

CLIENT ALERT

Suitability and Best Interests in Life Insurance and Annuity Transactions

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The New York Department of Financial Services (the “Department”) has dramatically expanded the obligations of 158,000 life insurance producers by amending Insurance Regulation 187 (11 NYCRR 224). Under the amended regulation, insurance producers (brokers and agents) must “act in the best interest of the consumer” when recommending most life insurance policies and annuities. The amendment represents a radical shift from the previous version of the regulation, which applied only to annuity contracts and imposed a less stringent “suitability” standard for recommendations to consumers.

Obligations of Insurers and Insurance Producers Under Amended Insurance Regulation 187

The amended regulation applies to any transaction (regardless of whether the transaction results in new sales compensation) or recommendation with respect to proposed or in-force life insurance policies or annuity contracts. Relatively few life insurance policies are not covered by the amended regulation: (i) policies purchased in response to a generalized offer, (ii) policies used to fund certain employee benefit plans, (iii) certain corporate or bank-owned policies, (iv) credit life insurance sold on a group basis, and (v) life settlement contracts. When recommending sales transactions involving life insurance policies or annuities, insurers or insurance producers must “act in the best interest of the consumer.” To satisfy this “best interest” standard:

1. The recommendation must be based on an evaluation of the consumer’s suitability information and must reflect the care and skill that a prudent person acting in a like capacity and familiar with such matters would use under the circumstances.
2. The transaction must be suitable.
3. There must be reasonable basis to believe, among other things, that the consumer has been reasonably informed of various features of the life insurance policy or annuity contract and the potential consequences of the transaction, both favorable and unfavorable, including any differences in features among fee-based and commission-based versions of the policy and the manner in which the producer is compensated for the sale and servicing of the policy.

Additionally, at the time a recommendation is made, an insurer or insurance producer must, among other things:

1. Disclose to the consumer a summary of all relevant suitability considerations and product information, both favorable and unfavorable, that provide the basis for any recommendations.
2. Document the basis for any recommendation made and the facts and analysis to support the recommendation.

Furthermore, a producer cannot recommend a sales transaction unless the producer has a reasonable basis to believe that the consumer can afford the policy. These requirements apply to every producer who materially participated in making a recommendation and received compensation as a result of the transaction, even if that producer had no direct contact with the consumer. A similar but less burdensome “best interest” standard must be satisfied when recommending a modification or election of a contractual provision with respect to an in-force policy that does not generate new sales compensation.

Obligations of Insurers

The amended regulation also requires insurers to establish, maintain, and audit a system of supervision reasonably designed to achieve the insurer's and producers' compliance with the regulation, including standards and procedures for, among other things:

1. The collection of a consumer's suitability information.
2. The documentation and disclosure of the basis for any recommendation with respect to sales transactions.
3. The auditing and/or contemporaneous review of recommendations to monitor producers' compliance with the regulation.

Insurers must also:

1. Maintain compensation and incentive practices that, when taken as a whole, are designed to avoid recommendations by producers that are not in the best interest of consumers.;
2. Train producers to make recommendations in compliance with the regulation.
3. Establish and maintain procedures designed to prevent financial exploitation and abuse.
4. Provide a comparison between versions of the same product if one version has a fee-based structure and the other version has a commission-based structure.

The amendments to Insurance Regulation 187 will take effect on August 1, 2019. However, insurers and producers must begin to comply with the requirements for transactions involving **life insurance** policies on **February 1, 2020**.

The Department obviously expects life insurers to be the primary, if not sole, enforcers of these new rules and will be auditing those insurers for compliance as part of regularly scheduled examinations, given that the Department clearly lacks the resources to examine tens of thousands of life insurance agents and brokers. For that reason, the Department has provided an additional eleven months for the new rules on life insurance to take effect beyond what it had originally proposed. How effective these new requirements will be in preventing abuse of consumers is an open question, as is the question of whether the Department has the statutory authority to mandate them. Recently, the New York State Supreme Court annulled new Department regulations limiting marketing activities of title insurance companies as lacking statutory authority, (*New York State Land Title Assn. et al v. Dept. of Financial Services*, N.Y. Co. 7/5/18), and these rules may face a similar challenge.

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