

MEMO# 22180

February 4, 2008

FINRA Fines Firm for Unsuitable Sale of Deferred Variable Annuities

[22180]

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TO: VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 7-08
BROKER/DEALER ADVISORY COMMITTEE No. 4-08 RE: FINRA FINES FIRM FOR UNSUITABLE
SALE OF DEFERRED VARIABLE ANNUITIES

FINRA settled charges against a member firm for unsuitable sales of deferred variable annuities to twenty-three customers, most of them elderly, and for having inadequate systems and procedures governing annuity exchanges. [\[1\]](#) In settling the matter, the firm neither admitted nor denied the findings.

Improper Sale of Deferred Variable Annuities

According to settlement documents, firm representatives recommended that the customers exchange their fixed annuities, then paying a minimum of 3 percent, into variable annuities. As recommended, the customers placed 100 percent of their assets into the fixed-income feature of the variable annuity, which paid a maximum of 3 percent. At the time of each of these transactions, all but one of the customers' fixed annuities was beyond the surrender period (the penalty period for early withdrawal). Yet, each of the newly purchased variable annuities contained a six-year surrender period. FINRA found that the firm's representatives made unsuitable recommendations to the twenty-three customers to purchase variable annuities based on the customers' age, investment objectives, financial situation and income needs.

Inadequate Supervisory Systems and Procedures

According to the settlement documents, the firm's principals reviewed exception reports and were thus aware of the customers' circumstances and the details concerning the exchanged fixed annuity and the new variable annuity. FINRA found that the principals failed to adequately consider the following factors during their review: the age of the customers; that the fixed annuities were out of surrender; that the fixed annuities were exchanged for variable annuities with a six-year surrender period; and that the customers allocated the entire proceeds of their fixed annuities to the fixed-income feature of the variable annuity that paid, at most, the same interest rate as the exchanged fixed annuity. FINRA also found that the systems and procedures did not require the principals to obtain or consider certain critical information regarding exchanges between variable annuities. Thus, FINRA found that the firm failed to establish, maintain and enforce a supervisory system and written supervisory procedures reasonably designed to detect and prevent unsuitable variable annuity exchanges.

FINRA found that the firm violated NASD Conduct Rules 2110, 2310 and 3010. [2] The firm was censured and consented to pay a fine of \$235,000. In addition, the firm agreed to reimburse the twenty-three customers for any surrender charges incurred when exchanging their fixed annuities into variable annuities, and to rebate any future surrender charges the customers may incur in connection with the sale or exchange of any of the variable annuities.

Heather L. Traeger
Assistant Counsel

endnotes

[1] See "FINRA Fines Banc One for Unsuitable Variable Annuity Sales, Inadequate Supervision of Fixed-to-Variable Annuity Exchanges," FINRA Press Release (January 29, 2008), available at <http://www.finra.org/PressRoom/NewsReleases/2008NewsReleases/P037846>.

[2] Rule 2110 requires a member, in the conduct of his business, to observe high standards of commercial honor and just and equitable principles of trade. Rule 2310, FINRA's suitability rule, requires firms to make reasonable efforts to obtain certain information from the customer, and to have a reasonable grounds for believing that a recommendation is suitable for a customer based on the customer's financial situation and needs. Rule 3010 requires firms to establish and maintain a supervisory system, including written procedures, to supervise the activities of its registered representatives and associated persons. The system must be reasonably designed to achieve compliance with applicable securities laws and regulations and NASD rules.

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