

Report On  
The Annuity Replacement Project  
(Data Year 2018)

as delivered to

Elizabeth Kelleher Dwyer  
Superintendent of Insurance

*on*

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State of Rhode Island  
Department of Business Regulation  
Insurance Division

## **Project Background and General Procedures**

The Rhode Island Insurance Division (the “Division”) has observed an increasing trend in Rhode Island of new annuity contracts replacing existing annuity contracts. In 2018, more than thirty percent of all new annuity sales in Rhode Island were replacements. The Rhode Island annuity replacement ratio measures replacements issues to total contracts issued (with data taken from insurers’ Market Conduct Annual Statements, Individual Annuity Ratio 1), and that ratio increased from 21% in 2016 to 31% in 2018. Both the large increase in a short time period as well as the high percentages were of concern to the Division due to the potential for ethical lapses when determining the suitability of replacement sales. The Division has concerns when replacement annuities are recommended because replacements can have negative consumer consequences, such as replacement charges, higher fees, or lower benefits.

In order to gain some insight into the replacement activity within the Rhode Island annuity marketplace, the Market Conduct Unit of the Division (the “MC Unit”) conducted additional analysis of the marketplace. It selected 32 insurers writing annuity business in Rhode Island based on a combination of factors, including market share, annuity replacement ratio, and number of replacement contracts issued in Rhode Island. The MC Unit then conducted an analysis in two phases, first asking questions and reviewing procedures for annuity supervision at all of the companies, and then reviewing specific sales for 19 of the 32 insurers by having the 19 insurers send us files for individual consumers.

In the first part of this additional analysis, the Unit asked insurers a common series of interrogatories and included a request for the insurers’ policies and procedures related to annuity replacements. The Unit also asked about the identity of third-parties involved in annuity replacement suitability review, procedures for internal tracking of annuity replacement activity,

forms used for annuity replacement transactions, reports issued to senior management, trainings utilized for annuity replacements, and thresholds related to surrender charges on annuity replacements. The MC Unit reviewed the insurers' responses in order to get a better understanding of industry practices within the Rhode Island marketplace in general, as well as to understand the practices of each individual company.

In the second phase, the MC Unit selected 19 of the 32 companies for annuity replacement testing. The MC Unit selected contracts for each company based on their volume of replacement business in Rhode Island during 2018, with a total of 201 total files selected for review. The MC Unit asked the nineteen companies for complete files for each selected annuity sale, and then reviewed the selected files for completeness, suitability, and the insurers' compliance with certain Rhode Island laws and regulations. This testing included both fixed annuity replacement sales as well as variable annuity replacement sales.

Based upon the review of these 32 insurers' policies and procedures as well as the 201 annuity replacement sales transactions, the MC Unit identified certain common strong and weak compliance practices, and similarly, some common strengths and weaknesses from individual companies' file reviews.

### **General Results and Observations of the 32 Companies**

The MC Unit reviewed the insurers' annuity replacement and suitability procedures set by companies and compared them to the requirements of Rhode Island's Suitability in Annuity Transactions Regulation ([230-RICR-20-25-1](#)), Rhode Island's Life Insurance and Annuities Replacement Regulation ([230-RICR-20-25-4](#)) (both of which are very close adoptions of NAIC model regulations), and Rhode Island's relatively unique twisting and churning rules ([R.I. Gen. Laws § 27-29-4.7](#), 230-RICR-20-25-4). [Note: All states have rules regarding misrepresentation,

otherwise known as twisting, but the Rhode Island churning rules are specifically designed to help prevent producers from selling unsuitable internal replacements as a means of obtaining additional producer compensation. The MC Unit therefore places an emphasis on its review of policies and procedures related to churning, which is a relatively unique law.]

### ***Weaker Procedures***

One concerning trend identified was that several companies appeared to be lacking policies and procedures in compliance with Rhode Island's twisting and churning rules (R.I. Gen. Laws § 27-29-4.7, 230-RICR-20-25-4). This somewhat unique Rhode Island statute was adopted in 2012 and was the result of discussions between the Department, a large life insurance trade association and the Rhode Island legislature. The law and its companion regulation required companies to adopt such written procedures by July 1, 2013. The apparent lack of knowledge about these requirements might be indicative of companies not properly monitoring the varying requirements of states insurance statutes and regulations that are not as universal as NAIC model laws and regulations. But the law also requires internal replacements to be held to a higher standard with additional comparisons required, and companies unaware of the law appeared not likely to hold internal replacements to the required level. Another weakness identified by the MC Unit was that during sample testing, roughly 14% of files reviewed did not contain adequate information to confirm the suitability of the transaction, though these files largely fell under safe harbor rules (See the Suitability Regulation, 230-RICR-20-25-1.6(L)) pertaining to suitability and supervision of annuity transactions sold by broker dealers. And while insurers may appropriately rely on broker-dealers for the suitability analysis, there were instances where insurers did not retain sufficient oversight over the replacement portion of the transaction, evidenced by a lack of collected requirement replacement forms. Additionally,

many companies were lacking documentation in their policies and procedures regarding the monitoring of cross-border sales (See the Suitability Regulation, 230-RICR-20-25-1.6, note that the annuity suitability best interest requirements were subsequently adopted in April 2021). Some companies did not reference monitoring cross-border sales at all, while other companies added a requirement for signed cross-border acknowledgement documents and maintained detailed state charts of rules related to cross-border activity. The MC Unit plans to monitor and follow-up with each of these companies in order to establish better compliance with these rules and to ensure such oversights are not leading to ethical lapses on the part of insurers and/or producers.

### ***Stronger Procedures***

Surrender charges are of particular concern with annuity replacement transactions, as the consumer is typically entering into a new surrender schedule with the new annuity and is experiencing a cost to do so with the surrender. The MC Unit identified a common strong compliance practice where companies mandated an enhanced review for any annuity replacement transactions that would result in a surrender charge of any amount. One prevailing method applied by insurers was to automatically reject any annuity replacement transactions where (a) the surrender charge involved an internal replacement or (b) the surrender charge was at least 3% of the account balance (in all cases or in combination with an owner age of 75/80 and older). Although implementing automatic disapprovals by surrender charge percentage or amount may assist in avoiding replacements that may harm consumers, in some cases there may be a valid justification for the replacement, but the MC Unit believes a strong compliance practice is to subject such sales to an enhanced review by the insurer.

Another stronger compliance procedure identified at multiple insurers was the documentation of comparison charts, with highly relevant data points comparing both the proposed and replaced contract. The MC Unit found that this type of objective information could assist an insurer’s otherwise subjective review of whether a transaction was suitable:

death benefit amount;	current interest rate;
product type;	surrender charge period;
minimum guaranteed interest rate (if any);	surrender charge triggered by the transaction;
types of riders;	mortality expenses;
bonuses (if applicable);	administration fees; and
free withdrawal percentages;	other costs (such as for riders) (as a percentage).

Some companies listed or checked-off any elements of annuity replacement transactions that qualify as advantages and/or disadvantages. In addition, companies sometimes mandate written suitability explanations in the annuity replacement documentation if: (a) surrender charges are triggered by the transaction; (b) the replacement led to a lower guaranteed interest rate (applicable for fixed annuities); (c) the replacement led to higher expenses/fees/other costs (as a percentage); (d) the replacement led to a lower death benefits; or (e) whether the new contract had different features than the replaced contract (such as, whether one or both had a living benefit). An insurer issuing a replacement should be able to conduct those basic comparisons as well as have a good comprehension of information about the consumer and their financial situation (such as through the Consumer Profile Information required to be captured by the suitability regulation), including age, income, net worth, and risk tolerance. The MC Unit believes companies should prioritize these types of analyses in their annuity replacement

suitability reviews because that information helps to determine whether the replacement is appropriate.

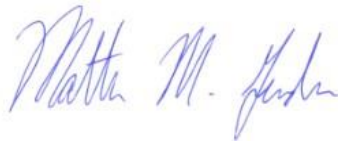
### **Project Closure and Next Steps**

Throughout this review, the MC Unit identified generally good insurer compliance with Rhode Island standards both in written policies and procedures and the suitability determinations within the sampled replacement transactions. The MC Unit sent out closing letters to each of the 32 companies under review, and these closing letters provided all of the above information as well as listing strengths and weaknesses specific to each company. The MC Unit plans to continue its oversight efforts on a company-by-company basis to ensure compliance with its rules regarding twisting and churning, the monitoring of cross-border sales, and the supervision of annuity transactions sold by broker-dealers. The MC Unit hopes the feedback from this project will lead to better company oversight over replacements within the Rhode Island marketplace.

### **Report Submission**

This Project was conducted by Brett Bache, Brian Werbeloff, Segun Daramola, Sarah Neil, and Matthew Gendron of the Rhode Island Department of Business Regulation Insurance Division.

Respectfully submitted,



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