

New York Department of Financial Services Rings in the New Year With New Suitability Requirements for Insurance Companies

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New York's Department of Financial Services (NY DFS) decided to bid farewell to 2017 and ring-in the new year by proposing to amend *Suitability in Annuity Transactions*, 11 NYCRR 224 (the Annuity Suitability Rule). On December 27, 2017, the first amendment to the Suitability Rule was published in the New York State Register (the First Amendment). The First Amendment, which would rename the Annuity Suitability Rule to the *Suitability in Life Insurance and Annuity Transactions* (the Life & Annuity Suitability Rule), offers a parade of new requirements to which insurers and producers would be required to march. In general, the First Amendment revisions:

- Broaden the scope of the Suitability Rule by applying to life insurance policies as well as in-force policies and by altering the definition of "recommendation" to include communications with the consumer, which "the consumer interprets to be advice" and to include "any act intended to result in a consumer entering into or refraining from entering into a transaction."
- Expand suitability analysis to include a consideration of "all available products, services, and transactions" and additional suitability information, including "the duration of existing liabilities and obligations" as well as "tolerance of non-guaranteed elements in the policy."
- Create a best interest standard requiring a prudent person standard of care and suitability of the transaction.
- Expand the disclosures that are required to be provided to the consumer.
- Prohibit a producer from stating or implying that a transaction is part of financial or investment management services unless the producer is adequately qualified in those areas.

- Expand the producers subject to the Life & Annuity Suitability Rule's requirements to all producers involved in the transaction, even those that do not have direct contact with the consumer.
- Mandate that insurers establish and maintain procedures to prevent financial exploitation and abuse.
- Allow for any type of, or amount of, compensation permitted under the New York insurance laws.

Set forth below is a brief discussion of the impact of some of these revisions. **Broadened Scope**

The biggest noisemaker in the Life & Annuity Suitability Rule is its broadened scope. The Life & Annuity Suitability Rule applies "to all transactions or recommendations with respect to a proposed or *in-force policy*." The Life & Annuity Suitability Rule defines policy to mean:

a *life insurance policy*, annuity contract, or a certificate issued by a fraternal benefit society under a group life insurance policy or group annuity contract.

Thus, if adopted, the Life & Annuity Suitability Rule would apply to recommendations made to a consumer with respect to the consumer's initial purchase of a life policy or annuity contract as well as recommendations subsequent to the consumer's initial purchase. For example, the Life & Annuity Suitability Rule would apply to these recommendations post-sale:

- For a life policy, as to whether to increase the face amount of a life policy, to change the death benefit option, or to elect to receive accelerated death benefits. It may also apply to recommendations as to whether to change the premium payments to be made under a universal life policy or to elect to abbreviate premium payments under a whole life policy.
- For an annuity contract, as to whether to elect a step-up to a benefit base for an income benefit or enhanced death benefit as well as to elect income benefits. It may also apply to recommendations as to whether to pay additional premiums.

Presumably recommendations with respect to allocations among the different interest crediting options or among different variable investment options would also be subject to the Life & Annuity Suitability Rule. Further broadening the scope is the revised definition of recommendation and the new definition of transaction. The Life & Annuity Suitability Rule defines recommendation to mean:

one or more *statements or acts* by a producer, or by an insurer where no producer is involved, to a consumer that: (1) reasonably may be interpreted by a consumer *to be advice* and that results in a consumer entering into or refraining from entering into a transaction in accordance with that advice; or (2) is intended by the producer, or an insurer where no producer is involved, *to result in a consumer entering into or refraining from entering into a transaction*.

It defines transaction to mean:

any purchase, replacement, modification *or election of a contractual provision* with respect to a proposed or in-force policy.

While the Life & Annuity Suitability Rule's definition of recommendation includes some of the language used in the Department of Labor's (DOL's) definition of recommendation within the DOL's fiduciary investment advice rule, it does not contain any of the DOL's exemptions from the definition of recommendation. Moreover, a key to triggering the DOL's fiduciary investment advice rule is the receipt of compensation in connection with the advice given. There is no such trigger in the Life & Annuity Suitability Rule. Under the Life & Annuity Suitability Rule's definition of recommendation, insurers and producers would need to exercise exceeding care to prevent their communications from unintentionally being interpreted by the consumer as advice. This would include communications that the insurers and producers intended to be merely educational, such as informing the consumer about the benefits and conditions of a life policy or annuity contract. Moreover, if for example, a producer meets annually with a consumer to review the consumer's life policy(ies), annuity contract(s), or any combination of the foregoing, the various duties of the insurer(s) and the producer contained in the Life & Annuity Suitability Rule could be viewed as being triggered. This may be the case even if the consumer decides not to take any action with respect to the insurance products the consumer owns and not to make any of the numerous possible elections, because under a broad reading, the consumer may have interpreted the discussion as providing advice to refrain from replacing the insurance products or making an election of a contractual provision. Thus, based on a broad reading, under the Life & Annuity Suitability Rule, the requirement to obtain the consumer's suitability information and to supervise the producer's recommendation would apply to the annual meeting. **Expanded Suitability Analysis** The First Amendment defines suitable and adds additional information that must be gathered to determine the suitability of a recommendation. In so doing, the First Amendment expands the required suitability analysis. The Life & Annuity Suitability Rule defines suitable to mean:

in furtherance of a consumer's needs and objectives under the circumstances then prevailing, *based upon* the suitability information provided by the consumer *and all available products, services, and transactions*.

The First Amendment also adds new items of suitability information that must be obtained, including:

tolerance of non-guaranteed elements in the policy, including variability in premium, cash value, death benefit, or fees.

The Life & Annuity Suitability Rule's inclusion of "all available products, services, and transactions" is similar to the National Association of Insurance Commissioners' (NAIC's) proposed *Suitability and Best Interest Standard of Conduct in Annuity Transactions Model Regulation's* (NAIC's Suitability and Best Interest Model) requirement imposed on the producer or insurer to evaluate "the types of

financial products which correspond to the consumer's disclosed suitability information and address the consumer's financial objectives" and raises some of the same issues. This seems to suggest that before making a recommendation, including a recommendation with respect to in-force policies, the producer or insurer must consider the universe of other products, services, and transactions that are available at the time of the recommendation. The Life & Annuity Suitability Rule, however, does not define products or services. To the extent that products would include securities, insurance licensed only producers would not have the requisite registration to consider securities products. Also like the NAIC's Suitability and Best Interest Model, the suitability information to be gathered under the Life & Annuity Suitability Rule includes information on non-guaranteed elements. This follows the NY DFS' promulgation of Rule 210 on non-guaranteed elements. No guidance is given as to what is meant by a consumer's tolerance of non-guaranteed elements. Moreover, it is unclear what information would reflect a consumer's tolerance. **Best Interest of the Consumer** The First Amendment turns a new leaf by imposing a best interest standard by adding the following "prudent person" requirement:

[a person] acts in the best interest of the consumer when . . . [the person's] recommendations to the consumer are based on an evaluation of the suitability information of the consumer that reflects the care, skill, prudence, and diligence that a prudent person familiar with such matters would use under the circumstances without regard to the financial or other interests of the producer, insurer, or any other party.

The Life & Annuity Suitability Rule also includes as part of its best interest standard, a requirement that the transaction is suitable, and the Annuity Suitability Rule's requirement that there be a reasonable basis to believe that (i) the consumer is reasonably informed of key facts, (ii) the consumer would benefit from the features of the life policy or annuity contract, and (iii) if the transaction is a replacement, the replacement is suitable, taking into consideration specified items of analysis. The Life & Annuity Suitability Rule's prudent person language follows the best interest language from the DOL's Best Interest Contract Prohibited Transaction Exemption language.

Expanded Disclosure Although there is already a confetti of disclosure that must be provided to consumers, the First Amendment requires even more disclosure. As part of the best interest standard, the First Amendment adds the following to the list of items that the consumer has to be reasonably informed of:

potential consequences of the transaction, whether favorable or unfavorable. . . . potential tax implications of the various transactions that can occur under a life policy or annuity contract. . . . the manner in which the producer is compensated for the sale and servicing of the policy.

The First Amendment also adds the following new disclosures:

all relevant suitability considerations and product information, whether favorable or unfavorable, that provide the basis for any recommendations. . . . all relevant policy information with respect to evaluating any transaction or proposed transaction,

including a comparison, in a form acceptable to the superintendent, of all available policies of the same product type offered by the insurer.

Each of these additional disclosures raise a host of interpretative questions which may give producers and insurers a hangover. For example, would disclosures of potential consequences of a transaction require the use of personalized disclosures because whether or not a transaction or a feature of an insurance policy or annuity contract is favorable or unfavorable may depend on the individual circumstances of the consumer? The same issue arises with respect to potential tax implications unless it would be sufficient to provide a general description of the tax consequences and then direct the consumer to his or her tax advisor. Also, does the disclosure on "the manner" in which the producer is compensated merely require disclosure that the producer receives an upfront commission based on premiums paid or trail commissions based on the value of the insurance policy or annuity contract? Or, is the amount of commissions also required to be disclosed? Further, what about other amounts received by the producer, such as amounts for advertisement or administrative expenses? Is the disclosure limited to the producer that interacts with the consumer, or does it also include other producers who may receive overrides or other compensation? Finally, what information is required in the comparison of products offered? Does this comparison need to be delivered only for initial sales or also for recommendations with respect to in-force policies?

Prohibiting Statements or Implications of Financial or Investment Services The First Amendment restricts the fanfare that a producer may use in communicating with consumers. Under the Life & Annuity Suitability Rule, a producer is not permitted to:

state or imply to the consumer that a recommendation to enter into a transaction is part of financial planning, financial advice, investment management, or related services unless the producer has a specific certification or professional designation in that area.

This new limitation may also cause some headaches as producers try to determine what "specific certification or professional designation" would allow them to say they are providing financial planning, financial advice or related services. **All Producers in a Transaction are Subject to the Requirements** The First Amendment extends its merrymaking by inviting all producers involved in a life policy or annuity contract transaction to the party. Under the Life & Annuity Suitability Rule:

Any requirement applicable to a producer shall apply to *every producer in the transaction*, even if that producer does not have direct contact with the consumer.

This new provision was apparently added to reach all those who may receive an override or other compensation from a life policy or annuity transaction. Does this mean every duty imposed on producers must be performed by each producer in the transaction, or is this merely a means to impose penalties against every producer in the transaction in the event of a transaction that was not in the best interest of the consumer? **Preventative Financial Exploitation and Abuse Procedures** As if there was not enough carousing with all the other requirements added by the First Amendment,

the Life & Annuity Suitability Rule also requires insurers to:

establish and maintain procedures *designed to prevent financial exploitation and abuse* . . . [i.e.,] the improper use of an adult's funds, property, or resources by another individual, including fraud, false pretenses, embezzlement, conspiracy, forgery, falsifying records, coerced property transfers or denials of access to assets.

This requirement goes further that the proposed NAIC Suitability and Best Interest Model which merely requires financial exploitation of seniors and other vulnerable adults be added as a new training topic. While imposing a heavy burden on insurers to establish and maintain procedures, the Life & Annuity Suitability Rule does not provide insurers with tools to assist them in preventing abuse. For example, it does not allow insurers to delay disbursement of funds if the insurer has a reasonable belief that the disbursement would result in financial exploitation. It also does not provide immunity to insurers: (i) who report suspected financial abuse to government agencies or (ii) who in good faith and exercising reasonable care implement procedures to prevent financial abuse from administrative or civil liability. **Compensation of Producers** Producers may wish to raise a glass in celebration of the First Amendment's lack of compensation limits. The Life & Annuity Suitability Rule states "nothing in this part shall be construed to prohibit the payment to a producer of any type or amount of compensation otherwise permitted under the Insurance Law." **Next Steps** The public comment period on the First Amendment expires on February 12, 2018. Based on what happened for Regulation 210, after the NY DFS reviews the submitted comments, it is likely that it will publish additional proposed amendments with the goal of finalizing the Life & Annuity Suitability Rule by the end of the summer with an effective date in 2019, perhaps to coincide with the July 1, 2019 delayed applicability date of certain requirements of the DOL Fiduciary Rule's Best Interest Contract Exemption and the Principal Transactions Exemption, and of certain amendments to Prohibited Transaction Exemption 84-24. What happens next on New York's Life & Annuity Suitability Rule as the ball drops at midnight and 2018 begins will likely have an impact on the NAIC's Suitability and Best Interest Model. We will continue to monitor and report on the activities of the NY DFS and the NAIC's Annuity Suitability Working Group.

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