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New York Proposes Best Interest Requirements on Insurance Product Recommendations

by George Michael Gerstein

Just over a month ago, the U.S. Department of Labor (DOL) partly explained an 18-month extension of its fiduciary rule by saying the additional time was necessary to allow for ample opportunity for input from, and, ideally, coordination with, the U.S. Securities and Exchange Commission (SEC) and state regulators. Just a few days ago, however, the state of New York announced proposed changes to its rules governing the sales of insurance and annuity transactions (http://www.dfs.ny.gov/about/press/pr1712271.htm) involving both retirement and nonretirement accounts. If implemented, these changes could have a significant effect on New York insurance agents and brokers. Though the revised rule was styled as merely "clarifying" the duties and obligations of producers when making recommendations to consumers, New York Governor Andrew Cuomo tied this proposal to the delay of the DOL fiduciary rule when he said, "As Washington continues to ignore and roll back efforts to protect Americans, New York will continue to use its role as a strong regulator of the financial services and insurance industries to fight for consumers and help ensure a level playing field."

Here are our observations:

- The proposed changes to New York's annuity suitability rule would require that any "recommendation" to a consumer by an insurance agent or broker regarding a proposed or in-force "policy" be "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 insurer would need to make this best interest determination if "no producer is involved." This best interest requirement is in addition to the existing determination of suitability under New York law.

- As is always the case, the devil is in the details. The proposed regulation, like the DOL fiduciary rule, broadens the types of communications that give rise to a "recommendation": namely, "one or more statements or acts" by a broker or agent that either "reasonably may be interpreted by a consumer to be advice," which results in "a consumer entering into or refraining from entering into a transaction" in accordance with the recommendation, or where the communication "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." A "policy" means a "life insurance policy, annuity contract, or a certificate issued by a fraternal benefit society or under a group life insurance policy or group annuity contract." As with the existing rule, policies used to fund ERISA or other plans, such as governmental plans, are exempted.

- There are a number of other proposed changes, including a need to disclose, at the time of the recommendation, "all relevant suitability considerations and product information, whether favorable or unfavorable, that provide the basis for any recommendations," as well as a prohibition against any recommendation stating or implying "that a recommendation to enter into a transaction is a part of financial planning, financial advice, investment management or related services unless the producer has a specific certification of professional designation in that area." There would also be a new requirement to establish and maintain procedures "designed to prevent financial exploitation and abuse" and additional disclosures.

- The proposed amendments to the New York annuity regulation differ from what is currently being contemplated by the National Association of Insurance Commissions (NAIC), which is in the process of adopting its own updated model suitability rule (on which the New York regulation was based). This means that, barring changes by either NAIC or New York, there may be material differences among the states regarding when a duty of best interest is required for the sale of insurance products, and what specific obligations flow from the best interest duty.

- The New York regulation, as proposed and already in effect, along with similar regulations of other states, is generally considered coterminous with the DOL fiduciary rule, meaning that advisers are subject to both. The DOL recognized as much when it stated in the preamble to the final version of its fiduciary rule: "The Department's obligation and overriding objective in developing regulations implementing ERISA (and the relevant prohibited transaction provisions in the Code) is to achieve the consumer protection objectives of ERISA and the Code. The Department believes the final rule reflects that obligation and objective while also reflecting that care was taken to craft the rule so that it does not require people subject to state banking, insurance or securities regulation to take steps that would conflict with applicable state statutory or regulatory requirements. The Department notes that ERISA section 514 expressly saves state regulation of insurance, banking, or securities from ERISA's express preemption provision."

- New York's best interest proposal comes on the heels of the passage of Nevada's revisions to its financial planner law (http://www.stradley.com/insights/publications/2017/07/im-client-alert-july-28-2017), which now imposes fiduciary duties on, and creates a cause of action against, advisers and broker-dealers. The Nevada securities regulator is still due to issue regulations sometime this year on the specific requirements of the amended financial planner law. Other states, meanwhile, have either introduced their own laws that would tighten the screws around investment advice (http://www.stradley.com/insights/publications/2017/10/im-briefing-oct-25-2017) or are contemplating doing so. The states seem committed to updating their standards as if anticipating a significant rollback of the DOL fiduciary rule. Leadership at both the DOL and the SEC appear to recognize the importance of working with the states to avoid an unwieldy maze of regulations governing the same conduct. Only time will tell whether New York's and Nevada's actions will expedite the DOL's or SEC's timetables.

- The proposed amendments to the New York regulation are subject to a comment period that closes on Feb. 26, 2018 (http://www.dfs.ny.gov/insurance/r_prop/rp187a1text.pdf).

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