

Summary of the Revised Regulatory Impact Statement for the First Amendment to 11 NYCRR 224 (Insurance Regulation 187).

1. Statutory authority: The authority of the Superintendent of Financial Services (“Superintendent”) to promulgate the First Amendment to Insurance Regulation 187 (11 NYCRR 224) derives from Financial Services Law (“FSL”) sections 202 and 302, and Insurance Law (“IL”) sections 301, 308, 309, 2103, 2104, 2110, 2123, 2208, 3209, 4224, 4226, 4525, and Article 24.

FSL section 202 establishes the office of the Superintendent.

FSL section 302 and IL section 301, in pertinent part, authorize the Superintendent to effectuate any power accorded to the Superintendent by the IL, FSL, or any other law, and to prescribe regulations interpreting the IL.

IL section 308 authorizes the Superintendent to address to any authorized insurer or its officers any inquiry relating to its transactions or condition or any matter connected therewith.

IL section 309 authorizes the Superintendent to make examinations into the affairs of entities doing or authorized to do business in this state as often as the Superintendent deems it expedient.

IL sections 2103 and 2104 set forth licensing requirements for insurance agents.

IL section 2110 authorizes the Superintendent to revoke or suspend the license of an insurance producer if, after notice and hearing, the producer has demonstrated untrustworthiness or incompetence, violated the IL or regulations promulgated thereunder, or engaged in certain other specified behavior.

IL section 2123, among other things, prohibits an insurance agent, insurance broker, or representative of an insurer from making misrepresentations or misleading statements about a life insurance (“LI”) policy or annuity contract or an incomplete comparison for the purpose of inducing, or tending to induce, a person to lapse, forfeit or surrender any insurance policy.

IL section 2208 provides that an officer or employee of an authorized insurer that has been certified pursuant to IL Article 22 is subject to IL section 2123.

IL Article 24 prohibits unfair methods of competition and unfair or deceptive acts or practices.

IL section 3209 mandates disclosure requirements in the sale of LI, annuities and funding agreements and authorizes the Superintendent to promulgate regulations to implement this section.

IL section 4224 proscribes unfair discrimination and other prohibited practices by insurers.

IL section 4525 applies IL sections 2110(a), (b), (d)-(f), 2123, 3209 and 4226, and IL Articles 2, 3, and 24, to authorized fraternal benefit societies.

IL section 4226 prohibits an authorized life insurer from making misrepresentations, misleading statements about a LI policy or annuity contract or an incomplete comparison for the purpose of inducing, or tending to induce, a person to lapse, forfeit or surrender any insurance policy.

2. Legislative objectives: IL sections 2103, 2104, 2110, 2123, 2208 and Article 24 establish standards of conduct for insurance producers, including competent and trustworthy standards. IL section 4226 establishes standards of conduct for LI companies and fraternal benefit societies (collectively, “insurers”), and Article 24 permits the Superintendent to regulate trade practices in the business of insurance to prevent acts or practices that are unfair or deceptive.

This amendment accords with the public policy objectives that the Legislature sought to advance in IL 2103, 2104, 2110, 2123, 2208 and Article 24 by clarifying the duties and obligations of insurance producers and insurers to ensure that a transaction is in the consumer’s best interest and appropriately addresses the consumer’s insurance needs and financial objectives at the time of the transaction.

3. Needs and Benefits. 11 NYCRR 224 (Insurance Regulation 187) was promulgated in 2013 and was based on the National Association of Insurance Commissioners’ (“NAIC”) Suitability in Annuity Transactions Model Regulation (“NAIC Model”). Since 2013, the Department of Financial Services (“Department”) has monitored the financial market and the application of the regulation’s standards. The primary objective of this amendment is to address deficiencies in the regulation.

The purchase of annuities and LI has become a more complex financial transaction, resulting in a greater reliance on professional advice. Products offer a wider range of benefits which are more complex, making disclosure alone inadequate and additional standards of care necessary.

A number of Department investigations and examinations since 2013 have demonstrated the need for a best interest standard of care for LI and annuity sales. The Department believes, in light of all of the facts and its expertise, that a regulation is needed to prevent insurers and producers from recommending a transaction that is properly disclosed and determined to be suitable for a consumer, but that is otherwise not in the best interest of that consumer and is designed to maximize compensation to the sellers.

The U.S. Department of Labor (“DOL”) issued 29 C.F.R. 2510 (the “Rule”) which expands the federal definition of investment advice and requires financial advisors to adhere to enhanced standards of conduct. The Rule makes the sale of many insurance products involving qualified money subject to a fiduciary standard. As an alternative, an exemption exists under the Best Interest Contract Exemption (26 C.F.R. 2550), where the producer would still be required to act in the best interest of the consumer. Although delays and conflicting court decisions leave the Rule’s implementation uncertain, the Department believes that the best interest standard is an important consumer protection and intends to pursue this protection for NY consumers. According to the DOL’s Regulatory Impact Analysis, conflicted advice is causing harm to consumers; disclosure alone would not remedy the harm. This is consistent with the Department’s own observations in New York. Like the DOL, the Department believes that regulatory action is necessary. The amendment imposes a consistent standard of care across LI and annuity product lines and protects consumers from conflicted recommendations.

Regulation 187 requires a producer, or insurer where no producer is involved, to have reasonable grounds for believing that the recommendation is suitable for the consumer based on information provided by the consumer. This amendment defines “suitability” and specifies a best interest standard of care that applies to all transactions in NY, including in-force transactions generating new sales compensation, to ensure fair treatment

of consumers purchasing both retirement and non-retirement annuity and LI products. This amendment adds consumer protections by: prohibiting producers from implying that any recommendation is financial planning unless the producer has such a designation; prohibiting producers from recommending a sales transaction unless the consumer has the financial ability to handle the policy; and requiring disclosure requirements to prevent financial abuse.

4. Costs: Insurers and insurance producers subject to this amendment likely will incur costs because of this amendment. The amendment expands the regulation's current training requirement, requires an insurer to establish and maintain procedures to prevent financial exploitation and abuse, and requires an insurer to provide a consumer with all relevant information to evaluate a transaction.

This amendment requires a producer or an insurer to also disclose to a consumer all relevant suitability information that provides the basis for a recommendation to enter into a sales transaction involving LI, and to document any LI sales recommendation subject to 11 NYCRR § 224.4(a) and (b) and, if relevant, to obtain a signed statement documenting a consumer's refusal to provide suitability information and when a transaction is not recommended.

However, the amendment takes a principle-based approach to compliance with the requirements of the regulation, which is expected to greatly minimize costs by allowing the leveraging of existing systems and procedures. While the costs to implement this amendment may vary by size and business, and thus difficult to estimate, the Department does not anticipate the costs to be significant. Some producers have indicated implementing a best interest standard regardless of what happens with the Rule. The Department believes that cost savings will result where the same standards apply across product types.

Insurers and producers in NY have different business models and are at different levels of readiness for compliance with the Rule. The amendment is consistent with the core requirements of the Rule but significantly less onerous in terms of supervision and compliance requirements. Firms that already comply with the Rule

have minimal additional costs to comply with the amendment. The benefits of the regulation are expected to be substantial. The elimination of conflicted recommendations to consumers is expected to yield great cost savings to consumers.

This amendment does not impose additional costs on the Department or state or local governments.

5. Local government mandates: The amendment imposes no new programs, services, duties or responsibilities on any county, city, town, village, school district, fire district or other special district.

6. Paperwork: The amendment adds a documentation requirement for any sales recommendation for LI; requires an insurer to provide a consumer with all relevant policy information with respect to evaluating a transaction; and requires an insurer to provide a producer with all relevant replacement information necessary for the evaluation of the replacement. The documentation required by this amendment with respect to LI is similar to the requirements of the current Regulation 187 and Financial Industry Regulatory Authority (“FINRA”) Rule 2111 with respect to annuities. Minimal additional paperwork, including obtaining a consumer signed statement, is expected but over time costs are likely to be reduced because of consistency.

7. Duplication: The amendment does not duplicate, overlap, or conflict with other state requirements. The amendment has the potential to partially duplicate the Rule, if the Rule is fully implemented in that both rules impose a best interest standard of care and a recordkeeping requirement. Since the best interest standard of care and the recordkeeping requirement in the regulation are consistent with the Rule, there is currently no conflict. Also, it is possible that there would be no overlap whatsoever since recent conflicting court decisions have left uncertainty about the implementation of the Rule and the SEC process is uncertain,.

8. Alternatives: Since the promulgation of Regulation 187 in 2013, the Department monitored developments in suitability standards and ascertained that additional oversight and regulation is needed to provide a level playing field and to protect consumers when they are considering the purchase of LI and annuities in NY or are considering a modification to existing LI and annuities. The Department participated in discussions with

various stakeholders, a trade association for independent insurance agents and brokers regarding the potential impact of the Rule, finalized on April 8, 2016, and the proposed amendment on consumers, producers and insurers. The Department has conducted outreach to discuss the Rule and participated in discussions with the NAIC's Annuity Suitability Working Group.

The Department considered not implementing the amendment, but the Department has rejected this alternative because doing nothing would be disadvantageous to consumers. Moreover, NY consumers should not be denied the protections of this proposal because other regulators in other jurisdictions have not adopted similar protections. The Department is the sole regulator for the majority of insurance activities occurring in NY and maintains unique expertise that makes it appropriate for the Department to lead on issues of insurance regulation.

9. Federal standards: The Rule includes standards that apply to certain annuities and LI that involve qualified funds. The standards in this amendment utilize the standards imposed by the Rule in imposing a best interest standard of care; however, since the Rule applies only in certain circumstances where the producer receives commission from the annuity transaction; the annuity's funding comes from a tax-qualified source; or where the annuity contract or LI policy results from reinvestment of qualified plan and IRA distributions, the amendment extends those requirements to all LI and annuity transactions in NY, regardless of the source of funds or the manner of compensation, to achieve a consistent regulatory scheme for all product types in NY. It should be noted that recent conflicting court decisions have created uncertainty about the implementation of the Rule.

10. Compliance Schedule: The amendment will take effect March 1, 2019. As of the effective date, insurers and producers must comply with the requirements of the rule for any transaction with respect to an annuity contract. Six months from the effective date, insurers and producers must comply with the requirements of the rule for any transaction with respect to a LI policy.