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New York Issues Final Life Insurance and Annuity Suitability and Best Interests Regulation

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On July 18, New York's Department of Financial Services (the "NY DFS") issued the final version of its Suitability and Best Interests in Life Insurance and Annuity Transactions Regulation (the "Suitability and Best Interest Regulation"). On December 27, 2017, the NY DFS circulated the First Amendment to Part 224 of Title 11 of the Official Compilation of Codes, Rules and Regulations of the State of New York (Insurance Regulation 187) renaming it the Suitability and Best Interests in Life Insurance and Annuity Transactions Regulation. After considering 36 sets of comments from the insurance industry and consumer groups, the NY DFS made only "wordsmithing and clarification" changes to its May 16, 2018 proposed changes to the Suitability and Best Interest Regulation.

While some of the revisions are favorable, the Suitability and Best Interest Regulation contains a number of provisions that raise questions regarding the meaning and implementation of the regulation. Below, we summarize the key changes.

Generally applicable revisions to the Suitability and Best Interest Regulation include:

- Extending its effective date with respect to annuities from March 1, 2019 to August 1, 2019 and with respect to life insurance from September 1, 2019 to February 2020. While any additional time is helpful, this is still a very short time frame to implement the new requirements of the Suitability and Best Interest Regulation.
- Revising its direct response exemption by clarifying that the following are permitted under the exemption: (i) the "purchase of a policy where the application is solicited and received . . . ***at the worksite***" and (ii) producer involvement in "***customer service, administrative support, or enrollment services"*** where there is no recommendation made.
- Revising the exclusion from the definition of recommendation to include the "***use of an interactive tool***" as follows:
    - to estimate a consumer's insurance, future income, or other financial needs;
    - to compare different types of products; or
    - to refer the consumer to a producer,

    provided that the interactive tool is not used by a producer, or an insurer where no producer is involved, to satisfy any requirement imposed by the Suitability and Best Interest Regulation.

    While illustrations and calculator tools can be used by consumers to compare different annuity and life insurance products, as well as understand the operation of a particular product, it would have been more helpful if these commonly used tools were expressly included in the new exemption language. None of the other NY DFS materials issued with the Suitability and Best Interest Regulation contain a discussion of this new language.
- Clarifying that new sales compensation does not include, "compensation provided to a producer when, after the initial premium or deposit under a policy, the consumer pays further premiums or deposits pursuant to the policy." By adding this new language, the requirements of the Suitability and Best Interest Regulation will not be triggered by renewal compensation paid on ongoing payments made to life insurance and annuity products.

Revisions to the Suitability and Best Interest Regulation with respect to making a recommendation include:

- Adding new language allowing producers and insurers to "weigh multiple factors that are relevant to the best interests of the consumer including, but not limited to, the benefits provided by the policy, the price of the policy, the financial strength of the insurer, and other factors that differentiate products or insurers." The NY DFS' materials note that "[t]he weighing of these factors in recommending a product makes clear that best interest does not necessarily mean the least expensive product available. Best interest is an evaluation process resulting in a recommendation in the consumer’s best interest rather than the one singular product that is in the consumer’s best interest."

- Eliminating the requirement to "obtain a consumer signed statement" documenting that a consumer has refused to provide suitability information or has decided to enter into a sales transaction that is not recommended. Producers and insurers, however, must maintain documentation.
- Clarifying that, for sales transactions and in-force transactions, a producer may "state or imply that a sales recommendation is a component of a financial plan." However, a producer may not state or imply to the consumer that a recommendation is comprehensive financial planning, comprehensive financial advice, investment management, or related services unless the producer has a specific certification or professional designation in that area. Moreover, the NY DFS' materials "make clear that the use of such titles and designations is not appropriate if the producer does not actually sell securities or other non-insurance financial services. It is the [NY DFS'] view that producers, even if certified or licensed as a financial planner, financial advisor or other similar title, should not hold themselves out as such if all they actually sell are insurance products."
- Clarifying that if a producer does not sell both fee-based and commission-based versions of an insurer's products, a comparison between the two versions is not required to be provided to the consumer. The NY DFS added the following bolded language: "*Where* ***a producer is authorized by*** an insurer ***to offer*** different versions of ***an insurer's*** product, one with a fee-based structure and one with a commission-based structure, an insurer shall provide to the consumer a comparison, in a form acceptable to the superintendent, showing the differences between the products."

  The NY DFS also added that if such comparison is required, an "insurer may also include additional information related to the differences in the producer's compensation structure for the different versions of the insurer's product."

  While the NY DFS' changes eliminate the comparison form if a producer does not sell both fee-based and commission-based versions of a product, the NY DFS' materials did not provide additional information on what should be included in the comparison form and did not provide additional information on how the form would be submitted for approval.

Revisions to the Suitability and Best Interest Regulation as to insurers' supervision requirements include:

- Clarifying that an insurer's suitability supervisory responsibility may be done "without regard to the availability of products, services, and transactions of companies other than the insurer."
- Adding that an insurer's suitability supervisory responsibility does not apply to a sales transaction that results from the exercise of a contractual right in a policy.

  The NY DFS' materials explain that these two changes were added to clarify that an "insurer's supervisory responsibilities generally only apply to new sales transactions with respect to the insurer's own policies." The NY DFS' materials acknowledge that "insurers generally have little to no knowledge of a producer's actions with respect to recommendations related to in-force transactions and, in many cases, the recommendation may be made by a new producer who did not sell the original policy."
- Adding that an insurer may rely "on a written certification of compliance with [the collection of suitability information and the documentation of the basis of a recommendation] provided by the producer." This eases the burden of an insurer's supervisory obligation.
- Adding that "[a]n insurer may contract with a third party to establish and maintain a system of supervision for recommendations of sales transactions involving the insurer's policies." The NY DFS' materials note that "it was not the intent of the proposal to disallow this practice." This clarification assures insurers that the common industry practice of relying on third parties remains permitted.

Revisions to the Suitability and Best Interest Regulation also added clarification with respect to compensation, as follows:

- The revisions allow an insurer to vary compensation by stating that "[a]n insurer may maintain within and across product lines variations in compensation or other incentives that comply with the Insurance Law and the Insurance Regulations provided that the insurer's compensation and incentive practices, when taken as a whole, are designed to avoid recommendations by producers that are not in the best interest of consumers."
- The revisions also acknowledge that variations in compensation, are not per se violations of the Suitability and Best Interest Regulation by stating that: "[a] difference in compensation and incentives based solely on the amount of premium paid among policies shall not be deemed to violate paragraph (1) of this subdivision."

The NY DFS' materials note that it added this clarification because "maintain[ing] within and across product lines variations in compensation or other incentives . . . accords with the intent of the proposal." While variations in compensation are permitted, insurers will nonetheless need to carefully consider whether their compensation practices may unintentionally allow producers to make recommendations that are not in the best interest of consumers. The NY DFS' materials do not provide guidance to insurers on how to avoid the unintentional consequences.

In addition, the NY DFS added the following bolded language in Sections 224.4 and 224.5 to clarify the Suitability and Best Interest Regulation requirements only apply:

> to every producer who ***materially*** participated in the making of a recommendation and received compensation as a result of the sales transaction, regardless of whether the producer has had any direct contact with the consumer, [and that] ***product wholesaling or product support based on generic client information, or the provision of education or marketing material, does not constitute participating in the making of a recommendation***."

However, the NY DFS' materials do not explain what "materially" means. Considering the language "based on generic client information," it appears that if a wholesaling producer assists the selling producer with a particular sales transaction or in-force transaction for a consumer, for example by providing specific client illustrations, or providing the selling producer speaking points for a sale, this activity would not fit within the "exemption-like" bolded language above.

Now that the NY DFS has finalized the Suitability and Best Interest Regulation, it will be interesting to see what impact it has on the activities of the NAIC Annuity Suitability (A) Working Group. We will continue to monitor the activities of the NAIC Annuity Suitability (A) Working Group as well as whether further clarifications are provided by the NY DFS.