



Summary of Insurance Regulation 187

On August 1, 2019, New York's Department of Financial Services finalized Insurance Regulation 187, "Suitability & Best Interests in Life Insurance & Annuity Transactions" (Reg 187), which outlines NY's version of best practices for annuity and life insurance sales. The finalized version of Reg 187 does take many of the comments from the industry into account, but it still leaves some unanswered questions and has a broader reach than anticipated. Reg 187 applied to annuities August 1, 2019, and will apply to life insurance starting February 1, 2020.

Reg 187 covers sales practices (suitability and best interest), disclosure, and documentation. It applies to a transaction or recommendation to purchase (or replace) an insurance or annuity contract issued or delivered in New York state. This includes residents of New York, former residents of New York with ILITs domiciled in New York, ILIT trustees domiciled or resident in New York (even if the ILIT situs is outside of New York), and producers in New York if they're delivering a policy in New York. Interestingly, Reg 187 exempts policies that are used to fund a plan that's covered by ERISA, a qualified retirement plan, a government or church plan, or a nonqualified deferred compensation arrangement. In addition, Reg 187 does not apply to corporate or bank-owned policies or to life settlement contracts, as defined by Article 78 of the Insurance Law.

Sales Practices

The recommendation to buy or not to buy must be in the customer's best interest with both a suitability and a best interest standard now applying to the recommendation. Suitability requires that the producer have reasonable grounds for believing the recommendation is suitable to the customer on the basis of relevant facts disclosed regarding the customer's financial situation. Best Interest requires that the producer act in the best interest of the customer by exercising the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with the circumstances would use.

Suitability: For a policy providing solely term life insurance (with no cash value) information that is reasonably appropriate to determine the suitability of a recommendation includes some or all of the following information, as relevant to the consumer:

- Age
- Annual income
- Financial situation and needs, including financial resources for funding the policy
- Financial objectives
- Intended use of the policy, including attached riders
- Financial time horizon, including duration of existing liabilities and obligations
- Existing assets, including investment and insurance holdings
- Willingness to accept non-guaranteed elements in the policy, including variability in premium death benefit, or fees
- Any other information provided by the consumer that in the reasonable judgment of the producer (or of the insurer where no producer is involved) is relevant to the suitability of the transaction

For policies other than those that are solely term products, Reg 187 adds the following additional factors to the list for term products:

- Financial experience
- Liquidity needs
- Liquid net worth
- Risk tolerance
- Tax status

Best Interest: Any policy recommendations must reflect the customer's best interest in terms of costs, performance, and risks related to benefits. Costs include cost of insurance, mortality and expense charges, investment advisory fees, and surrender changes. Performance considerations should take into account what's reasonable to expect from the recommended policy, available cash values, equity index features and limitation on interest returns. The risk inherent in the recommended product must be appropriate for the circumstances and should include an analysis of market risk and interest rate risk.

The producer's receipt of compensation is not permitted to influence the recommendation. Reg 187 provides, therefore, that compensation or other incentives may be received only when: 1. the amount of compensation or receipt of an incentive does not influence the recommendation; 2. the sales transaction is suitable, based on the factors listed above, and 3. there is a reasonable basis to believe that the customer has been informed of the various features of the insurance contract, including favorable and unfavorable consequences of the sales transaction. Those factors include: surrender charges, availability of cash values, tax implications of policy changes, policy fees, expenses, performance and risk, and the manner in which the producer is compensated for the sale and service of the policy.

Disclosures

Both the producer and the insurance carrier are required to make disclosures. Disclosures must be made to the customer in a reasonable summary format, including all relevant suitability considerations and product information, both favorable and unfavorable, that provide the basis for any recommendations. Producers should also disclose their compensation structures along with any fee-based vs. commission-based comparisons.

Disclosure needs to include any limitations on the range of products available to the producer due to the arrangement the producer has with selected carriers. The disclosure of affiliation with a particular carrier is insufficient if it merely states that the producer may limit recommendations without specific disclosure of the extent to which recommendations are, in fact, limited.

Documentation

This relates to those items that are kept in a client's file and made available for inspection, if required. Any recommendation made should be documented, subject to the facts and analysis in support of that recommendation and the basis for the recommendation made. Documentation must include the consumer's refusal to provide suitability information, if any, and reference to a consumer who enters into a transaction against the producer's recommendation. Forms requiring customer acknowledgement of the disclosures identified above also become part of the documentation file.

As a side note, producers may not use the title or designation of financial planner, advisor, or similar title unless the producer is properly licensed or certified.

Outstanding Questions

While New York responded to some of the comments provided by the industry, they failed to adopt the suggestion that life insurance illustrations be certified as sufficient to meet the required product disclosures. While not accepting the suggestion that life insurance illustrations are de facto sufficient disclosure, New York did not prohibit the use of illustrations to disclose relevant product information. This leaves life insurance producers with uncertainty as to how to ensure that they are meeting the disclosure requirements of Reg. 187.

The industry is also waiting to see how life insurance carriers will respond to these requirements, particularly given that the enhanced disclosure and documentation requirements fall on both producers and the carriers. What steps will carriers take to ensure that the disclosures are made and acknowledged? How much more information will carriers require on their product applications? What enhanced producer trainings will be required? Will carriers choose to follow the trend set by some of their peers and simply stop selling products in New York? And how will the enhanced disclosures impact those producers who are part of the "captive insurance system" that limits their access to the broader product market place?

NFP and PartnersFinancial are working closely with our carrier partners to navigate the rules imposed under Reg 187 as well as the new SEC Regulation Best Interest applicable to variable products. We will keep you updated as we learn more and get answers to our outstanding questions.