One Less Compliance Issue – Annuity Fund Transfers

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Once upon a time, compliance was a lower case "c" and lived in a small room somewhere in a company's legal department. All that changed with the discovery in 2003 of market abuses that eventually led regulators to impose whopping fines and, of course, issue more regulations.

While the insurance industry wasn't hit nearly as hard as the fund industry, the wake-up call was loud and clear: create new monitoring procedures, or suffer the consequences.

One unexpected place where investigators began to unearth a pattern of late trading, market timing, unsuitable trades and questionable business practices was in the broker-initiated transfer of funds within variable annuities. What particularly disturbed them was the lack of a standard mechanism through which reps could request and complete a fund transfer without the full knowledge of their registered broker-dealer which, ultimately, bears the burden of supervisory responsibility.

By circumventing the broker-dealer and going directly to the carrier, either through a carrier's website, phone, fax or e-mail, controls slipped away. Not only that, according to several regulatory findings many transactions were questioned, whether the reps making transfers had gotten proper authorization from customers or whether they were compatible with their customers' suitability profiles – a possible violation of **NASD** Rule 2310 and IM 2310-2.

In response, the **Security Industry Association**'s (now **Securities Industry and Financial Markets Association**) Insurance Panel in August 2005 issued an advocacy paper highlighting the need for a standardized, centralized industry process that would provide a window of transparency into these transactions. The panel warned that there was little time to waste and urged the industry to fast-track a solution using **The Depository Trust & Clearing Corp.**'s (DTCC) automated processes.

The task of meeting the SIFMA Panel's recommendation fell to DTCC's Insurance Services area; the challenge was to create an efficient and cost-effective way to automate the fund transfer process, allowing broker/dealers to better monitor their reps actions and increase the number of "in good order" transactions sent to carriers. Now in its tenth year, Insurance Services has helped transform a paper-driven, non-standardized industry into one closer to the ideal of straight-through processing for annuities, life insurance products and, more recently, retirement-income programs. And several of its services have been created specifically to address regulatory and compliance issues.

The solution DTCC came up with, called "Fund Transfers," will make current practices more efficient by automating the entire procedure of a variable annuity fund transfer through a single secure processing source. And, by using the **Association for Cooperative Operations Research and Development**'s (ACORD) XML data model, carriers can maximize their current technology investments.

Stephen T. Marynowski, senior vice president at **Smith Barney** and a member of DTCC's pilot advisory group, expects the new service to create a more desirable environment for all parties involved in a variable annuity fund transfer and remain in compliance with regulatory guidelines.

"With an automated process, financial advisors will find it much easier to service their clients; broker-dealers will have much more control over monitoring and documentation than they do today; and there'll be a complete audit trail," Marynowski said. "In addition, advisors will have a single, standardized way to execute these transactions and will know immediately that the transfer has been completed properly."

Step one begins with a rep request to a distributor's front-end system. Using Insurance Services' new real-time function, Policy Inquiry, the distributor can request and receive the most current contract information on the variable annuity in addition to any trading restrictions that a carrier has put in place. This allows the distributor to validate that the transfer request is in sync with its own and the carrier's requirements, and approve it.

The distributor then uses Fund Transfers to forward the request to the carrier for immediate pre-cycle validation and confirmation that the request is either "pending approval" or rejected. This will all be handled in real time, with each step completed within seconds.

If the transfer is approved, the carrier will transmit it during that evening's batch process. Once that happens, the distributor will receive a post-cycle transaction confirmation and have the option to receive comprehensive details of the completed fund transfer, along with other financial activities such as disbursements, rebalances and asset allocation changes, through Insurance Services' Financial Activity Reporting service.

As Marynowski suggested, the net result will be a multiple win for the industry and its investors, reducing costs, expanding efficiencies and eliminating a problem through best practices, innovative technology and wide and consistent use of data standards. Such a business model could have far-reaching benefits, way beyond the transfer of funds, in meeting the needs of a changing industry whose customers will continue to demand better accountability.

DTCC plans to begin pilot-testing the new service in September and launch it before the end of the year. For more information, contact DTCC's Insurance Services at 1 800 422-0582. amn