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NYS DFS scores Big Win in New York Court of Appeals

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On October 20, 2022, the New York Court of Appeals ? the highest court in New York ? issued its opinion in In the Matter of Independent Insurance Agents and Brokers of New York Inc., et al. v. New York State Department of Financial Services, et al., which significantly affects life insurance agents doing business in New York either as resident or non-resident producers.

The insurance agent petitioners challenged amended Regulation 187 (11 NYCRR Part 224) on the grounds that it is unconstitutionally vague, arbitrary, capricious, unreasonable, and that the New York Department of Financial Services (DFS) exceeded its statutory authority in issuing the amended rule. Petitioners also claimed that the amended Regulation comprised an impermissible exercise in policymaking and that DFS violated the State Administrative Procedure Act (SAPA). The Court of Appeals rejected all of petitioners' arguments and upheld the amended regulation.

The rule creates a new compliance standard for all annuities and life insurance producers and insurers when they make "recommendations" to consumers purchasing insurance. The amended regulation applies equally to "sales" and "in-force" transactions, and, among other things, requires producers, or insurers (when no producer is involved), to act in the "best interest of the consumer" in making a "recommendation" so as "to help ensure that a transaction . . . appropriately addresses the insurance needs and financial objectives of the consumer at the time of the transaction."

To comply with the amended regulation, producers and insurers must:

- make "reasonable efforts" to obtain the consumer's "suitability information";
- base any recommendation(s) on relevant suitability information that 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 recommend "suitable" transactions to consumers;
- have a "reasonable basis" to believe that the consumer has been reasonably informed of the features of a policy, and favorable and unfavorable potential consequences of the transaction, and that the consumer would benefit from features of the policy and that particular policy as a

whole; and

- consider only the interests of the consumer in making the recommendation, and not be influenced by compensation or other incentives.

In challenging the above requirements, petitioners argued that, among other things, the terms "recommendation," "suitability information," and "best interest" are unconstitutionally vague because they fail to provide notice of what conduct is, or is not, permitted. The Court of Appeals disagreed, reasoning that the regulation clearly defined those terms via "standard legal terminology" with "an accepted meaning long recognized in law and life." The Court opined that the terms provide adequate notice since, *inter alia*, "a communication's legal impact [from producers or insurers] will not depend on the sensitivities of a communication's recipient [the consumer], and is both sufficiently definite to provide notice to those regulated [producers and insurers] and to prevent arbitrary enforcement" of the regulation. The Court explained that the amended regulation "provides flexibility as to what exact information a producer or insurer must consider for a particular consumer" and "the definition of 'suitability information' provides clear boundaries for what must be considered." As to acting in the "best interest" of the consumer, the Court noted that the regulation requires producers or insurers to, among other things:

- collect and evaluate "suitability information";
- confirm that the recommended transaction is "suitable";
- have a reasonable basis to believe that the consumer will benefit from the recommended policy's features; and
- document and disclose to the consumer the basis for the "recommendation."

The Court explained that the regulation generally requires insurers and producers "to reasonably recommend a suitable policy that will benefit the consumer."

Likewise, the judges dismissed petitioners' arguments that DFS exceeded its authority because the amended regulation is "aimed at ensuring that consumers buying insurance are doing so with the relevant information — and without fear that the salesperson is acting in their own contrary interest" and "fills in the details of the legislature's pre-stated policy." The Court determined that DFS did not violate SAPA because, among other reasons, "producers will already have in place standards and procedures that can be leveraged to comply with the amendment."

?Accordingly, New York-licensed life and annuity agents will need to document their compliance with Insurance Regulation 187, including as to efforts to obtain suitability information, the actual suitability information obtained, and their communications to the consumer about favorable and unfavorable consequences of the transaction and reasons to purchase or refrain from purchasing a life insurance or an annuity contract.

This important victory for DFS is just the latest in a string of cases upholding the DFS's broad authority to regulate the insurance industry stretching back nearly 45 years. *See*, *e. g.*, *Ostrer v. Schenk*, 41 N. Y. 2d 782 (1977) (upholding commission limits on mass-merchandised life insurance policies); *New York Public Interest Group v. New York State Ins. Dept*., 66 N. Y. 2d 444 (1985) (rejecting challenge to regulation utilizing aggregate data instead of individual insurer results for determining excess profits on motor vehicle policies); *Malpractice Ins. Assn. v. Superintendent of Insurance*, 72 N.Y.2d 753 (1988) (sustaining Superintendent's determination to limit increase in rates for medical malpractice insurance). Instead of unproductive litigation, clients should consider how best to navigate the DFS' stringent rules with the aid of expert counsel.

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