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## Off to the Races: Will 2018 Be a Sprint for State Regulators to Impose Heightened Duties When Selling Life Insurance and Related Products?

*by William T. Mandia, Steven B. Davis and Elizabeth A. Kuschel*

Consistent with the philosophy that “[m]ore regulation is not the best answer to every problem,”<sup>1</sup> the Trump administration has placed a well-publicized emphasis on deregulation across a broad swath of industry sectors. As a result, there has been an increase in activity among state legislatures and regulatory bodies to expand their reach to fill perceived gaps created by federal deregulation. Chief among the areas where increased state activity is already underway and will continue into 2018 (and beyond) is the regulation of life insurance and related financial products.

There can be no question that in 2018 state regulators will place a particularly heavy emphasis on regulating the standard of care owed to the customers who purchase life insurance products and, in doing so, may adopt regulations and rules that vary substantially across jurisdictions regarding the scope of the duties owed and the specific products covered. As a result, those entities and individuals who provide recommendations regarding the purchase of life insurance products must be aware of this evolving area of the law and take proactive measures to remain in compliance with the differing legal and regulatory standards that are beginning to emerge.

### **The Department of Labor’s “Fiduciary Rule”**

The recent increased regulatory focus on the standard of care owed to customers who purchase life insurance-related products first surfaced in 2015, when the Department of Labor (DOL) proposed its “fiduciary rule.” The final rule, published in 2016, was different in certain respects from the proposal, but those differences were minor. The rule, which applies only to advisors to ERISA plans or IRA accounts, has the effect of causing broker-dealer representatives, insurance agents and other individuals who recommend investment products to become fiduciaries to plans and IRAs. Consequently, these advisors’ recommendations must be in their clients’ best interests without regard to the advisors’ interests whenever they recommend a commission generating investment or otherwise provide advice for a fee or compensation, direct or indirect. Because the fiduciary rule was limited in scope to retirement accounts, the rule, as it pertained to life insurance products, applied only to those products, such as variable annuities, in a customer’s retirement account.

In November 2017, the Trump administration announced that it was delaying the enforcement of some of the more challenging requirements of the fiduciary rules, although the basic requirements of the “best interest” standard are in effect now. Specifically, the DOL announced that it would delay the full implementation of the fiduciary rule by 18 months – thus extending the compliance date for certain aspects of the rules to July 1, 2019 – in order to further study and potentially refine the rule. This delay also has created the opportunity for the Securities and Exchange Commission (SEC) to work with the DOL to

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develop coordinated rules. The DOL and SEC are expected to release their fiduciary rule proposals in fall 2018.

### **National Association of Insurance Commissioners' Proposed Revisions to the Suitability in Annuity Transactions Model Regulation**

In late November 2017, the National Association of Insurance Commissioners (NAIC) announced proposed changes to its Suitability in Annuity Transactions Model Regulation (the Model Regulation). The Model Regulation, which NAIC promulgated in 2003 and has periodically amended, covers a broader scope of products than the DOL's fiduciary rule. Specifically, the Model Regulation applies to the sale of all annuity products irrespective of whether those sales take place in retirement accounts.

The amendments NAIC proposed in November 2017 would revise the Model Regulation in a number of material ways. These amendments include, among other changes, the adoption of a "best interest" standard defined as "acting with reasonable diligence, care, skill and prudence in a manner that puts the interest of the consumer first and foremost." Notably, this best-interest standard does not substitute for the current "suitability" standard in the Model Regulation but rather is in addition to the existing suitability requirement and therefore mandates that a recommendation be "suitable" and in the "best interests" of a customer.

### **Legislative and Regulatory Activity at the State Level**

Like NAIC, state legislators and regulators have not sat idly by while the DOL and SEC determine the fate and scope of the fiduciary rule. Indeed, just last week, the Massachusetts securities regulator commenced an enforcement action based on a broker-dealer's alleged violation of an internal impartial conduct standard the firm adopted to comply with the fiduciary rule. In so doing, the Massachusetts regulator left no doubt that it intends to fill a perceived void in federal enforcement activity: "If the Department of Labor will not enforce its own laws and rules, then the states must do what

they can to protect retirees from firms who believe they can play with peoples' life savings by conducting sophomoric contests."<sup>2</sup> Thus, while the activity of the Massachusetts regulator does not pertain to life insurance per se, it sends an ominous message that state regulators will not hesitate to take aggressive actions against those who are perceived not to be in compliance with existing federal regulations.

In addition to the potential for increased enforcement activity, state legislatures and regulators have begun to propose legislation and regulations in response to the delayed implementation of the fiduciary rule. A sampling of the approaches taken by the states includes:

- Nevada passed legislation in June 2017 that requires financial advisers who provide investment advice on securities to disclose any profit or commission that they receive based on advice to clients and to make a diligent inquiry about clients' financial background.
- New Jersey introduced proposed legislation in January 2018 that requires financial advisers to disclose whether they are acting as a fiduciary to investors seeking to purchase securities. If adopted, the legislation would require financial advisers who are not acting as a fiduciary to disclose to their clients that they are not required to act in the clients' best interests.
- Members of the Maryland legislature introduced proposed legislation in February 2018 that requires brokers to act in the best financial interest of clients, with the goal of protecting retirement savings. Currently, under Maryland law, only investment advisors must meet this fiduciary requirement. This proposal extends the requirements to brokers. The bill's primary sponsor cited the delay in the DOL's fiduciary rule as the impetus of the proposal.<sup>3</sup>
- New York's Department of Financial Services (NYDFS) proposed a rule in December 2017 that would add a



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best-interest standard to New York’s current suitability regulation and would expand the scope of that state regulation to apply to both annuities and life insurance products.

The rule New York proposes is significant not only because it would add a best-interests standard to the existing suitability rule in the state but also because of the scope of the products it covers. Unlike the DOL fiduciary rule and the NAIC model regulation – both of which would apply only to annuity products – NYDFS’ proposed rule would cover recommendations made in connection with the purchase of all life insurance products, thereby vastly expanding the scope of products and activities covered by the rule.

The potential impact of the proposed New York rule is made all the more significant because NYDFS is actively urging NAIC to adopt its proposed rule in lieu of NAIC’s November 2017 proposed amendments to the Model Regulation. In a submission to NAIC on Jan. 22, 2018, NYDFS made its case for expanding the NAIC rule to cover all life insurance products by noting that, in its view, the same concerns that exist with the sale of annuity products also apply to more “plain vanilla” term life insurance and other products.<sup>4</sup> NYDFS staked out its position that the best-interests standard should apply to an expansive set of life insurance products because such products are often relied on by consumers for retirement security and estate planning purposes and could be subject to the same “conflicted advice” that the DOL sought to eliminate through its fiduciary rule.

### The Path Forward

2018 is shaping up to be a significant year for the life insurance industry because of the joint efforts of the DOL and SEC to address the fiduciary rule, as well as the potential for regulatory and enforcement activity at the state level. The comment period for NAIC’s proposed revisions to the Model Regulation closed on Jan. 22, 2018. After reviewing the comments received, including those from NYDFS urging NAIC to adopt New York’s proposed rule, NAIC may share a new draft with the public that will be subject to additional review and comment. The comment period for NYDFS’ proposed rule change will expire on Feb. 25, 2018, after which NYDFS could present a new draft or adopt the current proposal. It should be noted that NYDFS is not required to

open a revised draft to further review and comment unless the changes are deemed to be material. Consequently, NYDFS’ amendments could take effect before NAIC has settled on a final proposed set of revisions to its Model Regulation.

It is evident that the life insurance industry currently finds itself in choppy, unsettled waters regarding the scope of the duties it will owe to its customers. Until the DOL, SEC and NAIC definitively address both the applicable standard of care and the scope of products covered, there is a risk that the states will take an aggressive, piecemeal and inconsistent approach to regulating the sale of life insurance products. This could become the case particularly if the New York rule as currently drafted takes effect before and differs materially from NAIC’s final revisions to its Model Regulation. Additionally, as the recent activity by the Massachusetts regulator demonstrates, state enforcement activity may increase due to the perception that the federal regulators are not doing enough to protect consumers.

The uncertainty in the current environment places the life insurance industry in the unfortunate position of having to address present and future compliance and related operational hurdles as well as face additional and significant litigation risk from the plaintiff’s bar or so-called “private attorneys general” under differing standards that could vary from jurisdiction to jurisdiction. It is therefore imperative that the companies and individuals involved in the marketing and sale of life insurance products stay on top of the developments at the federal and state levels and do their best to prepare for what at the moment is an uncertain future.

<sup>1</sup> Fed Chairman Jerome Powell, from an Oct. 3, 2017, speech at a meeting of the Treasury Market Practices Group.

<sup>2</sup> Feb. 15, 2018, press release of the Secretary of the Commonwealth of Massachusetts.

<sup>3</sup> Mark Schoeff Jr., “Maryland Jumps into Fiduciary Fray with Legislation Requiring Brokers to Act in Best Interests of Clients,” *InvestmentNews*, Feb. 21, 2018.

<sup>4</sup> See letter from Superintendent of Financial Services Maria T. Vullo to NAIC, dated Jan. 22, 2018.



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## In The News

Stradley Ronon received accolades for several practice areas in the 2018 *U.S. News – Best Lawyers* “Best Law Firms” publication, including 12 national rankings and 13 top-tier rankings in Philadelphia. The firm’s insurance, securities litigation and investment management/mutual funds practice groups received national rankings. Click here (<https://www.stradley.com/insights/news/2017/11/stradley-ronon-named-best-lawyers-best-law-firm>) to see the full list of practice areas in which Stradley Ronon is nationally ranked.

**Greg DiMeglio** served as a panelist at the American Bar Association’s National Institute on Securities Fraud in Salt Lake City. Greg’s panel, “Whither the ALJs?” discussed what might happen if the U.S. Supreme Court weighs in on the issue of whether Securities and Exchange Commission Administrative Law Judges are constitutionally permissible.

**Paula Shaffner** served as a panelist at SIFMA’s C&L Annual Seminar in Orlando, Florida. Paula’s panel, “Compliance for small and regional firms,” discussed privacy and cybersecurity, anti-money laundering, senior investors and a Q&A to understand peer firm practices.

**Steve Johnson** was named the 2017 Person of the Year by the Association of Insurance and Reinsurance Runoff Companies’ at the 13th Annual Commutations and Networking Forum in New Brunswick, New Jersey. Steve was recognized as an international thought leader in the insurance and reinsurance runoff business.

**Nicole Stover** and **Elizabeth Kuschel** were featured speakers at the Human Resources Council sponsored by the Chamber of Commerce of Southern New Jersey. Nicole and Elizabeth’s presentation, “Me too or Not Us: Revisiting Sexual Harassment and Response,” addressed key action items for human resources professionals in the wake of current headlines and discussed existing and proposed laws impacting sexual harassment investigation and response.

**Steve Davis** has been appointed to the board of directors of the Committee of Seventy. The Committee of Seventy was established in 1904 for the express purpose of combating corruption in Philadelphia, playing a major role in the adoption of civil service reforms and the passage of the 1919 and 1951 Home Rule Charters. A nonprofit and nonpartisan organization, Seventy does not endorse candidates or represent any special interests.

Twenty-five Stradley Ronon attorneys including members of the securities and insurance practices were named to the recently released 2018 edition of *The Best Lawyers in America*, regarded as a definitive guide to legal excellence. Best Lawyers lists are compiled based on an exhaustive peer-review evaluation. Click here (<https://www.stradley.com/insights/news/2017/08/2018-best-lawyers-in-america-list>) to view the full list.