

# RESEARCH BRIEFINGS



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## Enabling STP for Annuity Business

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### Summary

LIMRA International and the National Association for Variable Annuities (NAVA) jointly conducted a survey to assess the status of the annuity industry's standardization and straight-through processing (STP) developments. The survey was sent to NAVA and LIMRA members, including NAVA's Operations, Technology and Regulatory Affairs committees. There was one reply per company. Forty-five companies responded, 26 representing manufacturers and 19 representing distributors.

NAVA has been working on an STP initiative for five years. Industry working groups have developed some of the necessary standards, but clearly there is more that needs to be done. This survey was conducted to allow for wider input from the industry.

### Key Survey Findings

- New business submission is ranked as the most important business-critical area by companies implementing STP.
- Ninety-one percent feel that industry standards are necessary to achieve broad implementation of STP in the annuity industry.
- Seventy-two percent have begun to implement STP; 20 percent plan to but have not begun.
- Eighty-seven percent feel the industry needs to resolve state-specific issues for STP to be successful.
- Suitability requirements, NAIC replacement issues, and appointment procedures were identified as key areas for creating operational best practices.
- Department of Insurance (DOI) conformity, e-signature, and data conformity were ranked as the top three enabling capabilities needed to implement STP.

NAVA will use information from this survey to identify and prioritize the next key areas of focus for the annuity industry regarding STP.

In order to comply with the ever-increasing number of regulatory issues affecting the annuity industry and to remain competitive in today's financial services market (including the growing retirement income market), companies are realizing the importance of developing automated systems for the straight-through processing (STP) of annuities. The ability to process transactions with less paperwork, eliminate duplicative efforts, and build in compliance parameters is critical to the industry. This change to an automated functionality will require more than just the increased use of technology. It will involve streamlining processes, addressing regulatory interpretations, and coordinating implementation efforts.

In 2003, the industry held a strategy summit to develop a blueprint of future-state STP.<sup>1</sup> Participants at that meeting of 50 senior-level operational and IT executives, representing both manufacturers and distributors, reached consensus with respect to issues, goals, trends, and the necessary enabling capabilities. Over the past two years, the annuity industry has been working on the building blocks that it identified as crucial, including data formats, a common data dictionary, standardized forms, and industry best practices. The blueprint is also being endorsed by other industry groups.

To determine the current status of the annuity industry's STP implementation, and to help prioritize the importance of future standardization initiatives, LIMRA and NAVA jointly sponsored a survey of annuity manufacturers and distributors to identify what the industry views as important next steps.

The survey was comprised of three sections — Industry Standards, STP Issues, and Compliance. Industry Standards covered the development and adoption of standards; STP Issues covered the components that hinder adoption; and Compliance covered critical regulatory requirements.

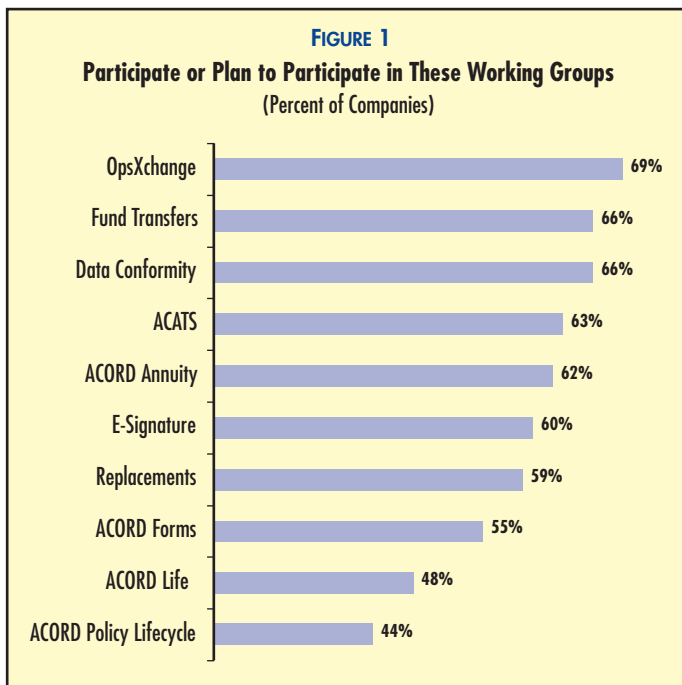
### Industry Standards

In 2001, NAVA's Technology Committee decided to support and encourage the use of XML open data messages as the industry standard. NAVA partnered with ACORD (a standards setting organization for the insurance industry) in creating XML standard data messages for annuities. The committee also decided that the existing DTCC flat file formats, if made open and available to the industry, would be considered "defacto" industry standards. The

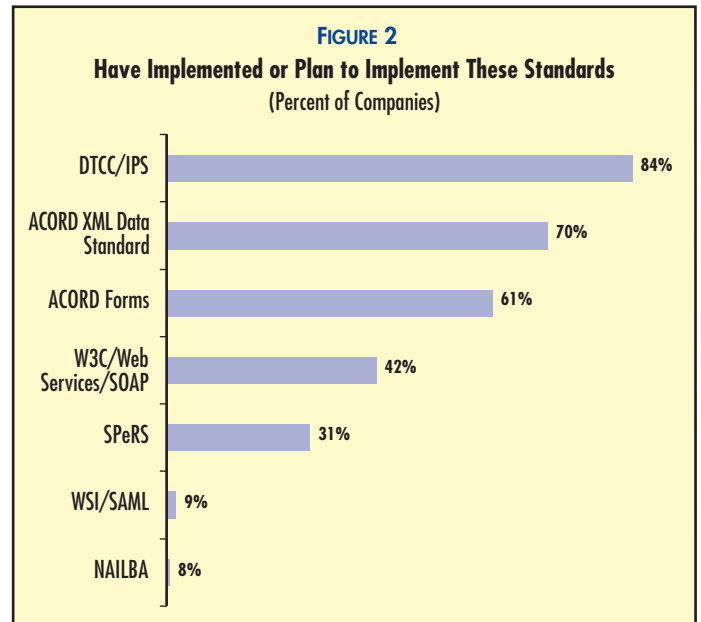
<sup>1</sup> A copy of the blueprint is available at [www.navanet.org/industry/NAVASummitBlueprint.pdf](http://www.navanet.org/industry/NAVASummitBlueprint.pdf).

group further agreed that all future data messages would be developed in ACORD XML. These standards are now being created and used by various industry working groups.

**Participation in Creating Standards** — A key ingredient needed to successfully implement STP for annuities is the buy-in and involvement of industry players. While there are many different points of view and levels of participation in the process, the overwhelming majority of survey respondents (91 percent) agree that industry standards in general are necessary to achieve broad STP implementation. To get a snapshot of how committed each company is to developing standards, respondents were asked to indicate their participation in various working groups. A majority of the respondents currently participate or plan to participate in an industry annuity-focused working group — the exception being working groups that relate to traditional life products (Figure 1).



**Intention to Use Standards** — In terms of actually implementing specific standards, the vast majority of companies surveyed have implemented or plan to implement DTCC/IPS, ACORD XML data standard, and ACORD forms. Companies indicate they have lower adoption rates for other standards such as W3C/Web Services/SOAP, SPeRS, WSI/SAML, and NAILBA (Figure 2). As STP development progresses, these other standards may become more widely used as companies grapple with the encryption and security issues addressed by these standards.

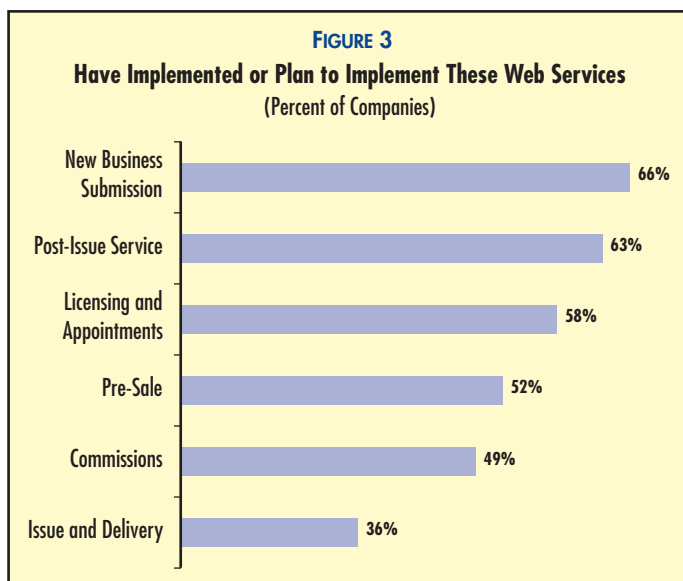


While the efforts of various working groups and the adoption of the product profile (the first ACORD annuity data message) have already reduced the number of proprietary feeds the industry uses, opinions differ as to whether it is possible for one standard to fit all needs. This was evident when participants were asked whether different distribution channels would require different standards. Responses were fairly evenly distributed between those who strongly agree and those who strongly disagree. However, a number of participants feel that what the industry really needs is a standard flexible enough to meet the varying needs of each distribution channel.

Survey respondents generally acknowledge that the industry is moving forward in adopting standards — but feel the progress is slow. As one respondent put it, “The annuity industry is a mature industry and change takes time — especially when there are so many differing legal interpretations and levels of system preparedness.” Another respondent feels the industry is “starting to see progress, but many wait for the big wirehouses to lead in this area.” There is also the feeling that significant progress in accepting standards will be made only when the big players step up to the plate. These mixed feelings were evident when respondents were asked whether the annuity industry is making reasonable progress in adopting industry standards. Fifty-six percent neither agree nor disagree. The remaining 44 percent are evenly split between those who agree and those who disagree.

**Use of Web Services** — Web services are XML-based information exchange systems that use the Internet for direct application-to-application interaction or real-time processing. These systems can include programs, objects, messages, or documents.

Real-time processing is an important piece of the overall design for STP. To better understand where companies are most likely to use this technology and to help prioritize future projects, respondents were asked to indicate their current or planned use of Web service technology for real-time messaging. The top three areas survey participants selected are new business submission, post-issue service, and licensing and appointments (Figure 3).



**Comparison Between Manufacturers and Distributors on Industry Standards** — Both manufacturers and distributors feel strongly that industry standards are necessary to achieve broad implementation of STP in the annuity industry (96 percent and 84 percent, respectively). Actual participation within working groups, however, differs greatly between these two sectors. Manufacturers are far more involved in working groups than distributors and a much higher percentage of distributors have no plans to participate. Despite this lack of involvement in the process, 95 percent of distributors have begun to implement or plan to implement STP (vs. 89 percent of manufacturers). When asked whether the industry is making reasonable progress in adopting standards, 27 percent of the distributors agree or strongly agree while 63 percent neither agree nor disagree. Among manufacturers, 19 percent agree and 50 percent neither agree nor disagree.

When it comes to implementing specific standards, many manufacturers and distributors have implemented or plan to implement DTCC/IPS, ACORD forms, and/or ACORD XML data standards. The percentage of manufacturers that have implemented or plan to implement these standards, however, is higher (and in some cases much higher) than the percentage of distributors (88 percent vs. 79 percent for DTCC/IPS; 73 percent vs. 44 percent for ACORD forms; and 89 percent vs. 44 percent for ACORD XML data standard). It should be noted that many of the distributors are using front-end solution providers, all of whom use the ACORD XML data standard.

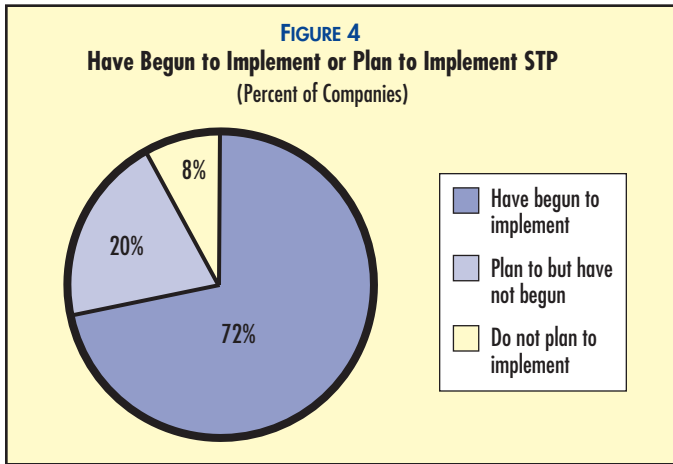
In terms of Web services, many manufacturers and distributors have implemented or plan to implement real time processing in the areas that affect them most directly. Manufacturers show a much higher propensity to implement Web technology for pre-sale (67 percent vs. 33 percent) and post-issue service (74 percent vs. 47 percent) than distributors. Distributors, on the other hand, focus more on new business submissions (78 percent vs. 57 percent) and commissions (70 percent vs. 32 percent).

### **STP Issues**

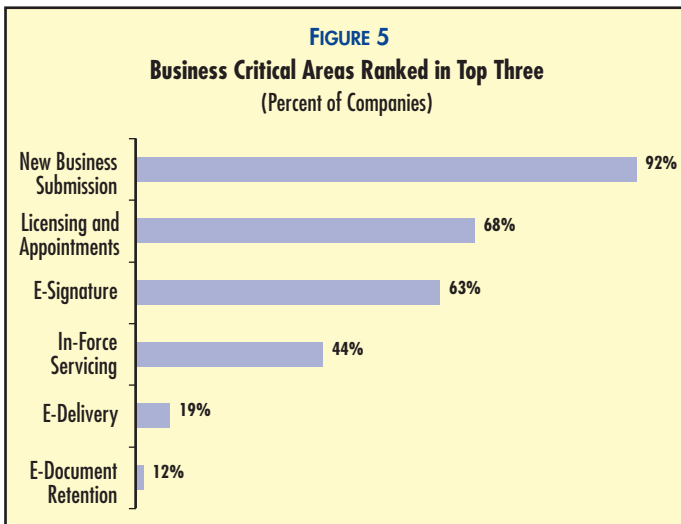
Along with the development of the blueprint of future-state STP, participants in the 2003 strategy summit identified three challenge areas that need to be addressed for STP to be paperless, compliant, and seamless — technology, company operations/compliance, and regulatory agencies. The technology challenge was to create standard tools and a framework that would enable STP transactions to occur. The company operations/compliance challenge was to develop operational best practices that would be interpretive in nature and within the internal control of each company to implement. The regulatory agencies challenge was to effect desired change through discussion and negotiations with regulators at the federal and state levels.

Many of the working groups mentioned in the Industry Standards portion of this report have created enabling capabilities in the area of technology, and some have done so in the area of company operational best practices. When analyzing why companies have or have not begun implementation, it is helpful to find out what business-critical areas are most important to them, what enabling capabilities are priorities in STP, and what they see as obstacles to implementation.

Seventy-two percent of the companies surveyed have already begun to implement STP; 20 percent plan to implement STP but have not yet begun (Figure 4).

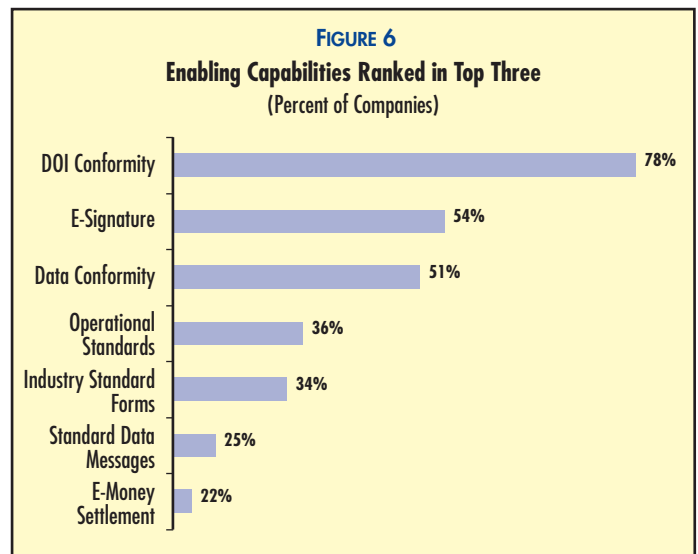


When asked to rank the top three business-critical areas for their companies in terms of implementing STP, 92 percent of respondents name new business submission, 68 percent cite licensing and appointments, and 63 percent rank e-signature in the top three (Figure 5).



As discussed earlier, numerous enabling capabilities have been identified as crucial for STP implementation. While working groups have made progress in creating some of them, much work remains to be done, particularly with issues relating to operations/compliance and regulatory agencies. The survey identified several key areas the industry needs to tackle — DOI conformity, e-signature, and data conformity (Figure 6).

Implementation of STP is a complex issue with a variety of obstacles. Different business-critical areas face different challenges from different sectors. The one issue that cuts across all sectors in the survey, however, is e-signature. Eighty percent of respondents feel e-signature is a key

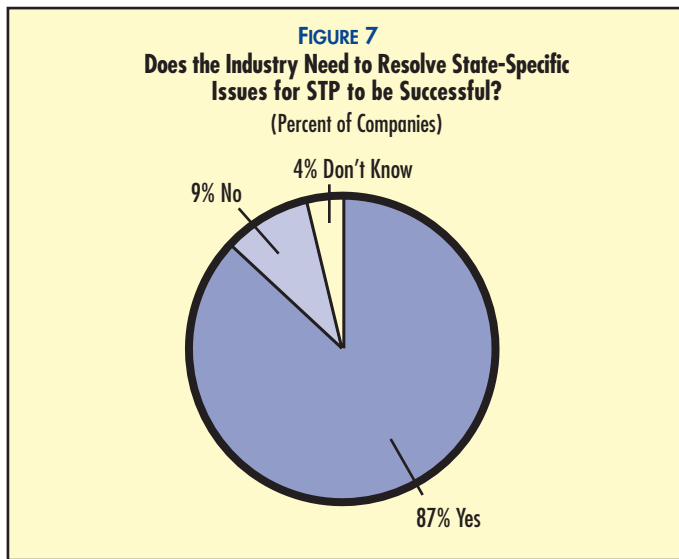


obstacle for their companies in the regulation and compliance area; 60 percent in technology; 51 percent in adoption rate; and 44 percent see it as an operational obstacle. Given the current complexity of the sales process, the increased focus on compliance issues, and the need to obtain signatures on an ever-increasing number of documents, overcoming the e-signature obstacle will be critical in the evolution to STP.

In addition to e-signature, when asked to identify their greatest obstacles to implementing STP, participants chose cost and time to implement, use and implementation of standards, and regulatory conformity (Table 1).

For your company, what is the greatest obstacle to implementing STP?		
Category	Number of Companies	Sample
Cost and time to implement	14	"Limited technology resources and cost are equally important obstacles."
Use and implementation of standards	14	"Adoption of and implementation of industry standards across the industry. In some cases there may not yet be effective and affordable technology solutions to support STP initiatives, especially as many of the standards supporting STP are in their infancy."
Regulatory conformity	11	"Lack of DOI conformity drives carrier and distributor interpretation differences and undermines development of uniform best practices and standards."

Another key area to address in implementing STP is the impact individual state regulations have on the sale of annuities. Creating a system that helps companies overcome the challenges they face in uniformly interpreting the practices, standards, and regulations of each state is vital to gaining widespread acceptance of STP. The importance of this issue was evident when companies were asked whether the industry needs to resolve state-specific issues for STP to be successful. Eighty-seven percent said yes; 9 percent answered no; and 4 percent didn't know (Figure 7).



**Comparison Between Manufacturers and Distributors on STP Issues** — In terms of the top three business-critical areas for implementing STP, new business submission, licensing and appointments, and e-signature were ranked one, two, and three, respectively, by both manufacturers and distributors. But the obstacles to implementing STP in these areas were quite different. Manufacturers rate regulatory and compliance, and adoption rate as far larger obstacles in all business critical areas than distributors.

Manufacturers and distributors both agree that DOI conformity is the most important enabling capability for STP. Distributors also feel that e-signature, industry standard forms, and data conformity are priorities; manufacturers agree that e-signature and data conformity are important, but rank industry standard forms far lower than distributors (26 percent vs. 45 percent).

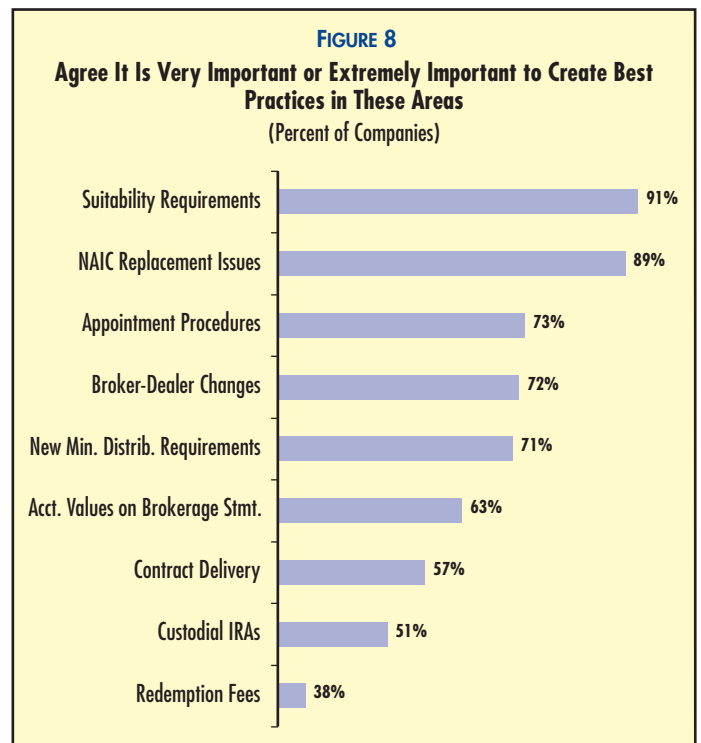
Both manufacturers and distributors agree that the industry needs to resolve state-specific issues for STP to be successful (88 percent for manufacturers; 84 percent for distributors).

**Compliance**

The sale of variable insurance products is subject to both federal and state regulations. Considered securities under federal law, variable annuity contracts are required to be registered under the Securities Act of 1933 and are subject to a number of federal rules, such as those relating to prospectus delivery and document retention. At the same time, they are also regulated as insurance products by the various state insurance departments.

On both levels, new and proposed regulations have imposed additional obligations on insurance companies and their distributors with regard to disclosure, sales practices, and suitability. Any STP solution must ensure compliance with these and all other federal and state regulatory requirements.

Many operational challenges pertaining to implementing STP in companies center on how to meet new and existing regulatory requirements. To better understand this area, companies were asked the importance of creating operational best practices for the industry in specific areas. Suitability requirements (regular and senior) are rated as very important or extremely important by 91 percent of respondents. This is followed closely by NAIC replacement issues, which 89 percent rate as very or extremely important. Other issues of importance include appointment procedures, broker-dealer changes, and new minimum distribution requirements (Figure 8).



To meet these challenges, many companies are turning to technology. When asked to describe how their companies use or plan to use technology to support compliance requirements related to implementing STP, many respondents focused on built-in suitability and compliance rules along with the use of e-signature. Table 2 summarizes the responses received.

Table 2		
Please describe how your company uses or plans to use technology to support compliance requirements related to implementing STP.		
Category	Number of Companies	Sample
Create order entry and work flow systems that ensure compliance and regulatory requirements are met	17	“Our order entry system has a great deal of compliance requirements built in to indicate when a sale is outside of normal tolerances. Any sale that is outside of tolerances is electronically routed to PRD for review and repair if necessary.”
Undecided	11	“We are in discussion with our compliance area at this time.”
Address signature requirements through e-signature	5	“[We plan] to engage in e-signature initiatives that will satisfy state and federal regulations and limit manual intervention and paper that remains part of the annuity servicing process.”

**Comparison Between Manufacturers and Distributors on Compliance** — When asked to identify key areas for creating operational best practices, both manufacturers and distributors rate suitability requirements (regular and senior) as very important or extremely important (88 percent and 95 percent, respectively). While both also rate NAIC replacement issues as very important or extremely important (92 percent and 84 percent), distributors rate broker-dealer changes far higher than manufacturers (85 percent vs. 64 percent).

**Conclusion**

The annuity industry has made significant progress over the past few years in developing many of the components needed for STP, but a great deal of work remains to be done. The industry now needs to pull these components together with a uniform approach in order to address the critical business areas identified.

**LIMRA and NAVA thank the following companies for their participation:**

**Manufacturers:**

- Aegon
- AIG/SunAmerica
- Allianz Life Insurance Company
- Allstate Financial
- AXA Equitable Life Insurance Co.
- Fidelity Investments Life Insurance Co.
- Genworth Financial
- Guardian Insurance and Annuity Company
- Hartford Life
- ING USA Annuity & Life Insurance
- Integrity Companies
- Jackson National Life
- John Hancock
- Lincoln Financial Group
- MassMutual Financial Group
- MetLife (including Travelers)
- Minnesota Life
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