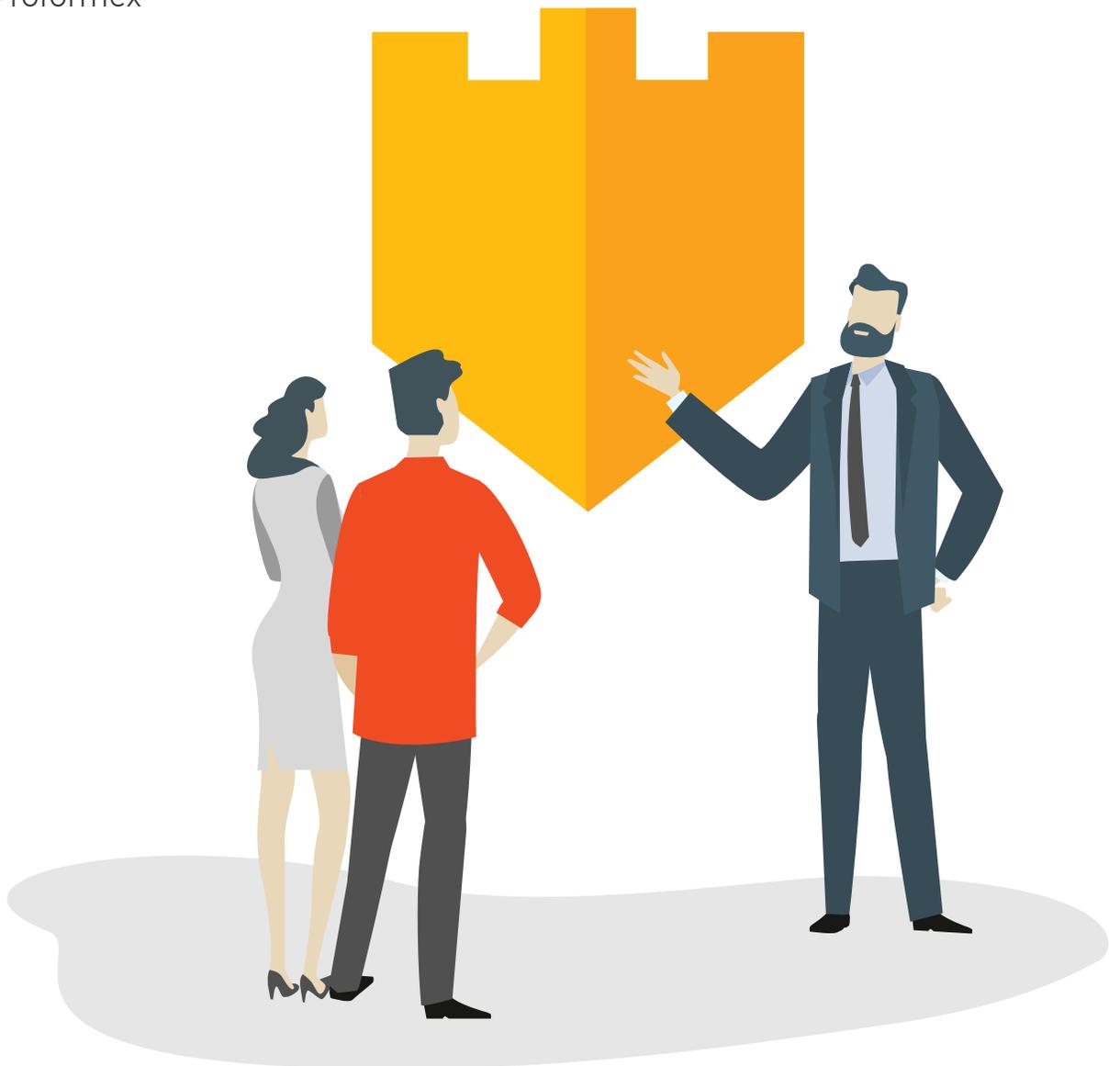


EXECUTIVE BRIEFING

An In-Depth Look: Best Interest Standards for Life Insurance



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Best Interest Standards: Where did they start, where are they now & where are they going?

“Best interest standards” are regulations that require carriers and producers that sell life insurance to establish criteria and processes overseeing product recommendations given to retail consumers. Under best interest standard regulations, all investment recommendations given to consumers must be made with the consumer’s needs top of mind. The ultimate

goal is to protect the consumer and define the ethical duties of agents and advisors selling life insurance. This paper takes a deeper look of how best interest standards have been introduced to the life insurance industry, the various moves made on the state level to legislate these standards, and the future direction of the industry.

A brief history of Fiduciary & Best Interest Standards

The idea of legislating best interest standards regulations was initially introduced to the life insurance industry shortly after the United States Department of Labor (DOL) proposed the “Fiduciary Rule”.

The premise of the Fiduciary Rule was inherently simple – if financial service providers want to offer advice to their clients, they must put their clients’ interests above their own. However, there was much debate on the scope and impact of implementing this rule. The U.S. Fifth Circuit Court of Appeals vacated the DOL Fiduciary Rule in June 2018.⁴

In response to the DOL Fiduciary Rule being vacated, individual states such as New York, New Jersey, California,

Massachusetts, Illinois, Connecticut, Maryland and Nevada began proposing their own statutory adaptations of this rule.⁵ The most impactful has been New York’s best interest standards regulations, which were formally approved on July 17, 2018 and went into effect as of August 1, 2019.¹

Most recently the Securities and Exchange Commission (SEC) proposed a Regulation Best Interest (referred to as Reg BI) to escalate its legislation to the national level and avoid the potential confusion of having different versions of best interest standards regulations in all 50 states. On June 5, 2019, Reg BI was approved in a 3-1 vote by the SEC.³

Current Best Interest Standards Legislation – New York

As the financial epicenter of the United States, New York was one of the first states to craft its own interpretation of suitability and best interest standard regulations for annuities and life insurance in July 2018. The NY Department of Financial Services (DFS) proposed what is known as the “First Amendment to 11 NYCRR224 (Insurance Regulation 187)” – often shortened to “NY DFS Reg. 187”.¹ The regulation has since been published and implemented, but what material changes were made with its passing?

Primarily, NY DFS Reg. 187 requires agents and advisors selling annuities and life insurance to maintain a significant amount of documentation regarding their clients’ financial needs and the advice they may offer clients to help meet those needs. Specifically, in regard to the “suitability” portion of the standard, advisors must adhere to a strict ruling that requires the advisor to gather a number of data points relative to a client’s financial situation and objectives before making any product recommendations.

In other words, advisors must explicitly articulate through the data they collect how their recommendation aligns with the client’s needs, one of the most important factors of which is affordability. Moreover, the advisor must illustrate a fair and accurate presentation of the products and how said products can be incorporated into client-specific goals and plans for the future.

All of this documentation must clearly demonstrate that the advisor acted in accordance with the Prudent Person Rule² which states that the recommendation must “reflect the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under the circumstances then prevailing”. The legislation holds advisors accountable to a higher standard of care and guarantees protection of consumers.

The Future of Best Interest Standards – Reg BI

After seeing other states following New York’s lead, the SEC decided to draft, and vote to pass, Regulation Best Interest or Reg BI. The centerpiece is a requirement of brokers to act in clients’ best interests. Reg BI attempts to improve retail consumer investor protections beyond suitability but not to the extent of the DOL’s Fiduciary Rule.

According to the SEC, Regulation BI consists of four main sections referred to as “obligations”:



1. Disclosure Obligation

Broker-dealers must disclose material facts about the relationship and recommendations of the products and services they provide.



2. Care Obligation

Broker-dealers must exercise reasonable diligence, skill and care when making a recommendation to the retail customer. The broker-dealer must understand potential risks, rewards and costs associated with the recommendation.



3. Conflict of Interest Obligation

Broker-dealers must establish, maintain and enforce written policies and procedures reasonably designed to identify – and at a minimum – disclose or eliminate conflicts of interest. These policies and procedures must:

- Mitigate conflicts that create an incentive for the firm’s financial professionals to place their interest, or the interests of the firm, ahead of the retail customer’s interests;
- Prevent material limitations on offerings – such as a limited product menu or offering only proprietary products – from causing the firm or its financial professional to place their interest or the interests of the firm ahead of the retail customer’s interests; and
- Eliminate sales contests, sales quotas, bonuses and non-cash compensations that are based on the sale of specific securities or specific types of securities within a limited period of time.



4. Compliance Obligation

In an enhancement from the original proposal, broker-dealers must establish, maintain and enforce policies and procedures reasonably designed to achieve compliance with Regulation Best Interest as a whole.

While proponents of Reg BI are confident that this legislation will ensure clients’ best interests will always take precedence over those of the advisor or the firm, many critics fear the regulations are not strict and specific enough. Some consumer protection groups argue that the disclosures can protect advisors in nearly every instance short of outright fraud and that the implementation of these regulations must be more stringent with severe penalties outlined.

Experts will continue to analyze Reg BI in its entirety, but advisors should not wait to begin establishing compliance with these new regulations. As of now, all registered financial services firms and advisors must be compliant with Reg BI by June 30, 2020.³

About the Author - Kris Beck

Kris is the Chief Executive Officer at Proformex, an inforce policy management platform for life insurance. Proformex protects the investment that hundreds of millions of Americans make in life insurance to protect families and grow wealth by helping producers and financial advisors proactively monitor policy performance against client objectives.

About Proformex

Proformex provides life insurance inforce policy management solutions to independent agents, financial advisors and trustees. The multi-carrier and distribution agnostic platform enables users to securely store, manage and analyze their entire inforce book of business in one place. Designed to proactively monitor policy health, Proformex expedites the policy review process and proactively identifies potential problems with a client's life insurance policy, protecting policies against lapsing, degradation and asset erosion.

References

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4: "[Everything You Need to Know About the DOL Fiduciary Rule](#)", Published June 25, 2019 by Mitchell Grant on Investopedia

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