Future of New York's "Best Interest" Rule for Life and Annuities in Doubt after Being Found Unconstitutional

May 6, 2021

On April 29, 2021, a New York State intermediate court[1] unanimously held that the First Amendment to New York Department of Financial Services ("NYDFS") Regulation 187 (11 NYCRR pt. 224), "Suitability and Best Interests in Life Insurance and Annuity Transactions" ("Regulation 187"), was unconstitutionally vague. As we previously discussed, on July 18, 2018, the NYDFS promulgated a final version of amended Regulation 187, which adopts a best interest standard in the sale of life insurance and annuities. The amended Regulation 187 became effective for annuity products on August 1, 2019 and for life insurance products on February 1, 2020.

The amended Regulation 187 sets forth the duties and obligations of producers when making recommendations to consumers with respect to life insurance policies or annuity contracts delivered or issued for delivery in New York to help "ensure that the transaction is in the best interest of the consumer and appropriately addresses the insurance needs and financial objectives of the consumer at the time of the transaction." 11 NYCRR 224.0(c). The best interest standard set forth in amended Regulation 187 "requires a producer, or insurer where no producer is involved, to adhere to a standard of conduct to be enforced by the superintendent, but does not guarantee or warrant an outcome." *Id.* In a subsequent February 2020 guidance note, the NYDFS clarified that Regulation 187 (i) is intended to be a principles-based approach, setting standards that must be met but also affording significant flexibility in how producers and insurers meet those standards and (ii) does not impose any particular systems, forms, or procedures for meeting the requirements of the regulation. Indeed, the principles-based approach and lack of particular systems—both of which were advocated by many in the industry leading up to the Regulation 187's adoption—were focal points in the court's decision in striking down the amendments for being unconstitutionally vague.

Before amended Regulation 187 became effective, the Independent Insurance Agents and Brokers of New York, Inc., the Professional Insurance Agents of New York State, Inc. Testa Brothers, Ltd, and Gary Slavin filed an Article 78 petition challenging the amendments, alleging that the promulgation of the amendments violated the State

[1] New York Supreme Court, Appellate Division, Third Judicial Department.

Administrative Procedure Act, that the amendments lacked a rational basis, were arbitrary and capricious and otherwise unconstitutionally vague. The same day, the National Association of Insurance and Financial Advisors—New York State, Inc. also filed a petition challenging the amendment on similar grounds. On August 7, 2020, the Supreme Court dismissed both petitions on the merits, determining that NYDFS complied with the State Administrative Procedure Act in promulgating the amendment, that it did not unlawfully usurp legislative authority when it did so and that the amendment was not arbitrary, capricious, irrational or unconstitutionally vague. Independent Insurance Agents of New York and Testa Brothers appealed.

The Appellate Division reversed the trial court's decision concluding that the amendments violated due process rights and were unconstitutionally vague. Specifically, the Appellate Division held that "while the consumer protection goals underlying promulgation of the amendment are laudable, as written, the amendment fails to provide sufficient concrete, practical guidance for producers to know whether their conduct, on a day-to-day basis, comports with the amendment's corresponding requirements for making recommendations and compiling and evaluating the relevant suitability information of the consumer." The Appellate Division went on to note that while the amendment provides certain examples of what a recommendation does not include, "the remaining definitional language is so broad that it is difficult to discern what statements producers could potentially make that would not be reasonably interpreted by the consumer to constitute advice regarding a potential sales transaction and therefore fall within the purview of the amendment."

The Appellate Division also explained that the guidelines with respect to suitability information that producers must obtain from the consumers and the suitability consideration that must be disclosed provide insufficient guidance with respect to how producers must conduct themselves in order to comply with the amendment. The Appellate Division acknowledged that the NYDFS intentionally did not mandate a particular format or system nor prescribe specific forms that producers must use to comply with the amendment in an effort to mitigate the costs of implementation. Although the NYDFS indicated that the standards were purposefully left vague, the Appellate Division determined that the resulting ambiguities, coupled with a lack of clear standards, rendered the amendment unconstitutional.

The NYDFS has publicly stated that the agency is reviewing the decision and considering its appellate rights. If the NYDFS appeals, it will likely also move for a stay, which would maintain the amendments in effect until the Court of Appeals determines a final resolution. If the NYDFS elects not to appeal, it will likely propose a new amendment with more prescriptive requirements to comply with the Appellate Division's opinion.

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