

# The Most Frequently Asked Questions about NY's Reg 187

In August 2019 the NY Department of Financial Services finalized the "Suitability and Best Interests in Life Insurance and Annuity Transactions" Regulation (Reg 187), outlining new consumer-focused rules for transactions involving life insurance or annuities. These rules went into effect immediately for annuities and will be effective February 1, 2020 for life insurance transactions. As the effective date draws near, questions have been arising around how to comply with Reg 187. There are many outstanding issues involving the application of Reg 187, but this document seeks to answer the most frequently asked questions, based on the information outlined in the final regulation.

## Who is subject to Reg 187?

Reg 187 applies to recommendations made to consumers with respect to policies delivered or issued for delivery in New York State, putting obligations on both carriers and producers. Further, any requirement of Reg 187 applicable to a producer applies to every producer who materially participated in the making of a recommendation and received compensation as a result of the sales transaction, regardless of whether the producer has had any direct contact with the consumer. Product wholesaling or product support based on generic client information, or the provision of education or marketing material, does not constitute participating in the making of a recommendation.

## What is a "recommendation" under Reg 187?

As defined by Reg 187, a recommendation is one or more statements or acts by a producer to a consumer that 1) reasonably may be interpreted by a consumer to be advice and that result in a consumer entering into or refraining from entering into a transaction in accordance with that advice or 2) is intended by the producer to result in a consumer entering into or refraining from entering into a transaction. All recommendations made to a consumer must be in the best interest of the consumer.

A recommendation does not include: general factual information to consumers, such as advertisements, marketing materials, or general information regarding insurance or financial products; or general administrative services. A recommendation also does not include use of an interactive tool that solely provides a prospective consumer with the means to estimate insurance, future income or other financial needs, or to compare different types of products.

Neither the producer nor the insurer has any obligation under Reg 187 to the consumer if: 1) a recommendation is not made; 2) a recommendation was made and was later found to have been based on materially inaccurate information provided by the consumer; 3) the consumer refuses to provide relevant suitability information and the transaction is not recommended; or 4) the consumer decides to enter into a sales transaction that is not based on a recommendation of the producer or insurer.

In making a recommendation, the producer may weigh multiple factors that are relevant to the best interests of the consumer including, but not limited to, the benefits provided by the policy, price of the policy, the financial strength of the carrier, and other factors that differentiate products or insurers.

The producer must provide the consumer with a summary of all relevant suitability considerations and product information, both favorable and unfavorable, that provide the basis for the recommendation. The producer must also document:

- The basis for any recommendation made and the facts and analysis to support that recommendation
- The consumer's refusal to provide suitability information, if any
- That a sales transaction is not recommended if a consumer decides to enter into a sales transaction that is not based on the producer's recommendations

A recommendation shall not be made to a consumer to enter into a sales transaction unless the producer has a reasonable basis to believe that the consumer has the financial ability to meet the financial commitments under the policy.

## What is a “transaction” under Reg 187?

Reg 187 defines “transaction” as both a “sales transaction” and an “in-force transaction.” A sales transaction is the purchase or issuance of a policy, any replacement under Section 1035, conversion, or any modification or election of contractual provision on an in-force policy, that generates new sales compensation. An in-force transaction is the modification or election of a contractual provision with respect to an in-force policy that does not generate new sales compensation.

All transactions must be in the best interest of the consumer and sales transactions must be accompanied by a review of the suitability information relevant to the type of product under consideration.

In-force transactions, while not required to include a suitability review, must also be in the best interest of the consumer and are subject to the “prudent person” standard. In addition, the producer must have a reasonable basis to believe the consumer has been reasonably informed of the relevant features of the policy and the potential consequences of the in-force transaction, both favorable and unfavorable. While not explicitly required under Reg 187, there might be wisdom in performing a “suitability-light” review when making recommendations for in-force transactions so that the producer can demonstrate that the recommendation was, in fact, made in the consumer's best interest.

## What is the “best interest” of the consumer?

A producer acts in the best interest of the consumer when the producer's 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. Only the interests of the consumer shall be considered in making the recommendation.

While Reg 187 starts out with establishing a “prudent person” rule for determining the best interest of the consumer, NY added several other important considerations when establishing that a recommendation is in the consumer's best interest. They include:

- Recommendations must be based on an evaluation of the relevant suitability information of the consumer.
- Receipt of compensation or other incentives is permitted as long as the amount of compensation or incentive does not influence the recommendation. NY does not provide any additional information outlining how to establish that the receipt of compensation or incentive has not influenced the recommendation — but it seems likely that 1) full disclosure of compensation and 2) documentation of non-compensation reasons for the recommendation made will be helpful should the receipt of compensation become an issue.
- The consumer has been informed of how the producer is compensated for the sale and servicing of the policy.
- The producer has adequate knowledge of the product or product feature(s) being recommended — here the carrier's requirements of product-specific training will be invaluable.
- The transaction recommended is suitable to the consumer.
- There is a reasonable basis to believe the consumer has been informed of the relevant product features of the policy and potential consequences of the transaction, both favorable and unfavorable — a fully documented suitability review will help to establish the reasonable basis.
- There is a reasonable basis to believe:
  - a. That the consumer will benefit from certain features of the product
  - b. That the product as a whole, the underlying subaccounts to which funds are allocated at the time of the sales transaction (if applicable), and riders and other product features, if any, are suitable for the consumer based on the consumer's suitability information

- In the case of a replacement, the replacement is suitable taking into consideration:
  - a. The advantages and disadvantages – such as surrender charges, changes to the premium due, duration of the coverage, the amount of death benefit, and any tax implications – of the new product compared to the existing product
  - b. Whether the consumer would benefit from policy enhancements and improvements such as a decrease in premium or fees, increased coverage duration, increased death benefit or income amount
  - c. Whether the consumer has had another policy replacement, in particular, a replacement within the preceding 36 months

## What is the “suitability information” a producer is required to obtain?

Reg 187 defines “suitable” as being in furtherance of a consumer’s current needs and objectives under the circumstances then prevailing, based upon the suitability information provided by the consumer and all products, services, and transactions available to the producer. In order to determine whether a transaction is “suitable” the producer must gather some basic information about the consumer and then product-specific information based on whether the recommendation is for term insurance or permanent insurance.

The basic suitability information that must be obtained when recommending term insurance includes:

- Age
- Annual income
- Financial situation and needs, including the financial resources that will be used to fund the policy
- Financial objectives
- Intended use of the policy and any riders attached
- Financial time horizon, including duration of existing liability and obligations
- Existing assets, including investment and insurance holdings
- Willingness to accept non-guaranteed elements in the policy, including variability in premium, death benefit, and/or fees
- Any other information provided by the consumer which, in the reasonable judgement of the producer, is relevant to the suitability of the transaction

When the recommendation is for permanent insurance – or as Reg 187 defines it, “any product other than solely providing term life insurance with no cash value” – the producer must gather the basic information for term insurance plus the following:

- Liquidity needs
- Liquid net worth
- Risk tolerance
- Willingness to accept non-guaranteed elements in the policy, including variability in premium, cash value, death benefit, and/or fees
- Tax status
- Any other information provided by the consumer which, in the reasonable judgement of the producer, is relevant to the suitability of the transaction

## Are there transactions that are exempt from Reg 187?

There are several exceptions provided in Reg 187, outlining transactions and uses of policies that are not subject to the best interest and suitability requirements of Reg 187. They include:

- Wholesaling support, as long as there is no material participation or compensation paid with the making of the recommendation
- Policies used to fund employee pension or welfare benefit plans covered by ERISA
- Policies used to fund qualified plans covered by IRC Sections 401(a), 401(k), 403(b), or 408(p)
- Government or church plans under IRC Section 414, government or church welfare benefit plans, or deferred compensation plans under IRC Section 457
- Nonqualified deferred compensation arrangements established or maintained by an employer or plan sponsor
- COLI or BOLI insurance
- Any life settlement contract

## What are the insurer's responsibilities under Reg 187?

Reg 187 puts quite a few new oversight obligations on insurers, all of which will likely be interpreted slightly differently by the various carriers doing business in New York. Specifically, an insurer cannot effectuate a sales transaction with respect to its policies unless there is a reasonable basis to believe that the sales transaction is suitable based on the suitability information provided by the consumer.

Therefore, the carriers must establish, maintain, and audit a system of supervision that is reasonably designed to achieve the insurer's and producer's compliance with the requirements of Reg 187. This includes standards and procedures for:

- Collation of a consumer's suitability information with respect to sales transactions involving the insurer's policies
- Documentation and disclosure of the basis for any recommendation with respect to sales transactions involving the insurer's policies
- Review of complaints received by the insurer regarding recommendations inconsistent with the best interest of the consumer
- Auditing and/or contemporaneous review of recommendations to monitor producers' compliance in making recommendations that are in the best interest of the consumer

Interestingly, insurers may continue to maintain, within and across product lines, variations in compensation or other incentives provided that the insurer's compensation practices, when taken as a whole, are designed to avoid producer recommendations that are not in the best interest of the consumer.

## Is there additional training required to ensure compliance with Reg 187?

Yes, Reg 187 requires training of all producers licensed in New York State. The insurer is also responsible for ensuring that every producer recommending any transaction with respect to an insurer's policies is adequately trained to make the recommendation in accordance with requirements of Reg 187. All of the carriers operating in New York State have determined that this training requirement must be filled in two ways. First, all producers licensed in New York state must take general training on the requirements of Reg 187 and second, all producers licensed with the insurer must take product-specific training on all products offered by that carrier. The carriers have widely stated that they will accept proof of universal training done on Reg 187 (offered variously by RegEd, Kaplan, and LIMRA) but will still require that the producer complete product-specific training on the products offered by each insurer.

This training will be required of all producers who materially participate in the recommendation, regardless of whether they had direct contact with the consumer, but it is less clear for those producers who merely receive some compensation from the sales transaction. Given that the training must be completed and certified as such with the insurer before any new business is submitted with the insurer, it would be wise for all producers that might be involved in the sale or delivery of a policy in New York to complete the training.

## Can I continue to use my professional designations?

Yes, but take note that Reg 187 specifically prohibits a producer from using a 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. Although the producer may 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 a related service unless the producer has a specific certification or professional designation in that area.

## What do I need to do to submit new business in New York State?

Each insurer is likely to have a slightly different interpretation of the requirements of Reg 187, which means that their submission requirements will vary slightly. Generally speaking, you should plan to be able to document/submit the following information.

For each transaction in which a sales transaction is conducted:

- Customer profile/needs analysis
- Product comparisons
- Signed carrier application
- Signed suitability and best interest form(s)

For each transaction in which you interact with a client, you should document:

- Whether a new recommendation is made
- A description the basis for the recommendation
- Whether a post-issue recommendation is made — keep in mind that a recommendation to do nothing is still a recommendation
- Product advantages/disadvantages and non-guaranteed elements
- Whether a client decision is made against product recommendation
- How compensation is paid for the sale and servicing of the product
- Any impact of replacing the product

For each transaction you must provide the client with:

- Applicable disclosures
- Carrier product summary or guide
- Fee/commission based disclosure (if applicable)
- NY Reg 194 compensation disclosure
- NY Reg 60 paperwork for replacements (if applicable)

## How long do I need to maintain documentation relating to the recommendation?

All documentation supporting the transaction and used in making the recommendation, and anything else that may assist in supporting the recommendation and protecting you from potential customer complaints or regulatory scrutiny should be maintained. Reg 187 refers to Part 243 of NY Insurance Regulation 152 in establishing requirements for record keeping. Under Part 243, records for active clients must be kept indefinitely and records for inactive clients and/or terminated policies must be kept for seven years following the year of termination. The documentation that must be maintained includes, but is not limited to:

- Training completion Certifications
- Customer profile/needs analysis/annual suitability reviews
- Product comparisons
- Signed carrier applications
- Signed suitability form
- Signed illustrations
- Sales material
- Personal notes
- Any required post-issue documents, such as delivery receipts

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