

New York Reg 187 – Best Interest & Suitability Under the New Regulation



eNotice, September 2019

Summary

At the end of 2018 the New York Department of Financial Services (DFS) finalized amendments to their Regulation 187. These amendments created a Best Interest and Suitability standard for recommendations relating to both life insurance and annuity sales, as well as recommendations for post-issue transactions taking place with New York contracts related to both new and existing life insurance and annuity contracts. The amendment also extended an annuity suitability standard to life insurance in New York.

This amended Regulation became effective for annuities on August 1, 2019; it will become effective for both new life insurance sales and post-issue transactions taking place starting on February 1, 2020.

Although this Regulation is specific to contracts and policies issued in New York, this Regulation is important for all Financial Professionals to understand. First, it is not unusual in today's society that a producer generally practicing outside of New York will, at some point, transact business in New York. Additionally, New York often influences the conversation as other states, regulatory bodies or the NAIC look at this issue.

A prior eNotice, from AXA Equitable, offered an overview of Regulation 187. This eNotice will offer some additional discussion on the Best Interest and Suitability standards, and the open questions left by the Regulation. Future eNotices will offer additional detail and insight on this Regulation.

What is Best Interest & Suitability?

The vast majority of Financial Professionals, regardless of their affiliations (Registered Representatives, Independent Agents, Investment Advisors, etc.) work in financial services to benefit their clients and help them meet their goals. However, Investment Advisor and Investment Brokers have, for years, been governed by different Regulations. Investment Advisors have been held to a fiduciary standard while Investment Registered Representatives have been held to a suitability standard.

Now, under New York Regulation 187, a Best Interest standard is being extended to all Financial Professionals transacting any life insurance and annuity business New York, while other parties to the transaction must also determine suitability.

Although there may be a fine line between these two standards, it's important to have an appreciation of the two as we explore this new Regulation.

- A **Fiduciary standard** was set some time ago for Investment Advisors by the Securities and Exchange Commission. It imposes a requirement that Financial Professionals owe their clients a fiduciary standard of loyalty and care.
- Although a **Best Interest standard** may be less than a Fiduciary standard, it remains a high standard. Financial Professionals operating under this standard must obtain and use accurate and complete information before enacting a transaction, must avoid any conflicts of interest and must disclose any potential conflicts. In all circumstances, they must place their client's interests above their own. Among other things enunciated in the Regulation, a Financial Professional may be able to accept commission-based compensation, but compensation cannot influence a recommendation in any manner.



- By contrast, a **Suitability standard** requires a belief that the recommendation is suitable based on a client's facts and circumstances. This may allow for a wider range of financial products, costs and charges than a Best Interest standard.

The American College offers a set of bullets, shown here, that helps demonstrate some of the nuances between the two standards.¹

Best Interest Standard	Suitability Standard
Put the client's best interest standard first	Understand the client's financial situation
Act with prudence to assure a best interest is met	Recommend products and give advice suitable to the client's situation
Avoid conflicts of interest	Be aware of the client's investment experience
Provide full disclosure of potential conflicts	Know the client's investment objectives
Manage any conflicts in favor of the client	

A few publications have used buying a car or SUV as a good analogy – noting that auto dealers are not confined to either a best interest or suitability standard. Assume that a new parent is seeking a car to help get to work and also transport the baby. They have a list of needs that fit an Acme model automobile. They happen to go to a Nuco Dealership and the salesperson shows them a Nuco SUV. It meets their objectives and budget, but it may be more vehicle than they need. While the Acme vehicle is in the parent's Best Interest the SUV is not inappropriate, so it might be Suitable.

What Standards Does New York Regulation 187 Place on Financial Professionals and Carriers?

In working with clients and making recommendations, a Financial Professional must disclose to a client all of a recommended product's benefits and features, both pro and con. This is for a client to fully understand the product and to understand why the specific product is being recommended. Although the Regulation doesn't discuss how this disclosure must be made, Financial Professionals would be advised to keep detailed records of what, in a given client's situation, lead them to make specific product recommendations including what product features benefited the client under their unique circumstances. Financial Professionals working with a Broker Dealer may have additional guidelines crafted for their transactions.

Going forward, Financial Professionals transacting life insurance and annuity business in New York, must comply to a Best Interest standard in all their dealings with clients.

Although a Financial Professional doesn't need to disclose or offer the universe of products to a client, where a Financial Professional operating in what's often called a "captive" distribution salesforce with limited product options, additional disclosure is required. This will include what is often referred to as proprietary/non-proprietary product disclosure by the "captive" Financial Professional so that the client is fully informed.

Where life insurance is concerned, there are some open questions. Many producers and carriers recognize that a product determination is one aspect, albeit a key aspect. However, a final determination of which product may be best for a client might not be able to be made until there is a final medical underwriting assessment and offer. A shift in an expected underwriting category might tip a recommendation from one carrier and life insurance policy to another. Still, as discussed on the next page, most determinations are expected to be made as a case comes in as a formal application.

It's important to note that the New York Regulation does not prohibit commission-based compensation. In fact, the Regulation notes that commission-based compensation is not prohibited, but that it cannot influence the product recommendation in any manner.

What are the major touchpoints that Financial Professionals need to consider in working with clients.

Although it's not an all-inclusive list, amended New York Regulation 187 spells out a set of 13 items that need to be collected from a client when making a product recommendation. There are a few variations between permanent and term life insurance products, but they can best be summarized in the following chart.

Financial Professionals operating in New York must collect and weigh each of these considerations, before making any product recommendations, from the products they are authorized to sell, and presenting these options to clients. They will want to tie their recommendations back to the particular items evidenced in the client's given situation.

Data Points Required for Suitability Under New York State Amended Regulation 187	
Permanent Insurance Sales	Term Insurance Sales
Age	Age
Annual Income	Annual income
Financial Situation & Needs (including resources)	Financial Situation & Needs (including resources)
Financial Experience	Financial Experience
Financial Objectives	Financial Objectives
Intended use – including any riders	Intended use – including any riders
Financial time horizon – including existing liabilities	Financial time horizon – including existing liabilities
Existing Assets, including investment & insurance	Existing Assets, including investment & insurance
Liquidity Needs	Liquidity Needs
Liquid Net Worth	Liquid Net Worth
Risk Tolerance	Risk Tolerance
Willingness to Accept Non-Guaranteed Elements	Willingness to Accept Non-Guaranteed Elements
Tax Status	Tax Status
Any other information that may be relevant	Any other information that may be relevant

For Insurance Carriers transacting business there is a different standard, one by which they need to determine if a sale is suitable. This must be done as the case is submitted to the carrier. Again, there are no specific guidelines but most carriers are interpreting this as a new business formal application (as opposed to an informal, or trial, application) and planning to complete the suitability determination before a contract is issued.

Although a Financial Professional must review the client's situation based on all information provided and make a Best Interest recommendation (noting all product pros and cons for the products they recommendations) a carrier

isn't required to review their product against the universe of products. Carriers do not have a suitability obligation on in-force transactions.

From a carrier perspective they only need to weigh a recommendation against their own products and not against the universe of products. In doing so, they must review the case and the suitability of the recommended product against the information provided by the Financial Professional. Typically, this will be assessed on information provided in the application and many carriers are likely to also be asking additional information for New York state cases.

As noted above, a Carrier's compensation cannot also steer a Financial Professional to favor one product over another. At the carrier level this has opened-up discussions on how they might manage future sales contests and rewards trips.

Does Regulation 187 Place Standards on Other Parties?

One of the sections of the amended Regulation that has raised questions is §224.4(k). Under this section any party who materially participates in the making of a recommendation, and receives compensation as part of the transaction, is subject to the amended Regulation, even if they had no contact with the client. How far this extends is still subject for debate. The Regulation notes that it excludes discussions that are purely educational. Many agencies that work with Financial Professionals may need to look at how they provide information to a FP and whether it is a specific product recommendation, or whether they are offering informational and business processing services. No matter what, many agencies may begin to additionally document their sales discussions more thoroughly in the event that New York State begins to audit their cases – something that is entirely possible if they are receiving compensation from the sale.

Effect on Carrier New Business

As noted above, life and annuity carriers must determine the suitability of a sale. Each carrier is adopting or adapting existing procedures to accommodate this requirement.

For the most part carriers will likely review the data points that New York State noted for Financial Professionals, and in some instances, this may go beyond purely reviewing the data points. How carriers might enact this review will vary widely. This could range from:

- Automating the process as part of the New Business process.
- Using new or existing suitability desk that they may have as part of a Compliance or other department, or
- Building the suitability review into the Underwriting process.

Some carriers, however, may elect to react to this requirement by limiting or restricting their product offerings in New York. Others may elect to delegate some or all of their suitability review to others (usually the agencies submitting business); this is permitted under the New York Regulation, although carriers must monitor and audit agencies where they've delegated suitability.

It's important to note that there are also training requirements that many carriers are adopting for New York State transactions. These will be covered as part of a future eNotice, but Financial Professionals should be certain to look for changes in requirements related to New York sales.

The Effect on Post-Issue Transactions

In addition to New Business transactions, amended New York Regulation 187 also extends to post-issue transactions where new compensation is paid. This could include product exchanges, adding optional riders, elections to expand coverage, etc. There's an exclusion for transactions that are contractually guaranteed (a classic example is a typical example is a term conversions); for contractual transaction a carrier can rely on a statement from a Financial Professional that the transaction is in a client's best interest. However, other transactions must also be reviewed for suitability. There will be other issues related to transactions initiated by clients that are not fully explored at this point, some months ahead of the effective date for Life Insurance.

Conclusion

New York's amended Regulation 187 will have a significant shift on how both Financial Professionals and life carriers do business going forward. There's a significant additional level of responsibility placed on Financial Professionals to select a product that is in a client's best interest. At the same time a number of checks are placed on this decision; both in the hands of the carrier and others that materially participate in the sale to assure that the product selected is suitable for the client.

While it remains to be seen how New York will enforce this Regulation, presumably through audit and fielding consumer complaints, Financial Professionals should be certain to take steps to assure that they document the rationale behind their recommendations.

Each carrier will be adopting various policies and procedures to help implement Regulation 187 on their end as the effective date for Life Insurance approaches. AXA Equitable will be releasing it's information late in 2019.

1 <http://knowledge.theamericancollege.edu/blog/how-to-discuss-suitability-versus-best-interest-standards-with-clients>

For more information, please contact AXA Advanced Markets.

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