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2018 CEFLI Annuity Suitability Benchmarking Survey Report

Benchmarking Survey Report

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Introduction

CEFLI is pleased to report the results of its 2018 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 2018 Annuity Suitability Benchmarking Survey. This Report summarizes the key findings of CEFLI's 2018 Annuity Suitability Benchmarking Survey.

Purpose

The purpose of the Survey is to gauge the current state of annuity suitability compliance practices in the life insurance industry.

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.

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 57 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 (32%), medium companies (63%) and large companies (5%).

Roles

When asked to identify their role within their respective life insurance companies, the majority (73%) of Survey respondents indicated that they have overall suitability compliance oversight responsibility, either for their company or their broker-dealer (as opposed to serving in a business management or administrative capacity). A smaller percentage of Survey respondents (14%) indicated that their primary responsibility is to serve as a reviewer or manager of those who review transactions to determine annuity suitability.

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

Organizational Structure

When asked to identify the department or division in which they work within a life insurance company, the majority of Survey respondents (70%) reported that they reside within the compliance department at their life insurance company. A growing number of Survey respondents (14%) indicated that they work in a standalone suitability department within their company.

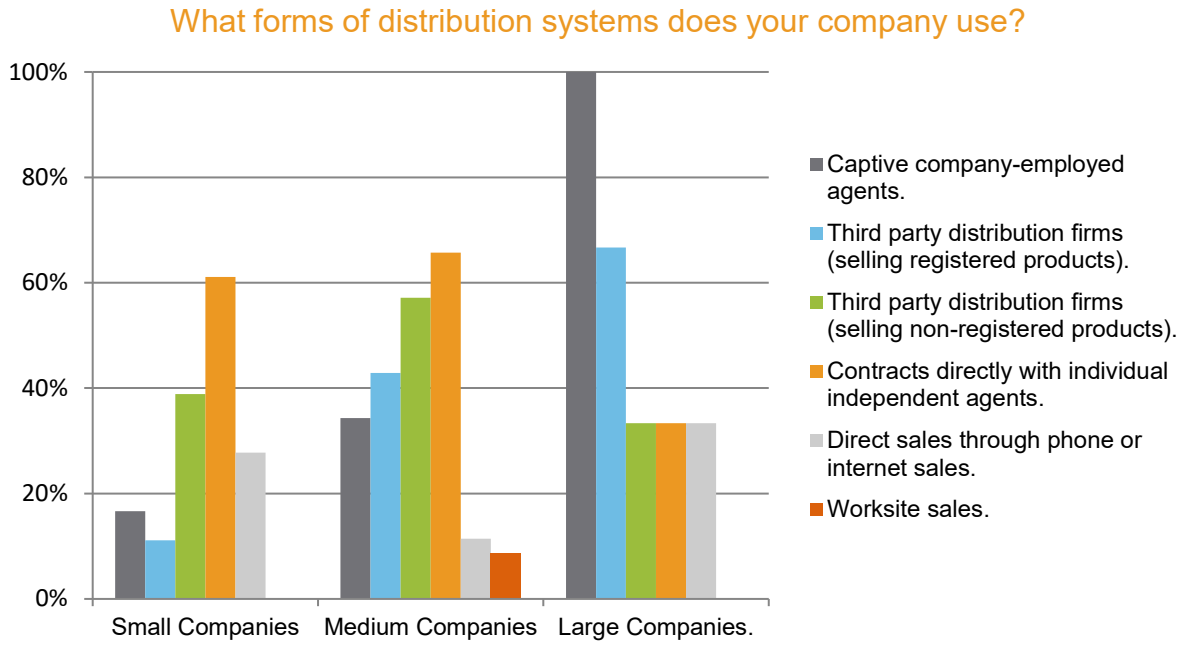
Annuity Product Types

When asked to identify the types of annuities sold by their companies, the Survey results indicated that more than half (52%) of all companies responding to the Survey sell only fixed annuities, which was true at 82% of small companies. While other companies (43%) indicated that they sell both fixed and variable annuities, only some small and medium companies (5%) indicated they sell variable annuities only.

For those companies who indicated they sell fixed annuities, the majority of medium (71%) and large (67%) companies offer both traditional fixed and fixed indexed products, while the majority of small companies (71%) offer traditional fixed annuities only. A small number of medium companies (4%) indicated that they offer fixed indexed annuities only.

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 using independent agents, third-party distribution firms (TPDs) selling non-registered products and direct sales. Respondents representing medium companies were also most likely to utilize independent agents and TPDs selling non-registered products, but also commonly use TPDs that sell registered-products. Large companies indicated that they primarily use captive agents and third-party distribution firms selling registered products to distribute their annuities.



Third-Party Distribution

The Survey also sought to gauge the number of distribution system relationships utilized by life insurers according to company size. While in past years some larger companies indicated engaging over 750 third-party distribution firms to distribute their annuity products, this year's Survey results indicate that companies of all sizes limit their engagement of TPDs to sell their non-registered annuities to 250 firms or fewer.

For distribution of registered annuities it may be interesting to note that both small and large companies indicated contracting with 100 or fewer TPDs, while some medium companies reported using up to 500 different TPDs to sell these products.

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.

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 are limiting 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.

Captive Distribution

For those companies that use captive agents to distribute their annuity products, the majority of small companies (65%) indicated the size of their captive sales force to be under 100 agents, though some reported a captive field of over 1,000. Most medium companies (60%) indicated a captive sales force of between 100 and 500 agents, with the remainder reporting higher numbers. Large company respondents reported maintaining a captive field of 500 to over 10,000 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 (e.g., company employed 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 over annuity suitability recommendations.

The Annuity Suitability Review Process

Background

The NAIC Suitability in Annuity Transactions Model Regulation ("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."[1]

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 over the years.

As anticipated, a vast and growing majority (95%) of Survey respondent companies indicated that their company maintains their own annuity suitability review process.

[1] Section 6. F(d) NAIC Suitability in Annuity Transactions Model Regulation.

Organizational Structure

The Survey sought to determine the organizational structure associated with the annuity suitability review process at life insurance companies. At small companies the New Business Unit was most likely (50%) to be responsible for this function, though many small companies house this responsibility in Compliance & Legal (31%). Survey respondents representing medium companies were evenly split (30%/30%) in reporting the review function is the responsibility of New Business or a standalone Suitability Review Unit. All large company respondents reported having established a separate Suitability Review Unit.

It may be interesting to note that when compared to prior year's responses, it appears that the responsibility for reviewing annuity recommendations for suitability is moving away from Compliance & Legal.

Reporting Relationships

When asked to identify the reporting relationships for individuals completing the annuity suitability review process, Survey respondents representing small companies indicated that their annuity suitability reviewers report to New Business (67%) or Compliance/Legal (33%) Survey respondents representing medium companies were roughly split with their annuity suitability reviewers reporting either to New Business (39%) or Compliance/Legal (36%). This year's Survey results show a growing number of medium companies (25%) with a standalone Suitability Unit that reviewers report to. All reviewers at large companies surveyed also report to the Suitability Unit.

These results also appear to affirm a trend away from having those with responsibility for suitability review to report up to Compliance and Legal.

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, nearly 18% of respondents reported their companies have identified an individual to serve in this capacity, though no small company reported having taken this step.

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 (68%) 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 as the secondary review is taking place at the broker-dealer (BD) level.

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.

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 (80%) of Survey respondents indicated that they maintain a written agreement with their FINRA member broker-dealers requiring them to perform annuity suitability reviews and supervision of fixed annuity sales. Medium and large companies also routinely do so for sales of their variable annuties through FINRA member broker-dealer firms.

The majority of Survey respondents maintain a written agreement with their FINRA member broker-dealers requiring performance of annuity suitability reviews and supervision of annuity sales.

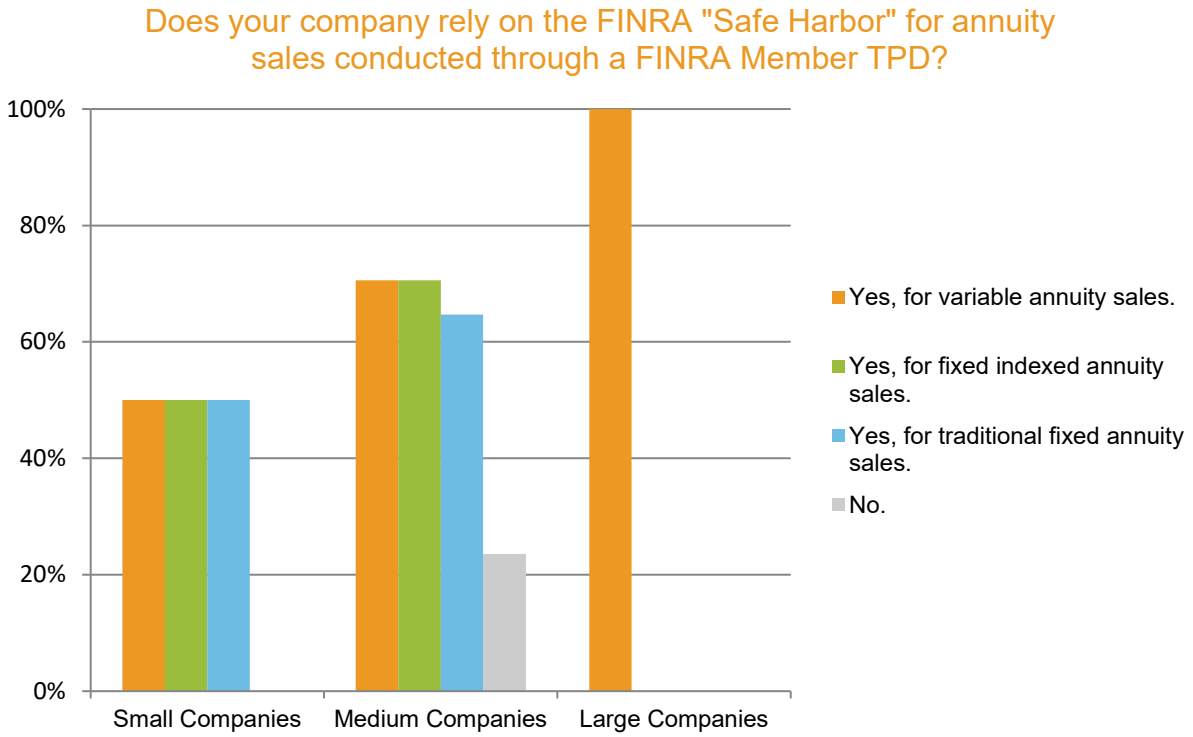
Moreover, all large Survey respondent companies and many medium companies indicated that they will only enter into an agreement with a FINRA member broker-dealer firm to conduct annuity suitability reviews and supervision of annuity transactions after the life insurance company has had an opportunity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

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 is often 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 majority 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.

The Survey results indicated that approximately 70% 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, more than half of the small and medium companies surveyed indicated they rely on the "safe harbor" for fixed indexed sales (65%) and traditional annuity sales (60%) as well.



Reports to Distribution Partners

The Survey also sought to determine whether life insurance companies routinely provide reports to their FINRA broker-dealer firm distribution partners to assist those firms in their suitability analysis and supervision of annuity sales.

All large companies and approximately half of all medium companies surveyed indicated that they routinely provide such reports to broker-dealers that sell their annuity products. While small companies were less likely to indicate that they routinely provide reports to FINRA broker-dealer firms, this year's Survey results appear to show that this practice is growing throughout the life insurance industry overall.

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 the vast majority of 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 the Survey indicated that large companies are most likely to receive such reports, only a small number of other Survey respondents indicated that their life insurance company receives reports from FINRA broker-dealer firms on a routine basis.

A growing number of insurance 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 annuity sales.

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 and suitability complaints received were the most important reporting metrics.

Non-FINRA Member Third-Party Distributors

The Survey also sought to determine the extent to which companies may enter into agreements with non-FINRA member third-party distributors to perform suitability review and supervision functions. The majority of companies surveyed (84%) indicated that they do not enter into such agreements.

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 by third-party distribution firms.

100% of Survey respondents rely upon annual suitability certifications as a key element of their monitoring of TPDs.

This year 100% of Survey respondents reported that they 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 has been steadily growing throughout the life insurance industry. (It may be interesting to note that 35% of companies surveyed utilize the CEFLI Annuity Suitability Certificate Clearinghouse to gather required annual certifications.)

Other important components of Survey respondent companies' overall suitability monitoring programs include requesting copies of the third-party distribution firm's written supervisory procedures, periodic monitoring of random contracts, periodic red flag monitoring of business intelligence data and customer survey programs.

Trend Analysis

Many life insurers conduct sophisticated trend analysis utilizing a wide range of data for suitability monitoring purposes. The Survey attempted to identify common trend categories utilized by life insurers to monitor annuity transactions conducted through third-party distribution firms.

The Survey results indicated that 100% of life insurance companies identified customer complaints as the top suitability trend category for monitoring purposes. Other trend categories closely monitored included patterns of replacement activity, the percentage of replacement cases transacted, volume and percentage of "free looks" and age-based patterns of sale (i.e., senior sales).

All life insurers responding to the Survey reported they monitor for trends involving suitability related complaints by customers as part of TPD oversight.

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. Most Survey respondent companies indicated that they perform periodic monitoring of their third-party distribution partners on an annual or quarterly basis, though some life insurance companies perform periodic monitoring as frequently as monthly.

In instances in which life insurance companies conduct periodic audits of a third-party distribution firm, Survey respondents were evenly split on whether they provide the audit results to the third-party. Those that do provide audit results to the third-party 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.”

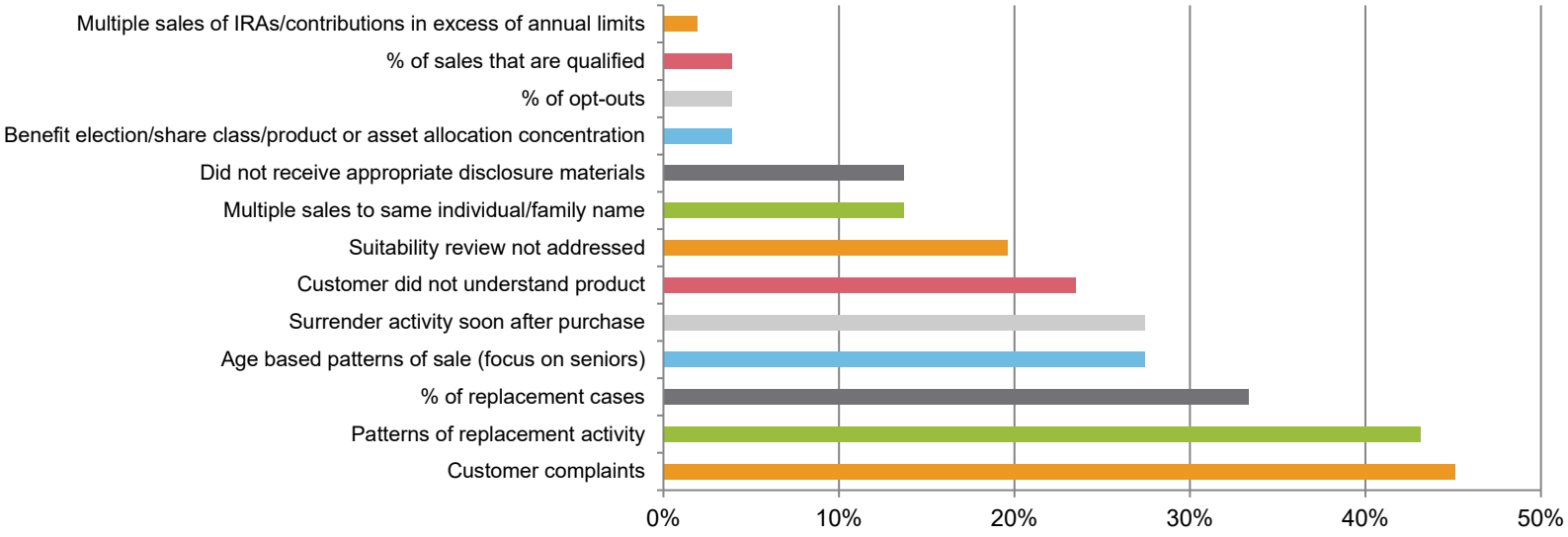
Captive Agent Practices

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.

Similar to the monitoring conducted for third-party sales, companies that conduct trend analysis for monitoring their captive agents most often rely upon customer complaints and patterns of replacement in a producer's business as the most useful data points for monitoring purposes. This was true for the majority of companies regardless of company size. Other points of indicia for trend monitoring of captive agent activity are included in the chart below.

Trends Most Commonly Monitored for Captive Agents



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 more than two-thirds (70%, up from 51% in 2016) of Survey respondent companies indicated that their companies require every annuity transaction to be subject to some type of "secondary review."

Suitability Guidelines

The Survey also asked whether companies publish F suitability guidelines for producers. A slight majority (53%) of Survey respondent companies indicated that they do publish suitability guidelines for their producers. Of those companies that publish suitability guidelines for their producers, 41% indicated that they provide guidelines that take into account the specific features and benefits of each product individually.

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

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 (61%) indicated that they use the Florida Annuity Suitability Questionnaire for this purpose. Larger companies were more likely to have developed their own company-specific form.

Reverse Mortgages

Some states require 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.

Overall Survey respondents were fairly evenly split on whether they accept or decline business involving a reverse mortgage. Most companies that accept business involving a reverse mortgage indicated they would only consider 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 (94%) 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 (89%) 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.

In addition to the FL Annuity Suitability Questionnaire, there are a number of states that request state-specific suitability information. When asked whether there are states other than FL in which the company utilizes a state-specific form (or additional questionnaire), company respondents indicated yes in the following states: AK, AR, CA, NH, NJ, NV, NY, MA, MN, MT, OR, VT and WI.

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 (38%) take the position that, if all of the information requested is not provided by the customer, then the application will be rejected. Other companies (42%) 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 (68%) 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. Still other companies indicated they will accept “opt out” transactions, but will undertake efforts to contact the customer to obtain the outstanding information.

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.

This year fewer companies indicated their companies maintain an automated screening process for annuity suitability purposes (40%, down from 50% in 2016), though all large company respondents reported using an automated screening process.

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:

- Replacements;
- Applicant's liquid assets after purchase;
- Applicant's age;
- Applicant's net worth;
- Applicant's monthly income; and
- Applicant’s disposable income.

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."

An increasing number of respondent life insurers indicated that their company employs a committee review approach to determine which cases will be escalated for 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, Distribution and Customer Service to determine which cases will be escalated.

"Failed" or Unsuitable Transactions

Inevitably, some annuity transactions will "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.

The Survey also asked respondents to indicate the process the company follows when an annuity transaction is deemed to be unsuitable. The majority (65%) of Survey respondent companies indicated that they notify the agent of the unsuitable determination. In some instances (37%), companies reported that they also notify the applicant of the determination.

The Survey also sought to determine whether life insurance companies provide to the customer the specific reason as to why a particular transaction may have "failed" the company's annuity suitability review process. The majority (65%) 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 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".

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 received;
- Number of applications rejected;
- Number of applications that went through the company's annuity suitability review process;
- Number of applications that were escalated to a heightened review;
- Summary of oversight performed on TPD suitability processes
- 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.

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 but growing number (18%) 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 most commonly found at larger companies.

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 (84%) indicated that they are not requiring any cognitive skills assessment for annuity transactions involving seniors. It is encouraging to note that some medium and large 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.

Producer Training

The Model Regulation requires 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.

With respect to captive agents, companies were fairly evenly split with half applying the general training requirement in all states and the other half opting instead to require it only in states that have adopted the Model regulation. Small and Medium companies took the same approach with respect to general training for TPDs, but large companies indicated that they apply the general training requirement uniformly across all states for their TPDs.

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

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.

The majority (75%) of Survey respondents indicated that they apply the annuity product-specific training requirements found in the Model Regulation in all states, not only those that have adopted the Model Regulation. This was true for companies of all sizes.

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 (68%) 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. A minority (22%) of companies maintain different requirements regarding when a producer must undergo company product-specific training. Some companies require product-specific training only initially upon the inception of their appointment. Others require product-specific training annually and others require it periodically throughout the producer's appointment.

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.

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

The majority practice is to offer web-based training on the company's website or online through a third-party, though a smaller number of companies conduct in-person training sessions.

New York Training

While New York holds the life 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 continuing education 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.

Verification of Training Completion Prior to 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 large majority of Survey respondent companies indicated that they will reject the application until the mandated training requirements are met. 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.

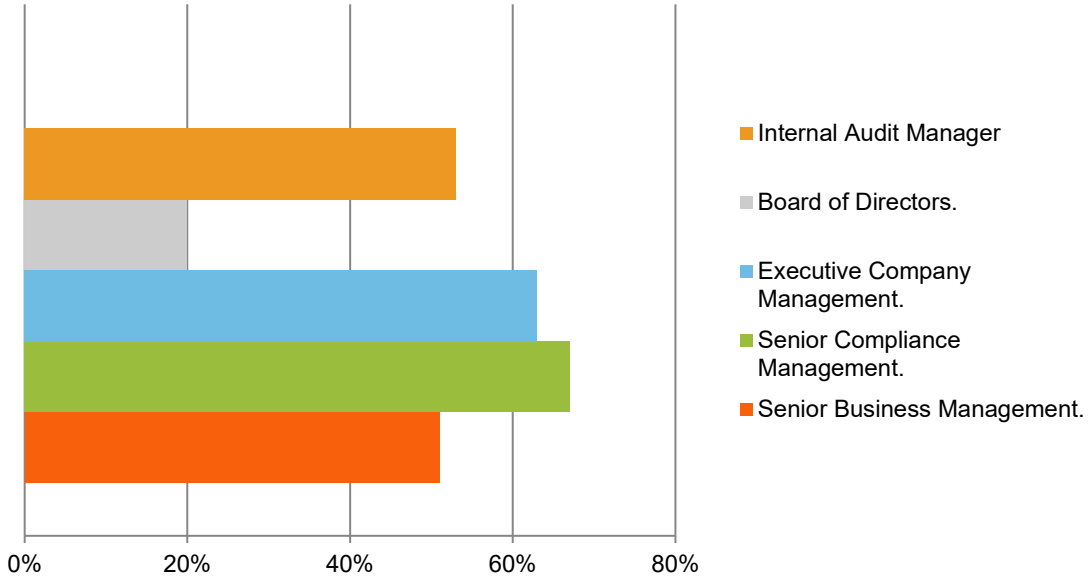
100% of Survey respondent companies have a process in place to verify completion of the general and company product - specific training requirements by a producer before an annuity contract will be issued.

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 Executive Company Management. Internal Audit Management and Senior Business Management are also frequently recipients of compliance reports.

Who is the required Annual Suitability Report distributed to?



Survey responses this year appear to affirm a growing trend of providing the Annuity Suitability Report to the company's Board at companies of all size.

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

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. Nearly half of Survey respondents indicated that they provide a detailed report including specific issues and action items, though a significant number of companies (33%) 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 to help determine the effectiveness of the company's suitability system. A significant majority of companies (76%) 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 (37%), reviews of a third-party distributor's suitability process (16%) and reviews of a specific third-party distributor's business (16%).

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.

Nearly two-thirds (62%) of Survey respondent companies with affiliated broker-dealers indicated their broker-dealer had been subject to FINRA examinations to determine compliance with FINRA Rule 2111 (Suitability) and FINRA Rule 2330 (Deferred Variable Annuities).

The majority (63%) 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 responses indicated that state insurance department examiners are most likely to review the company's policies and procedures related to annuity suitability, request a copy of the suitability report to senior management and request to look at sales involving replacements. Other areas commonly reviewed included (in order of priority):

62% of Survey respondents indicated that their affiliated broker-dealer has been subject to FINRA suitability examinations and 63% indicated that their companies have been examined for compliance with state-specific suitability requirements.

- Documentation supporting the transactional suitability determination;
- Review of a company's escalation process.
- Implementation and tracking of producer training requirements;
- The percentage of business that is rejected through the annuity suitability process;
- Annual certifications from third-party distributors; and
- Specific trends concerning agents.

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 (94%) 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) (82%), and their review of systems and processes to ensure selling producers have met annuity training requirements prior to accepting annuity business (71%) as the key ways their company is demonstrating suitability compliance.

Summary

CEFLI's 2018 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 fourth 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 the majority of small companies indicated the size of their captive sales force to be under 100 agents, and most medium companies indicated a captive sales force of between 100 and 500 agents.

The goals of the drafters of the revised 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 the new requirements.

The majority of companies that utilize third-party distribution firms have taken steps to limit the number of firms they engage to 250 or fewer, likely as a means to limit the scope of compliance oversight requirements pertaining to 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 New Business Unit was most likely to be responsible for this function, though many small companies still house this responsibility in Compliance & Legal. Medium companies were evenly split in reporting the review function is the responsibility of New Business or a standalone Suitability Review Unit, while all large companies reported having established a separate Suitability Review Unit. It may be interesting to note that when compared to prior year's Survey responses it appears that the responsibility for reviewing annuity recommendations for suitability is moving away from Compliance & Legal.

Though previous Survey results indicated that only a very few life insurance companies had taken the step to appoint a Chief Suitability Officer, this year we were pleased to see that a number of medium and large companies have demonstrated industry leadership in underscoring the importance of annuity suitability by designating 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 the majority of medium and large life insurers routinely provide reports to their FINRA broker-dealer distribution partners to assist them in their suitability analysis and supervision of annuity sales. While small companies were less likely to indicate that they routinely provide suitability reports to FINRA broker-dealer firms, this year's Survey results appear to show that this information sharing practice is growing throughout the life insurance industry overall.

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

100% of Survey respondents rely upon annual suitability certifications as a key element of their monitoring of TPDs.

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, including: requesting copies of the third-party distribution firm's written supervisory procedures, periodic monitoring of random contracts, periodic red flag monitoring of business intelligence data and implementing customer survey 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, customer call out programs, cognitive skills assessment for annuity transactions involving seniors, and employing a committee approach, which may involve input from Compliance, Legal, New Business, Actuarial, Distribution and Customer Service, 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.

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 training 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 reviews of specific producers and third-party distributor suitability processes and business. Often these reports will identify specific issues and action items that may be used by life insurance companies to enhance their existing annuity suitability practices.

Overall, the 2018 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 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 2018 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 2018 CEFLI Annuity Suitability Benchmarking Survey.

THE FORUM THAT CONNECTS.

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