

Welcome

We will begin today's program at 2:00 PM Eastern.

"NASD (FINRA) Rule 2821: Understanding the New Annuities Rule"

If you have joined this event early, we invite you to sit back, relax and learn about other upcoming FPA Educational Opportunities.

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VLC Educational Track: Technical Knowledge

About the Program:

This presentation will describe new FINRA Rule 2821, which provides the new requirements for broker-dealers related to the sales of variable annuities.

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[November 14, 2007 \(2-3:30 p.m. ET\)](#)
Compliance for the State Registered Advisers
Presented by: LaVerne Zellmann
Educational Track: Technical Knowledge
Pending Approval for 1.5 CFP CE

[November 16, 2007 \(2-3:00 p.m. ET\)](#)
How to Use a Benchmark Study
Presented by: Daniel Inveen and Kenneth Evans
Educational Track: Practice Management
Free to FPA Members

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NASD (FINRA) Rule 2821: Understanding the New Annuities Rule


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New Variable Annuity Rule

- On September 7, 2007, the SEC approved proposed NASD (FINRA) Rule 2821, entitled "Members' Responsibilities Regarding Deferred Variable Annuities." The rule applies to the purchase, sale, or exchange of deferred variable annuities for broker-dealers and their reps, and implements a whole series of new stringent requirements for the sale or exchange of variable annuities.


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When Does It Become Effective?

- FINRA has 60 days after 9/7 to publish the new rule.
- The Rule must then have an effective date within 180 days of that publication date.
- In other words, the new rule will be effective in the first half of 2008.

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Why Does It Matter to You?

- If you are licensed as a broker-dealer representative (e.g., series 6, series 7, series 23, series 24, or series 26), this rule will apply directly to you.
- If you are not a broker-dealer representative, but do fee-only planning, you should still be familiar with the rule since it will impact b/ds who will implement your product recommendations.

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Why was this Rule Enacted?

- The NASD believed and the SEC agreed that the industry needed a specific rule to address variable annuity sales abuses.
- The NASD has been so concerned about variable annuity sales that it had issued 4 Notices to Members and 3 investor alerts on the subject.

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Why was this Rule Enacted?

- The SEC and numerous states had also issued a number of promulgations warning against the potential problems with variable annuities.
- Rule was passed (after 4 tries) despite overwhelming opposition from the industry, which thought that rule was unnecessary and brought undue expense since the general standards of fair dealing and the anti-fraud provisions were already in place.

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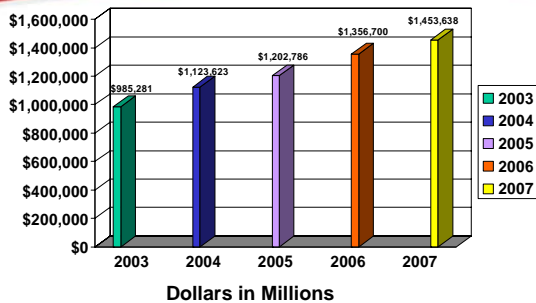
Bottom Line – Regulators Don't Like Variable Annuities

- Complex products, which the regulators themselves don't understand (numerous sub-accounts, riders, annuitization options, lock-in periods, disparate tax and estate treatment, etc.).
- Usually bring higher commissions to reps than mutual funds or other managed products.
- Long lock in periods.
- The regulatory prejudice has resulted in 100's of cases in the past few years with 100's of millions of dollars in fines to broker-dealers and numerous suspensions and bars to individuals.

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Variable Annuities - Assets Under Management (Comparison by Year)



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But Variable Annuities are Great Products for Some Customers

- Provide protection against possibility of outliving assets (through living benefit riders)
- Provide protection against market downturns (through purchase of death benefit and living benefit riders)
- Death Benefits can supplement life insurance

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But Variable Annuities are Great Products for Some Customers (continued)

- No transaction costs
- Favorable income tax treatment
- Avoidance of probate and protection from creditors

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But Variable Annuities are Great Products for Some Customers (continued)

- True, but the regulators just made this product harder to sell. You better have a good rationale for a sale; it better be disclosed to client; and it all better be well documented in file.

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Requirements of New Rule – Four Areas

- Suitability review and disclosure
- Enhanced principal review and approval
- Enhanced written supervisory procedures
- New Training programs specifically for variable annuities.

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First Area: Suitability Review and Disclosure

- Rep must have reasonable basis to believe:
 - Transaction is suitable;
 - The customer has been informed of the product's features, including:
 - a. surrender period and surrender charge,
 - b. potential tax penalties for early redemptions,
 - c. mortality and expense fees,
 - d. investment advisory fees,
 - e. potential charges for features and riders,
 - f. the insurance and investment components, and
 - g. market risk

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First Area: Suitability Review and Disclosure (continued)

- The customer will benefit from the benefits of the variable annuity, such as tax-deferred growth, annuitization, or a death or living benefit;
- The specific annuity, the underlying sub-accounts, and the riders and enhancements are all suitable;

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First Area: Suitability Review and Disclosure (continued)

- Suitability determination will be based on the following customer information, at a minimum, collected by the rep:
 - a. Age
 - b. Annual income
 - c. Financial situation and needs
 - d. Investment experience
 - e. Investment objective
 - f. Intended use of annuity
 - g. Investment time horizon
 - h. Existing assets (including investment and life insurance holdings)
 - i. Liquidity needs
 - j. Liquid net worth
 - k. Risk tolerance
 - l. Tax status
 - m. other information, which may be reasonably determined to be pertinent

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First Area: Suitability Review and Disclosure (continued)

- In cases of exchanges, rep must also consider whether customer:
 1. would incur a surrender charge
 2. be subject to the commencement of a new surrender period
 3. be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements)
 4. would *substantially* (editorial addition) benefit from product enhancements and improvements
 5. has had another annuity exchange in the past 36 months

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First Area: Suitability Review and Disclosure (continued)

- All of these suitability determinations must be documented and signed by the registered representative recommending the transaction.

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WOW! How will this be done?

- It will require new specific suitability assessment and disclosure form, addressing each of these items and signed by the representative and the customer. (In other words, more paperwork!)
- It will require many b/ds to collect additional customer information to make the suitability determination.
- It will also require all b/ds to keep a log of exchanges and implement new exception reports to ensure that exchanges are given extra scrutiny and don't occur within a 36 month period of another annuity transaction for the same account.

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Second Area: Enhanced Principal Review and Approval

- A principal must determine whether he or she approves of the purchase or exchange prior to sending the annuity transaction to the issuer for processing (and within 7 days of the customer signing the application).
 - Track the date the application was signed
 - Return if not reviewed within 7 days?
- The principal can approve the transaction only if he or she has determined that there is a reasonable basis to determine that the transaction is suitable based on an independent evaluation of all of the suitability factors previously mentioned.

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Second Area: Enhanced Principal Review and Approval (continued)

- The only time a principal can approve an annuities transaction without meeting this standard is where the transaction is unsolicited and the customer is informed through a disclosure signed by the customer that the principal would not otherwise approve the transaction had it been recommended by the registered representative.
- Each transaction requires a principal to document in writing the principal's determinations and sign a record of such determinations.

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WOW!

- Now Principals are really putting their necks on the line with each annuity approval!
- They must be product experts and have a true independent assessment of each recommendation.
 - Not just looking for red flags or inappropriate sales.

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Third Area: Enhanced Written Supervisory Procedures

- Firms must establish specific written supervisory procedures designed to achieve compliance with the rule.
- Firms must implement surveillance procedures to monitor annuity exchanges, rates of annuity exchanges, and possible inappropriate exchanges (i.e., a 1035 log and exception reports)
- Firms must have policies and procedures to ADDRESS and CORRECT inappropriate exchanges and sanction representatives who engage in inappropriate exchanges.



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Third Area: Enhanced Written Supervisory Procedures (continued)

- Among other things, this means that firms must retroactively review 1035 exchanges and address those that are questionable.



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Fourth Area: New Training

- B/Ds must develop specific training policies and programs to ensure that reps and principals:
 1. comply with the new variable annuity rule
 2. understand the material features of variable annuities, including:
 - a. surrender period and surrender charge,
 - b. potential tax penalties for early redemptions,
 - c. mortality and expense fees,
 - d. investment advisory fees,
 - e. potential charges for features and riders,
 - f. the insurance and investment components, and
 - g. market risk



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Fourth Area: New Training (continued)

- In other words, firms must ensure that advisors are product experts before they are allowed to sell annuities. They must also ensure that reps are well versed in the requirements of this new rule.

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Conclusion

- Despite all of the talk about principles-based regulation to ensure our competitiveness in the global market place (like those adopted by the UK's FSA), and returning to a more balanced regulatory approach, the SEC and NASD have made it clear that (at least in this area) they intend to micromanage and second guess firms sales and practices.

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Thank you for your attention.

Are there any questions?

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