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Is New York's Newly Adopted "Best Interest Standard" for the Sale of Life Insurance and Annuity Products an Outlier or a Sign of Things to Come in Other Jurisdictions?

by William T. Mandia, Steven B. Davis and Elizabeth A. Kuschel

Earlier this year, we noted that 2018 promised to be an active regulatory year at state level for the standards that govern the sale of life insurance and annuity products. (See our prior coverage of this issue here (https://www.stradley.com/insights/publications/2018/02/insurance-and-securities-lit-february-26-2018).) On July 18, 2018, New York made the most significant move of the year to date by issuing its much anticipated final regulation imposing a "best interest" standard on the sale of life insurance and annuity products in the Empire State. In promulgating the final regulation, the New York Department of Financial Services (NYDFS) heightened the existing "suitability" standard of care and vastly expanded the scope of the products covered under its existing regulations.

The NYDFS made it clear that it was acting in response to a perceived rollback of regulations at the federal level, including the vacatur of the Department of Labor's so-called "fiduciary rule" in March 2018.[1] It remains to be seen whether the New York regulation, combined with a perceived rollback of federal regulation, will have an impact on other jurisdictions. The timing of New York's release of its final regulation is significant because of its potential to influence the debate on the National Association of Insurance Commissioners' (NAIC) forthcoming model regulation. A committee of NAIC is scheduled to address the model regulation at a meeting in Boston on August 4, 2018. The freshly-minted New York regulation will certainly be a topic of discussion as NAIC attempts to finalize its draft model regulation.

New York's "Best Interest Regulation"

The newly-adopted "best interest" standard places a number of requirements on "insurers" and "producers" in connection with the sale of life insurance and annuity products in New York. The regulation, among other things:

- Places a duty on a "producer" or, where there is no producer, on the "insurer," to ensure that a "recommendation" for "a proposed or in-force" life insurance policy or annuity is in furtherance of the consumer's needs and objectives when taking into consideration only the interests of the consumer and without regard to the producer's or insurer's financial compensation or incentives.

- Provides specific criteria for determining if a recommendation is in the best interests of a consumer. These criteria include, without limitation, that the "recommendation to the consumer 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," the "interest of the consumer" is the only consideration in making the recommendation, and the recommended transaction is "suitable," as defined by the regulation.

- Requires certain disclosures to be made to the consumer at the time of the recommendation, including specific disclosures by producers who have a captive or affiliation with a particular insurer. Such a disclosure must be in a form acceptable to the Superintendent of the NYDFS and identify the circumstances under which the producer will and will not limit recommendations.

- Prohibits a producer from using the title or designation of "financial planner, financial advisor or similar title unless the producer is properly licensed or certified and actually provides securities or other non-insurance financial services." Further, while the regulation allows a producer to "state or imply that a sales recommendation is a component of a financial plan, a producer shall not state or imply to the consumer that a recommendation to enter into a sales transaction 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."

- Obligates an insurer, before it effectuates the sale of a life insurance or annuity product, to determine if there "is a reasonable basis to believe that the sales transaction is suitable based on the suitability information provided by the consumer and without regard to the availability of products, services, and transactions of companies other than the insurer."

- Mandates that insurers enact a comprehensive program of supervision "that is reasonably designed to achieve the insurer's and producer's compliance" with the regulation when recommending the purchase of a covered product. The regulation specifically requires insurers to maintain standards for the "collection of a consumer's suitability information," the "documentation and disclosure of the basis for any recommendation with respect to sales transactions involving the insurer's policies," the review of complaints alleging a recommendation was "inconsistent with the best interests of the consumer," and the "auditing and/or contemporaneous review of recommendations to monitor producers' compliance" with certain provisions in the regulation.

- Requires insurers to ensure that "every producer recommending any transaction with respect to the insurer's policies is adequately trained to make the recommendation in accordance" with the requirements of the regulation.

- Places a duty on insurers to establish procedures designed to "prevent financial exploitation and abuse."

- Deems a violation of the regulation to be "an unfair method of competition or an unfair or deceptive act and practice in the conduct of business of insurance" in violation of Section 2403 of the New York Insurance Law, thereby creating the potential risk for enforcement actions and associated penalties for noncompliance.

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- Becomes effective for annuity contracts on August 1, 2019 and for life insurance products on February 1, 2020.

In light of the stringent and detailed requirements the regulation imposes, insurers and producers who sell life insurance and annuity products in New York will need to begin developing comprehensive policies, procedures, and programs to ensure compliance by the applicable effective dates. The potential for aggressive enforcement action by the NYDFS should not be taken lightly, as evidenced by the statements of the Superintendent for the NYDFS. In announcing the regulation, the Superintendent made it clear that she views the regulation as "essential" because of "the key role insurance products play in providing financial security to middle class New Yorkers" and to "fill in regulatory gaps to protect New York consumers from the elimination of the federal Department of Labor's Conflict of Interest Rule, which the Trump Administration failed to protect on appeal after a ruling from the U.S. Fifth Circuit Court of Appeals."[2]

Potential Impact on NAIC Model Regulation

As noted above, NAIC will discuss its proposed "best interest" model regulation at its upcoming meeting on August 4, 2018. The NAIC proposed rule, as currently drafted, differs from the New York regulation in material respects, including that it applies only to annuity products that are regulated by state insurance commissioners.

When New York announced its proposed best interest regulation in late in 2017, it generated a significant amount of buzz among industry and consumer groups. This largely stemmed from the uncertainty surrounding the "fiduciary rule," an emphasis on deregulation under President Trump's administration, and the expanded scope of products covered by New York's proposal. As a result, NAIC received pressure from New York, as well as certain consumer groups, to expand the scope of its proposed rule to, at a minimum, include life insurance products.

It is uncertain as to whether New York's regulation will have any material impact on NAIC's forthcoming model regulation. The initial pressure placed on the NAIC has dissipated some since New York's announcement of its proposed rule in December 2017. Among other developments in the interim, the Securities and Exchange Commission has taken the lead on investment advice reform at the federal level by releasing its own proposed "best interest" rule for public comment in the spring of 2018. While there will continue to be pressure on NAIC from consumer groups and certain states, such as New York, that would like to see a more expansive approach, it remains to be seen if NAIC will, in line with its current model regulation, continue the focus on annuitized products only or if it will expand the model regulation to include life insurance products.

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[1] *See* NYDFS Press Release of July 18, 2018 (https://www.dfs.ny.gov/about/press/pr1807181.htm) ("As the federal government continues to roll back essential financial services regulations, New York once again is leading the way so that consumers who purchase life insurance and annuity products are assured that their financial services providers are acting in their best interest when providing advice. …")

[2] *See* NYDFS Press Release of July 18, 2018 (https://www.dfs.ny.gov/about/press/pr1807181.htm).