain types of transactions for "heightened review" based upon data collected through the annuity suitability information process, such as age or whether a replacement is indicated. Often this will involve "scoring," a transaction based upon the data collected.

Automated screening processes evaluate a wide range of data collected for annuity suitability purposes. Survey respondents indicated the following types of information (in priority order) as the key elements of automated screening processes:

- Applicant's age;
- Replacements;
- Applicant's liquid assets after purchase; and
- Applicant's net worth.

*Automated screening processes are more often in place at medium and large life insurance companies, though this practice is growing even among small companies.*



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Other elements screened included monthly income, disposable income, surrender periods/charges, risk tolerance, amount of sale, source of funds and other recent annuity purchases.

### Heightened Review

The majority (85%) of Survey respondent companies indicated that they have a "heightened review" process for escalating transactions that do not "pass" the standard review process. This raised questions concerning who may be assigned with responsibility for making the final determination on which transactions will be subject to "heightened review."

The Survey results indicated that Compliance makes the final determination on which transactions will be subject to "heightened review" at the majority of companies of all sizes, though an increasing number of respondents (18%) indicated that their company employs a committee approach, which may include representatives from Compliance, Legal, Actuarial, New Business and Sales and Marketing, to determine which cases will be escalated.

*An increasing number of respondent life insurers indicated that their company employs a committee approach, which may include representatives from Compliance, Legal, Actuarial, New Business and Sales and Marketing, to determine which cases will be escalated for heightened review.*



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### "Failed" or Unsuitable Transactions

Inevitably, some annuity transactions may "fail" a company's annuity suitability review process (i.e., the transaction is deemed to be unsuitable). The Survey sought to gather information concerning company practices in these instances.

The Survey asked respondents to indicate whether their companies target a certain percentage of business to be rejected for suitability reasons. Virtually all companies indicated that they do not maintain a target but would revisit transactions on a case by case basis.

The Survey also asked respondents to indicate the process the company follows when an annuity transaction is deemed to be unsuitable. The majority (85%) of Survey respondent companies indicated that they notify the agent of the unsuitable determination. In some instances (32%), companies reported that they also notify the applicant of the determination. In such cases it is also common (81%) for companies to return any funds submitted with the application.

The Survey also sought to determine whether life insurance companies provide to the customer or producer the specific reason as to why a particular transaction may have "failed" the company's annuity suitability review process. The majority (72%) 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. This may be an effort to avoid providing information that may offer an opportunity for customers or producers to "game the system".

*The majority 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. This may be an effort to avoid providing information that may offer an opportunity for customers or producers to "game the system".*



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### Metrics

Companies are increasingly focused upon metrics to evaluate the performance and effectiveness of company compliance programs. Due to the unique nature of the annuity suitability review process at many companies, the Survey attempted to gather information concerning the types of metrics that may be collected and applied to evaluate the performance and effectiveness of a company's annuity suitability review process.

The most common types of metrics reported by Survey respondents (in priority order) concerning their company's annuity suitability review process included:

- Number of applications rejected;
- Number of applications received;
- Number of applications that were escalated to a heightened review;
- Number of applications that went through the company's annuity suitability review process;
- Number of applications that involve a client electing to "opt out" of providing annuity suitability information; and
- Number of applications for which a third-party distribution firm completed the annuity suitability review process.

Other metrics reported on this year's Survey included the number of cases withdrawn by the producer, number of replacements by a producer, and number of suitability related complaints received.



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### Role of Compliance Department

Though it was reported that representatives of the Compliance Department may make the final determination with respect to whether transactions will be subject to "heightened review" and also participate on committees as part of the "heightened review" process at many companies, the Survey also asked respondents to indicate what the primary role of the Compliance Department is within the overall annuity suitability review process.

The Survey results indicated that the Compliance Department provides "general oversight" of the entire annuity suitability review process at most life insurance companies. In addition, the Survey results indicated that the Compliance Department is generally charged with developing the policies and procedures associated with the annuity suitability review process.

### Customer "Call Out" Programs

The Survey also sought to determine the extent to which companies utilize customer "call out" programs as part of their annuity suitability review process. The Survey results indicated that a small minority (13%) of life insurers utilize "call out" programs for annuity suitability purposes. These programs are often used to confirm a customer's understanding of the annuity product and are utilized by companies of all sizes.



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### Cognitive Impairment - Senior Sales

The Survey collected information regarding whether cognitive skill assessments are conducted for senior applicants as part of the company's overall annuity suitability review process. The majority of Survey respondents (85%) indicated that they are not requiring any cognitive skills assessment for annuity transactions involving seniors. It is encouraging to note that some companies are starting to implement such practices, from requiring supplemental questions to be asked at point of sale to conducting interviews with senior applicants prior to issue.

Given the changing demographics of the country with an increasing number of retirees entering their senior years, challenges associated with cognitive impairment in sales to seniors may become a more prevalent compliance issue over the years ahead.



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### Producer Training

The 2010 revisions to the Model Regulation require producers to undergo general annuity training as well as company product specific training as part of their compliance with the requirements of the Model Regulation. Therefore, the Survey collected data concerning company practices regarding producer training requirements.

#### General Annuity Training

With respect to the general annuity training requirement, the Survey asked respondents to indicate whether they apply the general annuity training requirement uniformly across all states for all captive agents and third-party distributors.

Recognizing that not all states have adopted the Model Regulation and that some states have developed a state specific training course, it is perhaps not surprising that fewer than half of the companies responding to the Survey at this time indicated that they apply this requirement uniformly across all states. While some small and medium companies apply this requirement in all states regardless of whether the state may have adopted the general annuity training revisions, no large company indicated that it does so, opting instead to apply this requirement for captive agents and third-party distributors

only in those states that have adopted the Model Regulation.

*Company practices indicate that the majority of respondents retain the responsibility of verifying a producer's completion of the general annuity training requirement rather than relying on a TPD to perform this function.*

Company practices indicate that the majority of respondents (66%) retain the responsibility of verifying a producer's completion of the general annuity training requirement rather than relying on a third-party distributor to perform this function.



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### Product Specific Training

With respect to company product specific training, the Survey also asked respondents to indicate whether they apply this training requirement uniformly across all states for all captive agents and third-party distributors.

Unlike the data collected concerning general annuity training, Survey results concerning the company product specific training requirement indicate that the majority of companies require compliance by producers in all states, not only those that have adopted the Model Regulation.

*Survey results concerning the company product specific training requirement indicate that the majority of companies require compliance by producers in all states, not only those that have adopted the Model Regulation.*

### Timing and Frequency of Company Product Specific Training

The Survey asked respondents to indicate how often their company requires completion of company product specific training requirements for producers. The majority (73%) of Survey respondents indicated that their companies require producers to undergo company product specific training every time there is a material change in an annuity product. Other responses indicated that a minority (15%) of companies require a producer to undergo company product specific training only initially upon the inception of their appointment, some require such training annually (8%), and others require it periodically throughout the producer's appointment.

Company practices were split evenly with respect to whether they offer this training internally or through a vendor.

For companies who indicated that company product specific training was conducted internally, the majority practice is to offer web-based training on the company's website (40%) as opposed

*A majority of Survey respondents indicated that their companies require producers to undergo company product specific training every time there is a material change in an annuity product.*





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to in-person training sessions, which are conducted at a smaller number of companies (10%).

### New York Training

While New York holds the insurance company responsible for ensuring that every producer recommending its annuity products is adequately trained to make the recommendation, it does not require the completion of product specific training such as that specified in the Model Regulation. As such, the Survey sought to determine what training companies may require for producers transacting annuity business in the state of New York. Survey responses indicated that the predominant practice is to require both company product specific training and general annuity CE training for all producers.

### Tracking

Companies must be able to track completion of the general and product specific training requirements in order to comply with the applicable provisions of the Model Regulation.

The Survey results indicated that companies who offer training internally will rely upon company generated reports to track completion of various training elements, while those who utilize a vendor for training purposes are more likely to rely upon reports from vendors providing the applicable training.

Recent discussions concerning compliance challenges associated with producer training indicated that companies could benefit from a central resource to provide this type of information. Thus far, initiatives developed through third-party organizations such as the National Insurance Producer Registry have not come to fruition to assist compliance professionals in meeting this requirement.



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### Verification of Training Completion versus Sales Activity

This year's Survey results indicated that 100% of Survey respondent companies have a process in place to verify completion of the general and company 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 vast majority (94%) of Survey respondent companies indicated that they will reject the application until the mandated training requirements are met. In cases where a producer's completion of required training is unclear, most companies (70%) indicated they will hold the case and funds in suspense until completion is confirmed. However, some companies indicated that they will accept the application and afford the producer the opportunity to obtain the requisite training. In such cases a new signed application may be required upon delivery.

*100% of Survey respondent companies have a process in place to verify completion of the general and company product specific training requirements by a producer before an annuity contract will be issued.*

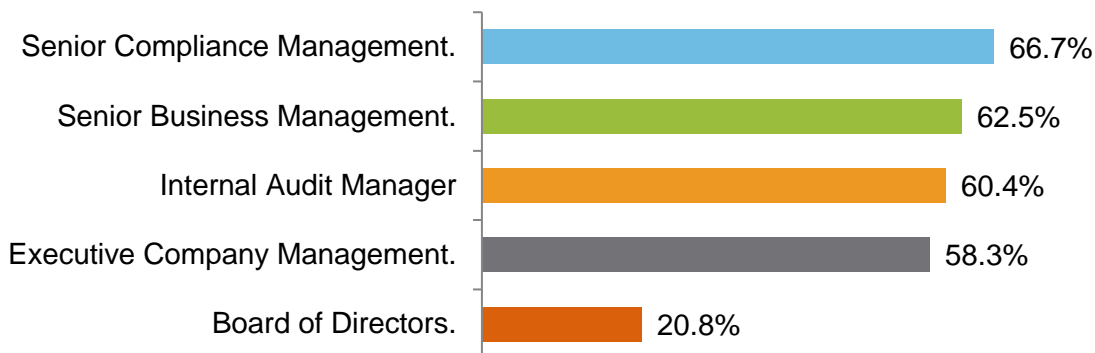


### Annuity Suitability Reports to Senior Management

Section 6 F (1)(f) of the Model Regulation requires insurers to provide an annual report to senior management, which is reasonably designed to determine the effectiveness of the company's annuity suitability system. Accordingly, the Survey sought to collect information regarding annuity suitability reports to senior management.

The Survey asked respondents to indicate the recipients of the required Annuity Suitability Report. The Survey results indicated that the Annuity Suitability Report is most often provided to Senior Compliance Management followed closely by Senior Business Management and Executive Company Management.

#### Who Is The Required Annual Suitability Report Distributed To (select all that apply)?





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Survey responses this year appear to indicate a growing trend of providing the Annuity Suitability Report to the company's Internal Audit Manager, and the number of small and medium companies who indicated that they provide a copy of the Annuity Suitability Report to the company's Board of Directors grew as well.

The Survey also asked respondents to identify the type of report (e.g., summary report, detailed report or detailed report with specific issues and action items) is provided on an annual basis. Just under half (48%) of Survey respondents indicated that they provide a detailed report including specific issues and action items, though a significant number of companies (34%) opted instead to provide a summary report on an annual basis to comply with the requirements of the Model Regulation.

Survey respondents were also asked to indicate the types of audits or reviews the report details, which help determine the effectiveness of the company's suitability system. A significant majority of companies (84%) indicated they would include details from an internal audit review of the company's suitability process. Other audits or reviews relied upon include reviews of a specific producer's business (29%), reviews of a third-party distributor's suitability process (20%) and reviews of a specific third-party distributor's business (20%).

*A growing number of companies provide a copy of the Annuity Suitability Report to the company's Board of Directors.*



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### Examinations

The Survey also gathered information concerning whether Survey respondent companies have been subject to examinations by FINRA and state insurance departments to determine compliance with applicable suitability rules and regulations.

Over half (58%) of the Survey respondent companies indicated that their affiliated broker-dealer has been subject to FINRA examinations, as applicable, to determine compliance with FINRA Rule 2111 (Suitability) and FINRA Rule 2330 (Deferred Variable Annuities).

The majority (70%) of Survey respondent companies indicated that their companies have been subject to state insurance department examinations to determine compliance with the Model Regulation or state specific annuity suitability laws.

Survey respondents also identified key areas of review during state insurance Department examinations. The Survey responses indicated that state insurance Department examiners are most likely to request documentation supporting transactional suitability determinations and conduct a review of the company's policies and procedures related to annuity suitability. Other areas commonly reviewed included (in order of priority):

- Sales involving replacements;
- Implementation and tracking of producer training requirements;
- Annual Report to Senior Management;
- Documentation supporting the transactional suitability determination;
- The percentage of business that is rejected through the annuity suitability process;

*58% of Survey respondents indicated that their affiliated broker-dealer has been subject to FINRA suitability examinations and 70% indicated that their companies have been examined for compliance with state specific suitability requirements.*



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- Annual certifications from third-party distributors; and
- Review of a company's escalation process.

Finally, companies were asked to identify the top three ways their company is demonstrating proof of compliance with the Model Regulation or specific state Annuity Suitability Laws. Nearly all Survey respondents (98%) pointed to their documented policies and procedures, followed by their annual report to senior management designed to determine the effectiveness of the overall supervision system, including results from an appropriate level of testing (78%), and their review of systems and processes to ensure selling producers have met annuity training requirements prior to company accepting annuity business (70%) as the key ways their company is demonstrating suitability compliance.



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### Summary

CEFLI's 2016 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. This is the third Annuity Suitability Benchmarking Survey conducted by CEFLI.

This year's Survey validated that since the adoption of the Model Regulation in 2010 many life insurers have developed annuity suitability review processes that, in some instances, may not have been in place prior to the revisions being introduced. The overwhelming majority of Survey respondent companies now indicate that their company maintains its 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 distribute their annuity products through captive agent field forces may rely upon thousands of producers to sell annuity products on their behalf, though small companies tend to maintain a field force of fewer than 100 captive agents. 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

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annuity suitability. The Survey results also demonstrate that life insurers have developed unique annuity suitability review processes that are tailored to the different types of distribution systems the company uses to distribute their annuity products.

Organizational structures related to annuity suitability review processes vary based upon company size. At the majority of small life insurers, the annuity suitability review process takes place in the compliance or legal department, while at most medium and large life insurers the annuity suitability review process resides within their new business processing unit. Many life insurance companies responding to the Survey indicated that they maintain a dedicated annuity suitability review unit within their organizational structure.

While it may be too soon to determine whether the establishment of the role of Chief Suitability Officer constitutes a growing trend within the life insurance industry, we were pleased to see that many companies have demonstrated industry leadership in underscoring the importance of annuity suitability by appointing a senior officer with responsibility for this function within their organizations.

The majority of life insurers rely upon the "safe harbor" provision of the Model Regulation for annuity transactions conducted through a FINRA broker-dealer firm, including transactions involving traditional fixed and fixed indexed annuities. The Survey results indicated that some life insurers and FINRA broker-dealers cooperate to routinely 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 assessing the effectiveness of their suitability processes, we may see an increase in reporting and information sharing as an opportunity to enhance the annuity suitability practices of life insurers and FINRA broker-dealers.

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





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broker-dealer firms to conduct annuity suitability reviews and supervision of annuity transactions only after an appropriate due diligence review of the FINRA broker-dealer firm's annuity suitability and supervision systems have taken place.

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 commonly includes the review of customer complaints and replacement activity, life insurers also reported that periodic monitoring of random contracts, periodic red flag monitoring of business intelligence data and review of the third-party distribution firm's written supervisory procedures serve as key components of their overall monitoring programs.

While periodic monitoring of third-party distribution partners is most often performed annually or quarterly, some life insurance companies have developed monthly auditing processes in an attempt to more quickly identify results which may fall outside of the norm.

Life insurers also have established comprehensive procedures to promote annuity suitability. These procedures include, among other practices, the publication of suitability guidelines that take into account the specific features and benefits of each of the annuity products sold by the company, increased use of automated screening processes to evaluate annuity suitability, cognitive skills assessment for annuity transactions involving seniors, and employing a committee approach, which may involve input from Compliance, Legal, Actuarial, New Business and Sales and Marketing, to determine which cases should be subjected to a "heightened suitability review". The life insurance industry should be commended for the human and financial resources and innovative creativity that have been dedicated to enhance the annuity suitability process. Recent discussions that CEFLI has had with regulators have confirmed that the overall



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marketplace has benefited from these important compliance initiatives at life insurance companies.

One of the key goals of the 2010 revisions to the Model Regulation was to require producers to undergo general annuity training and company product specific training. As a result, life insurers have developed appropriate systems to ensure that state specific general annuity training has been completed and the majority have implemented company product specific in all states, regardless of whether they have adopted the revisions to the Model Regulation. 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 track producer compliance with general annuity training requirements.

Life insurers also fulfill the compliance requirements of the Model Regulation by providing senior management, and increasingly their Board of Directors, with annual reports which are designed to determine the effectiveness of the company's annuity suitability system. The Survey results indicated that these reports often include details from internal audit reviews of the company's suitability process and specific producer and third-party distributor business and identify specific issues and action items that may be used by life insurance companies to enhance their existing annuity suitability practices.



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Overall, the 2016 Annuity Suitability Benchmarking Survey affirms that life insurers have taken proactive steps to develop appropriate strategies and systems to meet the compliance requirements of the 2010 revisions to the 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 producer 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 2016 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 2016 CEFLI Annuity Suitability Benchmarking Survey.*

# THE FORUM THAT CONNECTS.



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