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Changes to New York's Regulation 187 May Not Be in Anyone's Best Interest

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On April 27, 2018, the New York State Department of Financial Services (DFS) proposed an [updated first amendment](#) to its Regulation 187 that imposes a "best interest" rule on life insurers and producers licensed in New York. The issuance of the updated proposed first amendment follows the consideration of more than 35 sets of comments submitted on the December 27, 2017 version of the proposed first amendment.

As many of our insurance clients are aware, the DFS first proposed an amendment to 11 NYCRR 224 (also known as Regulation 187) on December 27, 2017. The amendment adopted a best-interest standard for insurers and producers selling life insurance in New York, whereas Regulation 187 previously only pertained to annuity products sold in New York.

The proposed amendment required *any* recommended life insurance transaction to be in the best interest of the consumer and to address the consumer's insurance needs at the time of the transaction. The best-interest standard imposes a host of duties on the insurer to ensure that a consumer was protected before the purchase or replacement of any life insurance or annuity product. For example, the best interest standard requires that an insurer or producer recommend a purchase based on an evaluation of the consumer's "suitability information," ensure that the transaction is in furtherance of the consumer's needs and objectives under the circumstances, and reasonably inform the consumer of the consequences of the transaction.

Notably, the proposed amendment defined "suitable" as meaning "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 proposed amendment also required, as part of the evaluation, information about the manner the producer is compensated for the sale and servicing of the policy, using procedures specified in the DFS's producer compensation regulation.

The proposed amendment was far-reaching, prohibiting producers from (1) making recommendations to purchase unless the producer has a reasonable basis to believe the consumer could meet the financial obligations under the policy; and (2) stating that the recommendation is part of financial or investment planning unless the producer has the appropriate professional designation. The amendment also created additional responsibilities for insurers by requiring them to establish and maintain procedures to prevent exploitation and abuse, provide relevant policy information to a consumer for evaluating a transaction, and provide relevant policy information to a producer for evaluating a replacement transaction.

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The April 27 Updated Proposed First Amendment

On April 27, 2018, the DFS updated its proposed first amendment to Regulation 187 after it had taken into consideration the comments submitted by various interested parties following the December 27 amendment. Based on these comments, the DFS made several key revisions to the original first amendment.

Suitability

The updated proposed first amendment:

- **Revised the definition of “suitability information.”** In the former version of the amendment, suitability information was defined as “information that is reasonably appropriate to determine the suitability of a recommendation.” The updated proposed first amendment replaced that definition with “information that is reasonably appropriate to determine the suitability of a recommendation *commensurate with the materiality of the transaction to a consumer’s financial situation at the time of the recommendation and the complexity of the transaction recommended ... as relevant to the consumer.*”
- **Created two different suitability standards.** One for term life insurance policies with no cash value, and one for all other types of policies. The specified list of relevant suitability considerations for all other types of policies differs from term life insurance policies in that it also includes financial experience, liquidity needs, liquid net worth, risk tolerance, and tax status.
- **Clarified that a producer need only consider a consumer’s needs based on the “products, services, and transactions available to the producer”** when considering whether a product, service, or transaction is suitable to the consumer. The former first amendment did not limit this consideration to only those products, services, and transactions available to the producer.

Duties for a sales transaction or an in-force transaction

The updated proposed first amendment now recognizes two types of transactions—sales transactions and in-force transactions—and applies different best-interest duties for each.

- **For sales transactions,** the updated proposed first amendment kept the best-interest duties from the original first amendment but added a new requirement when fee-based and commission-based versions of a policy are available. For sales transactions, a producer or insurer acts in the best interest of the consumer when the recommendations to the consumer “are 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” and the “sales transaction is suitable.” Under the new amendment, to act in the best interest of the consumer, insurers and producers would also be obligated to ensure that the consumer has been reasonably informed of the various features of the policy and any differences in features among fee-based and commission-based versions of the policy. If an insurer offers different versions of a product (one fee-based and one commission-based), there would also be an obligation on the person making the recommendation to provide the consumer a comparison, in a form acceptable to the DFS, showing the differences between the products.

- **For in-force transactions**, the updated proposed first amendment also applies a best-interest duty. For in-force transactions, a producer or insurer acts in the best interest of the consumer when the recommendation to the consumer “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” and “there is a reasonable basis to believe the consumer has been reasonably informed of the relevant features of the policy and potential consequences of the in-force transaction, both favorable and unfavorable.” A producer would also be prohibited from stating or implying that a recommendation to enter into an in-force transaction is financial planning or advice unless the producer has a specific certification or professional designation in that area.
- **For both types of transactions**, under the original first amendment, producers’ and insurers’ recommendations were required to be “without regard to” their own financial interest. The updated proposed first amendment removed the “without regard to” language and replaced it with: “The financial or other interests of the producer, insurer, or any other party other than the consumer, shall not be considered in any respect in making the recommendation.”

Changes to the definition of “recommendation”

- **The updated proposed first amendment limits the definition of “recommendation” so that it does not apply to certain types of communications.** Under the updated proposed first amendment, a recommendation “does not include general factual information to the public, such as advertisements, marketing materials, general education information regarding insurance or other financial products and general administrative services to the consumer.”

Implications of the April 27 Amendment

There are several issues with the updated proposed first amendment that give rise to concerns about its enforcement.

The addition of a “materiality” consideration to the definition of suitability information is problematic because it suggests that the suitability information outlined in the amendment may not always be sufficient in every case. For example, the suitability information factors identified may be necessary considerations, but there may also be other factors that an insurer must consider depending on the specific consumer. This ambiguity may lead to inconsistency in its application within the insurance industry because the determination of what is “material” will depend on the individual consumer.

Additionally, the updated proposed first amendment is problematic because it continues to subject in-force transactions to its regulatory standards. This inclusion increases cost and complexity in execution to insurers and producers by requiring them to act in the best interest of the consumer even if the suitability information required to be taken into account for a sales transaction is absent. In practice, insurers and producers would need to spend additional time and expense to ensure that any modification or election is in the best interest of the consumer for even the most routine policy transactions when the insurer is not generating new sales compensation. Such a requirement creates an unnecessarily burdensome process, the costs of which will ultimately be borne by the consumer.

The updated proposed first amendment also problematically assumes that the recommendation of a life insurance product can become a uniform, standardized process. The insurance industry has always operated by focusing on the specific needs of the individual insured, but leaving it to the expertise and professional discretion of the producer to recommend a particular product based on the information provided. This professional judgment can differ in practice from client to client and producer to producer, even in those instances where the most basic of information is accounted for.

If the updated proposed first amendment does take effect, Regulation 187 may be subject to certain legal challenges. For example, as raised in litigation over the Department of Labor (DOL) fiduciary rule, Regulation 187 arguably constitutes an unconstitutional content-based regulation on commercial speech because it targets conversations involving recommendations and limits what producers or insurers are allowed to say about certain products. Another possible challenge to the regulation would be to contend that the DFS did not comply with the New York State Administrative Procedure Act (SAPA) because the superintendent did not consider utilizing approaches designed to avoid undue deleterious economic effects or overly burdensome impacts of the regulation on persons affected by it (e.g., insurers, producers, and consumers). While the DFS contends that the proposed regulation is necessary, the DFS provides no quantitative analysis demonstrating the purported need. To the contrary, the DFS admits that many insurers and producers have already determined to voluntarily comply with the now derailed DOL fiduciary rule requirements. If so, why is the proposed amendment necessary? At best, the DFS posits only anecdotal “support” for the amendment. Similarly, the DFS has not provided any quantitative analysis supporting its conclusion that the costs of implementing the amendment, or its economic impact on insurers, producers, and consumers, are minimal. Ultimately, it is the consumers who will pay for the cost of implementing the amendment.

Ultimately, the issues raised by the updated proposed first amendment to Regulation 187 may lead to reductions in consumer access and choice, closing the doors on many independent insurance agents who may exit the New York market due to the new standards and duties imposed on them. They will also lead to increased costs (procedural and litigation) that ultimately will be passed on to the consumer. The changes proposed will almost certainly lead to an increase in litigation given the supervisory duties imposed on insurers and a best-interest standard that is ambiguous, highly individual, and subjective.

What to Expect Next

If issued, the updated proposed first amendment would take effect on March 1, 2019. The updated proposed first amendment was published in the *New York State Register* on May 16, 2018, and the public comment period expires on **June 15, 2018**.

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