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## People are Talking about "OIDs"

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By Kerry Pechter      Thu, Aug 19, 2021

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*The California Insurance Commissioner fined Jefferson National Life (owned by Nationwide) after an 86-year-old contract owner claimed that she didn't understand the variable annuity that her Investment Advisor Representative had recommended.*

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Outsourced insurance distributor (OID) is an expression (and an acronym) that I never heard before last Monday, though I've written several articles about them.

These are online annuity distribution platforms like RetireOne and DPL Financial Partners. Registered Investment Advisors (and their Investment Advisor Representatives, or IARs) without insurance licenses can use OIDs to learn about the no-commission annuities that life/annuity companies have created for the RIA market. Licensed OID agents can broker the sale of an annuity to the IAR's client.

Now, thanks to a case in California, questions have arisen: Who should bear responsibility for the suitability of an annuity sale on an OID? Should it be the platform's agents, the insurance carrier who issued the annuity, or the RIA adviser who recommended the annuity to his client? This issue was the subject of a spirited discussion on LinkedIn this week.

Three weeks ago, on July 29, the Insurance Commissioner of California announced the settlement of a complaint against Jefferson National Life Insurance, the direct provider of low-cost, investment-only variable annuities to RIAs. Nationwide bought Jefferson National in 2017.

An IAR, on behalf of an 86-year-old client, had exchanged (using the customary "1035 exchange" process) three existing variable annuities, involving some \$636,000, for Jefferson National Life Monument variable annuities between 2015 and 2017.

Some of the exchanged annuities were evidently still within the so-called surrender period (the initial post-sale years during which a carrier typically recaptures the commission it paid to the agent or broker in the original sale). So the elderly client had to pay about \$16,682 in surrender charges.

The client's bank, noticing large checks to Jefferson National, alerted the client in 2017.

The client complained to the California Insurance Commission. She said she didn't understand what had been going on.

**'Know your customer'**

That led to an investigation and to the recent settlement. Without acknowledging guilt or innocence, Jefferson National agreed to refund \$14,342 in surrender fees to the client and to pay California a fine of \$150,000. The settlement was signed by Craig A. Hawley, Nationwide's head of annuity distribution and the president of Jefferson National.

The regulator said that Jefferson National's "sales process did not include an adequate independent review of the recommendations of [its] annuities by the non-insurance licensed investment adviser [or] ...an independent analysis of Consumer's insurance needs and of the financial objectives of the Consumer at the time of the transactions recited herein, as required by California Insurance Code §10509.910."

The RIA in the case was not cited for any misconduct—perhaps because state insurance commissioners don't regulate RIAs. But some believe the case should raise issues for RIAs.

Michelle Richter, founder of [Fiduciary Insurance Services LLC](#), which advises companies on hybrid insurance-annuity businesses, claimed that the "Know Your Customer" (KYC) rule established by FINRA (Financial Industry Regulatory Authority) looms over this case.

The KYC rule says: "Every [FINRA] member shall use reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer." FINRA doesn't regulate RIAs, but RIAs may have broker-dealers that FINRA regulates.

The extent of the RIA's responsibility for following the KYC rule needs more "clarity," Richter commented on LinkedIn. "The clarity over who is responsible for annuity know-your-customer (KYC) in the event of placement by an insurance-licensed individual who isn't the regular adviser is not there," she wrote.

"When FINRA weighs in on this case, I think we will see a push from distribution overseers for answers to two questions: Do RIAs need to have insurance consultants' licenses to charge fees on AUM that includes insurance? And, do OID/direct-placing-insurers need to expressly speak with an RIA's client when an annuity is being placed?" she added.

Richter invoked the principle that if RIAs are charging advisory fees on the account value of an annuity in their clients' portfolios—a relatively new practice for fee-based advisors—then they need to be accountable for an annuity sale that they recommend and seek.

But that could threaten the viability of the OID business. RIAs are not likely to get their insurance licenses just to help a few clients acquire an occasional annuity, or merely to execute a few 1035 exchanges for new clients. RIAs remain a tiny market for annuities.

David Stone, the founder of RetireOne (and of ARIA, a pioneer in the field of lifetime income riders for investment portfolios) told *RIJ* in an email that OIDs are providing adequate oversight over transactions involving RIAs, insurance-licensed OID agents, and insurance carriers.

"It is the OID rep/agent that determines if a transaction is in the client's best interest and not the RIA," Stone wrote. "Every transaction goes through a full suitability/best interest assessment. All OID reps/agents are subject-matter experts in the solutions offered and are typically salaried employees of the OID and whose compensation is not tied to the sales of any particular solution or carrier."

He added: "Our model is similar to the old Vanguard model with the big difference being the open architecture. We offer access to multiple carriers and solutions."

(He's referring to the period when Vanguard had an annuity phone desk where consumers could buy white-label annuities direct from salaried, insurance-licensed Vanguard employees. I worked in annuities at Vanguard when this was still the case. Vanguard has never owned a life insurer, or issued annuities, and has since discontinued distributing them.)

David Lau, founder of DPL Financial Partners (and a co-founder of Jefferson National), told *RIJ* in an email that the OID model—which was not under scrutiny in the California case, in which the RIA dealt directly with an agent of the annuity issuer, Jefferson National—is working.

The IARs, he said, based on their knowledge of the client, merely refer clients to the OID, which is accountable for the suitability of the annuity sale.

"The general model for insurance professionals working with RIAs has been in place for a long time and is the same whether you are providing commission-free annuities or commissioned ones: the RIA is a referral source for clients. RIAs are not unique in being

referral sources to insurance professionals," Lau wrote.

"As the licensed agent, once working on a recommendation for a client, it is incumbent [on the OID] to be compliant with the regulations regardless of how the client came to you. At DPL, we hold ourselves to a fiduciary standard in regard to our recommendations," he added.

"The OID model also trains non-insurance licensed RIA's about the do's and don'ts of how to engage with insurance. The bottom line is if [RIAs] are not licensed, they cannot solicit, negotiate, or transact insurance. So they work with the OID through a referral process."

To me, this whole case sounds more like a misunderstanding than a legal or ethic violation. It is muddled by the fact that Jefferson National was both the issuer of the new annuity and the agent-of-record, as well as by the client's advanced age—an age when many people become inattentive to the details of their finances.

Given the available evidence, which doesn't include the fees the 86-year-old client had been paying on her existing annuities, the IAR appears to have done what you would expect an IAR to do when acquiring a new client who already owns variable annuities.

She was probably trying to reduce the client's VA expenses by exchanging the client's presumably high-fee existing VAs for a single \$20-per-month Jefferson National contract. With \$636,000 in VAs, the client could have been paying \$20,000 or more in annual fees. Therefore it might have made sense for her to pay \$16,000 in surrender fees to eliminate almost all current and future VA contract fees.

Unfortunately, we don't know if the client stood to lose any valuable living benefits—like guaranteed income for life—by exchanging her previous contracts. Given the age of the client and the fact that the contracts were still in their surrender periods, that was probably not the case.

Richter, nonetheless, believes that regulatory bodies need to catch up with new circumstances in the retirement industry, such as the development of fee-based annuities, of in-plan 401(k) annuities, and of retirement portfolios that contain both investments and insurance products. These hybrid solutions have the potential to test jurisdictional boundaries.

"I feel that RIAs advising on assets including insurance should need insurance consultants' licenses in the future," she wrote. "But I have seen no guidance suggesting that this is

required, and if it were, how it would be policed, since insurance is regulated state-by-state and not federally as securities are."

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