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Subject: Barry Flagg: New York Best Interest Rule for Life Insurance – New Requirements for Life Insurance Producers and Ethical Considerations for Other Estate Planners

"On July 18th 2018, the New York State Department of Financial Services (NY DFS) issued a Best Interest Rule for life insurance (Regulation 187). This new Rule re-defines the meaning of 'clients' best interests' for product recommendations to be more consistent with other fiduciary rules, requiring life insurance producers to 'act in the best interests of the consumer … based on an evaluation of relevant suitability information … and the care, skill, prudence, and diligence [of] a prudent person … considering only the interests of the consumer in making recommendations… [and] prominently disclos[ing] in writing limit[ations in] the range of policies recommended.' Previously, due diligence for life insurance product recommendations was governed by the National Association of Insurance Commissions (NAIC) Life Insurance Illustrations Model Regulation #582. This commentary will, therefore, contrast due diligence requirements for product recommendations under each, and explore the ethical implications for estate planning professionals who serve fiduciaries and/or work under a fiduciary definition of "clients' best interests."

Barry Flagg provides members with important commentary that examines the New York State Department of Financial Services' Best Interest Rule for life insurance Regulation 187.

Barry Flagg, **CFP®**, **CLU**, **ChFC**, **GFS®** is inventor and founder of Veralytic® - a leading publisher of pricing and performance research and ratings for life insurance products. Veralytic is the invention of his unique background as both the now oldest youngest Certified Financial Planner (CFP®) in history schooled in the fiduciary investment business, as well as life insurance practitioner consistently ranked in the top 1% of the industry. He's a recognized expert in applying Prudent Investor principles to life insurance product selection and portfolio management and serves as subadvisor to thousands of life insurance trusts. Barry has written articles

for numerous national publications and has delivered continuing education to attorneys, CFP®s, CPAs, and CTFAs on the management of life insurance as an asset according to established and proven asset management principles. He's among a small handful of life insurance professionals worldwide who've qualified for the Top of the Table every year since first qualifying in 1997 and attributes that success principally to a Prudent Process for life insurance that is much like the NY Best Interest Rule for life insurance. As such, he's uniquely qualified to help all estate planning professionals understand the ethical implications of a new meaning of clients' best interest for life insurance, and help life insurance professionals prosper in a clients'-best-interest environment.

Here is his commentary:

EXECUTIVE SUMMARY:

On July 18th 2018, the New York Department of Financial Services (NY DFS) issued a Best Interest Rule (Regulation 187) that (re)defines the meaning of "clients' best interests" for life insurance product recommendations effective February 2020. Previously, due diligence for life insurance product recommendations was governed by the National Association of Insurance Commissions (NAIC) Life Insurance Illustrations Model Regulation #582 (as adopted by each State).

However, NY DFS Regulation 187 prohibits such illustration comparisons as due diligence for product recommendation (i.e., attorneys for the life insurance industry lobbied to "expressly include" illustration comparisons, but NY DFS rejected this request[i]). The Rule's omission of illustrations comparisons is also consistent with guidance from other financial, insurance, and banking industry authorities warning against illustration comparisons as "misleading"[ii], "fundamentally inappropriate"[iii], and unreliable[iv].

Instead, NY DFS Regulation 187 requires product recommendations be based on a careful, skilled, prudent, and diligent evaluation of costs, performance, and risks relative to benefits. Defining clients' best interests in terms of costs, performance, and risk is consistent with well-established practices for clients' best interests determinations. Conversely, NAIC Life Insurance Illustrations Model Regulation doesn't require care, skill, prudence, diligence or disclosure of costs, performance, or risk.

The NY Best Interest Rule is also significant given the broad efforts to more clearly define clients' best interests (e.g., the DOL Rule and the SEC Best Interest Rule) and NY DFS "reputation as a first mover on important insurance regulation matters."[v] For instance, Nevada and Connecticut have already enacted legislation[vi], and Maryland, New Jersey, and Illinois have introduced legislation [3], and the California Department of Insurance is working on life insurance regulation[vii] all to better define clients' best interests.

Given the predominant use of illustration comparisons as supposed due diligence, the questionable use of illustration comparisons as decision-support for product recommendations, the growing legislative and regulatory activity around re-defining clients' best interests for product recommendations, and NY DFS's standing as first-mover on important insurance regulation, the NY Best Interest Rule for life insurance raises significant ethical considerations for estate planners serving fiduciaries and/or working under a fiduciary definition of "clients' best interests" both in and outside New York.

COMMENT:

Product Recommendations under NY DFS Best Interest Rule for Life Insurance

The NY DFS Best Interest Rule defines clients' best interest in terms of a) costs that can be justified, (i.e., cost of insurance charges, mortality and expense fees, investment advisory fees, surrender charge, charges for riders, etc.), b) performance that is reasonable to expect (i.e., availability of cash value, equity-index features, limitations on interest returns, etc.), and c) risk that is appropriate for the circumstances (i.e., market risk, guaranteed interest rates, etc.) "based upon all products, services, and transactions available to the producer."[viii]

Defining clients' best interests for life insurance product recommendations in terms of costs, performance, and risk is well-established by centuries of debate, legislation, litigation, and case law. However, the life insurance industry argues that additional "regulation is unnecessary because … comprehensive state laws and regulations … [already] assure that life insurance products are sold consistent with the best interest of

consumers."[ix] But this position seems uninformed, out-of-step with related authority, and replete with loopholes.

For instance, the NAIC Life Insurance Illustrations Model Regulation was promulgated in 1995 with stated goals to "ensure that illustrations do not mislead purchasers of insurance and to make illustrations more understandable". However, in Actuarial Guideline XLIX (AG49), the NAIC concluded in 2015 that the Illustrations Model Regulation failed to achieve those goals by instead producing a "lack of uniform practice … [resulting in] illustrations that use [apparently] the same index and crediting method [but] often illustrated different credited rates."[x]

In addition, NAIC Illustrations Model Regulations don't require disclosure of costs, performance, or risk. As such, the prevailing practice of comparing illustrations as a means of due diligence for product recommendations doesn't even consider the very elements essential to well-established definitions of clients' best interest. To the contrary, NAIC-compliant illustration comparisons are now considered "misleading", "fundamentally inappropriate", and unreliable by financial, insurance, and banking industry authorities.

For instance, FINRA issued IM-2210-2(c) stating that "[i]t is inappropriate to compare a … life insurance policy with another product based on hypothetical performance…" because "[a]ny comparison… must disclose all material differences…including investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return [i.e., risk], …[the] omission [of which] … would cause the communications to be misleading" according to Rule 2210(d).

Similarly, the OCC's Handbook for Unique and Hard-to-Value Assets cautions that a "policy illustration is subject to a high degree of fluctuation" and therefore not reliable for determining which product(s) are in the client's best interest. Even the Society of Actuaries concluded in their FINAL REPORT OF THE TASK FORCE FOR RESEARCH ON LIFE INSURANCE SALES ILLUSTRATIONS that "Illustrations should not be used for comparative policy performance purposes" because doing so "is fundamentally inappropriate."

NY DFS Regulation 187 also requires that a product recommendation "reflects the care, skill, prudence, and diligence that a prudent person

acting in a like capacity and familiar with such matters would use under the circumstances then prevailing."[xi] The duty to exercise reasonable care, skill, and caution is also well-established as an essential element of product recommendations in the clients' best interests, but also absent from NAIC Life Insurance Illustrations Model Regulation.

Given the predominant use of illustration comparisons as supposed due diligence, the questionable use of illustration comparisons as decision-support for product recommendations discussed in the next section, the growing legislative and regulatory activity around re-defining clients' best interests for life insurance product recommendations, and NY DFS's standing as a "bellwether" for important insurance regulation, the NY Best Interest Rule for life insurance poses significant ethical implications for estate planning professionals who serve fiduciaries and/or work under a fiduciary definition of "clients' best interests "both in and outside New York for reasons detailed in the next section below.

Product Recommendations under NAIC Illustrations Model Regulation

NAIC Life Insurance Illustrations Model Regulation was intended to "ensure that illustrations do not mislead purchasers of insurance and to make illustrations more understandable". With such a goal, it's certainly plausible that supposed "apples-to-apples" illustration comparisons would be used as due diligence for product recommendations. However, the NAIC since concluded that illustration comparisons "lack of uniform practice … [result in] illustrations that use [apparently] the same index and crediting method [but] often illustrated different credited rates."[10]

Let's therefore examine below why illustrations comparisons are considered "misleading", "fundamentally inappropriate", and unreliable by financial, insurance, and banking industry authorities, and in turn create an ethical dilemma for estate planners with a fiduciary duty to exercise reasonable care, skill, and caution.

Consider a 45-year-old extra-healthy client needing $1,000,000 of permanent life insurance and wanting cash value as an exit strategy in case he no longer needs this coverage. The estate planning attorney, CFP®, CPA, or trust officer calls their trusted life insurance professional(s) for premium quotes payable for 20 years and calculated using a 5.0%

interest rate so quotes can be compared “apples-to-apples” to determine which product is best for this client.

The trusted life insurance professional(s) send over a comparison of illustrations for two different products – a traditional universal life (UL) product and an indexed universal life (IUL) product – from two well-known insurers that are both highly-rated for financial strength and claims-paying ability. Both illustrations prominently display the requested 5.0% assumed rate of return in column headers immediately above the hypothetical values that were (supposedly) calculated using that rate of return.

The premium for the UL product is ~$8,500. The premium for the IUL product is ~$13,000. No competition, right? This (supposedly) “apples-to-apples” premium comparison clearly indicates the UL product offers lower costs to this client in this situation, right? After all, the premium for any product will always be equal the difference between sum of all cost of insurance charges (COIs) and expenses (E), less the sum of interest earned (i%) and used to pay internal costs (i.e., premiums = COIs + E – i%). So, if the interest rate used to calculate hypothetical premiums is the same, then the difference in premiums must be attributable to the difference in costs, right?

Let’s take a closer look at excerpts from the actual insurance-company-produced illustrations for both products showing actual costs the insurer represents they will charge, as well as the interest presumably calculated at the requested 5.0% assumed interest rate. As you can see in Figure 1, the UL product charges $30,463 in premium loads, $122,760 in fixed administration expenses (FAEs), and $991,804 for cost of insurance (COI) charges, totaling of $1,145,027 through policy year 50.

Figure 1

Based on Current Charges and an Initial Current Rate of 5.05%

Policy Year	Planned Premium	Premium Charge	Admin/ Contract Charges	Insurance Charges	Amount Credited	Policy Value	Surrender Charge	Net Surrender Value
41	0	0	2,455	38,017	47,979	225,463	0	225,463
42	0	0	2,455	42,873	52,697	232,832	0	232,832
43	0	0	2,455	48,330	57,973	240,019	0	240,019
44	0	0	2,455	54,482	63,888	246,970	0	246,970
45	0	0	2,455	61,409	70,478	253,584	0	253,584
46	0	0	2,455	69,049	77,748	259,828	0	259,828
47	0	0	2,455	77,499	85,757	265,631	0	265,631
48	0	0	2,455	86,918	94,678	270,936	0	270,936
49	0	0	2,455	97,330	104,532	275,683	0	275,683
50	0	0	2,455	108,672	115,285	279,841	0	279,841
Totals:	169,240	30,463	122,760	991,804	1,255,628			

On the other hand, the insurer of the IUL product represents they will charge a total of $822,421 comprised of $15,252 in premium loads, $377,177 in fixed administration charges (FAEs), and $429,992 in cost of insurance charges (COIs) also through policy year 50 (i.e., age 94 as an example life expectancy of an extra healthy, high-net-worth client), as shown below in Figure 2.

Figure 2

Non-Guaranteed Values (EOY) @ 5.00% [1]

		What You Pay	What We Deduct					What Is Added	What Your Policy Values Are			
Yr	Age	Premium Outlay*	Non-Guaranteed Premium Loads	Admin and Rider Charges	Non-Guaranteed Coverage Charge	Non-Guaranteed Cost of Insurance	Total Charges	Interest Credit[1]	Accumulated Value	Policy Surrender Charge	Cash Surrender Value	Alternate Accum Value
41	85	0	0	-90	-6,562	-16,425	-23,076	39,891	666,610	0	666,610	78,244
42	86	0	0	-90	-6,562	-17,339	-23,991	40,722	683,340	0	683,340	62,193
43	87	0	0	-90	-6,562	-18,307	-24,958	41,536	699,918	0	699,918	44,844
44	88	0	0	-90	-6,562	-19,321	-25,973	42,330	716,276	0	716,276	26,123
45	89	0	0	-90	-6,562	-20,355	-27,006	43,101	732,371	0	732,371	5,983
46	90	0	0	-90	-6,562	-21,402	-28,053	43,846	748,163	0	748,163	0
47	91	0	0	-90	-6,562	-22,794	-29,445	44,660	763,378	0	763,378	0
48	92	0	0	-90	-6,562	-24,218	-30,869	45,324	777,833	0	777,833	0
49	93	0	0	-90	-6,562	-25,630	-32,282	46,046	791,597	0	791,597	0
50	94	0	0	-90	-6,562	-26,894	-33,546	46,614	804,666	0	804,666	0
Total		258,500	-15,252	-4,500	-372,677	-429,992	-822,421	1,368,587				

But how can the premium for the UL product (i.e., ~$8,500 a year for 20 years) be 35% LESS than the premium for the IUL product (i.e., ~$13,000 a year for 20 years) when the costs in the UL product are nearly 40% MORE than the IUL product? It is mathematically impossible for a premium calculated using the same assumed rate of return to be lower when policy expenses are greater, unless the amount of assumed interest credited is not as it appears.

So, let's look more closely at the interest component. Interest actually credited to a policy in any given year will be calculated starting with the end-of-prior-year policy account value, adding new premium contributions, deducting cost of insurance charges (COIs) and policy expenses, and then multiplying that result by the applicable interest rate. For instance, the interest credited on an account of $110,000, plus $0 in premiums, less $9,000 in COIs and expenses, would be a little more than $5,000.

However, the amount shown to be calculated and credited in these UL and IUL products is different than the above math suggests. As shown in Figure 3, the account value of the UL policy is projected to be $110,461 at the end of policy year 25, plus premium contributions of $0, less $9,137 in total policy costs deducted (i.e., $0 in premium loads, $2,455 in FAEs, and $6,682 in COIs) equals $101,324. However, the amount of interest shown to be credited is $14,170, which is NOT 5.0% and instead closer to 14.0%.

Figure 3

Based on Current Charges and an Initial Current Rate of 5.05%

Policy Year	Planned Premium	Premium Charge	Admin/ Contract Charges	Insurance Charges	Amount Credited	Policy Value	Surrender Charge	Net Surrender Value
21	0	0	2,455	3,824	6,091	116,703	0	116,703
22	0	0	2,455	4,252	6,068	116,065	0	116,065
23	0	0	2,455	4,745	6,020	114,884	0	114,884
24	0	0	2,455	5,313	5,940	113,057	0	113,057
25	0	0	2,455	5,964	5,823	110,461	0	110,461
26	0	0	2,455	6,682	14,170	115,493	0	115,493
27	0	0	2,455	7,432	16,281	121,887	0	121,887
28	0	0	2,455	8,309	17,377	128,500	0	128,500
29	0	0	2,455	9,309	18,583	135,319	0	135,319
30	0	0	2,455	10,429	19,899	142,333	0	142,333
Totals:	169,240	30,463	73,656	97,996	175,208			

Similarly, Figure 4 shows the account value of the IUL policy is projected to be $392,777 at the end of policy year 25, plus premium contributions of $0, less $15,470 in total policy costs deducted equals $377,307. Once again, interest of $31,597 shown to be credited on $377,307 is clearly NOT 5.0%, and instead closer to 8.0%. While the degree of exaggeration of interest earnings is less than in the UL product, both illustrations are clearly NOT "apples-to-apples", and instead down-right misleading. Simply put, both policies were "illustrating" 5% returns, yet in practice both require a rate of return that is materially-higher-than-5% to prevent client disappointment.

Figure 4

			Non-Guaranteed Values (EOY) @ 5.00% [1]									
		What You Pay	What We Deduct					What Is Added	What Your Policy Values Are			
Yr	Age	Premium Outlay*	Non-Guaranteed Premium Loads	Admin and Rider Charges	Non-Guaranteed Coverage Charge	Non-Guaranteed Cost of Insurance	Total Charges	Interest Credit[1]	Accumulated Value	Policy Surrender Charge	Cash Surrender Value	Alternate Accum Value
21	65	0	0	-90	-8,748	-3,955	-12,793	27,201	331,811	0	331,811	210,775
22	66	0	0	-90	-8,748	-4,433	-13,271	28,013	346,553	0	346,553	210,419
23	67	0	0	-90	-8,748	-4,957	-13,795	28,914	361,672	0	361,672	209,526
24	68	0	0	-90	-8,748	-5,530	-14,368	29,762	377,066	0	377,066	208,037
25	69	0	0	-90	-8,748	-6,155	-14,993	30,704	392,777	0	392,777	205,885
26	70	0	0	-90	-8,748	-6,632	-15,470	31,597	408,904	0	408,904	203,208
27	71	0	0	-90	-6,562	-7,111	-13,763	30,061	425,202	0	425,202	199,994
28	72	0	0	-90	-6,562	-7,611	-14,263	31,016	441,955	0	441,955	196,210
29	73	0	0	-90	-6,562	-8,127	-14,779	31,987	459,163	0	459,163	191,828
30	74	0	0	-90	-6,562	-8,663	-15,314	33,036	476,885	0	476,885	186,818
Total		258,500	-15,252	-2,700	-241,445	-95,399	-354,796	573,181				

To be clear, this is not to say that either of these insurers cannot actually credit more than 5.0%. For instance, some insurers claim to be able to credit higher interest due to investment strategies that includes greater exposure alternative asset classes, but illustrations don't consider the greater risk inherent in such asset classes. Other insurers claim to expect cost savings under certain circumstances that they project (but don't guarantee) to pass back to the policyholder in the form of interest credits. Others still inflate the amount of hypothetical interest illustrated by charging additional costs to purchase additional options on an equity index (e.g., S&P500) that are presumed to result in additional policy earnings, but without reflecting the additional risk associated with such equity options expiring "out-of-the-money" resulting in a loss of principal instead of an increase in policy earnings.

In other words, the above is not intended to dispute any insurer's potential ability to earn and credit more interest, but is instead intended to demonstrate that comparing hypothetical premiums, cash values and death benefits does not necessarily identify the product with the lower costs, as has been commonly promoted by IMOs, BGAs and even fee-only consultants. As such, hypothetical illustration comparisons are useLESS as due diligence for product recommendations, and can expose estate planners, other fiduciary advisors, and especially trustees to risk of breach of duty to exercise reasonable care, skill, and caution for reliance on "decision support" that's now considered "misleading", "fundamentally inappropriate" and unreliable by financial, insurance, and banking industry authorities.

The above is also far from an isolated example of “misleading”, “fundamentally inappropriate” and unreliable illustration comparisons. As many as 70% of all IUL products plus some UL and WL products calculate hypothetical policy values using un(der)-disclosed inflated interest assumptions. And because such inflated interest assumptions are un(der)-disclosed, it’s at least difficult for most advisors and almost certainly impossible for most clients to discern the illustrations that include inflated interest assumptions from those that do not, and adjust for the risk of whether those higher returns are really likely to occur or not. With so many advisors and clients relying on illustration comparisons for product selection decision-support, and with so many IUL products illustrating inflated interest assumptions above their stated illustration rate, it’s no wonder IUL products are the top-selling “flavor-of-the-day” product type according to LIMRA.

Notably, this is also not the first time that illustrations with inflated interest assumptions have been used in illustration comparisons to sell a particular product-type. The practice of comparing illustrations for product recommendations effectively started in the 1980s when illustrations of UL products calculated hypothetical policy values using then double-digit interest crediting rates and were compared to illustrations of WL products that calculated hypothetical policy values using much lower dividend interest crediting rates even though invested assets underlying the cash values of both are required by regulation as a practical matter to be invested predominantly in the same asset classes.

As we saw above, when an illustration calculates hypothetical policy values using a higher assumed rate, and is then compared to another illustration that calculates hypothetical policy values using a lower assumed rate, the illustration using the higher assumed rate can appear to be a “better” product when in fact the costs in the supposedly “better” product are actually higher. The rational(ization) back then was that UL products would actually credit higher rates because UL products introduced in the high-interest-rate environment of the 1980s and could invest in higher interest-bearing securities without the drag of an existing portfolio of lower interest-bearing securities.

However, life insurance products by their very nature are long-term financial instruments. As such, if prevailing interest rates remained high, then the yield on interest-bearing securities underlying WL policies would

have migrated up as bonds and mortgages matured and were re-invested in higher interest rate instruments. On the other hand, because prevailing interest rates have instead steadily declined, the crediting rates on UL policies have also steadily fallen as yields on interest-bearing securities underlying UL policies have migrated down as bonds and mortgages matured and were re-invested in lower interest rate instruments.

Today, UL interest crediting rates are generally lower than WL dividend interest crediting rates (at least for the time being until the direction of interest rates shifts again). As such, WL products now generally appear "better" than UL products in today's illustration comparisons (in direct contradiction to the expectations set by UL illustrations in the 1980s). This temporary timing difference between policy interest crediting rates and methods is another example of the flaws in using or accepting illustration comparisons as decision-support for product recommendations.

Nonetheless, this practice of comparing hypothetical illustrations as due diligence for product recommendations began innocently enough. The 1980s brought a variety of new and different products, and illustrations were the only source of information for trying to understand costs, features and benefits. However, comparing hypothetical policy values for UL versus WL products calculated using dramatically different assumed crediting rates even though both products are required by regulation to invest assets underlying cash values in the same asset classes is just nonsense, and now the subject of critical articles in the financial press (e.g., Universal Life Insurance, a 1980s Sensation, Has Backfired).

The use of questionable illustrations comparisons continued in the 1990 when Variable Life (VL) illustrations were compared to UL and WL illustrations even though VL hypothetical values were calculated using assumed earnings rates that were again 100s of bps higher than the illustrations for UL and WL products, and without any consideration of the inherent volatility of equity returns and the corresponding impact on hypothetical policy values.

Ironically, the insurers of the products shown in Figures 1-4 had resisted misleading illustration practices for years, but were at a competitive disadvantage to those insurers less inclined to follow the spirit of NAIC regulations. In such an environment where prudence is punished and recklessness is rewarded, even otherwise responsible insurers have too

many incentives to eventually “game the rules” under NAIC Illustrations Model Regulation to better compete in the illustration comparison “beauty contest”.

In fact, comparing hypothetical illustrations has become so common that insurance marketing organizations (IMOs), brokerage general agencies (BGAs), producer groups, individual agents/brokers, and/or fee-for-service consultants have created or use computer software to graphically present comparisons of hypothetical policy values like in Figure 5 below showing the ranking of “[hypothetical] premiums, [hypothetical] distribution amounts, [hypothetical] cash surrender values, … [hypothetical] internal rates of return, … that help you fully understand the competitive positioning of [the hypothetical illustrations of] products for 30+ life insurance companies.”

Figure 5

Payment Structure	Gender	RiskClass	20	25	30	35	40	45	50	55	60	65	70	75	80	85	90
Full Pay	Male	Preferred Best	1	1	1	1	1	1	1	1	1	1	1	1	2		
		Preferred	1	1	1	1	1	1	1	1	1	1	1	3	7	10	4
		Standard Plus	2	1	1	1	1	1	1	1	1	1	1	1	4	11	4
		Standard	4	2	2	2	1	1	1	4	4	8	11	11	19	27	6
		Best Tobacco	3	1	1	1	1	1	1	1	1	1	15	21	23	15	5
	Female	Preferred Best	2	1	1	1	1	1	1	1	1	1	2	3	5		
		Preferred	2	1	1	1	1	1	1	1	1	1	1	3	6	2	3
		Standard Plus	3	1	1	1	1	1	1	1	1	1	1	1	1	8	4
		Standard	4	2	1	1	1	1	1	3	3	3	4	5	15	27	6
		Best Tobacco	3	1	1	1	1	1	1	1	2	7	11	23	22	13	4
Ten Pay	Male	Preferred Best	1	1	1	1	1	1	1	1	1	1	1	1	1		
		Preferred	1	1	1	1	1	1	1	1	1	1	1	1	1	5	4
		Standard Plus	1	1	1	1	1	1	1	1	1	1	1	1	1	8	4
		Standard	3	1	1	1	1	1	1	1	1	1	1	2	13	26	6
		Best Tobacco	2	1	1	1	1	1	1	1	1	1	2	14	21	17	5
	Female	Preferred Best	1	1	1	1	1	1	1	1	1	1	1	1	2		
		Preferred	1	1	1	1	1	1	1	1	1	1	1	1	5	2	3
		Standard Plus	2	1	1	1	1	1	1	1	1	1	1	1	1	4	4
		Standard	3	1	1	1	1	1	1	1	1	1	1	2	6	24	6
		Best Tobacco	2	1	1	1	1	1	1	1	1	1	2	15	15	13	4
Single Pay	Male	Preferred Best	1	1	1	1	1	1	1	1	1	1	1	1	1		
		Preferred	1	1	1	1	1	1	1	1	1	1	1	1	4		
		Standard Plus	2	1	1	1	1	1	1	1	1	1	1	2	3		
		Standard	3	2	1	2	1	1	1	1	1	1	2	2			
		Best Tobacco				2	1	1	1	1	1	1	4				
	Female	Preferred Best	1	1	1	1	1	1	1	1	1	1	1	1	1		
		Preferred	2	1	1	1	1	1	1	1	1	1	1	1	5		
		Standard Plus	2	1	1	1	1	1	1	1	1	1	1	2	4		
		Standard	3	1	1	1	1	1	1	1	1	1	2	2	6		
		Best Tobacco					1	1	1	1	1	1	3				

As we already know, the product with the lowest hypothetical premium or highest hypothetical cash value or death benefit may or may not be the product offering the lowest cost. In fact, to the contrary, the product in Figure 5 that is overwhelmingly ranked #1 is the same product that actually charges significantly higher costs as shown in Figure 1.

While such computerized systems and graphical presentations certainly seem professional, these charts and graphs are too often still simply portraying the same “misleading”, “fundamentally inappropriate”, and unreliable comparison of hypothetical values as discussed above and only for some limited number of products. In computer science parlance, this is GIGO (i.e., garbage in, garbage out) where flawed or nonsensical input data produces nonsensical output and flawed conclusions.

As such, while the NAIC Life Insurance Illustrations Model Regulation was well-meaning, the practice of comparing hypothetical illustrations as decision-support for product recommendations is proving to be “misleading”, “fundamentally inappropriate”, and unreliable. Most other segments of the financial services industry have evolved beyond using hypothetical product comparisons as due diligence for product recommendations. NY DFS Regulation 187 is an indication that the life insurance industry may also be evolving past using hypothetical illustration comparisons for product recommendations, and instead provides a checklist for due diligence alternatives to illustration comparisons discussed further in the next section.

Due Diligence Alternatives to Illustration Comparisons

Comparing hypothetical illustrations as supposed due diligence or product recommendations never made sense to me. I grew up in the financial services business – literally. I’m the son of an actuary and Certified Financial Planner™, started my career as an analyst in the Pension Investment Advisory department of his financial planning practice while still in college, and became the youngest CFP® in the history of the College for Financial Planning at that time. My first job involved providing the partners in the firm with due diligence on mutual funds to document that product recommendations were in the client’s best interest.

I used Morningstar to research and document that costs were justified and performance expectations were reasonable. When I graduated from college, I took a position in a life insurance agency to diversify my experience and build my resume. That experience – where due diligence for product recommendations didn’t consider costs, performance, or risk, and instead consisted of comparing illustrations of hypothetical values for

some limited number of products – could not have been more different than my earlier experience in a fiduciary environment.

So, I spent the next/last 30 years searching for and/or developing tools and techniques for analyzing internal policy costs and evaluating the reasonableness of performance expectations based on my experience with same type of analysis on other financial products. Along the way, I invented and founded Veralytic Research as a tool for fiduciary-oriented advisors to measure the competitiveness of internal policy costs and the reasonableness of performance expectations (among other things) against the universe of peer-group alternatives as follows.

Cost competitiveness

The pricing and performance of all cash value life insurance products is a function of just a few factors, namely:

- Cost of insurance charges (COI) for death benefit claims
- Policy Expenses (E) for policy design, underwriting, distribution and administration
- Investment gains and/or interest income (i%) credited to policy cash values in excess of COIs and E

In other words, premiums are always based on the following formula in minimum-premium defined-death-benefit policy designs, and policy performance is always based on the following formula in maximum-accumulation defined-contribution policy designs:

Premiums/Performance	**=**	**Cost-of-Insurance Charges (COI)**	**+**	**Policy Expenses (E)**	**-**	**Policy Interest/Earnings (i%)**

This simple formula can therefore be used to evaluate the pricing of either proposed coverages and/or inforce policies by first separating policy costs into either cost of insurance charges (COIs), and policy expenses (E), and then grouping expenses by their nature into the only three ways that insurers calculate and collect policy expenses, namely 1) fixed administration charges (FAEs), 2) cash-value-based “wrap fees” (e.g., M&Es), and 3) premium loads.

Because these costs vary from year-to-year resulting in hundreds of cost figures that are difficult to evaluate or compare, evaluation and comparison

of costs becomes much more practical when “normalized” to account for differences in amounts and timing of the different charges in different policies. This “normalizing” of varying policy charges computes a single value for each pricing component by adjusting for differences in timing at the rate of interest/earnings at which the policy cash values would otherwise grow, but for the deduction of the given charge(s). These normalized values can then easily be compared with industry benchmarks for each pricing component (see Figure 6 for example table of “normalized” costs below, courtesy of Veralytic).

Figure 6

Cost of Insurance (COI) Charges

	Policy Under Evaluation	Institutional Pricing Benchmark	Benchmark for All Policies
Weighted-Average Annual COI	$13,166	$12,940	$14,734

Policy Expenses

% of Cash Value	Policy Under Evaluation	Institutional Pricing Benchmark	Benchmark for All Policies
M&E Risk %	0.05	0.55	0.60
Other %	0.00	0.00	0.00
Total %	0.05	0.55	0.60
Loan Spread %	0.75	1.00	2.00
Fixed Charges Per Policy Yr	$2,529	$1,728	$1,728

Premium Loads

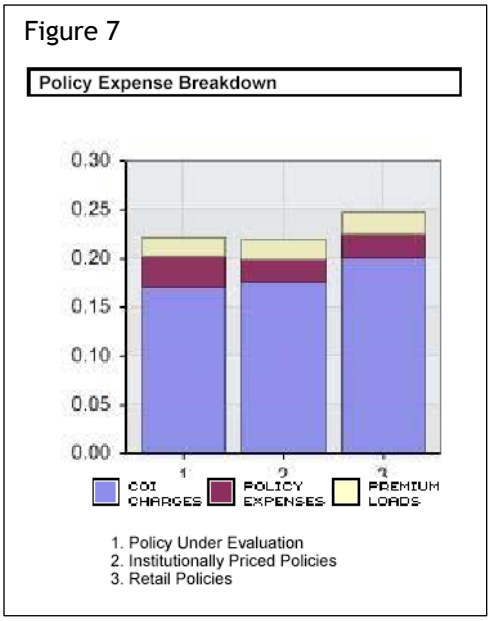
% of Premium	Policy Under Evaluation	Institutional Pricing Benchmark	Benchmark for All Policies
State Tax %	2.35	2.35	2.35
Fed DAC Tax %	1.50	1.50	1.50
Carrier % Load(s):	0.00	0.00	0.00
Sales/Service % Load(s):	3.15	3.65	3.65
Total %	7.00	7.50	7.50

The practice of benchmarking is well-established and common in the financial services industry where the performance of a financial product is frequently compared to a standard, independent point of reference. For instance, to determine the appropriateness of a given mutual fund selection, the performance of that mutual fund is often compared with the Dow Jones Industrial Average, the S&P 500, the NASDAQ, or the Wilshire 5000 depending on the fund’s investment objective.

Likewise, comparing COIs and expenses for a given life insurance product to industry standard mortality tables (e.g., Society of Actuaries 75-80 Basic Select & Ultimate Gender Distinct Mortality Tables at www.soa.org) and industry aggregate expense ratios (see Society of Actuaries Generally Recognized Expense Table for 2001 also at www.soa.org), reveals actual cost competitiveness. This practice of comparing costs to benchmarks is consistent with prevailing practices in most all other segments of the financial services business, is compliant with FINRA Rules, and addresses the requirements of NY DFS Regulation 187.

To understand the competitiveness of total costs relative to the universe of peer-group alternatives, “normalized” costs are calculated relative to death benefits (which can fluctuate over time and/or be different between different products), and are again compared to industry benchmarks (See example Policy Expense Breakdown in Figure 7 for showing the present value of all policy costs per $1.00 of death benefit over the expected policy holding period, courtesy of Veralytic).

Figure 7



Measuring aggregate costs per $1.00 of death benefit relative to benchmarks also provides insights as to the relative impact and fairness of individual pricing components on overall policy pricing. As shown in Figure 7, cost of insurance charges (COIs) typically comprise 85% of total costs, whereas fixed administration expenses (FAEs), premium loads, and cash-value-based “wrap fees” (e.g., M&Es) make up 15% of total costs as explained below.

Cost of Insurance Charges (COIs) – Whether disclosed or not, all policy types are priced for expected cost of insurance charges or COIs. COIs are deductions from permanent life insurance policies to cover anticipated payments by the insurer for death claims. As with most types of insurance, claims are, and arguably should be, the largest single cost factor of any insurance policy (If claims are not the largest single cost factor, then is the product really insurance against the risk of death, or something else?). With life insurance, COIs typically account for about 85% of total costs, and can vary by as much as 80% between different insurers and different products (even different products from the same insurer). At the risk of stating the obvious, the higher the COIs, the higher the premiums required to pay higher COIs.

COI charges are calculated year-by-year on the net at risk policy death benefit (i.e., the difference between the death benefit less policy account values) multiplied times a COI rate provided by the insurance company for each age corresponding to each policy year for each product. These

deductions are much like term life insurance premiums in that they are predominantly for claims paid during a given period (typically 1 year). For this reason, COIs are frequently referred to as the pure "risk" portion of the premium, reimbursing the insurance company for the risk associated with paying the death benefit, and because the risk of death increases with age, so do the COIs.

In addition, some insurers "load" the COIs to cover other policy expenses that are not disclosed elsewhere. For instance, some policies are marketed as "no-load" or "low-load" policies, and as such do not disclose certain policy expenses or loads. The expenses or loads that are typically "hidden" are sales loads, and other premium based loads. However, because certain premium based loads must be paid (e.g. state premium taxes, federal deferred acquisition costs (DAC) taxes, and the cost to distribute the policies), some insurers "hide" these distribution costs inside "loaded" COIs in order to market a product as “no-load” or “low-load” even though distribution costs are really still in there but just in another form as loaded COIs.

Because COIs are calculated on the NAR (i.e., net amount at risk difference between the death benefit less policy account values), and because COIs increase geometrically with age as discussed above, the NAR is a significant factor in the determination of COIs. For instance, COIs are minimalized when cash values are nearly equal to the policy death benefit even at the older ages when COI rates are at their highest. However, because policy cash values are “collected” by the insurer upon death in addition to COIs collected in prior years, cash values in the policy account on death are also a cost of maintaining the death benefit that must be considered.

Fixed Administration Expense (FAE) – FAEs are typically charged for expenses related to actuarial design, underwriting and new business processing, and service and administration, and are calculated as some fixed amount set at the time of policy issued either as a flat monthly charge (e.g. $10.00 a month), or in relation to the originally issued policy face amount (e.g. $1.00 per $1,000 of policy face amount). While this charge is fixed in amount at the time of policy issued, it can vary from year to year by a predetermined schedule (e.g. $10.00 a month and $1.00 per $1,000 of policy face amount during the first 10 policy years, and $5.00 a month and $0.00 per $1,000 of policy face amount thereafter).

In addition, FAEs can also include contingent or back-end policy surrender charges that are deducted from the policy cash account value upon surrender or cancellation/termination of the policy. These surrender charges are calculated in relation to the initially issued policy face amount and can be as much as 100% or more of the planned annual premium for policy types available to the general public at large (i.e. policies commonly referred to as "Retail Policies"), or can be less or even 0% for policies purchased in larger volumes (i.e. frequently referred to as "Institutionally Priced Policies") or fee-only-type products. In either case, this surrender charge typically remains level for an initial period of years (e.g. 5 years), then reduces to $0 over a following period of years (e.g. policy years 6 through 10 or 6 through 15).

Premium Loads – Premium loads are calculated as a percent of premiums paid in a given year and typically range between 0% and 35%. Premium-based charges customarily cover state premium taxes that average 2.50%, DAC taxes averaging 1.5%, and Sales Loads/Expenses ranging between 0% and 30%. In addition, while state premium taxes and DAC taxes are generally calculated by the respective government agencies as a percent of premium, and while insurance companies must certainly pay these taxes, insurance companies are not required to assess the charge as a percent of premium. As such, some insurance companies charge no (i.e. 0%) premium charges, and collect state and federal taxes from other charges within the policy (usually COIs).

Premium-based charges can also vary depending on either the policy year in which a premium is paid or the level of the premium paid into a given policy. For instance, a higher premium load may be assessed in the early policy years to recover up-front expenses related to underwriting, issue and distribution of a given policy. After these up-front expenses have been amortized (frequently over a period of ten policy years), premium loads are then often reduced to cover the relatively lower policy owner service and policy administration expenses.

In addition, a higher premium load may be charged on premiums paid up to a "Base Policy Premium" or "Target Premium" level, while a lower premium load may be charged on premiums in excess of the Base/Target Premium amounts. This Base/Target Premium is set by actuaries and generally calculated using conservative assumptions as the amount necessary to

cover COIs and expenses required to maintain life insurance death benefit. As such, this Base/Target Premium can be thought of as the "insurance premium" (i.e. the premium paid to maintain life insurance coverage).

Premium amounts paid into the policy in excess of this Base/Target Premium can, therefore, be viewed as "excess premium" above and beyond that required to cover the costs of maintain the death benefit. "Excess premiums" are typically intended to either create a cash value reserve as “pre-payment” of what would otherwise be future premiums and/or to grow the policy account for wealth accumulation, retirement planning, and/or asset protection.

As such, premiums paid up to the "insurance premium" are typically subjected to higher "insurance loads" to cover policy expenses unique to the insurance component of the policy, while “excess premiums” are typically subjected to a lower “investment-like loads” on those monies contributed toward cash values accumulations. In either case, Veralytic Reports calculate the blended premium load for easy comparison to industry benchmarks and/or peer group products.

Cash-Value-Based “Wrap Fees” – Cash-value-based “wrap fees” are insurance fees charged as a percent of policy account values (e.g., M&Es found in variable products) similar to Fund Management Fees (FMEs) that are also charged as a percent of assets under management. However, these cash-value-based *insurance fees* are specific to the policy, separate from and in addition to FME *investment fees,* can vary over time (e.g. 1.00% of cash values during the first 10 policy years, and 0.5% of cash values thereafter), and/or the amount of the cash value (e.g. 1.00% of cash values up to $25,000, and 0.5% of cash values above $25,000), and in either case typically range from 0% to 100 bps (1.00%).

These cash-value-based *insurance fees* are specific to each policy, without regard to the underlying general account investment portfolio or mutual-fund-like separate account funds, and are therefore a cost that needs to be considered in any analysis of policy costs. On the other hand, *investment fees* are specific to the respective separate accounts within a policy, and as such are a function of the underlying separate account fund selection, which usually change within the same policy over time with changes in asset allocations of invested assets underlying policy cash values. As such, *investment fees* are more logically addressed in the

evaluation of cash value investment performance (see further discussion of fund specific investment expenses under Historical Performance section).

Some products disclose cash-value-based insurance expenses in both dollar amount and percentage rate (i.e., when deducted at the policy level), whereas other products disclose cash-value-based insurance expenses only in a percentage rate (i.e., when deducted at the separate account level). For uniformity of cost analysis across all products, "normalization" of policy costs for differences in amounts and timing of charges should use the expected policy interest/earnings rate less the percentage rate of cash-value-based insurance charges (i.e., the rate at which policy cash values would otherwise grow, but for the deduction of the costs).

Reasonableness of Performance Expectations

While past performance is no guarantee of future results, measuring past performance against relevant benchmarks is a generally-accepted measure for the reasonableness of performance expectations. The reasonableness of performance expectations is, therefore, generally a function of historical performance of cash value investment options appropriate for acceptable risk, the expense ratios for invested assets underlying policy cash values, and number and diversity of cash value investment options (see Figure 8 for an example of performance expectations factors below, courtesy of Veralytic).

Figure 8

Traditional Products
(Universal Life & Whole Life General Account)

Policy Under Evaluation		Avg for All Policies
6.89%	5-yr Avg. Net Portfolio Yield*	6.53%

Variable Products
(Self-Directed Separate Accounts)

Policy Under Evaluation		Avg for All Policies
38	# of Funds	37
28	# of Top Performers	24
0.87%	Avg Inv Mgmt Fee	0.86%

Policy account values in traditional products are invested in the insurer's general account managed by the insurer and required by regulation as a practical matter to invest predominantly in fixed income securities like high-grade corporate bonds and government-backed mortgages. Traditional products include all forms of universal life (i.e., even indexed universal life) and generally do not disclose such investment expenses.

Policy account values in variable products are directed by the policyowner among a family of mutual-fund-like separate accounts typically offering a wide range of asset classes including an assortment of domestic and foreign stock funds, an array of domestic and foreign bond funds, a money market account, and usually a fixed account (typically the same as the insurer's general account).

Also, because neither cash-value-based investment expenses (i.e., FMEs), cash-value-based insurance expenses (e.g., M&Es), nor life insurance policy earnings are generally illustrated in a consistent or standardized manner, care is needed in understanding differences between the rate of return shown in illustrations versus the actual rate of return that is reasonable to expect, as follows:

- **Gross Rate of Return** – The *gross* policy interest/earnings rate is that rate of return credited to policy cash values reported *before* deduction of *investment*-related fund management expenses (FMEs) and *before* deduction of cash-value-based *insurance* expenses. The gross rate is typically disclosed in variable life products but not typically disclosed in traditional universal life or whole life products. The reporting of the gross policy earnings rate is also somewhat unique to life insurance products as rates of returns for investment products are most often reported net of FMEs.
- **Net Rate (Investment Rate Of Return)** – The *net* policy interest/earnings rate is that rate of return credited to policy cash values reported *after* deduction of *investment*-related FMEs, but before deduction of cash-value-based *insurance* expenses. In other words, this "Net Rate" is equal to the Gross Rate minus FMEs, and as such is most closely analogous to the "**investment rate of return**" on policy cash values (e.g., universal life policy interest crediting rates and whole life dividend interest crediting rates are generally reported *after* deduction of investment expenses). This "Net Rate" is also consistent with mutual funds reporting of earnings *after* deduction of related investment expenses (i.e., FMEs) and is therefore most useful in comparing performance outcomes for different life insurance or other financial products.
- **Net-Net Rate (Policy Rate Of Return)** – The *net-net* policy interest/earnings rate is that rate of return credited to policy cash values reported *after* deduction of *both investment* FMEs *and* cash-value-based *insurance* "wrap fees" (e.g., M&Es). In other words, this "Net-Net Rate"

is equal to the Net Rate minus M&Es, and because this Net-Net Rate reflects the rate of return reported on policy cash values after *all* cash-value-based fees, it can also be referred to as the "**policy rate of return**" (i.e., the rate of return on policy cash values after deduction of both investment *and* insurance "wrap fees"). This "Net-Net Rate" is the rate of return at which cash values would otherwise grow but for the deduction of all other policy expenses COIs, FAEs and premium loads, and is thus most useful in accounting for differences in the timing and amount of different charges in different policies for easy comparison.

While certain practitioners may disagree with the use of a consistent Net Rate when comparing different products and calculation policy expenses, and instead suggest that using a consistent Gross Rate produces a more accurate means of policy comparison, the use of a consistent Gross Rate for the purposes of such comparisons is only valid when the appropriate cash value allocation is known and also made consistent in all products under evaluation.

For instance, consider a comparison of performance and costs between two products based on a consistent 8.0% Gross Rate but where the cash value allocation is assumed to be allocated to actively-managed separate accounts with an average FME of 100 bps in Product A, while Product B is assumed to be allocated to passive index accounts with low FMEs of only 25 bps, as shown in Figure 9 below, courtesy of Veralytic:

Figure 9

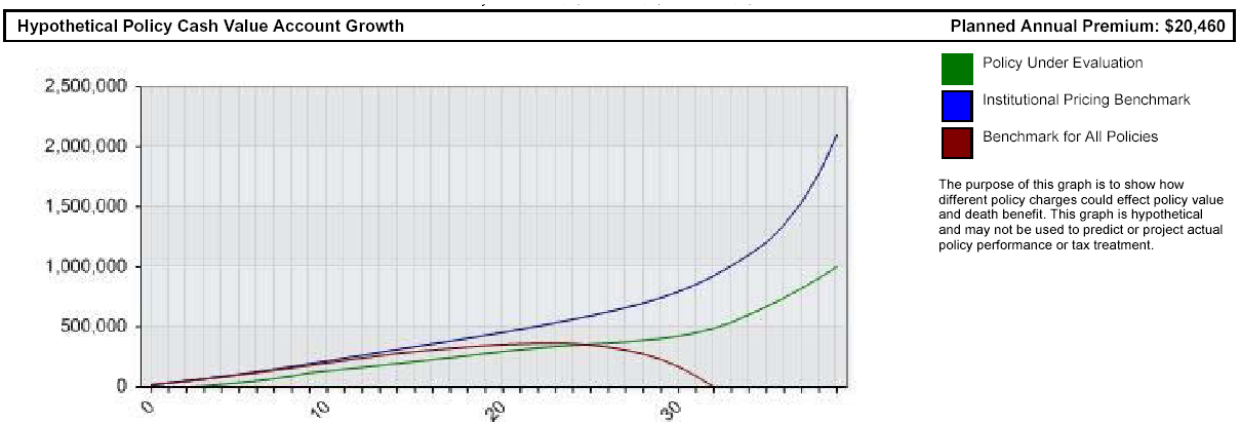
	Product A	Product B
Gross Rate	8.00%	8.00%
Less Investment Wrap-Fees (FMEs)	1.00%	0.25%
Net Rate	7.00%	7.75%
Less Insurance Wrap-Fees (e.g., M&Es)	0.75%	0.75%
Net-Net Rate	**6.25%**	**7.00%**

As shown above, comparing performance based on a consistent Gross Rate, but without knowing and also making consistent the cash value asset allocation, can result in understated investment expenses and overstated policy performance. In addition, because the asset allocation typically changes over time, which in turn also changes investment expenses, and because Separate Account funds are frequently added to and deleted from a given product, which in turn again changes investment expenses, comparing performance based on a consistent Gross Rate produces

inconsistent results. On the other hand, because cash-value-based insurance expenses (e.g., M&Es) are set at the time of policy issue, and do not change from that pre-set schedule, comparing performance based on a consistent Net Rate will produce consistent results over time.

The availability of cash value is also an element of suitability (i.e., specifically mentioned in NY DFS Regulation 187). Cash value, or cash surrender value (CSV), is a defining characteristic of permanent life insurance. In simple terms, CSV is the value available to the policyholder for withdrawal or upon policy termination, and is equal to the policy account value minus the surrender charge. All other factors being equal, the higher the accessible cash value after deduction of cost of insurance charges, policy expenses, and contingent surrender charges, the more suitable the policy. As such, once again measuring cash value accessibility against benchmark average cash values is useful in determining which products are in the client's best interest (see Figure 10 for an example measurement of accessible cash values, courtesy of Veralytic).

Figure 10



Risk Considerations

Risk is also an element of suitability, both generally speaking, and specifically mentioned in NY DFS Regulation 187. While the premium is often misconstrued as the price/cost of a life insurance policy, the premium is *not* the price/cost of the life insurance policy (e.g., like a contribution to an Individual Retirement Account is *not* the price/cost of the IRA). In both cases, the price/cost is the sum of the expenses deducted from the premium/contribution. As such, the stability of the planned premium payments in a minimum premium defined-death-benefit policy designs, and/or the reliability of projected benefits in a maximum accumulation

defined-contribution policy is always a function of the following formula: **Premiums/Benefits = COIs + E – i%**.

If costs are greater than expected or interest/earnings are less than expected, the additional premiums will be required to maintain expected benefits or expected benefits will be reduced or lost, resulting in client disappointment and possible complaint in either case. As such, to be suitable over the long term (versus just attractive in sales illustrations), cost of insurance charges must be adequate to meet the insurer's expected death benefit claims, and policy expenses must be adequate to meet the insurer's and servicing organization's service and administration commitments, and expected interest/earnings must be reasonable.

Due diligence for product recommendations should, therefore, consider whether expected cost of insurance charges are consistent with mortality experience, whether expected policy expenses are consistent with operating experience, and whether expected policy interest/earnings are consistent with historical performance of both invested assets underlying policy cash values and corresponding asset class benchmarks. NAIC Illustrations Model Regulation generally ignores these risks instead permitting both mortality improvements and operating gains (albeit with disclosures in footnotes not often read by advisors or clients), as well as a wide range of interest/earnings assumptions that have too often proved to be unreasonable.

For example, traditional "fixed products" (i.e., universal life and whole life) are required by regulation to invest assets underlying policy cash values predominantly in high-grade corporate bonds and government-backed mortgages as a practical matter. As such, the policy interest crediting rate for universal life products and the dividend interest crediting rate for whole life products will generally correlate over time with the 5.0% historical rate of return on high-grade corporate bonds and government-backed mortgages (higher for insurers with superior investment performance and perhaps for indexed products and lower for insurers with inferior investment performance).

However, NAIC Model Regulations permitted illustrations to calculate hypothetical policy values at interest crediting rates as high as 14.0% and continue to allow illustrations to reflect assumed interest crediting rates that vary significantly from the rate of return reasonable to expect based on

historical return for invested assets underlying policy cash values. Because these assumed rates are generally guaranteed for one year or less (considerably less than the expected holding period for permanent policies), and because insurers routinely change declared interest rates, proper due diligence requires looking beneath the current policy crediting rate to consider both historical performance of both invested assets underlying policy cash values and corresponding asset class benchmarks.

Likewise, NAIC Illustrations Model Regulation allows for an even wider range of earnings assumptions "variable products" (i.e., variable universal life and variable life). In addition, performance expectations are not generally set by the insurer in "variable products", and instead are set by the agent/broker, and too often **not** correlated with the actual rates of return for the asset allocation appropriate to the risk profile of the client. For instance, NAIC-compliant illustrations permit any policy earnings assumption between 0.0% and 12.0% without regard to the actual asset allocation appropriate to the risk profile of the client. Again, proper due diligence requires looking beneath the illustrated policy earnings assumption to consider the rate of return that's reasonable to expect from the asset allocation appropriate to acceptable risk.

Ethical Implications for Estate Planners

The NY DFS Best Interest Rule for life insurance prohibits hypothetical illustration comparisons as due diligence for product recommendation, and instead requires product recommendations be based on a careful, skilled, prudent, and diligent evaluation of costs, performance, and risks relative to benefits, and applies to any transaction with almost any connection to the State of New York. For instance, this NY DFS Rule could/would apply to current residents of New York even if they spend considerable time in another State and may have advisory relationships in another State, as well as to former residents of New York with a life insurance trust created in New York, or with a trustee domiciled in New York, or with financial advisors in New York.

In addition, NY DFS Regulation 187 offers guidance to estate planners, other fiduciary advisors, and especially trustees both in and outside New York for applying well-established practices for determining or confirming that life insurance product recommendations are in the clients' best interests. For instance, illustration comparisons that obfuscate costs,

performance and risk, and provide consumers with “misleading”, “fundamentally inappropriate” and unreliable product information can hardly be defended as being in the clients’ best interests. As such, estate planners that seek out life insurance professionals who have evolved beyond illustration comparison to comply with the NY Best Interest Rule for life insurance should/would enjoy the protection provided by well-established practices for serving clients’ best interests.

Altogether, NY DFS Regulation 187 provides a “checklist” for careful, skilled, prudent, and diligent evaluation of costs, performance, and risks relative to benefits. Given the predominant use of illustration comparisons as supposed due diligence, the questionable use of illustration comparisons for product recommendations, the growing legislative and regulatory activity around re-defining clients’ best interests for product recommendations, and NY DFS’s standing as first-mover on important insurance regulation, the NY Best Interest Rule for life insurance raises significant ethical considerations for estate planners serving fiduciaries and/or working under a fiduciary definition of “clients’ best interests” both in and outside New York.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Barry Flagg

TECHNICAL EDITOR: Ben G. Baldwin, Jr., CLU, ChFC, CFP®

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CITATIONS:

[i] Carlton Fields' Financial Services - Regulatory practice group Reaction to New York's Best Interest Rule: "illustrations … [are] used by [agents and brokers] to compare different … life insurance products [so] it would have been more helpful if these commonly used [illustration comparisons] were expressly included" https://www.carltonfields.com/about-us/newsroom/media-coverage/2018/reaction-to-new-york%E2%80%99s-best-interest-rule-reveals

[ii] Financial Industry Regulatory Authority (FINRA – i.e., chief regulator of the financial services industry) Rule 2210(d) and IM-2210-2(c).

[iii] Society of Actuaries (SOA – i.e., chief actuarial body of the life insurance industry) FINAL REPORT OF THE TASK FORCE FOR RESEARCH ON LIFE INSURANCE SALES ILLUSTRATIONS.

[iv] Office of the Comptroller of the Currency (OCC – i.e., chief regulatory body of the banking industry operated by the U.S. Department of the Treasury) Handbook for Unique & Hard-to-Value Assets.

[v] Life Annuity Specialist, Reaction to New York's Best Interest Rule Reveals Industry Fissures, July 20th 2018 http://lifeannuityspecialist.com/pc/2040493/239503

[vi] These Six States Have Pursued Fiduciary Rules, WealthManagement.com, October 23rd 2018 https://www.wealthmanagement.com/regulation-compliance/these-six-states-have-pursued-fiduciary-rules

[vii] California Department of Insurance (CDI) comment letter to NAIC Suitability in Annuity Transactions Model Regulation (#275) https://www.naic.org/documents/cmte_a_aswg_related_ca_doi_comments.pdf

[viii] § 224.3 (h) and § 224.4 (m) "A producer may limit the range of policies recommended to consumers based on a captive or affiliation agreement with a particular insurer, where the producer prominently discloses to each consumer in writing prior to a recommendation … the circumstances under which the producer will and will not limit the recommendations."

[ix] American Council of Life Insurers (ACLI) comment letter to the National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions Model Regulation (#275). https://www.naic.org/documents/cmte_a_aswg_related_0417_acli.pdf

[x] Executive (EX) Committee and Plenary 12/13/16. Adopted by the Life Insurance and Annuities (A) Committee – Dec. 11, 2016. Adopted by the Life Actuarial (A) Task Force – Nov. 17, 2016. https://www.naic.org/documents/committees_a_latf_iul_illustration_sg_related_actuarial_guideline_xlix.docx

[xi] § 224.4 (b)(1).

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For more information:
Barry D. Flagg, CFP®, CLU, ChFC, GFS™
bflagg@veralytic.com
888-908-8242