# Variable Annuities a Top Source of Customer Complaints: FINRA

FINRA 'very focused' on VAs; also watching inflation-sensitive products

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FINRA is especially focused on "structured" VAs, which have caps and buffers to mitigate market risk.

The Financial Industry Regulatory Authority continues to be “very focused” on variable annuities, as they remain one of the “top” products for customer complaints, Carlo di Florio, FINRA’s chief risk officer, said Monday.

Speaking at the Insured Retirement Institute’s Government Legal & Regulatory conference in Washington, di Florio said that while there’s been a “bit of de-risking” in the VA marketplace, other product providers are issuing VAs “with all the same risks” as complex structured products, such as VAs that include “buffers and caps.” Di Florio noted that it’s important for reps selling these types of VAs to be able to explain the “trade-off between the buffer and the cap.”

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Annuities with buffers and caps differ from more traditional variable annuities in that they may add to the existing product complexity by varying exposure to market volatility, and require a more sophisticated analysis of product features such as the tradeoff between the upside caps and downside buffers.

FINRA is also watching other complex products such as interest-rate sensitive products like long duration bonds and exchange-traded funds, as well as corporate bonds, di Florio said.

Chief among customer complaints about VAs, di Florio said, are disclosure, sales practices, VA exchanges and surrender charges.

Structured VAs, also called “collared VAs,” include caps on the account value growth with some downside protection, according to IRI.

Structured VAs are generally filed as variable annuities, though the account value growth is similar to fixed indexed annuities, as the performance is tied to an index such as the S&P 500, IRI explained in a recent white paper.
IRI offered the following examples of the choices that structured products offer clients.

The buffers allow clients to elect what percentage of market loss that their account value is protected from, with commonly available amounts including 10%, 20%, 30% and 100%.

One example would be a client investing $100,000 and electing a three-year term with a 20% buffer. In this example, assume the cap is 10%.

In an “up” market, if the index grows less than 10% over the three years, the account value will be credited with the full growth of the index. If the index grows 5%, the account value would be $105,000.

However, if the index grows more than 10%, the account value would be $110,000, as the growth is capped at 10%.

In a “down market,” if the index is down 20% or less, the account value will be $100,000 after three years, whereas if the index is down more than 20%, the account value will decrease based on the difference of the buffer (20% in this example) and the index.

If the index is down 25%, the account value will be decreased to $95,000 (25% less 20%).

IRI noted in its white paper that one company has recently launched a product covering the “tail” risk of a down market. For example, if a 10% “buffer” is elected, the account value will not decrease more than 10%.

As for caps, IRI notes that they are set by the company and differ based on the duration and index elected.

Di Florio also noted that since the financial crisis, there's been a "movement to formalize" the risk management function within firms. He noted that while some firms have a specific employee focused on risk management, this task can also be performed by a team. "There is no one-size-fits-all" approach when it comes to risk management compliance, he said, as practices vary across firms depending on their size, business models and products and services.

However, di Florio added that a firm's board should be knowledgeable about risk management issues.