

MEMO# 23402

April 17, 2009

FINRA Fines Firm for Unsuitable Variable Annuity Transactions

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TO: VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 6-09 RE: FINRA FINES
FIRM FOR UNSUITABLE VARIABLE ANNUITY TRANSACTIONS

FINRA settled charges against a member firm for unsuitable sales of deferred variable annuities and for inadequate supervisory systems and procedures to oversee sales and exchanges. [\[1\]](#) In settling the matter, the firm neither admitted nor denied the findings.

Improper Sale and Exchange of Variable Annuities

According to settlement documents, between January 2004 and December 2006, 42 of the firm's representatives made 250 unsuitable sales and exchanges of variable annuity products to 197 customers. One representative was responsible alone for 118 unsuitable exchanges. Unable to transfer certain variable annuity products held by 74 of his customers from his prior employer, the representative engaged in an exchange of those customers' variable annuities to a variable annuity sold through the firm. He sold the identical variable annuity with identical riders to each of the 74 customers ("switch transactions"), most within the first two months of his employment with the firm. He filled out all of the paperwork personally, checking off every investment objective and filling out identical risk tolerance data for each customer. He incorrectly indicated in the paperwork that customers would not incur surrender charges; filled out the same, incorrect surrender period; did not specifically identify the anticipated benefit to the customer; and, for most transactions, indicated that the transactions were unsolicited, when they were not. The representative and his supervisor won the firm's sales contest on the basis of the commissions produced from the switch transactions.

Forty-one other representatives recommended 132 unsuitable transactions, often using information from the firm's affiliated bank branches (i.e., lists of customers with maturing CDs) to solicit customers to purchase the same variable annuity. In each of the transactions, the customers used cash to invest in the variable annuity and all of the customers' premiums were invested in the variable annuity's fixed sub-account.

Inadequate Supervisory Systems and Procedures

According to settlement documents, the firm's supervisory systems and procedures were inadequate for policing the firm's variable annuity sales and exchanges. The firm approved each of the unsuitable transactions and failed to respond adequately to red flags evidencing that the transactions were unsuitable. The firm did not use any variable annuity-specific surveillance tools. Moreover, the firm had ample evidence that its systems and procedures governing variable annuity transactions were deficient. On four separate occasions, internal auditors and compliance audits had identified significant weaknesses in the firm's supervisory procedures. The firm failed to take adequate measures to remedy the identified deficiencies.

The firm also failed to maintain accurate books and records related to its variable annuity business. Specifically, it failed to retain correspondence that its representative sent to his 74 customers; retained inaccurate and incomplete information related to its representative's switch transactions; inaccurately reflected the representative of record on certain variable annuity transactions; and failed to retain records of rejected variable annuity transactions.

Based on the alleged conduct, FINRA found that the firm violated NASD Rules 2310, 3010, and 3110 and Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934. The firm was censured and ordered to pay a \$1.75 million fine. The firm also was ordered to pay more than \$260,000 in restitution to 74 customers to compensate them for surrender charges incurred in the unsuitable transactions. In addition, the firm was ordered to offer all 197 customers the opportunity to rescind their unsuitable transactions and receive the initial value of their purchase plus interest and any surrender charges required, adjusted for any withdrawals made. As part of the settlement, the firm agreed to retain an independent consultant to review the adequacy of, and recommend modifications to, the firm's supervisory system and procedures and training related to variable annuity transactions.

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endnotes

[1] See "FINRA Fines Fifth Third Securities \$1.75 Million for Unsuitable Variable Annuities Transactions," FINRA Press Release (April 14, 2009), available at <http://www.finra.org/NewsRoom/NewsReleases/2009/P118471>.

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