FINRA’s Variable Annuity Enforcement Efforts in 2018

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Introduction

The Financial Industry Regulatory Authority (FINRA) continues to prioritize enforcement actions related to variable annuities (VAs), particularly focusing on exchanges and multi-share class VAs. In 2018, FINRA settled 28 VA cases through Letters of Acceptance, Waiver, and Consent (AWCs) and filed three complaints related to VAs. This review of FINRA’s VA enforcement cases identifies 2018 enforcement trends, including exchanges, multi-share class VAs, restitution, and representative training.

In 2018, FINRA imposed more than four times the amount of fines compared with 2017. In 2018, FINRA settled 28 cases, imposing nearly $8.1 million in fines.\(^1\) By contrast, FINRA brought 23 VA cases in 2017, imposing $1.9 million in fines. Three of the 2018 settlements levied fines exceeding $750,000, which was the largest fine assessed in a VA case in 2017.

VA Exchanges

In 2018, FINRA continued to focus on VA exchanges. Indeed, all three of the complaints and ten of the settlements involved exchanges.\(^2\)

Two of the three largest VA settlements included allegations about supervisory failures related to VA exchanges. In the biggest 2018 VA settlement, FINRA fined a firm $4 million for recommending VA exchanges without having a reasonable basis to believe that the exchanges were suitable.\(^3\) The firm’s registered representatives allegedly did not consider or compare information about VA exchanges and misstated the costs and benefits of VA exchanges to customers. The settlement also identified supervisory failures related to these suitability issues, including failures related to the training of registered representatives and supervisory principals and the implementation of surveillance procedures. FINRA ordered the firm to make restitution payments of $2 million to customers who executed one or more VA exchanges.

In the other large settlement, FINRA charged one of four affiliated firms with failing to reasonably supervise the rates of VA exchanges.\(^4\) The firm allegedly reviewed only a limited number of

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\(^1\) The 2017 data comes from FINRA’s “Statistics” webpage, monthly disciplinary reports, press releases and other major news sources. https://www.finra.org/newsroom/statistics.

\(^2\) Cases may involve more than one alleged violation.

\(^3\) AWC No. 2013035051401 (May 8, 2018).

\(^4\) AWC No. 2016047636601 (July 24, 2018).
representatives using criteria unrelated to the volume of their VA recommendations, and the firm did not have “surveillance procedures” designed to identify representatives with problematic rates of VA exchanges. FINRA imposed a total of $1 million in fines against the four related firms.\(^5\)

**Multi-Share Class VAs**

FINRA has continued to focus on multi-share class VAs, particularly L-share contracts. Eight of the 2018 settlements and one of the complaints included allegations related to the sale of multi-share class VAs. On July 24, 2018, FINRA entered into two settlements alleging that two sets of affiliated firms (totaling eight firms) failed to establish, maintain, and enforce adequate supervisory systems and procedures and training for the sale and supervision of multi-share class VAs.\(^6\) For example, both settlements noted that the firms’ procedures did not address “the suitability concerns raised by the sale of an L-share contract when combined with a long-term income rider or to a customer with a long-term investment horizon.”

In one of those settlements, FINRA fined four affiliated firms a total of $1.69 million, which was the second largest VA settlement in 2018.\(^7\) In that settlement, FINRA alleged that three of the firms failed to identify a pattern of red flags associated with the large number of L-share VA sales accompanied by long-term riders and failed to investigate the suitability of these potentially incompatible recommendations. That settlement required the firms to provide at least $6 million in restitution to customers who purchased L-share contracts with long-term income riders. In the other case against four affiliated firms, FINRA imposed a total of $1 million in fines.\(^8\)

Later in 2018, FINRA fined a firm $100,000 for failing to identify a pattern of red flags related to L-share VAs sold in conjunction with a long-term income rider. The firm did not investigate the suitability of these incompatible recommendations even though 91% of the L-share VAs included a long-term income rider.\(^9\)

**Supervision**

Of the 28 VA settlements in 2018, 13 related to supervisory failures. This issue was also specifically highlighted in FINRA’s December 2018 Report on FINRA Examination Findings (Report).\(^10\) The Report noted examples of firms’ failures to establish, maintain, and enforce supervisory systems and written supervisory procedures (or WSPs) reasonably designed to ensure that representatives’ VA recommendations complied with suitability requirements. According to the Report, these supervision failures resulted in representatives’ making unsuitable recommendations related to VA exchanges to retail customers.

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\(^5\) The AWC imposed fines of $350,000, $200,000, $200,000, and $250,000 on the four firms, respectively. The $350,000 fine was levied against the firm with alleged violations relating to VA share classes and VA exchanges.

\(^6\) AWC No. 2015047177001 (July 24, 2018); AWC No. 2016047636601 (July 24, 2018).

\(^7\) AWC No. 2015047177001 (July 24, 2018). The AWC imposed fines of $650,000, $115,000, $325,000, and $600,000 on the four firms, respectively. FINRA also charged two of the firms for violations relating to the supervision of unit investment trust sales charge discounts.

\(^8\) AWC No. 2016047636601 (July 24, 2018).

\(^9\) AWC No. 2015043641901 (August 23, 2018).


Restitution

FINRA focused on restitution payments to customers in 2018, ordering restitution in 25% of the VA settlements (seven of 28 cases). Those seven settlements imposed a combined restitution amount of approximately $8.7 million. The largest restitution was the $6 million imposed in one of the July 2018 multi-share settlements. And the second largest was the $2 million ordered in the VA exchange settlement discussed above. FINRA has continued to apply a “rough justice” approach in determining the amount of restitution in these cases. The settlements did not explain how the parties determined the appropriate restitution amounts. Rather, the amount of restitution appears to be a negotiated amount and is not necessarily correlated with the losses suffered by customers.

Training

FINRA’s December 2018 Report also highlighted supervisory failures related to the training given to registered representatives on VAs. Consistent with the Report, eight of the 28 settlements cited firms’ difficulty in providing adequate training on evaluating different share classes of VAs.

FINRA Rule 2330(e), the variable annuity training provision, was cited in the three largest 2018 VA settlements. These AWCs noted that the firms failed to provide sufficient training to their registered representatives and supervisory principals to ensure that they understood the material features of the VAs. In the largest 2018 settlement, FINRA found that this failure led to unsuitable recommendations related to VA exchanges.

In 2018, FINRA also settled with individuals who recommended L-share class VAs to customers without a reasonable basis for believing that these VAs were suitable based on the customer’s goals and time horizon. The individuals allegedly did not understand the costs and benefits of the various VAs. FINRA ordered the individuals to complete continuing education related to the sale of VAs and to the factors that should be considered when determining whether a VA is suitable for a customer.

Prior Settlements

FINRA continues to weigh a firm’s “recidivism” or prior disciplinary record in determining sanctions, as evidenced by the AWC discussed above involving exchanges. FINRA specifically referenced that firm’s failure to comply with its 2009 FINRA settlement. For example, the settlement noted that the firm failed to comply with the recommendations of an independent consultant retained pursuant to the prior settlement.

Conclusion

In 2018, FINRA brought 20% more VA-related enforcement actions than in 2017. In addition, FINRA levied more than four times the amount of VA-related fines. FINRA’s December 2018 Report also indicated that FINRA is continuing to find VA deficiencies during examinations. Thus, firms that sell VAs may want to review the above issues and, if appropriate, enhance their supervision and sales practices.

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11 AWC No. 2016048637601 (September 16, 2018); AWC No. 2016049232201 (September 28, 2018).
12 In addition, FINRA suspended each individual for 30 days and fined each individual $7,500.