CENTER FOR CAPITAL MARKETS COMPETITIVENESS

TOM QUAADMAN
EXECUTIVE VICE PRESIDENT

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5540
tquaadman@uschamber.com

June 15, 2018

Mr. James V. Regalbuto
Deputy Superintendent for Life Insurance
New York State Department of Financial Services
One State Street
New York, NY 10004

Submitted Electronically – james.regalbuto@dfs.ny.gov

Re: Comments on the Re-Proposed Amendment to 11 NYCRR 224 (Insurance Regulation 187) Establishing a New "Best Interest" Standard for Life Insurance and Annuity Transactions

Deputy Superintendent Regalbuto:

The U.S. Chamber of Commerce ("the Chamber") is the world's largest business organization representing the interests of more than 3 million businesses of all sizes, sectors, and regions. We thank the New York Department of Financial Services ("the Department") for re-proposing this regulation and appreciate the opportunity to comment on the re-proposed Amendment to 11 NYCRR 224 (Insurance Regulation 187) that would establish a new "best interest" standard for life insurance and annuity transactions in New York ("the Proposal").

While we understand the Department's view that it has the authority to proceed and is not legally obligated to work with other regulators on complimentary regulatory standards, this position is not in the best interest of New York consumers. We are concerned that the revised Proposal is still based on the DOL Rule that was recently vacated by the 5th Circuit Court of Appeals.[1] The effect of this is that New York will be moving quickly into a new regulatory environment based on the one rule that will not be applicable in the future. We believe New York consumers would be

[1] *Chamber of Commerce of the U.S.A., et al. v. U.S. Dep't of Labor, et al.*, No. 17-10238, slip op. 46 (5th Cir. Mar. 15, 2018).

better served by the Department working with the Securities and Exchange Commission ("SEC") and the National Association of Insurance Commissioners ("NAIC") given that these entities are in the process of developing rules that may well be adopted.

The NAIC is actively working on its new model rule providing a suitability standard for annuity transactions. While New York is under no obligation to adopt this model rule, there are significant benefits to New York consumers in doing so. Indeed, the 2013 regulation the Proposal amends was the product of an earlier NAIC effort in which New York participated. It is very likely that the NAIC process can inform the Proposal, and slowing the regulatory process to accommodate that input could be very beneficial to the Department and to consumers.

The SEC has issued for public comment its new Regulation Best Interest which would apply to broker-dealers recommending variable annuities and certain other products that are regulated as securities as well as insurance products. Coordination would benefit both regulatory processes. FINRA has also proposed a regulation responding to the SEC's Regulation Best Interest.

We believe the Department would benefit from the discussion and comments received by the SEC and FINRA, just as the SEC and FINRA would benefit from comments received by the Department. It would be in the best interest of consumers and the Department to slow the process enough to coordinate with the SEC and FINRA.

We have more specific concerns detailed below.

Discussion

1. **The Department Failed to Provide a Reasonable Basis for the Original Proposal, and Continues to Fail to Provide a Reasonable Basis for the Revised Proposal**

Prior to the Proposal, our members generally felt the Department had provided a regulated but market-driven annuity and life insurance marketplace that served their needs. It appeared that the Department felt this was the case as well. Our review of the Department's annual reports and other public documents found no statements from the Department expressing concerns about the life insurance or annuity marketplace beyond routine oversight. In fact, the Department notes on its website that:

> "Annuity products approved for sale in New York generally provide greater consumer protections than products sold elsewhere. The minimum account values are higher, charges are lower and annuitization and death benefits are more favorable."[2]

The Department's view seems to have changed suddenly at the end of last year. Without showing any reasonable basis for its new conclusion that the current regulatory environment was insufficient to protect consumers, the Department issued the original Proposal providing sweeping new changes to annuity and life insurance sales modeled on the best interest standard from the DOL Rule.

To the extent the Department provided a justification for its new position, it was to achieve uniformity. Noting that DOL Rule that went into effect on June 9, 2107 applied to some annuity transactions in New York but not others, the Department argued that it would best address this lack of uniformity by adopting the DOL Rule best interest language "…because of the urgency to achieve uniformity of a best interest standard of care for all transactions in New York State."[3]

The Department also argued that there had been rapid changes in the marketplace since 2013, when the current standard was adopted, writing, "Since 2013, the purchase of annuities and life insurance has become a more complex financial transaction, resulting in a greater need for consumers to rely on professional advice, to seek assistance in understanding available life insurance and related products, and in making purchase decisions."[4] The Department provided no evidence to support these assertions.

In the revised Proposal, the Department no longer argues that the non-uniform requirements created by the DOL Rule are a reason for its actions. Instead, it simply embraces the DOL Rule. Noting that even though the DOL Rule likely will no longer apply, the Department has decided to go ahead, writing "Although delays and conflicting court decisions leave the Rule's implementation uncertain, the Department believes that the best interest standard is an important consumer protection and

---

[2] "Annuity Products in New York" webpage for consumer information, accessed on June 14, 2018 at http://www.dfs.ny.gov/consumer/cli_annuity_guide.htm.

[3] Regulatory Impact Statement for the Proposed First Amendment to 11 NYCRR 224 (Insurance Regulation 187); December 27, 2017; Section 8, page 6.

[4] Original Proposal RIS, Section 3, page 3.

intends to pursue this protection for NY consumers."[5] Again, the Department has failed to provide evidence supporting its assertions.

2. **The Department Fails to Abide by SAPA**

New York's State Administrative Procedure Act ("SAPA") does not permit a state regulatory agency to simply assert a problem, propose a solution, and begin regulating. In particular, Sections 202-a and 202-b of SAPA require an estimate of the effects of the rule, and a specific analysis of the effects of the rule on small businesses. These estimates can inform an analysis of alternatives to the adopted regulation. The agency must also provide detailed information about the studies on which it relied in making its decision. The Department has not followed these requirements.

A. Failure to Provide Required Cost Estimates

While the Department has written that the costs "are expected to be minimal" while the benefits "are expected to be substantial," mere words do not constitute a valid analysis of the effects of the proposal.[6] The reality is that the Department has not provided any true analysis even attempting to quantify the effects of its Proposal—literally only three numbers were even mentioned in the analysis: the number of agents, brokers and insurers in the state of New York. No other numeric information is provided. This does not meet the minimum requirements for an estimate "detailing" the effects of the rule.

Specifically, SAPA Sec. 202-a(3)(c) requires "a statement detailing the projected costs of the rule, which shall indicate: (i) the costs for the implementation of, and continuing compliance with, the rule to regulated persons;…and (iii) the information, including the source or sources of such information, and methodology upon which the cost analysis is based."

The Department did not "detail" the projected costs for implementation of continuing compliance. Instead, without using any numbers to quantify any aspect of the estimate, it merely asserts that because its compliance approach is "principle-based," it "does not anticipate the costs to be significant."[7]

---

[5] Regulatory Impact Statement for the Proposed First Amendment to 11 NYCRR 224 (Insurance Regulation 187); May 16, 2018; Section 3, page 3.

[6] Revised Proposal RIS, Sec. 4, page 9.

[7] Current RIS, Sec. 4, page 4.

SAPA Sec. 202-a(3)(c)(iv) states that, "where an agency finds that it cannot fully provide a statement of such costs, a statement setting forth its best estimate, which shall indicate the information and methodology upon which such best estimate is based and the reason or reasons why a complete cost statement cannot be provided [emphasis added]." Clearly, the statutory requirement is for a thorough analysis.

Here, the Department did not "fully" provide a "complete" cost estimate, but it also did not comply with these requirements for an alternative best estimate explaining why and how a complete cost estimate could not be provided. The Regulatory Impact Statement simply is non-complaint.

B. Failure to Provide Estimate of Effects on Small Business

Sec. 202-b requires the Department to conduct a regulatory flexibility analysis related to the impact of the Proposal on small businesses. Again, however, the Department uses no quantitative analysis.

The New York Department of State provides a format document to be used by agencies in submitting the Regulatory Flexibility analysis. That document states that the small business analysis should, "Estimate the initial capital costs that will be incurred by a regulated business or industry or local government to comply with the rule; estimate the annual cost for continuing compliance with the rule; and indicate whether or not the initial or continuing compliance costs will vary for small businesses or local governments depending on the type and/or size of such business or local government."[8] None of these estimates were actually provided—instead, the Department simply made statements and ultimately asserted that "any costs incurred by producers that are small businesses subject to this amendment should be minimal."[9]

C. Failure to Provide Required Information Related to Studies

While the Department alluded to studies it considered, it did not comply with the requirements of SAPA Sec. 202-a(3)(b) regarding such studies. It requires:

---

[8] "Regulatory Flexibility Analysis for Small Business and Local Governments (SAPA§202-b)" NYS Department of State (Rev. 1/17) accessed on June 13, 2018 at https://www.dos.ny.gov/info/pdfs/FMT-RFA.pdf.

[9] Revised Regulatory Flexibility Analysis for Small Businesses and Local Governments for the First Amendment to 11 NYCRR 224 (Insurance Regulation 187), May 16, 2018, Sec. 4, page 3.

> "…a citation for and summary, not to exceed five hundred words, of each scientific or statistical study, report or analysis that served as the basis for the rule, an explanation of how it was used to determine the necessity for and benefits derived from the rule, and the name of the person that produced each study, report or analysis."

There is not a single citation meeting this requirement.

For example, the Department writes, "According to the DOL's Regulatory Impact Analysis, conflicted advice is causing harm to consumers; disclosure alone would not remedy the harm. This is consistent with the Department's own observations in New York."[10] None of the SAPA required information regarding the DOL document is provided. As the Department should be aware, the DOL RIA was criticized extensively, and numerous studies and reports contradicting its findings were provided to the U.S. Department of Labor. None of this context, or any of the contrary findings, were referenced or discussed by the Department.

Similarly, to support its assertion that insurance markets have changed dramatically in the past five years, the Department cites as its source "insurance industry surveys" without identifying any of them.[11]

In response to criticism received in the first round of comments that the Department had not provided information supporting its assertions and justifying the policy decisions behind the Proposal, the Department provided some additional information in materials associated with the revised Proposal. However, none of the new information actually provides the information necessary to understand its relation to the Proposal, and would not meet the requirements above.

For example, citing its own experience in investigations, the Department noted that it had:

- Undertaken an investigation of "'buffer' or 'structured' annuities"—but the investigation began in November of 2017 and as yet has no findings;
- Completed a 2015 investigation into annuity replacement recommendations—but provided no information about what the investigation discovered and how it would affect the Proposal; and

[10] Current RIS, Sec. 3, page 3.

[11] Id.

- Completed Regulation 60 investigations in which the Department found "many" instances where "sales and replacements that were clearly not in the best interest of consumers were justified on the basis of the existing suitability standard for annuities." While this at least provides some explanation, it does not provide any information about the scope of the investigation and its findings needed to assess whether the results have any relevance to the Proposal. On what basis were the recommendations defective even though suitable? Without the underlying information, the public has no way to evaluate how these findings affected the Department's policy decisions.

The Department also noted some direct steps it had taken prior to the Proposal (such as helping the NAIC produce Actuarial Guideline 49, and issuing Circular Letter #7 regarding disclosure requirements), but did not explain why taking these steps was insufficient to address regulatory concerns or how these actions related to the Proposal.[12]

Taken together, these additional references and citations provide no useful information needed to evaluate the Proposal, and to the extent they are studies related to SAPA Sec. 202-a(3)(b), they fail to meet the requirements under the law.

D. Failure to Consider True Alternatives

The Department did not document its consideration of any alternatives other than not adopting the Proposal, which it rejected because "…doing nothing would be disadvantageous to consumers."[13]

While this technically may be an alternative, given the existence of the binary choice of "regulate" or "don't regulate," in our view is it not consistent with the intention of the statute. The statutory intention would be to consider alternatives to the form of the Proposal that may further its goals with less burdensome requirements. For example, a valid alternative would be to limit the scope of the Proposal to annuities (which has historically been the subject of this regulation) rather than applying it to life insurance in a brand new and quite disruptive way.

---

[12] Id at 3-4.

[13] Current RIS, Sec. 8, page 6.

3. <u>The Revised Proposal Creates Ambiguities Regarding Permissible Compensation Arrangements</u>

We are concerned about three changes in the revised Proposal that call into question whether the Department intends to modify previously-approved insurance-related compensation arrangements. We urge the Department to address these to avoid confusion that will serve neither consumers' nor insurance producers' interests.

First, Secs. 224.4(b)(1) and 224.5(b)(1) of the Revised Proposal go well beyond the already problematic DOL Best Interest standard that required a recommendation to be made "without regard" to the financial interests of the advisor. The Proposal states that "the financial or other interest of the producer…shall not be considered in any respect…" The "in any respect" language is even broader than the "without regard" language, as it may arguably prevent consideration of compliance requirements, such as fee-based vs. commission-based compensation that producers may be required to consider under Federal securities law. It also is likely to be perceived as a fiduciary standard by state courts. The sentence should be removed.

Second, Sec. 224.6(b)(4) of the revised Proposal requires an insurer to "establish, maintain and audit…standards and procedures for…the prevention of incentives that are intended or that would reasonably be expected to cause producers to make recommendations that are not in the best interest of the consumer." We are concerned that these limitations on "incentives" could be read to include common compensation methods approved and regulated by the Department that permit some variations in producer compensation from one product or insurer to another.

Finally, there is a rule of construction in Sec. 224.4(k) that preserves otherwise lawful compensation arrangements, explaining that the Proposal does not change their permissibility. This is a very important provision. However, unlike in the prior Proposal, it resides only in one section (regarding sales transactions), rather than clearly applying to the entire regulation. This provision should be relocated to apply to the Proposal in its entirety, including sections 224.5 and 224.6.

If it is the Department's intention to change insurance compensation rules, any such proposal should be clearly identified and submitted separately for public comment. The ambiguities in this revised Proposal do not provide clear notice allowing the public to understand and meaningfully comment on any such changes the Department might have intended here.

4. <u>Life Insurance Recommendations Should Not Be Governed by a Standard Developed for Retirement Investment Advice</u>

We continue to request that the Department not apply the Proposal to life insurance transactions. Even with the minor revisions in the revised Proposal relating to term life policies with no cash value, a detailed and intrusive set of suitability factors developed originally to govern investment advice to retirement investors is not serving the interests of consumers purchasing life insurance, especially term life insurance.

To ensure compliance with the Proposal, even for term life insurance with no cash value, producers or carriers would have to conduct a full-blown financial needs analysis including all 13 factors in Sec. 224.3(g)(1) to document their "best interest" recommendation, even though many of these factors have little to do with the term policy. This will significantly increase the cost and complexity of purchasing life insurance for consumers, while offering no additional benefit.

5. <u>Proposal Creates Risk due to Ambiguities about Financial Planning</u>

While the Proposal requires producers to consider specific suitability factors that include comprehensive financial information, sections 224.4(i) and 224.5(c) expose producers to unnecessary risk for doing so. Under these provisions, producers "shall not state or imply" that the recommendation for a sales or in-force transaction "…is financial planning, comprehensive financial advice, investment management or related services unless the producer has a specific certification or professional designation in that area."

However, the suitability factors that must be taken into account inherently require producers to consider issues that are directly related to financial planning or advice. These include the consumer's financial situation and needs, financial experience, financial objectives, and risk tolerance. We urge the Department to remove these provisions entirely, as they add very little additional protection for consumers, but create significant risk of frivolous litigation or arbitration for insurance license-only producers who follow the required analysis.

6. Implementation Will Take at Least 12 Months

It will take at least 12 months to implement a change of this magnitude, not the nine months or less assumed by the revised Proposal. Carriers and producers must develop and undergo training on the new requirements, internal policies and procedures must be developed to ensure documentation of compliance efforts, and client-facing materials will have to be amended.

Our experience related to the DOL Rule shows that these efforts cannot be done in any less than 12 months. The confusion, dislocation and cost of rushing implementation will be borne by the consumers.

Conclusion

We do not believe the Department has met its burden of demonstrating why the Proposal is necessary, or the minimum requirements of SAPA in promulgating the Proposal. These are not minor defects; they are fundamental parts of the regulatory process. We urge the Department to take the time to coordinate with the SEC and the NAIC before moving forward with the revised Proposal, as creating unnecessary conflicts among state and federal regulators is not in the best interest of New York consumers.

We appreciate the opportunity to comment, and ask for you sincere consideration of our concerns. We would be happy to discuss any questions or concerns you may have.

Sincerely,

Tom Quaadman