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## **DOL 101: The fiduciary rule's impact on insurance-only agents**

Opinion

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**MAY 31, 2016 | BY KEVIN W. MECHTLEY, J.D.**

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Part 1 of this series of articles about the DOL fiduciary rule's impact focuses on insurance-only producers.

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The **Department of Labor's new fiduciary rule** is the most significant industry game-changing development we have seen since the tax reform to annuities in the early 1980s. As a compliance expert with a leading consulting company, the biggest question I receive these days is: "How do I comply?" Even though I'd like to have a panacea response, my answer is often the same: "It depends." Every company, distributor and producer is in a unique position under this rule, and compliance answers will vary based on the licenses one carries and the type of products manufactured and marketed.

This is part 1 of a series of articles taking a deep dive into what the annuity world will look once the rule takes effect next April.

Part 1 takes a look from the perspective of the "insurance-only" producer.

By insurance-only, I am talking about those licensed insurance producers that do not maintain a securities license or investment advisory registration. Many of these individuals may work under an IMO/FMO umbrella for marketing support, and the only regulator he or she has ever known has been the state insurance department — not FINRA, not a state securities regulator, not the SEC, and certainly not the DOL or IRS.

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## Is it possible to comply with competing regulatory frameworks?

The fundamental conduct standard regulating agents' product advice has been **suitability**, which is rooted in the concept of needs-based sales. The insurance-only agent is likely comfortable operating within the current annuity suitability framework, given state and carrier requirements for suitability and product training before any sales can occur. This producer also likely understands the line that cannot be crossed when recommending annuities and rendering "investment advice" beyond the scope of their licensure. However, starting April 10, 2017, the producer will need to understand a new framework — **what it means to be a fiduciary**.

Herein lies an inherent problem. The DOL fiduciary rule broadly expands new ERISA-like fiduciary duties of prudence, care and loyalty, as well as a duty to offer "investment advice" in the best interests of the consumer for all qualified sales. Many agents will ask: "I thought I wasn't allowed to provide "investment advice" under my state insurance license? How can I comply with both state investment advice restrictions and these new DOL fiduciary standards?"

It's a difficult proposition.

In the past, a few states have provided guidance for agents to understand the boundaries of an insurance license. In 2011, Commissioner Susan Voss issued Iowa Insurance Bulletin 11-4, which offers a list of "Prohibited Activities for an Insurance-Only Person," including "Discussing risks specific to the consumer's individual securities portfolio." This instructive bulletin helps clarify for agents the limits of what they may and may not discuss with clients.

Complying with the strict language of the DOL rule may make it difficult to also comply with the spirit of Bulletin 11-4. Now, insurance-only agents must seek to meet a consumer's overall investment needs and objectives while not crossing a state or federal investment advice-without-a-license line.

## Best interests may not mean best product

Some have wondered how the enforcement of the **DOL Rule** will work for insurance-only

**Plaintiff's Counsel:** "Why did you sell this indexed annuity product with an income rider when your 45-year old client said he wanted more, not less, exposure to the market?"

**Agent:** "I don't have the appropriate licenses to offer securities, so I offered the best product I could offer under the circumstances."

**Counsel:** "But isn't it true that you acknowledged your fiduciary status to your client? And under such status, aren't you required to act in the best interests of your client, without regard to your own interests?"

**Agent:** "Yes, but I'm also obligated to follow my state's insurance and securities laws."

**Counsel:** "So how can you possibly consider yourself a fiduciary without all the necessary licenses to serve the best interests of your client? How could you even *know* it's in the client's best interest without requisite knowledge and ability to sell the full universe of financial products?"

Perhaps this is an extreme example, but it highlights the dilemma for insurance-only agents. Was this the DOL's intent?

Probably not.

Many believe the enforcement of the rule won't bully insurance-only agents into these exchanges but will instead provide fiduciary scrutiny when there is perceived bad advice *relative to other products available to that agent in the same asset class*. In other words, the agent may be in fiduciary hot water when he or she recommends an indexed annuity from a B-rated carrier that pays relatively high compensation when there was an identical product available with half the compensation and better benefits from an A-rated carrier.

The rule provides a bit of guidance that supports this opinion, noting that a producer acts in the "best interests" of the client when he or she acts: "... with the care, skill, prudence and diligence *under the circumstances then prevailing* that a prudent person *acting in a like capacity and familiar with such matters would use* in the conduct of an enterprise *of a like character and with like aims*, based on the investment objectives, risk tolerance, financial circumstances and needs of the plan or IRA ..."

The italicized language suggests that perhaps fiduciary obligations for insurance-only agents will be compared only in light of what other insurance-only agents in like capacity would do under similar facts and circumstances. The preamble to the Best Interest Contract Exemption (BICE) further provides that the standard does not impose on agents a requirement to "... somehow identify the single 'best' investment for the retirement investor out of all the investments in the national or international marketplace, assuming such advice were even possible."

As a result, it would appear that insurance-only agents can survive the fiduciary standard in the post-DOL world. Agents will need to reshape their businesses and client interactions to best demonstrate fiduciary compliance. This starts with understanding what it means to be a fiduciary, creating enhanced client processes and documentation, and maintaining an adequate range of insurance products to serve the client's best interest needs.

However, will carriers allow insurance-only agents access to these products in the qualified market under the rule?

## **BICE, PTE 84-24 and the carrier's dilemma with insurance-only distribution**

The DOL provided two possible exemptions to pay commissions to agents acting as fiduciaries — the Best Interest Contract Exemption (BICE) and PTE 84-24. At the time of this writing, fixed and indexed annuity carriers are faced with some very difficult questions around how they can pay insurance-only agents under one of these exemptions.

Because the DOL put indexed annuities into the BICE and traditional fixed-rate annuities into PTE 84-24, there are separate pathways to **compliance** for insurance-only agents, depending on the product sold. For those marketing indexed annuities, the BICE requires a written contract to be signed by a supervising financial institution and the client. The contract must warrant compliance and adherence to impartial conduct standards, and must disclose any conflicts of interest, among many other disclosures.

Many carriers are currently analyzing whether they would be willing to sign as the financial institution for their independent, insurance-only agents, or if they would instead defer that liability to some other party (such as a broker-dealer, bank or RIA firm). In practice, it may prove difficult for a carrier to effectively supervise all of an agent's conduct and activities when most insurance agents sell products for multiple carriers.

This is a very important question yet to be answered, because if the carrier is unwilling to sign as the supervising financial institution, then insurance-only agents would be left without a supervising party to sign off on sales of indexed annuities purchased with qualified money, effectively ending the opportunity to sell these products.

For fixed-rate annuity contracts, which fall under PTE 84-24, no contract is required to be signed by a financial institution. Many of the same standards will apply, however, including impartial conduct standards, serving the client's best interests, and disclosing conflicts of interest. Without the contract requirement under BICE, though, carriers are more likely to be willing to support insurance-only distribution.

Some have suggested that insurance-only agents should consider seeking a securities license

surrounding carriers' appetite for signing as financial institutions. Clarity is likely to come in a matter of months as carrier risk analysis is completed and anticipated litigation contesting the rule is decided.

## Bottom line

It would be a good thought exercise for independent, insurance-only agents to first determine how much business comes from the qualified marketplace and what products are sold in that marketplace. Will fixed and indexed sales in the nonqualified market and PTE 84-24 qualified annuities be enough to support the agent's business? If commissions dropped 20, 30 or 40 percent, would the agent be able to continue to operate? If not, it may be worth exploring additional licenses and potential pivots necessary to thrive in the post-DOL-rule environment.

*Disclaimer: The opinions expressed in this article are my own and not the opinion or position of my employer, First Consulting & Administration Inc., or its clients. Nothing in this article is intended nor should it be taken as legal advice.*

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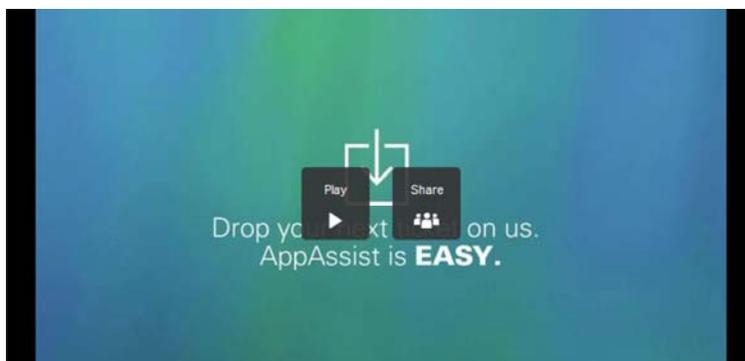
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