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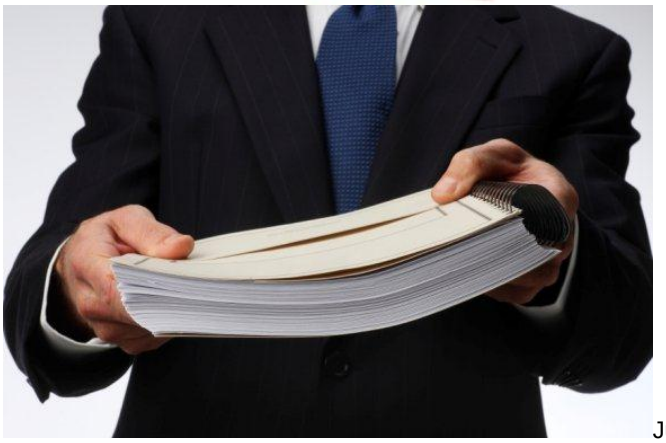

June 28, 2011

VA customers don't read prospectuses — and at 200 pages, who can blame them?

Some popular contracts mind-numbingly long and complex; IRI proposing slimmed-down, more-readable documents

By Darla Mercado

June 28, 2011 2:03 pm ET

Insurance customers looking to do some light reading this summer should probably avoid looking at a prospectus for a variable annuity.

Out of the 15 top-selling VA products, the prospectuses for eight stretch beyond 150 pages, according to a study from the Insured Retirement Institute. Two of them are over 200 pages.

The group also asked 709 retirees and pre-retirees with at least $100,000 in investible assets what they do with these tomes. Not surprisingly, few of the polled consumers read the prospectuses that came with their variable annuities. More than one in four said they never leaf through the information, while 42% said they “rarely” open the document. About half of the consumers said they never refer back to their prospectuses after they buy their VAs.

The few customers who do actually read the documents do so in small bites: 98% read the summary and highlights section, while 97% tackle the fees and expenses.

Nearly 90% read up on risks, deductions from their accounts — such as sales loads and commissions — and investment choices. Contract benefits are rarely examined; only 58% of the polled consumers venture into that part of the prospectus. But seven out of 10 that do read the documents go over death benefits.

The IRI has led the charge in support of the slimmed-down prospectus, sending the Securities and Exchange Commission a “proof of concept” VA summary prospectus nearly two weeks ago. Susan Nash, associate director, disclosure and insurance product regulation at the SEC's Division of Investment Management, spoke positively of the document.

She spoke on her own behalf, and not on the SEC's, noting she has read the IRI's summary prospectus but has not compared it with the corresponding statutory documents yet. “It avoids the temptation to talk about structural matters; it tells you what's going on rather than focusing on the legal underpinnings,” Ms. Nash said at the IRI's conference yesterday.

Still, there are a number of areas that need work. “An area we can't analyze is the traps for the unwary: How can you lose benefits, and is the presentation [of that] balanced?” she asked.

Focusing on VA features rather than on the relationship between the contract and its riders helps eliminate some jargon, she said. But the tie between the VA chassis and its riders can be an integral part of the outcome for investors.

“If the ‘how' is the nuts and bolts of what I get — 4% or 6% lifetime income — then that's a big ‘how' and I'd want to know when I get 4% and when I get 6%,” Ms. Nash said.

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B-Ds ought to review standards of conduct, supervisory procedures for VA sales: Finra lawyer

‘Three C's': SRO looks at concentration, costs and complexity when scrutinizing firms

By Darla Mercado

June 28, 2011 12:07 pm ET

Finra's variable annuity suitability rule should be old news to broker-dealers, but firms that want to avoid an arbitration land mine ought to review their procedures.

That warning came from Andrew A. Favret, associate vice president and regional chief counsel at the Financial Industry Regulatory Authority Inc.

He, along with Robert H. Watts, a Finra arbitrator and former compliance officer for John Hancock Financial Services Inc., held a boot camp on annuities at the Insured Retirement Institute's Government, Legal & Regulatory Conference in Washington yesterday. Both shared tales of broker-dealers' missteps on following VA suitability rules and highlighted the red flags that likely would bring a firm under Finra's suspicion.

“It's funny how often firms have good procedures [for sales practices] and the reps will say they've never seen them,” Mr. Favret said. “Firms need to be able to show they have good procedures and that they're getting the word out to their reps.”

Some broker-dealers have been caught with outdated supervisory procedures and standards of conduct, and have been unable to give Finra an adequate explanation as to how the procedures were drafted or who exactly is responsible for ensuring that reps follow the rules.

In some cases, the person responsible for providing supervisory approval at a broker-dealer had left the firm years ago, Mr. Favret said.

“Whenever Finra finds something, they look at who's the nearest principal,” said Mr. Watts. “What did they do? What should they have done?”

Common pitfalls for firms include failure to have written supervisory procedures, failure to have appropriate policies and steps to assess suitability, and failure to document complete suitability information.

Mr. Favret also highlighted “the three C's” that help determine whether Finra will pursue a case: concentration and how a firm justifies placing upward of 50% of a client's net worth into a VA; costs and whether the rep took that into account when either selling or transferring a VA; and complexity — whether the customer knows what he or she is buying.

Finally, Finra began an initiative this year where it combed through data from five or six major VA issuers for data on concentration levels and the sales of VA riders, Mr. Favret said. It's a way for Finra to highlight problem areas throughout the industry without having to rely solely on complaints.

“We had relied on customer complaints, which isn't a very efficient way to get at problems in the industry; you're looking for a needle in the haystack,” Mr. Favret said. Instead, data mining “is a big deal in terms of how we look at this going forward.”