# New York State Department of Financial Services (DFS) Suitability and Best Interests Regulations Insurance Regulation 187

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## Summary

In late summer 2018, the New York State Department of Financial Services (DFS) issued final regulations. These regulations, under the banner "Insurance Regulation 187, Suitability and Best Interests in Life Insurance and Annuity Transactions," were not unexpected. The regulation applies to all life insurance policies and annuity contracts delivered or issued for delivery in New York. DFS stated that "the regulation will fill in regulatory gaps to protect New York consumers from the elimination of the federal Department of Labor's Conflict of Interest Rule."

**The regulations are scheduled to become effective:**

- August 1, 2019 for annuity contracts
- February 1, 2020 for life insurance policies

Although there has been a suitability process established for annuities prior to these regulations (new regulations are an amendment to 11 NYCRR 224), these will require revisions for existing annuity processes and the adoption of new processes for life insurance to ensure that producers act in the customer's best interest when recommending a transaction.

## Overview: Life Insurance Regulations

The regulation requires that a producer act in the consumer's best interest when recommending a transaction, including inforce transactions (except those that result from the exercise of a contractual right in a policy). While the regulation does not define "best interest of the consumer," it provides that a producer act in the best interest of the consumer when the recommendation

*"is based on an evaluation of the relevant suitability information of the consumer and 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. Only the interests of the consumer shall be considered in making the recommendation. The producer's receipt of compensation…is permitted…provided that the amount of the compensation or the receipt of an incentive does not influence the recommendation."*

Additionally, insurers are prohibited from effectuating a transaction unless there is a reasonable basis to believe the transaction is suitable.

## Key Provisions in Determining Suitability

In keeping with the focus on suitability, the regulations detail several factors that should be weighed in making recommendations. Not every factor needs to be considered in all circumstances, but the factors listed are representative of the items that need to be considered.

The Regulations extend to both term and permanent insurance, regardless of the face amount (although there are some varying standards for these two broad types of insurance).

**These include (but are not limited to) a client's:**

- Age
- Annual income
- Financial situation, needs and objectives
- Time Horizon
- Liquidity
- Risk tolerance
- Willingness to accept non-guaranteed elements

From a Financial Professional's perspective, it will become important to be able to document that there were reasonable grounds for believing the recommendations, made to a client, were suitable based on all facts disclosed by the client. Additionally, a Financial Professional will be required to offer a reasonable summary of "all relevant suitability considerations and product information (favorable and unfavorable) that provide the basis for any recommendation." The client must also be reasonably informed of all policy features and the potential consequences of the sale. These include (among other things) surrender periods and charges, equity index features (if applicable), riders, expenses, costs of insurance and other charges, exclusions and restrictions. There are additional provisions for Financial Professionals who may be considered to have captive affiliations with a parent carrier. Where a producer limits their choices because of a captive affiliation, they need to disclose this in writing, before any recommendation is made, in a format acceptable to New York DFS.

The regulations extend to every producer who materially participated in making a recommendation and received compensation because of the transaction, regardless if there was any direct contact with the client. Insurers and distributors are just now sorting through how to best adopt the regulations, but it's important to note, the regulations could extend to point of sale, case designers, etc. who make or contribute to recommendations. This is pared back from an earlier version of anyone who participated in the sale, whether compensation was received or not.

Beyond Financial Professionals, the regulations require insurance carriers to establish, maintain and audit a system of supervision reasonably designed to achieve both the insurer's and the producer's compliance with the regulations. This can include a collection of the client's suitability information and documentation and disclosures surrounding the basis for the recommendation to the client. Insurers can, and some are likely to, delegate the responsibility to third-parties. Even then, the insurers must continue to audit the transactions and those to whom the obligations are delegated.

Additionally, insurers are required to ensure that "every insurance producer is adequately trained to make recommendations" to the client. What makes up adequate training remains to be determined; the earliest version of the regulations in December 2016 spoke about product training, in the specific product being sold, before an application was submitted, but New York State has moved to broader training than only the product sold.

Insurance carriers might also be called upon to justify the compensation paid on various products. In one section, the regulations note that there may be variations in compensation across products. However, carriers should evidence that compensation and incentives, taken as a whole, are not designed to create unsuitable recommendations.

## Inforce Transactions

There are additional responsibilities to both Financial Professionals and insurers on inforce transactions. Over the several iterations of the regulation, New York State cut back on the scope of determining suitability on inforce transactions, limiting the scope to transactions where compensation will be paid. However, this regulation will extend to modifications or elections of a contractual provision such as B to A changes, loans and term conversions. Carriers have some reprieve in that they may be able to rely on written certification by the producer. However, not all transactions are initiated based on a producers' efforts.

There is some cross referencing to Reg. 60 (aka the 1035 Exchange Regulation for New York). Carriers will need to interpret how they want replacing insurers to provide disclosure in coordination of other Reg. 60 paperwork.

## Important Items to Consider

- There are limits in the use of titles and designations (implementing some wording from the SEC's recent initial best interest proposal). New York doesn't go as far as the SEC initial regulations (see below), which limited the use of certain words entirely (such as "Advisor"). However, a Financial Professional cannot call themselves a Financial Planner or state that they are offering a (comprehensive) Financial Plan, without the proper certification, designations or licenses. Those designations still need to be determined by NY State.
- There are some items the regulation calls for that should generally be in place at most carriers. These would be mechanisms to detect and prevent financial abuse and a process to address consumer complaints. If they are not in place, a carrier needs to implement such processes.
- Both Financial Professionals and insurance carriers are relieved of any liability if there's mis-information provided by a client or if a client refused to disclose information, which should be documented.
- Some transactions are not covered – including what appears to be COLI and BOLI. For post issue, it appears carriers do not need to determine the suitability of a life settlement.

## The Future of Regulatory Action

**The New York State DFS Suitability Regulations are part of an increasing trend of regulators focusing on Financial Professionals and the quality of their interactions with clients.**

The New York Regulations won't be the last of the best interest or suitability regulations. A number of other states are anticipated to pursue their own versions. Additionally, other regulations and industry group proposals stand in various stages. These include:

- The SEC issued a first round and received comments in August; the sense is that we may not see a second version of the proposed regulations until after the first of the year.
- NY State wanted to be the first, but there are other states in the wings.
  - Nevada has something out.
  - New Jersey recently announced it will be issuing a rule.
  - California will be issuing something soon.
- The ACLI has stepped into the fray, but they are restricting themselves to annuities. The same may be true of NAIC. Even if there was a clear NAIC standard, NY State may have gone their own path akin what they've done with Reg. 60 for replacements.

## Conclusions

Over the next year, both Financial Professionals and carriers will be faced with how to best implement processes to comply with the New York State Suitability Regulations. Work with your distribution outlets and carriers to see what changes might be in place with your New York state based business. Because New York has certain documentation and comparison requirements, even the most diligent of Financial Professionals may need to adjust their own client interactions to comply with the final version of these regulations. AXA expects that, at some point before these regulations are finalized, New York might offer further guidance. However, we do not expect further changes in the regulations themselves. We will provide additional information as new policies and procedures are implemented to comply with these regulations.

**For more information, please contact AXA Advanced Markets.**


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