

CLIENT ALERT

New York Insurance Regulation 187 Overturned by the Appellate Division of the New York State Supreme Court

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In a stunning reversal of efforts by the New York State Department of Financial Services (“DFS”) to impose a “best interest” standard on all life insurance sales, the Appellate Division struck down recent revisions to New York Insurance Regulation 187 – Suitability in Annuity Transactions (“Revised NY Regulation 187”) as unconstitutionally vague. Insurers and producers who have been struggling with the complexities of complying with inconsistent new sales practice standards issued by DFS, the National Association of Insurance Commissioners (“NAIC”) and the U.S. Securities and Exchange Commission (“SEC”) are now faced with even more uncertainty as DFS is almost certain to appeal to the state’s highest court.

I. Background on New York Insurance Regulation 187

In December 2017, DFS exposed for comment until February 26, 2018 revisions to Revised NY Regulation 187, which not only incorporate the “best interest” standard but also expand the scope of the regulation from solely annuity sales to the sale of life insurance policies as well. Revised NY Regulation 187 explains that a licensee acts in the “best interest” of the consumer when the recommendation is based on the consumer’s suitability information and reflects the care that a prudent person would exercise in a similar situation without regard to the financial interests of any other party when the transaction is suitable and when the consumer has been reasonably informed of the consequences of the transaction. Among other requirements, Revised NY Regulation 187 requires licensees to make certain disclosures to the consumer; prohibits a licensee from making a recommendation unless the licensee has a reasonable basis to believe that the

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consumer can meet the financial obligations under the policy; and requires insurers to establish and maintain procedures to prevent financial exploitation and abuse.

Revised NY Regulation 187 was published in the New York State Register on August 1, 2018, with an effective date of August 1, 2019. In November 2018, Revised NY Regulation 187 was challenged in a Civil Practice Law and Rules Article 78 petition in both Albany and New York Counties, alleging the revised regulation violated the New York State Administrative Procedure Act and was arbitrary, capricious and unconstitutionally vague. After consolidating the petitions, the New York State Supreme Court issued a judgment on August 7, 2020, dismissing both petitions on the merits. The New York State Supreme Court determined that DFS had complied with the New York State Administrative Procedure Act, and Revised NY Regulation 187 was not arbitrary, capricious, or unconstitutionally vague.

II. The April 29, 2021 Appellate Division Decision

On April 29, 2021, the Appellate Division of the New York State Supreme Court, Third Department (the “Appellate Division”) reversed the August 7, 2020 judgment of the New York State Supreme Court, and struck down Revised NY Regulation 187. The Appellate Division determined that Revised NY Regulation 187 was unconstitutionally vague based on its application of a two-part test: (1) whether the regulation was “sufficiently definite so that individuals of ordinary intelligence are not forced to guess at the meaning of [regulatory] terms,” and (2) whether the regulation provided “clear standards for enforcement so as to avoid resolution on an ad hoc and subjective basis.” The Appellate Division determined that the definitional language contained in Revised NY Regulation 187 was overly broad, and failed to provide “concrete, practical guidance” for producers. Additionally, the Appellate Division noted that “given the resulting ambiguities in the language employed, coupled with its lack of clear standards for how these provisions will ultimately be enforced, [DFS has] ‘virtually unfettered discretion’ in determining whether a violation has occurred.”

DFS is likely to appeal the decision, and has thirty days to file with the New York State Court of Appeals. It is likely that DFS will file for and the New York State Court of Appeals may grant a stay, which will allow Revised NY Regulation 187 to stay in effect until a final resolution is reached.

III. Implications

In 2015, the United States Department of Labor issued a fiduciary regulation (the “DOL Fiduciary Rule”), which expanded the definition of “investment advice fiduciary” within the Employee Retirement Income Security Act of 1974, and required life insurance companies to comply with a new fiduciary or “best interest” standard. In June 2018, the Fifth Circuit vacated the DOL Fiduciary Rule – however, in the wake of the issuance of the DOL Fiduciary Rule, a number of state and federal agencies had already introduced regulations or legislation in an effort to develop fiduciary rules within their respective jurisdictions.

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Currently, life insurance and annuity writers have to address three major “best interest” standards in their life insurance and annuity sales processes, including: (1) Revised NY Regulation 187; (2) the SEC Regulation Best Interest (“[SEC Regulation](#)”); and (3) the NAIC Suitability in Annuity Transactions Model Regulation (the “[NAIC Model](#)”). The “best interest” standard contained in Revised NY Regulation 187 applies to both annuity and life insurance products, while the SEC Regulation only applies to variable life insurance policies and variable annuities (in addition to all securities sales). The NAIC Model includes much of the SEC Regulation framework, but differs in part because it applies to fixed and indexed annuities, and it does not apply to non-annuity and life insurance recommendations, recommendations impacting existing products, and investment strategy recommendations.

The elimination of Revised NY Regulation 187 would ultimately simplify compliance requirements for insurers and producers in the long run in New York. However, in the short term, companies will be forced to move forward with uncertainty about Revised NY Regulation 187 because the decision will likely be appealed and its effect may be stayed.

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