

October 2015

## Death of a Salesman: The Rise & Unfortunate Potential Demise of the Full-Time Life Insurance Salesman

Robert M. Rosh

Follow this and additional works at: <https://scholarship.law.stjohns.edu/lawreview>



Part of the [Insurance Law Commons](#)

---

### Recommended Citation

Robert M. Rosh (2014) "Death of a Salesman: The Rise & Unfortunate Potential Demise of the Full-Time Life Insurance Salesman," *St. John's Law Review*. Vol. 88 : No. 4 , Article 3.

Available at: <https://scholarship.law.stjohns.edu/lawreview/vol88/iss4/3>

This Article is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact [selbyc@stjohns.edu](mailto:selbyc@stjohns.edu).

# DEATH OF A SALESMAN: THE RISE & UNFORTUNATE POTENTIAL DEMISE OF THE FULL-TIME LIFE INSURANCE SALESMAN

ROBERT M. ROSH<sup>†</sup>

## I. BACKGROUND

Pity the poor life insurance salesman.<sup>1</sup> The “Father Knows Best”<sup>2</sup> era of the first half of the twentieth century where life insurance sales was portrayed as a respected pursuit is long over.<sup>3</sup> There were, of course, exceptions to this popular culture portrayal, such as Fred McMurray’s co-conspirator role in “Double Indemnity.”<sup>4</sup> Nevertheless, life insurance salesmen had

---

<sup>†</sup> Adjunct Professor of Insurance Law at St. John’s University School of Law and Vice-President & Deputy General Counsel at New York Life Insurance Company. J.D., Columbia Law School, 1991; Ph.D., State University of New York, 1986; B.A., Clark University, 1982. The views expressed in this Article are solely those of the author and do not necessarily reflect the views of New York Life. The author would like to thank Jessica Rosh, Guillermo Martinez, Crystal Venning, Jeffrey Drummond, and his very own salesman, Bill Mahoney, for their invaluable help and assistance.

<sup>1</sup> The profession remains overwhelmingly male, and I refer to people selling life insurance as salesmen, not salespeople. See Robin Leidner, *Serving Hamburgers and Selling Insurance: Gender, Work, and Identity in Interactive Service Jobs*, 5 GENDER & SOC’Y 154, 158, 161 (1991). For example, in 2010, there were a total of 163,814 affiliated agents of which twenty-two percent were female. MARGARET S. HONAN, LIMRA, LIMRA’S CENSUS OF U.S. SALES PERSONNEL 23 (2010). The industry needs more women and minority agents, including LGBT agents, because these constituencies are particularly underserved.

<sup>2</sup> See *Father Knows Best*, IMDB, <http://www.imdb.com/title/tt0046600/> (last visited Mar. 21, 2015). Jim Anderson, the main character, who was the wise patriarch of a prototypical 1950s show, was a well-respected insurance salesman. See *Father Knows Best*, MUSEUM OF BROADCAST COMM., <http://www.museum.tv/eotv/fatherknows.htm> (last visited Mar. 21, 2015).

<sup>3</sup> While far from an unambiguous public relations comeback, the portrayal of agents in the movie “Cedar Rapids” was at least a step forward. CEDAR RAPIDS (Fox Searchlight Pictures 2011).

<sup>4</sup> DOUBLE INDEMNITY (Paramount Pictures 1944); see also FOOL COVERAGE (Warner Bros. Pictures 1952) (Daffy Duck’s role as the uninvited life insurance salesman in the 1952 short is another exception).

status and political clout, peaking in the 1950s, and were not the general source of ridicule that they are in modern society and somewhat more recent media, including films such as “Groundhog Day” and “Take the Money and Run.”<sup>5</sup> Similarly, the comment made by Chief Justice Holmes in 1911 that “life insurance has become in our days one of the best recognized forms of investment and self-compelled saving”<sup>6</sup> no longer applies. Financial “experts” now routinely advise people to buy term and invest the difference, typically in no-load indexed mutual funds or exchange traded funds (“ETFs”).<sup>7</sup> A modern Frank Capra<sup>8</sup> would have a tough time with a no-load mutual fund as plot device, but it would be highly unlikely for a modern George Bailey<sup>9</sup> to have his limited personal net worth tied up in a whole life insurance policy.<sup>10</sup>

#### A. *Life Insurance Is a Tough Sale*

Permanent life insurance is a tough sell under the best of circumstances.<sup>11</sup> As a general rule, people do not like discussing their own mortality under any circumstances, never mind with a salesman.<sup>12</sup> It is one of the few products on the market where the

<sup>5</sup> GROUNDHOG DAY (Columbia Pictures 1993) (portraying an insurance salesman as the most annoying person to bump into on the street); TAKE THE MONEY AND RUN (Cinerama Releasing Corp. 1969) (Woody Allen's character is “tortured” by being forced to spend time in solitary confinement with a life insurance salesman).

<sup>6</sup> Grigsby v. Russell, 222 U.S. 149, 156 (1911).

<sup>7</sup> See, e.g., Suze Orman, *Suze Orman's What-If Policy*, O, THE OPRAH MAG., Jan. 2004, at 27, available at <http://www.oprah.com/money/Suze-Ormans-What-If-Policy> (“[T]he only type of life insurance that makes sense is term.”); *Understanding Affordable Term Life Insurance*, NETQUOTE, <http://www.netquote.com/life-insurance/save/affordable-term-life-insurance.aspx> (last visited Mar. 21, 2015) (“[F]or most people, the right type of life insurance can be summed up in a single word: term.”).

<sup>8</sup> Director of the movie “It’s a Wonderful Life.” IT’S A WONDERFUL LIFE (RKO Radio Pictures 1946). A whole life insurance policy is a major plot device—what Director Alfred Hitchcock would call a MacGuffin—because the lead character decides to commit suicide after the Bailey Building & Loan that he runs misplaces depositors’ monies and he is told that he is worth more dead than alive. *Id.*

<sup>9</sup> Lead character in the movie “It’s a Wonderful Life.” *Id.*

<sup>10</sup> However, the Bailey Building & Loan might now decide to purchase a significant amount of Bank Owned Life Insurance. *Id.*

<sup>11</sup> See GLENN S. DAILY, <http://www.glenndaily.com/history.htm> (last visited Mar. 21, 2015), for comments of former New York Life CEO Sy Sternberg made in 2005.

<sup>12</sup> See *id.*; Karen Demasters, *Life Insurance ‘Conversation’ Lacking, Survey Says*, FIN. ADVISOR (Sept. 13, 2012), <http://www.fa-mag.com/news/people-lack-life-insurance-survey-says--11946.html>.

people most interested in buying it—the unhealthy—are the people whom the manufacturer does not want their sales people to sell it to.<sup>13</sup> The high loads to pay for high commissions, charged in part because it is a tough sell that requires high commissions, make whole life and other permanent forms of insurance an even tougher sell in today's no-load environment.<sup>14</sup> Combine a tough product to sell with the low status of the person doing the selling,<sup>15</sup> and is it any wonder why the average age of a life insurance salesman has increased dramatically,<sup>16</sup> as fewer and fewer people get recruited into, and remain in, the business?<sup>17</sup> Only the most resolute can stand that much rejection.<sup>18</sup>

But it gets worse. Life insurance salesmen have increasing trouble even communicating with a prospect long enough to get rejected. The National Do-Not-Call (“DNC”) Registry became

<sup>13</sup> But see generally Peter Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat*, 113 YALE L.J. 1223 (2004).

<sup>14</sup> The percentage of adults who own individual life insurance has declined from fifty-nine percent in 1960 to thirty-six percent in 2010. JLM, *The Decline of Life Insurance*, TRUST & WEALTH MGMT. MARKETING BLOG (Feb. 29, 2012, 9:43 PM), <http://trustmarketing.blogspot.com/2012/02/decline-of-life-insurance.html> [hereinafter JLM].

<sup>15</sup> In October 2010, only thirteen percent of consumers indicated that they had “an extreme amount” or quite a bit of confidence in insurance agents or brokers. JENNIFER DOUGLAS ET AL., LIMRA, LIMRA CONSUMER SENTIMENT TRACKING STUDY: OCTOBER 2010 UPDATE 6 (2010).

<sup>16</sup> The median age of a life insurance agent is fifty-six, while the median age of the U.S. worker is thirty-seven. Brian Anderson, *Facing up to an Aging Producer Workforce*, LIFEHEALTHPRO (July 1, 2012), <http://www.lifehealthpro.com/2012/07/01/facing-up-to-an-aging-producer-workforce>.

<sup>17</sup> The Great Recession has proved to be a boon to recruiting by mutual insurers, but the number of life insurance agents affiliated with a specific company is still down by nearly one-third since the 1970s. Fran Matso Lysiak, *Sales Force: US Mutual Life Insurers Work at Recruiting Career Agents*, BEST'S REV. (Aug. 1, 2012), available at <http://www.thefreelibrary.com/Sales+force%3a+US+mutual+life+insurers+work+at+recruiting+career+agents.-a0299257938>.

Geographically dispersed agency forces are expensive to grow and maintain and do not necessarily show immediate profitability. This is primarily why mutual insurers, which can be focused on the long-term and not just quarterly results, are the only companies that continue to focus on developing their own field forces. See *id.* This also helps to explain why companies that have demutualized have turned to brokers and away from a homegrown agency force.

<sup>18</sup> The life insurance industry also did not do itself any favors in the late 1980s and 1990s when it pushed the sales concept of “vanishing premiums” that proved highly problematic as interest rates and, consequently, dividends declined. See, e.g., *Gaidon v. Guardian Life Ins. Co. of Am.*, 94 N.Y.2d 330, 342–43, 725 N.E.2d 598, 602–03, 704 N.Y.S.2d 177, 181–82 (1999).

effective in October 2003,<sup>19</sup> and includes hundreds of millions of residential and wireless phone numbers.<sup>20</sup> It severely limits the ability of insurance agents to initiate a “cold call” solicitation of a potential customer.<sup>21</sup> Caller identification technology probably does not help, either. Similarly, the CAN-SPAM Act of 2003 severely regulates unsolicited commercial emails.<sup>22</sup> There are even some municipalities, such as Claremont, California, that have created “Do Not Knock” registries prohibiting insurance salesmen from knocking on people’s doors.<sup>23</sup>

### B. Coping Strategies

So what is a poor, disrespected, and dejected life insurance salesman to do? First, they often ditch the label of “life insurance salesman” by becoming registered representatives or financial advisers after getting a Series 6 or Series 7 license from the Financial Industry Regulatory Authority (“FINRA”).<sup>24</sup> Second, they often develop other outside business activities (“OBAs”) that can attract prospects to whom a life insurance salesman can pitch life insurance.<sup>25</sup> There are, however, some inherent problems with these two strategies.

---

<sup>19</sup> *Do Not Call List*, FCC, <http://www.fcc.gov/encyclopedia/do-not-call-list> (last visited Mar. 21, 2015).

<sup>20</sup> *FTC Issues The FY 2011 National Do Not Call Registry Data Book; Nearly 210 Million Phone Numbers on Do Not Call List*, FED. TRADE COMMISSION (Nov. 30, 2011), <http://www.ftc.gov/news-events/press-releases/2011/11/ftc-issues-fy-2011-national-do-not-call-registry-data-book-nearly>.

<sup>21</sup> Delivery Restrictions, 47 C.F.R. § 64.1200 (2015).

<sup>22</sup> See Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, Pub. L. No. 108-187, 117 Stat. 2699; 15 U.S.C §§ 7701–7713 (2014); 16 C.F.R. § 316.1 (2015).

<sup>23</sup> “Do Not Knock Registry”—*New Ordinance*, <http://www.ci.claremont.ca.us/download.cfm?ID=25364> (last visited Mar. 21, 2015). Perhaps the next limitation will be based on the song by The Police titled “Don’t Stand So Close to Me.” THE POLICE, *Don’t Stand So Close to Me*, on ZENYATTA MONDATTA (A&M Records 1981).

<sup>24</sup> See FINRA Rule 1031, available at [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=4260&element\\_id=3584&highlight=registration#r4260](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4260&element_id=3584&highlight=registration#r4260).

<sup>25</sup> See Suzanne Barlyn, *COMPLY-Why Moonlighting Brokers May Not Be a Bright Idea*, REUTERS, Aug. 8, 2012, available at <http://www.reuters.com/article/2012/08/08/brokers-moonlighting-idUSL2E8J359020120808>. Getting great leads has always been a risky proposition. See GLENGARRY GLEN ROSS (New Line Cinema 1992) (real estate agents take desperate measures to get the good leads).

## 1. The FINRA Risk

Many life insurance salesmen end up as registered representatives of insurance affiliated broker-dealers that only offer a limited range of products to customers, including proprietary variable life and variable annuity products.<sup>26</sup> FINRA has historically looked with disfavor at variable annuity sales and the life insurance salesmen who make them.<sup>27</sup> One problem that these agents often run into, because of the limited offerings of their broker-dealers, is that when all you have is a hammer in your toolbox, everything looks like a nail, and every need can be filled by a variable annuity.

This problem has been exacerbated by FINRA's recent expansion of its suitability rules,<sup>28</sup> which impose obligations and traps for the unwary on registered representatives if they sell a security to fund a life insurance policy or use life insurance or fixed annuities as part of an overall investment strategy.<sup>29</sup> If a uniform fiduciary duty is imposed on registered representatives under the Dodd-Frank Wall Street Reform and Consumer Protection Act,<sup>30</sup> it may well be that life insurance agents who are registered representatives will have a fiduciary duty imposed on many—if not all—of their life insurance sales activities.<sup>31</sup>

---

<sup>26</sup> See FINRA, REPORT ON CONFLICTS OF INTEREST 4, 29–30 (2013) [hereinafter FINRA Report], available at <http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p359971.pdf>.

<sup>27</sup> See SEC. & EXCH. COMM'N & NAT'L ASS'N OF SEC. DEALERS, JOINT SEC/NASD REPORT ON EXAMINATION FINDINGS REGARDING BROKER-DEALER SALES OF VARIABLE INSURANCE PRODUCTS 2, 25 (2004) [hereinafter JOINT SEC/NASD REPORT].

<sup>28</sup> FINRA Notice 12-25, 2012 WL 1898671, at \*1 (May 2012).

<sup>29</sup> See *id.* at \*1–2.

<sup>30</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank Act].

<sup>31</sup> See Anderson, *supra* note 16. Increasingly, insurance salesmen start out in their capacity as a registered investment advisor and provide a client with a financial plan that includes life insurance. Currently, they can “switch hats” at implementation when they sell a life policy to help with estate planning or sell a mutual fund. Not allowing this in the context of a mutual fund sale or variable universal life sale may be the first step in not allowing it in a fixed life sale. Professor Joseph Belth notes that Chartered Life Underwriters (“CLU”) have long taken a “golden rule” pledge. Joseph M. Belth, *No. 70: Fiduciary Standard of Care—Rekindling the Debate*, JOSEPH M. BELTH BLOG (Oct. 17, 2014), [http://www.josephmbelth.com/2014/10/no-70-fiduciary-standard-of.html?utm\\_source=feedburner&utm\\_medium=email&utm\\_campaign=Feed%3A+JosephMBelth+%28Joseph+M.+Belth%29](http://www.josephmbelth.com/2014/10/no-70-fiduciary-standard-of.html?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+JosephMBelth+%28Joseph+M.+Belth%29).

This is a long way from the golden age of life insurance salesmen, when it was assumed that all life insurance sales were suitable and the only rule that applied was *caveat emptor*.<sup>32</sup> Indeed, at least one life insurance agent has recently been convicted of a felony for selling what was deemed an unsuitable indexed annuity to a woman who allegedly suffered from dementia.<sup>33</sup> FINRA also requires firms to supervise their registered representatives under a “reasonably designed” supervisory system,<sup>34</sup> which leads to, among other things, unannounced inspections and limits on client communications including the use of texting and social media, such as LinkedIn and Facebook.<sup>35</sup> Agents often end up wishing that they had tied themselves to their masts and not listened to the siren calls of FINRA registration.

## 2. The OBA Risk

OBAs can open up life insurance agents to regulatory threats and risky temptations.<sup>36</sup> Some agents have been lured into “selling away”—selling investments that are not authorized by their broker-dealers, some of which, unfortunately, have turned

---

<sup>32</sup> See Nick Ravo, *CAVEAT EMPTOR; Buying Insurance To Pay Off a Mortgage: Often No Bargain*, N.Y. TIMES (Apr. 23, 1994), <http://www.nytimes.com/1994/04/23/business/caveat-emptor-buying-insurance-to-pay-off-a-mortgage-often-no-bargain.html>.

<sup>33</sup> Steven A. Morelli, *Advisor Convicted of Theft for Selling an Annuity*, INSURANCENEWSNET (Feb. 29, 2012), <http://insurancenewsnet.com/innarticle/2012/02/29/advisor-convicted-of-theft-for-selling-an-annuity-a-331872.html#.Uux7JXddW24>. This conviction was later overturned by an appellate court. *People v. Neasham*, 163 Cal. Rptr. 3d 146 (Ct. App. 2013).

<sup>34</sup> See, e.g., NASD Notice 05-29, 2005 WL 894759, at \*1, 3 (Apr. 2005).

<sup>35</sup> See, e.g., FINRA Rule 2210(c)(1)(a) (2014), available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=10648](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=10648). FINRA requires firms to capture and supervise written communications. See FINRA Rule 2210(c)(6). This requirement poses real challenges in a world where young people increasingly text one another, and prefer not to speak on the phone. While new technologies potentially allow agents to access their social media contacts, such as Facebook, there are potential privacy concerns if an agent uses Facebook to determine which contacts have had babies, bought new homes, and may be in need of additional life insurance. See also ANNE OBERSTEADT ET AL., STATE OF THE LIFE INSURANCE INDUSTRY: IMPLICATIONS OF INDUSTRY TRENDS 88–89 (Aug. 2013), available at [http://www.naic.org/documents/cipr\\_home\\_130823\\_implications\\_industry\\_trends\\_final.pdf](http://www.naic.org/documents/cipr_home_130823_implications_industry_trends_final.pdf).

<sup>36</sup> See Barlyn, *supra* note 25.

out to be Ponzi schemes.<sup>37</sup> Others have gotten into significant regulatory difficulties by simply failing to disclose and get approval for their OBAs.<sup>38</sup>

Another threat from this two-prong business strategy, although less immediate, is that spending too much time on OBAs could undermine the very favorable tax status that many life insurance career agents continue to enjoy as a vestige of their political power during the golden age of life insurance sales. Full-time life insurance salesmen are entitled to statutory employee<sup>39</sup> status through their career companies. If they are engaged on a full-time basis in the sale of life insurance and annuities, they can be treated as employees for certain health and welfare purposes and independent contractors for tax purposes.<sup>40</sup> Statutory employees can get the best of both worlds, as discussed more fully below. If agents are too involved in OBAs, it is possible that they will lose this favorable tax treatment if the IRS concludes that they are not working for their career companies “full-time.” In their never-ending search for potential prospects, career agents can, therefore, theoretically jeopardize their extremely favorable tax status.

### C. Marketplace Developments

Full-time life insurance agents, therefore, have to traverse a regulatory path that is akin to Odysseus traveling between Scylla and Charybdis.<sup>41</sup> Furthermore, they are now confronted with young people who would rather shop and communicate on the Internet<sup>42</sup> or through texting and increasingly avoid phone calls and face-to-face meetings. The face-to-face meetings that life insurance salesmen would have in the early evening in

---

<sup>37</sup> See *id.*; Johnny Parker, *Company Liability for a Life Insurance Agent's Financial Abuse of an Elderly Client*, 2007 MICH. ST. L. REV. 683, 691–92 (2007).

<sup>38</sup> See FINRA, *Disciplinary Update* (Summer Issue/Jun. 2005), available at <http://www.finra.org/industry/enforcement/disciplinaryactions/monthlyactions/2005/p014271>.

<sup>39</sup> See 26 U.S.C.A. §§ 3121(d)(3)(B), 7701(a)(20) (West 2014).

<sup>40</sup> See *id.* § 7701(a)(20).

<sup>41</sup> See *Between Scylla and Charybdis*, THE FREE DICTIONARY, <http://www.thefreedictionary.com/between+Scylla+and+Charybdis> (last visited Mar. 22, 2015).

<sup>42</sup> See Bill Coffin, *Bridging the Mortality Protection Gap*, LIFEHEALTHPRO (Sept. 13, 2013), <http://www.lifehealthpro.com/2013/09/03/bridging-the-mortality-protection-gap>.



someone's suburban kitchen or dining room is facing extinction.<sup>43</sup> Whole life insurance offered by mutual insurers and sold by full-time life insurance agents has not yet gone the way of the VCR, or worse, the Sony Betamax, but it is certainly not a cutting edge Blu-ray player sold inexpensively through Amazon.<sup>44</sup>

All these marketplace and regulatory changes are happening just when Americans could most use someone sitting across their kitchen table offering them a whole life insurance policy to, among other things: (1) fund the special needs trust for their autistic child, given the explosion of diagnosed rates of autism; (2) supplement their meager savings while providing death protection after their employer dropped their defined benefit pension plan; or (3) provide LGBT partners with survival benefits still denied to them by many states.

Some people may have bought term, but few have invested the difference.<sup>45</sup> Instead of redoing their kitchens to create a center island, they could have benefitted from the forced savings that the uncorrelated asset, whole life insurance, imposed. Whole life insurance from a top-rated mutual insurer would have also provided predictable dividends and long-term returns while the stock market stagnated. Americans could also surely benefit from a lifetime income annuity to replace the defined benefit pension plan that their company likely eliminated, especially since many of us are living longer.<sup>46</sup> Most importantly, they could benefit from some personal advice and hand-holding. One recent study of Canadians determined that having a financial advisor for fifteen years or more resulted in clients having, on

---

<sup>43</sup> See Warren S. Hersch, *LIMRA: Consumers Who Research Insurance Products Online Increased by 60% Since 2006*, LIFEHEALTHPRO (Oct. 11, 2011), <http://www.lifehealthpro.com/2012/10/11/limra-consumers-who-research-insurance-products-on>. It is doubtful that a meeting through Skype will take its place.

<sup>44</sup> It should be noted that DVDs may be made obsolete by video streaming. Technological change stands still for no one, but interestingly, the Internet has not been a significant source of life insurance sales, except for some younger consumers. See OBERSTEADT ET AL., *supra* note 35, at 91–93. Google, Amazon, or some other Internet giant may yet turn its attention to life insurance sales and make it work, at least for term insurance.

<sup>45</sup> See Warren S. Hersch, *Coverage Gap Among Gen Xers Has Widened*, LIFEHEALTHPRO (Sept. 13, 2013), <http://www.lifehealthpro.com/2013/09/13/coverage-gap-among-gen-xers-has-widened>; OBERSTEADT ET AL., *supra* note 35, at 45, 50.

<sup>46</sup> See Dan Moisand, *Economists Love 'Em, Clients Hate 'Em*, FIN. ADVISOR (Feb. 1, 2012), <http://www.fa-mag.com/news/economists-love-em-clients-hate-em-9619.html>; James Crabtree, *Older. But Wiser?*, FIN. TIMES, July 23, 2011, at 1.

average, one hundred and seventy-three percent more assets than clients who did not receive financial advice.<sup>47</sup> Most brokerage and investment advisory firms are not interested in middle-market clients.<sup>48</sup> They do not have the time to help these middle-income clients deal with life's uncertainties, the "If in Life" that the Metropolitan Life commercials so aptly identify.<sup>49</sup>

One continuing truth is that nothing is certain, other than death and taxes, and a full-time life insurance salesman selling permanent life insurance across a kitchen table to middle-income Americans can help these families deal with both of these certainties. However, these full-time life insurance salesmen are in danger of disappearing from the scene just when they are needed most, although they have not yet suffered the fate of milk-men and Fuller Brush salesmen.<sup>50</sup> Where have you gone, Jim Anderson,<sup>51</sup> or the legendary life insurance salesman, Frank Nathan,<sup>52</sup> on which the "Father Knows Best" character was reportedly based? Our nation turns its lonely eyes to you.<sup>53</sup>

This Article traces the economic and regulatory rise and potential future regulatory demise of the full-time life insurance salesman. It outlines why these salesmen and many of the products that they offer are beneficial to American society, and why public policies should promote both the profession and the

---

<sup>47</sup> CLAUDE MONTMARQUETTE & NATHALIE VIENNOT-BRIOT, CIRANO INSTITUTE, *ECONOMETRIC MODELS ON THE VALUE OF ADVICE OF A FINANCIAL ADVISOR* 9 (2012), available at <https://web.archive.org/web/20130508150303/http://www.cirano.qc.ca/pdf/publication/2012RP-17.pdf>.

<sup>48</sup> See Coffin, *supra* note 42.

<sup>49</sup> Michael Kristof, *Famous Company Slogans: Collection of Famous Company Slogans Advertising Taglines and Company Mottos*, CLOSETFLIP, <https://web.archive.org/web/20140824090925/http://closetflip.wikispaces.com/file/view/famous-company-slogans.pdf> (last visited Mar. 22, 2015).

<sup>50</sup> THE FULLER BRUSH MAN (Columbia Pictures 1948).

<sup>51</sup> *Selling Whole Life Insurance*, CAREERBUILDER (Apr. 4, 2012), <http://www.careerbuilder.com/Article/CB-2976-Insurance-Selling-whole-life-insurance/> [hereinafter CAREERBUILDER].

<sup>52</sup> See Mary Anne Adler, *Frank Nathan, CLU: The Huebner-Hollywood Connection*, WEALTH CHANNEL MAG., Spring 2014, at 88–89, available at <http://www.theamericancollege.edu/twc-interactive-magazine/spring-2014/files/assets/basic.html>.

<sup>53</sup> This is not some angry post-2012 election rant about "taking our country back." Rather, it is an acknowledgement that, perhaps ironically, a product and process that reached its zenith in the 1950s could be of help in a diverse multicultural twenty-first century.

products sold by full-time life insurance salesmen. Finally, it suggests some modest regulatory reforms that would promote life insurance sales and the salesmen who make them.

## II. THE GOLDEN YEARS OF LIFE INSURANCE SALESMEN

Opportunities are often born of crisis, and the aftermath of the 1905 Armstrong Commission provided life insurance salesmen with the opportunity of a political vacuum as the large insurance companies retreated from the political scene.<sup>54</sup> The National Association of Life Underwriters ("NALU"—now known as the National Association of Insurance and Financial Advisors—"NAIFA") helped to fill this political vacuum with extensive lobbying efforts that continually bore fruit.<sup>55</sup> The regulatory framework passed by New York state in 1906<sup>56</sup> and other jurisdictions helped to create a predictable environment for agents who now knew that it was illegal to rebate a portion of their commissions, and who knew that their commissions and compensation were closely regulated by the precursor to Section 4228 of the New York Insurance Law.<sup>57</sup> The life insurance industry was also required to seek more consistent and reliable returns, because in 1906 New York State prohibited life insurance companies from buying stock, from investment banking, and from engaging in commercial banking.<sup>58</sup>

### A. *Early Twentieth Century Expansion*

The life insurance industry experienced tremendous growth and expansion in the years following the Armstrong Commission.<sup>59</sup> All servicemen in World War I received a \$4,500 life insurance policy, and many sought to replicate this coverage

---

<sup>54</sup> See generally MORTON KELLER, *THE LIFE INSURANCE ENTERPRISE, 1885-1910: A STUDY IN THE LIMITS OF CORPORATE POWER* 253-57 (Belknap Press of Harvard Univ. Press ed., 1963).

<sup>55</sup> See generally GEORGE A. NORRIS, *VOICES FROM THE FIELD* (1989), available at [http://www.naifa.org/NAIFA/media/ExecutiveOffice/exec/NAIFA\\_VoicesFromTheField.pdf](http://www.naifa.org/NAIFA/media/ExecutiveOffice/exec/NAIFA_VoicesFromTheField.pdf).

<sup>56</sup> KELLER, *supra* note 54, at 257.

<sup>57</sup> See Francine L. Semaya & Vanessa L. Sutter, *There's No Place Like Home: New York's Attempt To Keep Its Life Insurance Companies in New York*, *FORC Q. J. INS. L. & REG.* (1997), available at <http://www.forc.org/pdfs/vol8-ed2-art5.pdf>.

<sup>58</sup> See generally Scheherazade S. Rehman, *Can Financial Institutional Investors Legally Safeguard American Stockholders?*, 2 *N.Y.U. J.L. & BUS.* 683 (2006).

<sup>59</sup> See KELLER, *supra* note 54, at 285-86; see also OBERSTEADT ET AL., *supra* note 35, at 2.

when they returned from the war.<sup>60</sup> NALU was instrumental in ensuring the tax-favored status of permanent life insurance, pursuant to which the buildup of cash value and death benefits are typically income tax free.<sup>61</sup> NALU also sought to promote the professionalism of life insurance agents through education, professional designations, and a focus on promoting full-time life insurance salesmen.<sup>62</sup> The American College of Life Underwriters was founded in 1927, and developed the Chartered Life Underwriter degree, which Wharton Professor Solomon S. Huebner aided in establishing.<sup>63</sup> Throughout the interwar period, NALU was focused on promoting full-time, well-trained life insurance agents and eliminating part-time agents who were viewed as demeaning the profession.<sup>64</sup> The Million Dollar Round Table (“MDRT”) was also instituted in 1927 for agents at the top of their profession who had placed \$1 million or more of life insurance coverage in the previous twelve months.<sup>65</sup>

### B. *The Great Depression and World War II*

The Great Depression placed strains on the life insurance industry, like all sectors of the economy, as sales declined, demands for policy loans increased, and expenses needed to be drastically reduced.<sup>66</sup> However, there was not the same run on insurance companies as there was on banks.<sup>67</sup> Indeed, while the life insurance industry was scrutinized by the Temporary National Economic Committee (“TNEC”) beginning in 1938,<sup>68</sup> the

---

<sup>60</sup> See Sharon Ann Murphy, *Life Insurance in the United States Through World War I*, EH.NET (Robert Whaples ed., Aug. 14, 2002), <http://eh.net/encyclopedia/life-insurance-in-the-united-states-through-world-war-i/>. This pattern would be observed again during and immediately after World War II, when servicemen became used to having at least \$10,000 in life insurance coverage. See NORRIS, *supra* note 56, at 142.

<sup>61</sup> See generally 26 U.S.C. § 7702 (2012). See also NORRIS, *supra* note 55, at 67.

<sup>62</sup> See NORRIS, *supra* note 55, at 49.

<sup>63</sup> See *id.* at 99–101.

<sup>64</sup> *Id.* at 62.

<sup>65</sup> About MDRT, MDRT, <http://www.mdrt.org/about/index.asp> (last visited Mar. 22, 2015).

<sup>66</sup> See NORRIS, *supra* note 55, at 112.

<sup>67</sup> *Id.* at 119.

<sup>68</sup> Katherine M. Jones, *Law, Politics, and the Political Safeguards of Federalism: The Case of Insurance Regulation and the Commerce Clause, 1938-1948*, 11 CONN. INS. L.J. 345, 370–71 (2005).

TNEC concluded that the insurance industry was financially sound and did not require federal regulation, despite its concentration.<sup>69</sup>

War always drives home the fragility of human existence and reinforces the interdependence of families and communities. The total war that was World War II uniquely underscored this reality, both for the servicemen who appreciated the value of up to \$10,000 in life insurance that the U.S. government provided, and for their families.<sup>70</sup> By January 1944, "total applications form [sic] members of all branches of the armed forces for National Service Life Insurance had topped the \$100 billion mark."<sup>71</sup> This set the stage for a significant increase in demand for private life insurance in the late 1940s and 1950s.

First, however, the insurance industry had to deal with the curveball that the Supreme Court threw in its 1944 decision *United States v. South-Eastern Underwriters*,<sup>72</sup> where it overturned its 1869 decision in *Paul v. Virginia*, which held that insurance was not commerce.<sup>73</sup> The Court in *South-Eastern Underwriters* held that not only did insurance constitute commerce, but that it was interstate commerce that was subject to Congressional regulation, including the antitrust laws.<sup>74</sup> This decision threatened the status quo of state regulation of insurance, and it mobilized the entire insurance industry, including life insurance agents who enjoyed protection from outside encroachment because of state licensing requirements.<sup>75</sup> The National Association of Insurance Commissioners proposed, and Congress promptly passed, the McCarran-Ferguson Act,<sup>76</sup> with the primary intent to return the regulation of insurance back to the states.<sup>77</sup>

---

<sup>69</sup> *Id.* at 374.

<sup>70</sup> NORRIS, *supra* note 55, at 112.

<sup>71</sup> *Id.* at 152.

<sup>72</sup> 322 U.S. 533 (1944).

<sup>73</sup> *Paul v. Virginia*, 75 U.S. 168, 183 (1868).

<sup>74</sup> *South-Eastern Underwriters*, 322 U.S. at 549–50, 553.

<sup>75</sup> S. REP. NO. 78-1112, at 78 (1944).

<sup>76</sup> 15 U.S.C. §§ 1011–15 (2012).

<sup>77</sup> S. REP. NO. 78-1112, at 74.

C. *The 1950s: A High-Water Mark for Agents' Power and Prestige*

The 1950s were the high-water mark of life insurance agents' political power and prestige. On August 28, 1950, achieving a long-standing NALU agenda item, full-time life insurance agents became eligible for Social Security benefits with the passage of H.R. 6000.<sup>78</sup> Full-time life insurance agents could be characterized as statutory employees<sup>79</sup> under the Internal Revenue Code rather than common law employees and could enjoy the best of both worlds as independent contractors who are entitled to employee benefits.<sup>80</sup> Established agents for a career company could, and still can, file a Schedule C as independent contractors and deduct all of their reasonable business expenses from dollar one. They are not required to file expenses on Schedule A, which limits a common law employee's ability to deduct expenses to only those expenses in excess of two percent of adjusted gross income.<sup>81</sup> These statutory employees, while independent contractors for expense deduction purposes, also enjoy most of the benefits associated with being a common law employee.<sup>82</sup> For example: (1) they can participate in a number of employee benefit plans, including health and welfare plans and retirement plans; and (2) their insurer can pay the employer portion of the FICA tax, and, consequently, these statutory employees are not required to pay a self-employment tax even though they get to deduct all of their expenses.<sup>83</sup> Insurance companies try to be vigilant in ensuring that their agents are full-time life insurance agents for them, but, as discussed below, there is a great deal of pressure from agents to allow them to participate in OBAs, both to diversify their income and to generate leads.

---

<sup>78</sup> NORRIS, *supra* note 55, at 173.

<sup>79</sup> See 26 U.S.C.A. § 3121(d)(3)(B) (West 2014).

<sup>80</sup> See *id.* §§ 3121(d)(3)(B), 7701(a)(20).

<sup>81</sup> See *AMT Adjustments*, THE AMT ADVISOR, [http://www.amtadvisor.com/AMT\\_adjustments.html](http://www.amtadvisor.com/AMT_adjustments.html) (last visited Mar. 22, 2015). This is especially the case if they are subject to the Alternative Minimum Tax.

<sup>82</sup> See *Statutory Employees*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Statutory-Employees> (last updated Dec. 18, 2014).

<sup>83</sup> See *1099: Employee vs. Independent Contractor*, PAYCHEX (2012), available at <http://www.paychex.com/a/d/accounting/1099-employee-vs-independent-contractor.pdf>.

### III. THE RISE OF INTEREST RATES AND THE SEEDS OF DESTRUCTION

The 1950s produced steady growth in life insurance sales and were a golden age for life insurance agents.<sup>84</sup> The percentage of adult Americans who owned an individual life insurance policy reached fifty-nine percent in 1960.<sup>85</sup> Its subsequent decline to thirty-six percent, fifty years later in 2010,<sup>86</sup> is the story of the decline of life insurance sales as a profession. American society has not been well-served by this decline, as there was an increasingly public assumption of the risk of premature death by breadwinners.

#### A. *Headwinds for Life Insurance Agents*

The 1960s saw increasing returns from stocks and the increasing popularity of mutual funds that outpaced the returns that could be achieved through permanent life insurance.<sup>87</sup> Agents began to push their insurers to establish broker-dealers so that they could sell mutual funds and insurers began to design variable life and variable annuity products that included sub-accounts that mirrored mutual funds.<sup>88</sup>

The economic turmoil that began in the 1970s created headwinds for the life insurance industry and sowed the seeds for a decline in the prestige of life insurance agents in the 1990s. The rise of interest rates in the 1960s and 1970s, peaking in 1980<sup>89</sup>, harmed insurance companies in a number of ways. First, clients were able to take out low interest loans from their life insurance policies and invest the monies in secure investments at much higher returns, leading to a negative outflow of capital

---

<sup>84</sup> But see Corey Dahl, *The Not-So-Good Old Days*, LIFEHEALTHPRO (Dec. 12, 2012), <http://www.lifehealthpro.com/2012/12/12/the-not-so-good-old-days>.

<sup>85</sup> JLM, *supra* note 14.

<sup>86</sup> *Id.* See generally Note, *Redefining Insurance: Distinguishing Between Life Insurance and Investment Under Volatile Inflation*, 91 YALE L.J. 1659 (1982) [hereinafter *Redefining Insurance*].

<sup>87</sup> OBERSTEADT ET AL., *supra* note 35, at 17–18; see also *Redefining Insurance*, *supra* note 86, at 1665.

<sup>88</sup> See Tamar Frankel, *Variable Annuities, Variable Insurance and Separate Accounts*, 51 B.U. L. REV. 177, 179 (1971).

<sup>89</sup> *Interest Rates & Inflation: 1900-2013; An Inconsistent Relationship Before the Liberating 1960s*, CRESTMONT RES., <http://www.crestmontresearch.com/docs/i-rate-relationship.pdf> (last visited Mar. 22, 2015).

from insurers.<sup>90</sup> Second, insurance portfolio rates changed slowly so that whole life insurance became less competitive as interest rates rose because insurers had invested in long term debt at lower, now less competitive, rates.<sup>91</sup> As interest rates rose in the 1970s, insurance companies began increasingly to offer universal life and variable life insurance that could illustrate market rates of returns.<sup>92</sup> Third, selling variable life policies required insurance agents to become registered representatives of the National Association of Securities Dealers (“NASD,” now FINRA) in order to sell these products.<sup>93</sup> Additionally, insurance agents wanted to be able to sell mutual funds, which also required a securities license.<sup>94</sup> Insurance agents’ efforts to get securities licenses had unexpected subsequent consequences, as discussed below, in terms of their supervision. Finally, insurance agents were often encouraged to replace older whole life policies, which had lower returns because of the older portfolio of underlying investments, with new money universal life policies using the current higher interest rate assumptions.<sup>95</sup>

#### IV. THE LONG SLOW DECLINE OF BOTH INTEREST RATES AND AGENTS’ STATUS

After interest rates peaked in 1980, life insurance companies had the wind at their back for the next 30 years as rates gradually decreased over time.<sup>96</sup> This made their products, particularly whole life, more competitive over the long haul. However, it did create some long-term issues for insurers and agents, who were illustrating permanent life insurance policies

---

<sup>90</sup> See *John Hancock Financial Services, Inc.—Company Profile, Information, Business Description, History, Background Information on John Hancock Financial Services, Inc.*, REFERENCE FOR BUS., <http://www.referenceforbusiness.com/history2/95/John-Hancock-Financial-Services-Inc.html> (last visited Mar. 22, 2015).

<sup>91</sup> See Frank J. Rief, III, *Life Insurance Time Bombs*, SC35 ALI-ABA 81, 87 (1998).

<sup>92</sup> See *Redefining Insurance*, *supra* note 86, at 1661.

<sup>93</sup> See FINRA Rule 1031, available at [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=4260&element\\_id=3584&highlight=registration#r4260](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4260&element_id=3584&highlight=registration#r4260).

<sup>94</sup> *Id.*

<sup>95</sup> Douglas C. Doll, *A Brief History of Universal Life*, UNIVERSAL LIFE STUDY NOTE, 1999, at 112; see also Law of Commercial Agents and Brokers § 8:13 (West 2014).

<sup>96</sup> See *Interest Rates & Inflation: 1900-2013; An Inconsistent Relationship Before the Liberating 1960s*, *supra* note 89.



under current rates, even as those rates continued to decline along with the dividends being paid by mutual insurance companies.<sup>97</sup>

#### A. *Class Action Lawsuits*

Mutual insurance companies had developed, and insurance agents had run with, the concept of “vanishing premiums,” which would allow dividends, and the paid-up insurance that those dividends could purchase, to pay for whole life policies after a few years.<sup>98</sup> These illustrations, which agents began to run on their personal computers in the late 1980s and early 1990s, relied on current dividend scales to show out of pocket premiums going away after only a few years of payments.<sup>99</sup> As interest rates and, correspondingly, dividend rates, began to decline, policies failed to go on premium offset, and thousands of lawsuits, including a number of class actions, were filed in the 1990s.<sup>100</sup> Similarly, universal policies were being minimally funded based on projections of high interest rates on the illustrations provided, and as interest rates declined, policyholders found that the higher mortality rates charged in later years began to soak up the limited cash value accumulated, resulting in the self-destruction of these policies.<sup>101</sup>

#### B. *Stretching the Concept of Insurable Interest*

Another problematic trend was that the concept of insurable interest<sup>102</sup> began to stretch in the 1980s, with the aggressive marketing of corporate-owned life insurance (“COLI”) and bank-owned life insurance (“BOLI”), for organizations to insure the lives of “rank-and-file employees.”<sup>103</sup> While the COLI/BOLI

---

<sup>97</sup> OBERSTEADT ET AL., *supra* note 35, at 18.

<sup>98</sup> See *Gaidon v. Guardian Life Ins. Co. of Am.*, 94 N.Y.2d 330, 339, 725 N.E.2d 598, 600, 704 N.Y.S.2d 177, 179 (1999).

<sup>99</sup> See, e.g., *id.*

<sup>100</sup> See *id.* at 343, 725 N.E.2d at 603, 704 N.Y.S.2d at 182.

<sup>101</sup> See Darla Mercado, *Resurgence Ahead for Life Settlements Industry?*, INVESTMENT NEWS (Dec. 16, 2013, 2:09 PM), <http://www.investmentnews.com/article/20131216/FREE/131219929>.

<sup>102</sup> Long a mainstay of the life insurance industry, requiring an interest born of either love and affection or economic dependence. See *Grigsby v. Russell*, 222 U.S. 149, 155 (1911).

<sup>103</sup> High current crediting and dividend rates combined with favorable tax treatment made these policies attractive to businesses. See Susan Lorde Martin,

market created sales opportunities for some high end life insurance agents, overall, the loosening of insurable interest ties since the 1980s has had a deleterious effect on the industry and on the status of life insurance agents.<sup>104</sup> In the wake of the AIDS crisis, viatical settlement companies began to purchase the life insurance policies at a discount, taking advantage of the need to pay for the expensive treatment and maintenance of patients.<sup>105</sup> When medical advances allowed AIDS patients to live long and productive lives, harming the returns that Life Settlement Companies hoped to achieve, this industry pivoted to buying the existing policies of the elderly, which were deemed actuarially more valuable, especially since these policies could be packaged as non-correlated investments.<sup>106</sup> Finally, this morphed into Investor or Stranger Owned Life Insurance (“STOLI”), where unrelated parties would be the impetus behind the elderly purchasing large life insurance policies on their own lives and quickly assigning them to the individuals paying the premiums in return for a cash payment or a free death benefit.<sup>107</sup> All this unseemly activity tarnished the life industry and life insurance agents, making sales and market penetration ever more challenging.<sup>108</sup>

### C. *The Low Water Mark of the 1990s and Early 2000s*

The mid-1990s was perhaps the low water mark for market conduct issues related to life insurance agents and the life insurance industry.<sup>109</sup> Companies were caught up in a New York

---

*Betting on the Lives of Strangers: Life Settlements, STOLI, and Securitization*, 13 U. PA. J. BUS. L. 173, 178 (2010).

<sup>104</sup> *Id.* at 188.

<sup>105</sup> *Id.* at 174.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.* at 187. One ongoing industry concern is that the focus of life insurance as an investment undermines the rationale for the favorable tax status that life insurance policies enjoy. If life insurance were just another investment, there would be no rationale for a tax-free inside buildup. The significant societal good that vast majority of life insurance sales help to foster—protecting families from financial difficulty or devastation—is an important public good that justifies the favorable tax treatment.

<sup>108</sup> *Id.* at 188.

<sup>109</sup> See Joseph B. Treaster, *Three States Investigating Sales Practices of Met Life*, N.Y. TIMES (Nov. 7, 1997), <http://www.nytimes.com/1997/11/07/business/three-states-investigating-sales-practices-of-met-life.html>. However, the life insurance industry as a whole was highly profitable due to the growth of the annuity business. See OBERSTEADT ET AL., *supra* note 35, at 7.

state market conduct examination focused on agents who misrepresented insurance as a retirement plan.<sup>110</sup> Plaintiff class action securities lawyers turned their attention to agent sales practice litigation involving the premium offset sales concept.<sup>111</sup> And individual agents were caught up in allegations of churning<sup>112</sup> or creating or marketing Ponzi schemes.<sup>113</sup> Declining interest rates exacerbated these problems, as did the technological innovation of the personal computer and printer that allowed agents to develop their own marketing materials and communicate them via email to clients.<sup>114</sup>

The specter of competition from banks also hung in the air, thanks to the Supreme Court's 1996 decision in *Barnett Bank v. Nelson*<sup>115</sup> and the passage of the Federal Financial Services Modernization Act of 1999, otherwise referred to as the Gramm-Leach-Bliley Act.<sup>116</sup> However, bank cross-selling of life insurance has never really taken off and is not the primary threat facing life insurance salesmen.<sup>117</sup>

The early 2000s were not much better, as some agents got caught up in selling promissory notes that were either fraudulent or constituted the sale of securities not approved by their broker-

---

<sup>110</sup> See *Loguidice v. Metro. Life Ins. Co.*, 336 F.3d 1, 2–3 (1st Cir. 2003); James Martinez, *MetLife Offers Refunds Amid Accusations Over Sales Tactics*, ASSOCIATED PRESS (Oct. 6, 1993), <http://www.apnewsarchive.com/1993/MetLife-Offers-Refunds-Amid-Accusations-Over-Sales-Tactics/id-23658a9206822b7e47f8eefa0f734238>.

<sup>111</sup> See *Insurance Litigation*, MILBERG LLP (2015), <http://www.milberg.com/insurancelitigation/>.

<sup>112</sup> See Treaster, *supra* note 109.

<sup>113</sup> See, e.g., *Soranno v. N.Y. Life Ins. Co.*, No. 96 C 7882, 1999 WL 104403, at \*2 (N.D. Ill. Feb. 24, 1999).

<sup>114</sup> See OBERSTEADT ET AL., *supra* note 35, at 92; *Policies Of Deception?*, BUSINESSWEEK (Jan. 16, 1994), <http://www.businessweek.com/stories/1994-01-16/policies-of-deception>.

<sup>115</sup> 517 U.S. 25, 28 (1996).

<sup>116</sup> *Summary of Federal Financial Services Modernization Act of 1999 (Gramm-Leach-Bliley Act)*, N.D. LEG. COUNCIL STAFF FOR FAM. LAW COMM. (2001), <http://www.legis.nd.gov/assembly/57-2001/docs/pdf/39150.pdf>.

<sup>117</sup> See Eric R. Baron, *Why Banks' Cross-Selling Falls Short*, THE BARON GROUP, INC., [https://web.archive.org/web/20120105074209/http://www.barongroup.com/images/Why\\_Bank\\_s\\_Crps-Selling\\_Falls\\_Short.pdf](https://web.archive.org/web/20120105074209/http://www.barongroup.com/images/Why_Bank_s_Crps-Selling_Falls_Short.pdf) (last visited Mar. 22, 2015). Bank sales of annuities, however, have grown tremendously as an alternative channel for insurers, but this distribution system has its own share of regulatory issues. See, e.g., Dorothy Hinchcliff, *FINRA Fines Bank B-Ds For Variable Annuity Sales*, FIN. ADVISOR (Jul. 23, 2009), <http://www.fa-mag.com/news/finra-fines-bank-b-ds-for-variable-annuity-sales-4272.html>.

dealers.<sup>118</sup> Investor desperation, born of two bear markets and decreasing interest rates, provided the opportunity for unscrupulous insurance agents to take advantage of clients, especially elderly clients.<sup>119</sup> The elderly are particularly trusting of individuals who have designations promoting their expertise, and numerous life insurance agents sought “drive-by” designations that required little study and no continuing education in an effort to promote their legitimacy.<sup>120</sup>

## V. THE REGULATORS STRIKE BACK

The National Association of Securities Dealers (“NASD”—now renamed FINRA) increased its focus on life insurance salesmen in the late 1990s, particularly on the suitability of variable annuity sales made by these life insurance salesmen.<sup>121</sup> The NASD Notice to Members (99-35) set forth product specific suitability responsibilities when an insurance agent, who also needs to be licensed as a registered representative, recommended a variable annuity to a customer.<sup>122</sup>

### A. Variable Annuity Suitability

Most suitability requirements are general, but when selling a variable annuity, the broker-dealer and the agent or registered representative were specifically directed to obtain comprehensive customer information, including the customer’s occupation, marital status, age, number of dependents, investment objectives, risk tolerance, tax status, previous investment experience, liquid net worth, other investments savings, and annual income.<sup>123</sup> Registered representatives were also instructed to discuss all relevant facts with the customer regarding the specific terms of the variable annuity, including

---

<sup>118</sup> See Johnny Parker, *Company Liability for a Life Insurance Agent’s Financial Abuse of an Elderly Client*, 2007 MICH. ST. L. REV. 683, 693–94 (2007).

<sup>119</sup> See *id.* at 687–88.

<sup>120</sup> See *State Warns Consumers About ‘Senior Specialists’*, DEP’T OF CONSUMER BUS. & SERVICE 1 (March 2006), available at [http://www.cbs.state.or.us/dfcs/news\\_releases/2006/senior\\_specialist\\_release.pdf](http://www.cbs.state.or.us/dfcs/news_releases/2006/senior_specialist_release.pdf).

<sup>121</sup> See Clifford E. Kirsch, *Redefining the Retail Relationship: The Emerging Regulatory Framework Governing Suitability, The Standard of Care and Disclosure*, ST006 ALI-ABA 775, 779–86 (2011).

<sup>122</sup> See NASD Notice to Members 99-35 (May 1999), available at <https://www.finra.org/sites/default/files/NoticeDocument/p004395.pdf>.

<sup>123</sup> See *id.* at 230.

liquidity issues such as potential surrender charges and IRS penalties, fees, and market risk.<sup>124</sup> Ironically, one of the features of a variable annuity that the NASD and then FINRA objected to was the costs associated with riders guaranteeing the premium from market loss over a long, that is, ten-year period, because market losses had not, with the possible exception of the Great Depression, been previously experienced over this long a time-period. However, the long decline of the stock-market in the early twenty-first century has made those riders so valuable that many insurers have lost significant amounts of money on this business.<sup>125</sup>

The proposing release for FINRA's variable annuity sales practice rule, NASD Rule 2821, now known as FINRA Rule 2330, explained that it was the complexity of variable annuities and FINRA's uncovering of "questionable sales practices" that led this Self-Regulatory Organization to issue NTM 99-35.<sup>126</sup> As noted above, while FINRA has adopted suitability rules that govern the sale of all securities products, FINRA Rule 2330 is one of only a very few rules that deal with the suitability of a specific securities product. Rule 2330 requires that a member or person associated with a member recommending a purchase or exchange of a variable annuity have a reasonable basis to believe: (1) "the customer has been informed, in general terms, of various features of deferred variable annuities;" (2) "the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization,<sup>127</sup> or a death or living benefit;" and (3) "the particular variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements . . . are suitable."<sup>128</sup>

---

<sup>124</sup> See *id.*

<sup>125</sup> See Leslie Scism, *Misjudged Annuity Guarantees May Cost Life Insurers Billions*, WALL ST. J. (June 25, 2013), <http://online.wsj.com/news/articles/SB10001424127887323998604578565711321338272>.

<sup>126</sup> Kirsch, *supra* note 121, at 786.

<sup>127</sup> Banks have had more success selling fixed and variable annuities. See OBERSTEADT ET AL., *supra* note 35, at 18–19.

<sup>128</sup> FINRA Rule 2330(b)(1)(A)(i)–(iii), available at [http://finra.complinet.com/en/display/display\\_viewall.html?rbid=2403%20&element\\_id=3643&print=1](http://finra.complinet.com/en/display/display_viewall.html?rbid=2403%20&element_id=3643&print=1).

The registered representative recommending the purchase of a variable annuity must document these considerations and sign this documentation.<sup>129</sup>

Rule 2330, in conjunction with FINRA's new general suitability requirements codified in Rule 2111, makes the sale of variable annuities by life insurance salesmen potentially fraught with peril. Pursuant to Rule 2111, FINRA has outlined three separate components of suitability: (1) reasonable-basis suitability; (2) customer-specific suitability; and (3) quantitative suitability.<sup>130</sup> Rule 2111's focus on quantitative suitability may be the most problematic for insurance agents who only have a limited number of tools in their toolbox because it focuses firms and FINRA on sales of multiple annuities to the same customer. The sale of annuities generally results in higher commissions compared to the sale of mutual funds, and insurance agents generally favor annuities as a differentiator that cannot be sold by a registered representative who does not have an insurance license.<sup>131</sup> This can sometimes result in the overconcentration of a client's assets in annuities, which FINRA views more like disfavored mutual fund Class B shares with higher expenses and backend loads than the more favored Class A shares that have a load but have lower expenses.<sup>132</sup>

### B. Fixed Annuity Suitability

Fixed annuities, although not regulated by FINRA, have also been subject to increasing governmental regulation. The National Association of Insurance Commissioners began to focus on annuity suitability in the 1990s, especially in light of the Dingell report,<sup>133</sup> and published a white paper on suitability.<sup>134</sup> Initially, the focus was on the suitability of sales to seniors, but a

---

<sup>129</sup> Kirsch, *supra* note 121, at 788.

<sup>130</sup> *See id.* at 781.

<sup>131</sup> *See* JOINT SEC/NASD REPORT, *supra* note 27, at 2.

<sup>132</sup> *See* NASD Files Enforcement Actions Involving Unsuitable Sales of Mutual Funds, NASD (Aug. 12, 2003), <http://www.finra.org/Newsroom/NewsReleases/2003/P002885>.

<sup>133</sup> The Dingell Report, named after the investigating committee's chair, Rep. John D. Dingell, D-MI, accused "state insurance regulators for lacking adequate resources, using unreliable financial information, failing to coordinate, and performing infrequent examinations." OBERSTEADT ET AL., *supra* note 35, at 21 (internal quotation marks omitted).

<sup>134</sup> Kirsch, *supra* note 121, at 789-91.

model suitability act that applied to all clients was revised in 2006.<sup>135</sup> A majority of states have now adopted this model act.<sup>136</sup> It requires an insurance producer to have reasonable grounds to believe that the fixed or variable annuity is suitable for the consumer based on the consumer's financial status, tax status, and investment objectives.<sup>137</sup> An insurer is required either to ensure that a producer has a reasonable suitability review system or to develop such a reasonable suitability system itself, which is required if the insurer has career agents.<sup>138</sup> A four hour training requirement was added in 2010.<sup>139</sup> A primary focus of both state regulators and FINRA has been equity indexed annuities.<sup>140</sup> These annuities are complex products that seek to increase potential returns by tying them to a market index but come with complex caps, high surrender costs, and high commissions that have led to problematic sales practices.<sup>141</sup>

## VI. THE HOBGOBLIN OF LITTLE MINDS<sup>142</sup>

Crisis leads to regulation and is the primary impetus of regulatory change. The Great Recession of 2008 was no exception to this rule. The near total economic meltdown that impacted homeowners and investors alike in 2008 sent a shockwave through America's economic system.<sup>143</sup> The largest Ponzi scheme in history also unraveled because as the tide went out, all could see that Bernie Madoff and his investment advisory

---

<sup>135</sup> Sandy Praeger, Kansas Ins. Comm'r and NAIC President-Elect, Testimony of Sandy Praeger Before the Senate Select Committee on Aging (Sept. 5, 2007) [hereinafter Praeger], available at [http://www.naic.org/documents/testimony\\_0710\\_praeger.pdf](http://www.naic.org/documents/testimony_0710_praeger.pdf).

<sup>136</sup> See *id.*

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> See Kim O'Brien, *Annuity Facts: How Will the New NAIC Suitability Model Affect Education and Training in 2011?*, LIFEHEALTHPRO (Nov. 2, 2010), <http://www.lifehealthpro.com/2010/11/02/annuity-facts-how-will-the-new-naic-suit-ability-mo>.

<sup>140</sup> See OBERSTEADT ET AL., *supra* note 35, at 33–34.

<sup>141</sup> See *id.*

<sup>142</sup> See Ralph Waldo Emerson, *Familiar Quotations*, BARTLEBY.COM, <http://www.bartleby.com/100/420.47.html> (last visited Mar. 24, 2015).

<sup>143</sup> See generally Dimitris Christelis et al., *Wealth Shocks, Unemployment Shocks and Consumption in the Wake of the Great Recession* (Ctr. for Studies in Econ. and Fin., Working Paper No. 279, 2014), available at <http://www.csef.it/WP/wp279.pdf>.

firm were figuratively swimming naked.<sup>144</sup> The fact that Madoff's investment advisory firm, which assumed a fiduciary duty towards its clients, had committed the fraud and not his broker-dealer, who had no such fiduciary duty but was closely regulated by FINRA, did not give legislators or regulators pause that a uniform fiduciary duty would not cure what ailed the industry.<sup>145</sup>

#### A. *The Rand Study of Differentiated Regulatory Regimes*

Instead, regulators and the securities industry refocused on a 2008 study by the RAND Corporation.<sup>146</sup> RAND was commissioned by the Securities and Exchange Commission to study clients' understanding of the business practices of their broker-dealers and investment advisers, and in particular whether clients understood the distinctions between the duties owed to them depending on which type of financial adviser they chose to do business with.<sup>147</sup> Business models had long since converged as broker-dealers had begun offering fee-based brokerage platforms and investment advisers had begun offering asset under management wrap programs.<sup>148</sup> Despite this business model convergence, broker-dealers and investment advisers continued to be regulated by two different federal statutes—the Securities Exchange Act of 1934 (“34 Act”)<sup>149</sup> and the Investment Advisers Act of 1940 (“IAA”).<sup>150</sup> This resulted in two highly differentiated regulatory regimes.

Not surprisingly, therefore, the RAND Report concluded that clients were confused by the duties owed to them by their

---

<sup>144</sup> See *The Swimming Naked Awards*, *ECONOMIST* (Dec. 16, 2008), <http://www.economist.com/node/12796770>.

<sup>145</sup> See Kate McBride, *Six Choice Pieces of Fiduciary Misinformation*, *THINKADVISOR* (Mar. 18, 2010), <http://www.thinkadvisor.com/2010/03/18/six-choice-pieces-of-fiduciary-misinformation>.

<sup>146</sup> See generally ANGELA A. HUNG ET AL., *INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISORS AND BROKER-DEALERS*, RAND INSTITUTE FOR CIVIL JUSTICE (2008) [hereinafter *RAND STUDY*], available at [http://www.rand.org/pubs/technical\\_reports/TR556.html](http://www.rand.org/pubs/technical_reports/TR556.html).

<sup>147</sup> *Id.* at xiii–xiv.

<sup>148</sup> See, e.g., *Recommendation of the Investor as Purchaser Subcommittee Broker-Dealer Fiduciary Duty*, SEC, <http://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation.pdf> (last visited Mar. 25, 2015).

<sup>149</sup> Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (2014).

<sup>150</sup> Investment Advisers Act of 1940, ch. 686, 54 Stat. 847 (codified as 15 U.S.C. §§ 80b-1–21 (2012)).



financial advisers.<sup>151</sup> What the RAND Report also concluded, and what was typically overlooked by those pushing new regulations, is that despite this confusion, most clients were happy with the advice and service that they received from their financial professionals.<sup>152</sup>

Insurance agents are potentially subject to three, not merely two, separate and distinct duties of care when dealing with clients. First, when selling fixed insurance and annuities as an insurance agent, they are subject to state suitability laws.<sup>153</sup> Second, when selling variable life and variable annuities, they are subject to both the state insurance laws and FINRA's suitability rules.<sup>154</sup> Finally, if they act as Investor Adviser Representatives ("IARs") of a Registered Investment Adviser ("RIA"), they are subject, pursuant to the Supreme Court's decision in *Securities and Exchange Commission v. Capital Gains Research Bureau*,<sup>155</sup> to a fiduciary duty whereby they are required to disclose conflicts of interest by providing clients with their firm's Form ADV-Part II that sets forth these potential conflicts.<sup>156</sup>

### B. Dodd-Frank's Efforts at Harmonization

In the wake of the Great Recession and the Madoff Ponzi scheme, the Obama Administration proposed the Investor Protection Act of 2009,<sup>157</sup> which, after significant revisions, was signed into law as the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.<sup>158</sup> One of the key provisions of Dodd-Frank was Section 913, which authorized the SEC to conduct a study on the standards of care applicable to broker-

---

<sup>151</sup> RAND STUDY, *supra* note 146, at xix.

<sup>152</sup> *Id.*

<sup>153</sup> See THOMAS R. SULLIVAN & ADAM HAMM, LIFE INSURANCE & ANNUITIES COMMITTEE, SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION, *available at* [www.naic.org/documents/committees\\_a\\_suitability\\_reg\\_guidance.pdf](http://www.naic.org/documents/committees_a_suitability_reg_guidance.pdf).

<sup>154</sup> See, e.g., FINRA Rule 2330(a)(1), *available at* [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=14663&element\\_id=8824&highlight=2330#r14663](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=14663&element_id=8824&highlight=2330#r14663).

<sup>155</sup> 375 U.S. 180 (1963).

<sup>156</sup> See *id.* at 191-92; Uniform Application for Investment Adviser Registration, OMB No. 3235-0049, Part II, *available at* <http://www.sec.gov/about/forms/formadv-part2.pdf>.

<sup>157</sup> Investor Protection Act of 2009, H.R. 3817, 111th Cong. (1st Sess. 2009).

<sup>158</sup> Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

dealers and investment advisers and related issues.<sup>159</sup> Dodd-Frank also authorized the SEC, after conducting this study, to promulgate rules imposing a uniform fiduciary duty on broker-dealers and investment advisers when providing investment advice to retail customers.<sup>160</sup> Section 913 was a much watered-down version of the initial Obama vision of a uniform fiduciary duty of care whereby broker-dealers and RIAs would have been required to act solely in the customer's interest "without regard" to any interest of the firm's.<sup>161</sup> This proposed fiduciary standard of care is much more akin to that imposed on a guardian or trustee, as opposed to the disclosure-based regime that meets the fiduciary obligations of an RIA under the Investment Adviser Act of 1940.<sup>162</sup>

The Obama fiduciary duty standard would have been unworkable in a capitalist society, because even one's mother does not act solely in her child's best interest "without regard" to any interest she might have. By contrast, most firms believe that they can live with the fiduciary duty imposed by the Investors Advisers Act of 1940, which essentially requires disclosures of conflicts of interest, not the abolition of all conflicts of interest.<sup>163</sup> It was this disclosure-based regime that the SEC was authorized to create after studying the issue.<sup>164</sup> The provision adds further restrictions on any fiduciary duty created by the SEC that were crucial to insurance companies. Specifically, Section 913 also directs the SEC that any standard of care developed: (1) shall not prohibit commission or compensation based commission

---

<sup>159</sup> Dodd-Frank Act § 913(b)(1).

<sup>160</sup> Kirsch, *supra* note 121, at 55.

<sup>161</sup> See Investor Protection Act of 2009 § 103(f)(1).

<sup>162</sup> See Investment Advisers Act of 1940, ch. 686, 84 Stat. 1433 (1940) (codified as 15 U.S.C. §§ 80b-1-21 (2012)).

<sup>163</sup> Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 require an adviser to make full and adequate disclosure to clients on matters that may affect the adviser's independence and judgment. *See id.* ch. 686, sec. 206(1)-(2). Section 206 is intended to bring conflicts of interest to the attention of clients to permit fully informed decisions regarding the adviser. *See id.* There is a great deal of confusion about what constitutes a fiduciary duty because there is more than one potential definition. The Advisers Act sets forth a disclosure regime. Some news reports set forth a misimpression that it sets forth a guardian-like standard that might require the sale of the cheapest product, which is not the case. *See, e.g.*, Tara Siegel Bernard, *Before the Advice, Check out the Adviser*, N.Y. TIMES (Oct. 10, 2014), <http://www.nytimes.com/2014/10/12/business/mutfund/before-the-advice-check-out-the-adviser.html>.

<sup>164</sup> See Dodd-Frank Act § 913.

transactions; (2) shall not require a continuing duty of care or loyalty to the customer after providing the personalized investment advice; and (3) the standard of care shall not prohibit the sale of proprietary or limited range products.<sup>165</sup> For insurance affiliated registered representatives who sell only proprietary variable annuities for a commission as part of a “one and done” sale, these limitations were absolutely necessary to allow these representatives to continue with business as usual under enhanced disclosure.<sup>166</sup>

### 1. The SEC Study Authorized by Dodd-Frank

In January 2011, the SEC released its study on the effectiveness of legal and regulatory standards of care for broker-dealers and investment advisors called for under Section 913 of the Dodd-Frank Act.<sup>167</sup> The study makes two primary recommendations: (1) the SEC should “engage in rulemaking specifying a uniform fiduciary standard of conduct that is no less stringent than currently applied to investment advisers that would apply to broker-dealers and investment advisers when they provide personalized advice about securities to retail customers,” and (2) the “regulatory protections related to personalized investment advice about securities to retail customers provided by broker-dealers and investment advisers should be harmonized to the extent that harmonization appears likely to add meaningful investor protection.”<sup>168</sup>

The study was not well-received; most notably, two SEC commissioners concluded that the study failed to show that a uniform standard would enhance investor protection.<sup>169</sup> They asked for a more rigorous analysis rooted in economics and data.<sup>170</sup> Various House Republicans picked up on this criticism

---

<sup>165</sup> *Id.* § 913(k)(1).

<sup>166</sup> See Matt Zagula, *Are You a One-And-Done Closer Or a Client Advocate?* (June 2010), <http://insuranceneutralmagazine.com/article/are-you-a-one-and-done-closer-or-a-client-advocate-1460>.

<sup>167</sup> See generally SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS: AS REQUIRED BY SECTION 913 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (2011), available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>168</sup> Kirsch, *supra* note 121, at 816.

<sup>169</sup> *Proceedings of the 2011 Midwest Securities Law Institute Symposium*, 12 J. BUS. & SEC. L. 99, 249 (2012).

<sup>170</sup> *Id.*

and disparaged the SEC study for its lack of factual data and its failure to conduct a meaningful cost-benefit analysis of a fiduciary duty.<sup>171</sup> These criticisms were particularly troubling in light of the D.C. Circuit's decision in *Business Roundtable v. Securities and Exchange Commission*,<sup>172</sup> where the court found that the "Commission acted arbitrarily and capriciously for having failed . . . adequately to assess the economic effects of a new rule."<sup>173</sup>

## 2. The Subsequent SEC Data Request

On March 1, 2013, in response to these criticisms, the SEC published a request for data and other information to assist it in considering whether to make new rules about the standards of conduct and regulatory obligations for broker-dealers and investment advisers when they provide personalized investment advice about securities to retail customers.<sup>174</sup> The SEC stated that it was most interested in

quantitative and qualitative data . . . about the benefits and costs of the current standards of conduct of broker-dealers and investment advisers when providing advice to retail customers, as well as alternative approaches to the standards of conduct, including a uniform fiduciary standard of conduct applicable to all investment advisers and broker-dealers when providing personalized investment advice to retail customers.<sup>175</sup>

The SEC's data request was very complex and lengthy.<sup>176</sup> It is doubtful that firms, clients, or trade associations provided the type of data that the SEC needs to conduct a valid cost-benefit analysis. The data request also contained a red herring for insurance companies and agents. As part of the assumptions of what a fiduciary duty would look like, respondents to the data request were instructed to assume that "[t]he rule would prohibit the receipt or payment of non-cash compensation (*e.g.*, trips and prizes) in connection with the provision of personalized investment advice about the purchase of securities."<sup>177</sup> Most

---

<sup>171</sup> *Id.*

<sup>172</sup> 647 F.3d 1144 (D.C. Cir. 2011).

<sup>173</sup> *Id.* at 1148 (citations omitted).

<sup>174</sup> Duties of Brokers, Dealers, and Investment Advisers, Investment Advisers Act Release No. 34-69013, 78 Fed. Reg. 14,848, 14,848 (Mar. 7, 2013).

<sup>175</sup> *Id.* at 14,851.

<sup>176</sup> *See generally id.*

<sup>177</sup> *Id.* at 14,857.

insurers have annual meetings for their top producers, and the ability to hold these meetings is codified by New York Insurance Law.<sup>178</sup> It is an opportunity for these beleaguered souls to socialize with their peers, celebrate their sales accomplishments together, and learn about their career companies' new products and initiatives. Pursuant to FINRA's rules on non-cash compensation for variable products, all products, both proprietary and non-proprietary, must count equally as part of a total sales accomplishment, and there can be no sales contest tied to the sale of one individual product.<sup>179</sup> Given FINRA's rules and the SEC's other stated assumptions that conflicts need not be eliminated but can be disclosed, it is very curious that the SEC has chosen this one specific conflict of interest as the one that seemingly cannot be disclosed away. Certainly, differentiated cash compensation might pose a greater conflict than non-cash compensation. Furthermore, if trips were unavailable for the sale of securities products, they would remain available for the sale of fixed insurance products that are not regulated by the SEC.<sup>180</sup> This would create a conflict of interest where none previously existed. Trips for insurance salesmen are ingrained into the culture of life insurance companies.<sup>181</sup> It is certainly seen as a morale booster for individuals working in the life insurance industry.

### C. *The Department of Labor Inserts Itself into the Discussion*

The Department of Labor ("DOL") also inserted itself into the discussion of fiduciary duty in the context of insurance sales. In October of 2010, the DOL proposed a revision of its rules resulting in the imposition of a strict fiduciary duty in the context of 401(k) rollovers, which is the source of significant funds for variable annuities.<sup>182</sup> While Individual Retirement Accounts ("IRAs") are covered by ERISA-like rules and regulations, advice concerning a potential IRA rollover to a fixed

---

<sup>178</sup> N.Y. INS. LAW § 4228(e)(7) (McKinney 2014).

<sup>179</sup> FINRA Rule 2320(g)(4)(d)(ii), *available at* [http://finra.complinet.com/en/display/display\\_viewall.html?rbid=2403&element\\_id=8494&filtered\\_tag=](http://finra.complinet.com/en/display/display_viewall.html?rbid=2403&element_id=8494&filtered_tag=).

<sup>180</sup> *See* N.Y. INS. LAW § 4228(e)(7) (authorizing insurers to hold conventions and conferences).

<sup>181</sup> The movie "Cedar Rapids" explores the longing for camaraderie at one such agent conference. *See* CEDAR RAPIDS, *supra* note 3.

<sup>182</sup> Definition of the Term "Fiduciary," 75 Fed. Reg. 65,263, 65,270–72 (Oct. 22, 2010).

or variable annuity is currently deemed a purchase recommendation and not an investment related recommendation.<sup>183</sup> Consequently, no ERISA fiduciary duty currently applies when a registered representative suggests that a 401(k) participant consider a rollover to an annuity.<sup>184</sup> This allows, for example, a broker-dealer to pay its registered representative a commission for an IRA rollover.

Only suitability rules currently apply to rollovers. However, under the DOL's 2010 proposal, registered representatives who provided advice in the context of a 401(k) rollover to an IRA would be fiduciaries unless they were willing to provide prospective clients with disclosure that their interests were adverse and that they were not providing impartial investment advice.<sup>185</sup> Few financial services firms and fewer registered representatives would want to provide such disclosure to their clients.

Application of ERISA fiduciary rules would be problematic if applied to annuity rollover sales, because ERISA's fiduciary requirements are much stricter than the Investment Advisor's Act disclosure regime, and generally require fiduciaries to act as prudent experts would, and solely in the interest of plan participants to the exclusion of all other interests or concerns.<sup>186</sup> This is a guardian or trustee-like standard.<sup>187</sup> Without specific exemptions, which were not set forth as part of the DOL's rule proposal and are, therefore, not guaranteed, neither registered representatives nor their broker-dealers could have any conflicts of interest.<sup>188</sup> There could only be a flat fee for advice, no commissions, and variable annuities sold in the rollover market could not include proprietary sub-accounts.<sup>189</sup> While this proposal was subsequently withdrawn, the DOL was expected to propose a revised fiduciary duty rule in January 2015.<sup>190</sup> Unless

---

<sup>183</sup> See FRED REISH, PURSUING ROLLOVERS IN AN EVOLVING REGULATORY LANDSCAPE 4 (2013), available at <http://www.napa-net.org/Portals/1/PDFs/Partners/Pursuing-Rollovers-in-an-Evolving-Regulatory-Landscape-.pdf>.

<sup>184</sup> See *id.*

<sup>185</sup> See *id.* at 5.

<sup>186</sup> See *id.* at 3.

<sup>187</sup> See *id.* at 7–8.

<sup>188</sup> See *id.* at 4.

<sup>189</sup> See *id.*

<sup>190</sup> DOL To Delay Fiduciary Redraft Release Until January, THINKADVISOR (May 27, 2014), <http://www.thinkadvisor.com/2014/05/27/dol-to-delay-fiduciary-redraft-release-until-janua>. The proposal has been delayed further in the wake of a

the proposed rule is substantially reworked, it would clearly revolutionize the rollover process and might deny middle-class clients access to financial advice.

*D. FINRA Seeks To Cover the Gap*

Regulators abhor a vacuum, and the failure of both the SEC and the DOL to act has provided FINRA with the daylight to promulgate its own instructions to registered representatives and broker-dealers,<sup>191</sup> and this guidance brings sales of securities through broker-dealers closer to a fiduciary regime on the disclosure end of the spectrum, but with a few potentially troubling twists for insurance affiliated broker-dealers. In October 2013, FINRA released its “Report on Conflicts of Interest,” and while the report was not intended to create any new legal requirements, FINRA’s stated expectation was that firms consider the practices presented in the report and implement appropriate changes.<sup>192</sup> FINRA also cautioned that if broker-dealers do not make adequate progress on conflicts management, it will evaluate whether rulemaking related to conflicts would enhance investor protection.<sup>193</sup>

FINRA recommended that firms adopt a “best-interest-of-the-customer” standard in each firm’s code of conduct.<sup>194</sup> FINRA also advised firms to look beyond minimum disclosure obligations. FINRA suggested that firms evaluate the effectiveness of their disclosure by asking, “in the event of a reasonably foreseeable adverse product outcome, could an investor legitimately say, ‘I did not realize that could happen’ on the basis of information the firm provided apart from the prospectus.”<sup>195</sup> A best-interest-of-the-customer standard combined with fulsome disclosure of conflicts is the equivalent of

---

leaked White House memo that very negatively evaluated the brokerage industry, accusing it of providing conflicted and expensive advice, particularly in the IRA rollover context. See Melanie Waddell, *White House Memo Offers a Peek at DOL Fiduciary Strategy*, LIFEHEALTHPRO (Jan. 26, 2015), <http://www.lifehealthpro.com/2015/01/26/white-house-memo-offers-a-peek-at-dol-fiduciary-st>.

<sup>191</sup> See FINRA Report, *supra* note 26, at 1.

<sup>192</sup> *Id.* at 2.

<sup>193</sup> *Id.*

<sup>194</sup> *Id.* at 9.

<sup>195</sup> *Id.* at 13.

the potential fiduciary duty standard set forth in Section 913 of Dodd-Frank.<sup>196</sup>

FINRA, however problematically for insurance affiliated broker-dealers, goes even farther than Dodd-Frank by suggesting that firms involved in both the manufacture and distribution of products “maintain effective safeguards to alleviate pressure to prefer proprietary products to the detriment of customers’ interests.”<sup>197</sup> In general, FINRA is promoting open architecture for both mutual funds and VAs<sup>198</sup> and a neutral distribution grid<sup>199</sup>, whereas Dodd-Frank specifically recognizes that some firms may only allow their registered representatives to sell proprietary products.<sup>200</sup> This recognition in Dodd-Frank is particularly important to insurance companies, which may only allow their registered representatives to sell proprietary variable annuities, both because it helps pay for a geographically diverse distribution force and because it is difficult to evaluate the suitability of hundreds of variable annuities.

FINRA’s report also specifically focused on IRA rollovers. FINRA specifically instructed firms to enhance their supervision and surveillance of a registered representative’s recommendations around “key liquidity events” in an investor’s lifecycle, most particularly when an investor rolls over her 401(k).<sup>201</sup> FINRA notes that “[t]he recommendations a representative makes at this stage of an investor’s life have profound implications for the investor and deserve thorough scrutiny and review.”<sup>202</sup>

FINRA followed up in December 2013 with Regulatory Notice 13-45 entitled “Rollovers to Individual Retirement Accounts.”<sup>203</sup> FINRA notes that there is an inherent conflict of interest when a registered representative recommends that a client roll over their 401(k) because a commission will not be

---

<sup>196</sup> See Dodd-Frank Act, Pub. L. No 111-203, § 913(g), 124 Stat. 1376, 1828–29 (2010).

<sup>197</sup> FINRA Report, *supra* note 26, at 3.

<sup>198</sup> See *id.* at 24.

<sup>199</sup> See *id.* at 27–28.

<sup>200</sup> See Dodd-Frank Act § 913(k)(2).

<sup>201</sup> FINRA Report, *supra* note 26, at 31.

<sup>202</sup> *Id.* at 4.

<sup>203</sup> FINRA, Regulatory Notice 13-45, Rollovers to Individual Retirement Accounts (2013), available at <http://www.finra.org/sites/default/files/Notice Document/p418695.pdf>.



earned if the recommendation is that the client should keep his or her funds in a former employer's 401(k) plan.<sup>204</sup> FINRA therefore cautions both broker-dealers and their registered representatives to deal fairly with potential clients by comparing the advantages and disadvantages of remaining in their former employer's 401(k) plan or investing their money with the firm the registered representative is associated with.<sup>205</sup>

FINRA will likely particularly focus on 401(k) rollovers into variable annuities, which can have higher fees than employer sponsored plans. Insurers and their affiliated broker-dealers will need to demonstrate that the insurance features of the variable annuity recommended provide a real benefit to customers. Consequently, increasing the focus on products that allow annuity owners to convert funds within the annuity to guaranteed monthly payments or guaranteed death benefits will go a long way towards defending their suitability in the context of a 401(k) rollover.

#### VII. A TWENTY-FIRST CENTURY REGULATORY REGIME FOR TWENTIETH CENTURY PRODUCTS

Regulating to the lowest common denominator in order to deter bad actors is never a winning proposition. If a bad actor is determined to commit fraud, a standard of conduct will not stand in the way. It was Madoff's Investment Advisory firm that owed clients a fiduciary duty that defrauded clients, not Madoff's broker-dealer, which arguably operated under a less stringent standard.<sup>206</sup> As discussed above, there are insurance salesmen who are bad actors, and there need to be significant consequences for these bad acts, including license revocation and jail time. One answer is for the National Association of Insurance Commissioners to create a nationwide database, similar to FINRA's BrokerCheck database, which would serve as a uniform depository of information on agent terminations and customer complaints. This would allow both the public and insurers to avoid bad apples.

---

<sup>204</sup> See *id.* at 4.

<sup>205</sup> See *id.* at 4–5.

<sup>206</sup> See McBride, *supra* note 145.

A. *The Need for Pragmatic Regulation To Promote Market Penetration*

The answer, however, is not to place unrealistic regulatory obstacles in the path of the vast majority of insurance professionals who are trying to make suitable sales and generally trying to do right by their clients. One example of an easy solution is for FINRA to exclude text messaging that is merely administrative in nature—that is, “I’m running ten minutes late,” or “Can we meet next week to discuss?”—from the rules requiring firm capture and supervision. Texting is likely happening in any event, and so it is putting the compliant at a disadvantage, especially insurance agents in detached locations, who, unlike wire-house registered representatives, are still making house-calls.<sup>207</sup>

More fundamentally, a guardian-like fiduciary standard cannot work in a commercial society where there will always be conflicts. A geographically dispersed sales force, which many mutual insurers in particular have nurtured, is expensive to maintain and supervise, and the costs of this field force necessitate the focus of proprietary products to justify the expenses associated with a detached agent meeting in someone’s kitchen in, say, Lincoln, Nebraska.

There is no academic study that I am aware of indicating that Americans own too much term or permanent life insurance<sup>208</sup> and, similarly, there is no study indicating that Americans own too many lifetime immediate annuities. Both products serve a public interest in that the private assets distributed reduce reliance on public assets and assistance. Defined benefit pensions for employees in the private sector have almost disappeared, and both permanent life insurance and immediate annuities can help to fill that void. Contingent deferred annuities are also starting to help fill this gap.<sup>209</sup> Whole

---

<sup>207</sup> Technology may end up solving this problem, as firms like Global Relay race to capture text messages in a FINRA-compliant format. See generally GLOBAL RELAY, <http://www.globalrelay.com> (last visited Mar. 26, 2015).

<sup>208</sup> There are many so-called financial experts who make the argument. See, e.g., Dave Ramsey, *The Truth About Life Insurance*, DAVERAMSEY.COM (Oct. 25, 2010), <http://www.daveramsey.com/article/the-truth-about-life-insurance/>.

<sup>209</sup> Contingent deferred annuities only begin to pay an individual if and when they reach a set age. This allows for greater annual payments once they begin. See *Contingent Deferred Annuities*, NAT’L ASS’N OF INS. COMMISSIONERS, <http://www.>

life insurance is, for example, a non-correlated asset that performed well compared to the S&P 500 in the first decade of the twenty-first century<sup>210</sup> and is more likely to be available to a widow or widower than to other comparable assets. Immediate lifetime annuities are also a non-correlated asset that can help ensure that individuals insure against a longevity risk that they outlive their assets.<sup>211</sup> When combined creatively with securities investments, immediate annuities can help ensure a secure retirement.<sup>212</sup>

Studies using Monte Carlo simulations have suggested that an immediate annuity may be better than a portfolio of bonds to ensure against longevity risks.<sup>213</sup> Consequently, public policy should promote the distribution of well-designed immediate annuities and permanent life insurance policies. Immediate annuities and life insurance policies that are straightforward, relatively transparent, and market tested should have a presumption of suitability and appropriateness. Deferred annuities with these same characteristics and with valuable riders should at least have the presumption of suitability and not be assumed to be problematic. A start would be to subject plain vanilla variable annuities only to FINRA's general suitability standard.

Regulators need to shed their passive aggressiveness and just be aggressive with respect to products and sales practices that they deem unsuitable. If indexed annuities or indexed life insurance policies are too complicated,<sup>214</sup> the answer is not to subject all fixed products to a strict suitability review; rather, the answer is targeted regulation or targeted prohibitions directed at the offending products. Moreover, there should be a regulatory predisposition toward permanent life insurance and immediate

---

naic.org/cipr\_topics/topic\_contingent\_deferred\_annuities.htm (last updated Feb. 26, 2015).

<sup>210</sup> See CAREERBUILDER, *supra* note 51.

<sup>211</sup> See Walter Updegrave, *How a Lifetime Income Annuity Works*, CNNMONEY, (Mar. 6, 2013), [http://cached.newslookup.com/cached.php?ref\\_id=102&siteid=951&id=1544421&t=1362569205](http://cached.newslookup.com/cached.php?ref_id=102&siteid=951&id=1544421&t=1362569205).

<sup>212</sup> See *id.*

<sup>213</sup> Kelly Greene, *Say Goodbye to the 4% Rule*, WALL ST. J. (Mar. 3, 2013), <http://online.wsj.com/news/articles/SB10001424127887324162304578304491492559684>.

<sup>214</sup> See *Investor Alerts: Equity-Indexed Annuities—A Complex Choice*, FINRA, <http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/AnnuitiesAndInsurance> (last updated Sept. 13, 2010).

lifetime annuities. Market competition amongst insurers is the best defense against uncompetitive product features, costs, and designs. Overly burdensome regulations, including a fiduciary duty for fixed insurance products, might create more transparency, but it would do so at the cost of market penetration, because it would drive up compliance costs and potentially lead to an open architectural structure that is incompatible with a geographically dispersed career field force. It is this geographically dispersed field force that targets the middle market of Americans who might otherwise go without financial advice. That the advice is coming from someone trying to sell them a suitable product, and not someone who has their sole interest in mind, does not diminish the importance of access to suitable advice and to suitable products.

### *B. The Car Salesmen Analogy*

Insurance salesmen do not like being compared to car salesmen.<sup>215</sup> However, both sell products that are essential to the public and whose suitable design and performance are crucial to protecting the well-being and security of the consumers purchasing these products. Furthermore, some analogies between the sales of the two products can be useful. A person walking into a Ford Dealership should not expect the sales person to sing the praises of Hondas or Chryslers.<sup>216</sup> See revised footnote. Similarly, a customer dealing with a Northwestern Mutual sales person is not likely to hear how great a New York Life or Mass Mutual product is. This should come as no surprise, and, if it does, no amount of paternalistic regulation can save such consumers from themselves.

If car dealerships and car salesmen had to act in the customers' best interest, without regard to any interest they might have and with no conflicts, distribution penetration would likely decrease and distribution costs would likely increase. Perhaps the car buying experience would be fairer, although consumers might be overwhelmed by choice, and it is not always clear what constitutes their best interest. That is, what if they

---

<sup>215</sup> The reverse probably also holds true.

<sup>216</sup> Absent "A Miracle on 34<sup>th</sup> Street," where Kris Kringle recommended that a potential customer of Macy's go to Gimbels instead because Gimbels had a better deal on the product she wanted. *A MIRACLE ON 34<sup>TH</sup> STREET* (20<sup>th</sup> Century Fox 1947).

want to pay extra for a Lexus when a Toyota is more practical? Similarly, it is not clear that every life sale needs to be set forth on a spreadsheet, and that there is not some real value from buying a slightly more expensive policy from an insurer with a higher rating. There needs to be some personal responsibility on the part of consumers to understand the products they are purchasing, and if that lack of understanding is the result of a misrepresentation or a fraud, then there are both statutory and common law remedies available to consumers.

Insurers and their regulators need to guard against bad actors. Even if an insurer's field force is Ivory Snow pure,<sup>217</sup> there would still be fifty-six bad actors in a field force of ten thousand, which is a fairly typical size for larger career force companies. There is no question that some insurers have done themselves no favors by not always weeding out bad apples who have oversold, over-promised, or over-committed to unsuitable products and unsuitable sales.<sup>218</sup> Nevertheless, the fundamental truth is that life insurance salesmen are selling products that help ensure the security of American families. Their demise would harm American families and American society. Both mortality risks and longevity risks would further shift from a private concern to a public concern. At the risk of sounding Capraesque,<sup>219</sup> life insurance agents are an American institution and sell products that deserve regulatory support.

### CONCLUSION

My grandfather repeatedly told me when I was a young man that the secret to life was "to take everything in moderation." Many have been given that advice, but in this age of polarized

---

<sup>217</sup> *Ivory Snow*, PROCTER & GAMBLE, [https://www.pg.com/en\\_CA/product\\_card/hh\\_ivorysnow.shtml](https://www.pg.com/en_CA/product_card/hh_ivorysnow.shtml) (last visited Mar. 26, 2015).

<sup>218</sup> See *State Securities Cops: Senior Investors Facing a Perfect Storm for Investment Fraud*, N. AM. SEC. ADM'RS ASSOC. (Sept. 4, 2003), <http://www.nasaa.org/7975/state-securities-cops-senior-investors-facing-a-perfect-storm-for-investment-fraud/>. Consequently, I understand and respect Professor Joseph Belth's counter-argument that traditional life and annuity sales should fall under a fiduciary duty standard. See Belth, *supra* note 31. We simply reach different conclusions about how to best respond to these problematic practices while balancing market penetration concerns.

<sup>219</sup> *Capraesque*, DICTIONARY.COM, <http://dictionary.reference.com/browse/capraesque> (last visited Mar. 26, 2015) (referring to the movies of director Frank Capra, whose movies promoted the acts of ordinary people as heroic when they helped people achieve the American Dream).

politics and polarized economics, where Cadillac commercials now pay tribute to unabashed conspicuous consumption at the expense of other values,<sup>220</sup> few are heeding it. In the context of life insurance sales, this advice leads me to the conclusion that an under-regulated life insurance and annuity marketplace that led to an over concentration of these products would be just as problematic as an over-regulated marketplace that led to underpenetration of life and annuity products.

Permanent life insurance and immediate annuities can, when combined with other financial products, play an important role in protecting middle-class families and keeping them from solely having to rely on government programs. Pragmatic regulation of life insurance and annuity sales that flexibly responded to technological and sociological changes would help swing the pendulum back to the middle, allowing life insurance salesmen to greater penetrate what is currently an underserved market. By contrast, ever stricter suitability rules, especially for straightforward products, regulating agent conduct based on the lowest common denominator, or the imposition of a fiduciary duty to fixed product sales, while well-intentioned, would result in ever decreasing market penetration. The American Middle Class would live and die poorer as a result.

---

<sup>220</sup> Carolyn Gregoire, *Cadillac Made a Commercial About the American Dream, and It's A Nightmare*, HUFFINGTON POST (Feb. 26, 2014), [http://www.huffingtonpost.com/2014/02/26/this-commercial-sums-up-e\\_n\\_4859040.html](http://www.huffingtonpost.com/2014/02/26/this-commercial-sums-up-e_n_4859040.html).

