life annuity specialist

Life Insurers May Face Rising Risks as Rogue Agents Sell Securities

Many agents are engaging in unapproved business activities that could spell legal trouble for affiliated insurers. A particular worry for carriers: agents who have dropped their securities licenses.

By Warren S. Hersch | March 3, 2023

Life insurers may want to keep a closer eye on what the agents selling their products are doing.

Some are recommending products that fall outside the scope of what they are authorized to sell, and the repercussions could affect carriers. Many wayward agents have only an insurance license but are selling products requiring a securities license.

The unapproved products range from real estate investments and structured settlements to unregistered securities and premium-financed life insurance policies. A main driver of the activity, not surprisingly, is money: the ability to earn compensation often far more than the commission received on the sale of an annuity or life insurance.

Too often carriers look the other way when learning of the unauthorized activity, critics say.

They "just stick their head in the sand and don't pay any attention to it," said **Adam Gana**, a managing partner at the law firm **Gana Weinstein**. At other times, he added, they don't learn about the activity and "don't take reasonable steps to make themselves apprised of the conduct."

Adam Gana, a managing partner at the law firm Gana Weinstein.

Insurers' seemingly lackadaisical attitude toward what their agents are doing on the side, Gana said, often comes down to a cost-benefit analysis. Establishing additional supervisory procedures may be too burdensome, so they choose not to.

"They'd rather just pay in litigation afterwards if it does happen," he said in an interview.

What Brings in the Dough

Much of the unapproved business activity involves structured products: prepackaged investments encompassing different asset classes. **Secured Financial Solutions** CEO **Anil Vazirani** said agents are garnering referral fees and commissions from the sale of structured real estate.

Oftentimes, he noted, they will sell an annuity, then pitch the real estate investment, touting its potential to generate additional growth. Many of these investments have proven disastrous for the buyers — and not only because the agents lack the credentials to advise on them.

Secured Financial Solutions CEO Anil Vazirani

"Seniors are losing money because agents are putting them into real estate schemes," he said in an interview.

Vazirani identified cases in which agents were flagged for misconduct, including a 2020 enforcement action by the **Securities and Exchange Commission** against the private real estate firm **EquiAlt**. The firm's principals told investors they would pool their money to buy undervalued real estate, rent or flip the properties, then pay 8%-10% annual interest generated from the investments.

But much of the investor money went to support the principals' lavish personal spending, and money from one investment fund controlled by EquiAlt was allegedly used to make Ponzi-like payments to investors in another fund, according to the SEC's complaint.

Steve Roth, a life and disability insurance analyst with **Wealth Management International**, noted that much of the nefarious activity involves agents who are securities licensed, but are peddling a product without the authorization of their broker-dealer. They may, for example, be offering an investment promising a high rate of return that would then be used to fund a life policy carrying a high premium.

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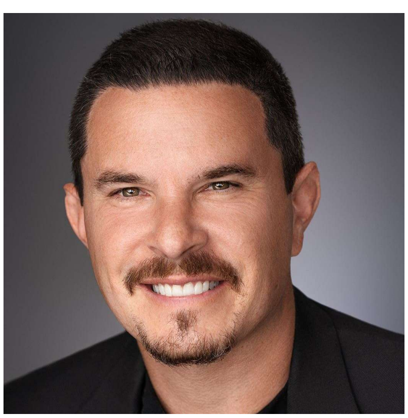
Litigation Risk for Carrier

The insurance company may be held liable in transactions where, for example, the unauthorized business activity is tied to the sale of a life insurance product that failed to meet underwriting and eligibility requirements, he noted.

"The key is the causal relationship," Roth said in an interview.

The insurer may be deemed complicit in a policy sale connected with an agent's sale of an unapproved investment when, he noted, the underwriting decision is on its face irrational, the insurer had received prior notice and thus was aware of the activity, or when the insurer is receiving premium payments for a new policy from a source other than the client.



On this last point, Roth cited as an example self-directed individual retirement account companies that let people invest in non-traditional, higher-yielding assets like real estate, private loans and commodities. These IRAs have been a prolific source of fraud, he noted.

"That's a red flag for the insurance companies, particularly when these customers are older people at or near retirement," he said.

Steven Roth, a life and disability insurance analyst with Wealth Management International

Gana, the attorney, said the insurer is responsible for agents' actions within the scope of their employment. Agents can be held accountable for conduct outside the scope of their employment under breach of contract theories and, in some locales, for fraud if an insured person believes the conduct is within the scope of the insurer's business.

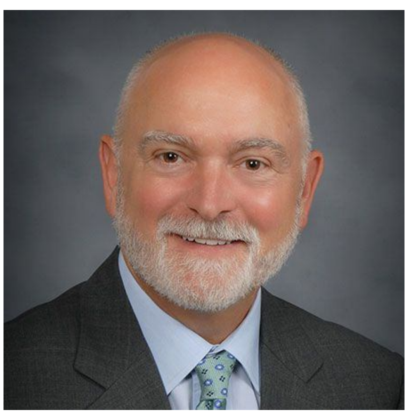
Citing a **Finra** notice to members, he added that, when unauthorized transactions involved the sale of securities, the delineation between independent contractor and employee is irrelevant.

"It's a distinction without meaning," he said. "Regardless of the designation — independent contractor or employee — the supervisory obligations are the same."

Three Researchers' Findings

The insurance industry has attracted some bad actors who have migrated over after being banned by the **Financial Industry Regulatory Authority**, which regulates brokers who sell securities. An April 2022 academic paper by three researchers found that brokers who drop their Finra registration and keep only a state insurance license are 250% to 300% more likely to engage in serious misconduct that harms clients.

"The rate of misconduct for those who exit the Finra regime but continue as insurance producers is more than double that for those who exit our dataset entirely," the report's authors write. "Taken together, these trends suggest that 'bad' advisors in the Finra broker regime exit but continue to provide consumer financial services. In particular, the evidence shows, many become insurance producers."



Larry Rybka, CEO of broker-dealer Valmark Financial

Larry Rybka, CEO of broker-dealer **Valmark Financial**, thinks that best interest legislation pending in California will make carrier liability for agent misconduct a more serious prospect going forward.

The envisioned best interest requirement would force "insurance companies to look more closely at bad agents they appoint and terrible transactions," he said in an email. The draft rule's requirements would "not allow carriers to disclaim any knowledge of bad agents doing bad things that obviously are not in a client's best interest."