Assessment of Public Comments to the First Amendment to 11 NYCRR 244 (Insurance Regulation 187).

The New York State Department of Financial Services (the "Department" or "DFS") released the First Amendment to Part 224 of Title 11 in December 2017 and received comments to the proposed amendment. On May 16, 2018, the Department released a revised proposal for public comment as well as an assessment of the public comments received in response to the initial proposal.

The Department received 36 sets of comments on the revised proposal. The Department received comments on the revised proposal from individuals and entities including insurers, producers, industry trade associations, consumer groups, and others. The commenters on the revised proposal were largely the same commenters who provided comments on the initial proposal. As with the initial proposal, the Department also met with interested parties during the comment period to discuss the proposal and to obtain clarification of the comments that were submitted. Some of the meetings with industry representatives consisted of detailed meetings in which the Department and industry representatives carefully reviewed, discussed and clarified the language of the revised proposal.

Many commenters again commended the Department for its efforts and most commenters again expressed support for a best interest standard for life insurance and annuity transactions. Many commenters also expressed support for the revisions that the Department made to the revised proposal. Some of the commenters who expressed support for the revisions nevertheless requested that the Department make some additional language-specific tweaks to certain sections of the revised language for greater clarification. The Department was open to this discussion and worked with commenters on drafting clarifying language. The differences between the revised proposal and the final proposal are related to this type of wordsmithing and clarification rather than making substantive changes to the requirements or intent of the rule. Some other commenters essentially just repeated comments that they provided on the initial proposed amendment with no new information or justification supporting the comments.

This summary is intended to provide an overview of the categories of comments received by the Department, the revisions the Department has made in response to those comments and, where applicable, the reasons for not making additional revisions. Generally, comments received during the comment period addressed issues such as the scope, the meaning, and/or the particular wording of nearly every section of the proposed rule. While the Department made some of the recommended clarifications, the Department did not make other recommended revisions because the Department determined, based on its experience and knowledge, that the revisions were unnecessary within the context of the proposal, were inconsistent with the standards or the purpose of the proposal, or were better addressed with an explanation in this assessment.

Harmonization and Other Regulatory Bodies

Some commenters repeated comments from the initial comment period that the proposal should harmonize with standards, both existing and future, of other regulatory bodies. However, these same commenters also recommended changes to the proposal that would result in less harmony with current standards proposed by other entities. These same commenters also recommended numerous exemptions to the revised proposal that would result in a lack of harmony even among life insurance and annuity transactions. The Department has monitored activity at the U.S. Department of Labor ("DOL"), the Certified Financial Planner Board of Standards ("CFP Board"), and the Securities and Exchange Commission ("SEC") all of whom have identified a need to bring a best interest standard of care to the financial services transactions. The Department supports the goal of consistency across regulatory standards, where appropriate. The Department made efforts in this rule to be consistent with the DOL Conflict of Interest rule ("DOL Rule") where the Department felt it was practicable and appropriate to do so even though the future of the DOL's efforts in this area are currently uncertain. Since the Department released its initial proposal, the CFP Board has released a proposed best interest standard of its own. The Certified Financial Planner (CFP®) designation is known to be one of the most rigorous and well-regarded designations in the financial services industry, making it an appropriate standard to consider when determining appropriate standards of conduct for licensed producers. Those standards have many similarities to the Department's rule, including requiring producers to act in the best interest of the consumer, requiring enhanced disclosures related to recommendations, and the elimination of any consideration of the financial or other interests of the producer in making a recommendation. Following the Department's proposal, the SEC has also released for public comment a proposal that seeks to introduce a best interest standard of care into certain transactions. The Department has also shared its proposal with the National Association of Insurance Commissioners (NAIC) and recommended that the NAIC consider the Department's proposal when drafting amendments to its model regulation. The Department has reviewed the proposals of each of these entities and has attempted to find consistency where the Department felt it was appropriate to do so.

Some commenters recommended that the Department wait for other regulatory bodies to promulgate rules or standards before taking any action to promulgate its own regulation. The Department does not view this as a viable alternative. The future of the DOL rule is uncertain. The Department has been working to have the NAIC propose a viable model regulation but when or if that will occur is uncertain. The SEC's proposal is still in the early stages so what the ultimate rule will be is unclear. New York has always been a strong leader in financial services regulation and will continue to lead on this issue. The Department is the sole regulator for the overwhelming majority of insurance activities occurring in New York State. Federal agencies such as the DOL and SEC or self-regulatory agencies such as the Financial Industry Regulatory Authority ("FINRA") have only concurrent jurisdiction with the Department over only those products that are both insurance products and securities; the regulation of all other life insurance and annuity products and sales is within the sole purview of the Department. The Department maintains unique expertise related to comprehensive insurance markets and products that make it appropriate for the Department to lead on issues of insurance regulation. There is uncertainty around whether other regulatory bodies may take action or how long it may take them to act. New York consumers should not be denied the protections of this rule because other regulators in other jurisdictions have not adopted similar protections within their areas of authority.

Some commenters again recommended that the proposal include language to the effect that if insurers or producers comply with standards of other regulatory bodies, such as the NAIC or the FINRA, then they will be deemed to be in compliance with this proposal. The Department did not make that recommended change. As previously noted, there is uncertainty around whether other regulatory bodies may act, or what that action may be. Currently, other regulatory bodies do not have best interest standards comparable to the Department's proposal. Further, such a provision would essentially delegate the Superintendent's rulemaking authority to another regulator, which the Superintendent is unwilling and unable to do.

Scope of the Regulation

Comments related to the scope and applicability of the revised proposal were largely repetitive of the comments received on the initial proposal. Some insurers again sought to have the product types they sell and the markets in which they sell them removed from the scope of the regulation. Other insurers and consumer groups continued to support applying the proposal equitably across life insurance and annuity product lines. As the Department expressed in the assessment of public comment on the initial proposal, it is an important goal of this proposal that there be a level playing field in the insurance marketplace regardless of the type of insurance product insurers offer to consumers. A shortcoming of federal regulations, either by the DOL or the SEC, is that those entities' limited jurisdiction would create a two-tiered standard of conduct for different types of annuities and life insurance products which would be harmful and confusing for consumers and producers alike.

Some commenters recommended that the regulation not apply to products or transactions that are not "complex". This would be an unworkable standard. Whether a particular product or transaction is "complex" may depend on the facts and circumstances of the particular case. A transaction or product that would not be considered complex to a producer or insurer may be considered extremely complex to a consumer. Even among producers, reasonable individuals could differ in opinion as to what constitutes a "complex" product or transaction. The Department believes that basing the applicability of the regulation on the complexity of the product or transaction would result in significant uncertainly and confusion among consumers and producers. Further, even a transaction with low complexity can have a significant impact on the consumer and therefore requires a best interest standard. The commenters provided no valid justification for why, even in a less complex transaction, a producer should be permitted to make recommendations that are in the producer's financial interest rather than in the best interest of the consumer.

Purpose

Some commenters continued to express concern that the revised proposal does not specifically state that it is not intended to create a private right of action. The DOL rule, with its requirement of a best interest contract to be executed by the insurer, producer and consumer was considered to create a private right of action based on that contract. This regulation does not require the execution of any such contract. This regulation clarifies the standard of conduct to which its licensees must adhere under the Insurance Law. Similarly, some commenters continued to express concern that the revised proposal does not specifically state that it is not intended to require the producer or insurer to guarantee to warrant a particular outcome. It is not typical for a regulation to set forth or list all the things that the regulation does not do. Since that could be an infinite list, it can raise uncertainty about items not included in the list. To clarify these matters, the Department added language to the purpose section stating, "The best interest standard set forth in this Part 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." The addition of this language to this proposal should not be considered in interpreting any other regulation that does not contain similar language. This language should also not be considered an exhaustive list of the things that the regulation does not do. This language is merely intended to provided clarification on these limited issues.

Section 224.2 – Exemptions (Generally)

Some comments from the insurance industry again recommended that various product lines be exempted from the proposal. These were essentially repeat comments provided on the initial proposal. The Department did not find the justification provided by those commenters any more convincing than the justification provided in the comments on the initial proposal. Recommendations for exemptions again included: all life insurance; all term life insurance; all life insurance with a face amount of $35,000 or less; all life insurance and annuities sold to anyone other than a natural person; all group life insurance and annuities; all variable life insurance and annuities issued in the private placement setting; and others. As discussed in the assessment of public comment on the initial proposal, the Department agrees with those commenters that support a consistent standard of care across life insurance and annuity product lines. A consistent standard promotes a level playing field among insurers, is more easily understood by consumers and is more auditable for the Department. Consistency across life insurance and annuity product lines also promotes cost savings for producers and insurers who would not have to develop multiple compliance systems and multiple supervision systems. A consistent standard across life insurance and annuity product lines gives certainty to consumers which also has the potential to bolster consumer confidence in the industry and strengthen the marketplace. If the Department were to adopt the various exemptions recommended by some of the insurance industry commenters, it would result in a patchwork of standards and uncertainty among producers and consumers about the standards of care that producers will provide to consumers in any given transaction. However, the Department has carefully considered the comments and added clarifying language to certain existing exemptions consistent with the purpose of this proposal.

One commenter requested clarification that the phrase "where all benefits under the policy are payable to the corporate or bank policy owner" in section 224.2(b)(6) would not prevent a policy in which there was a small incidental benefit provided to the employee from qualifying for the exemption. In response, the phrase "all benefits" was changed to "substantially all benefits".

Some commenters made recommendations related to the revised exemption in section 224.2 for direct response situations. Much like the initial comments on the direct response exemption in the initial proposal, the comments on the revised proposal ranged from expanding the scope of the exemption to limiting the scope of the exemption or completely removing the exemption. The Department believes that the descriptive language in the revised proposal clarifying that the exemption applies where the application is solicited and received in response to a generalized offer by the insurer by mail or under other methods without producer involvement and where there is no recommendation made should remain as is, with the exceptions discussed below. One commenter requested clarification that the exemption in section 224.2(a) would apply to worksite general solicitation that otherwise meets the other requirements of that exemption. While the Department believes that this is already covered by the phrase "or under other methods", for clarity the Department included a specific reference to worksite. Other commenters sought clarification that if the insurer's call center employees that provide customer service, administrative support, or enrollment assistance to the consumer responding to the general solicitation were licensed as producers, it would not disqualify the transaction from falling within this exemption. The Department added clarifying language to that effect that such administrative activities would not disqualify the transaction from falling within the exemption so long as it otherwise meets the other requirements of that exemption.

Some commenters again recommended an exemption from the regulation for corporate owned or bank owned life insurance products written pursuant to section 3205(a)(1)(B), commonly referred to as Key Person insurance. An exemption was not added for corporate or bank owned life insurance issued pursuant to section 3205(a)(1)(B) of the Insurance Law because, as stated in the assessment of public comment on the initial proposal, the Department continues to believe that small business owners and small partnerships purchasing insurance pursuant to section 3205(a)(1)(B) should benefit from the protections of this proposal. One commenter attempted to compare the exemption in this regulation to recently promulgated Insurance Regulation 210, which does include an exemption for corporate owned life insurance issued pursuant to section 3205(a)(1)(B). However, this is not an appropriate comparison. Insurance Regulation 210 serves a different purpose than this regulation and the exceptions are therefore appropriately different. Regulation 210 governs an insurer's ability to set and change non-guaranteed elements in an insurance product.

The Department also corrected a drafting error in the name of the Employee Retirement Income Security Act in section 224.2(b)(1). The language is correct in the current regulation and it was not the Department's intention to make any change to that language with this amendment.

A few commenters again recommended an exemption be added to the exemption section of the revised proposal for the sale of a group policy to a group policy holder. However, such exemption is not needed because the sale of a group policy to a group policy holder is not subject to the regulation since the definition of policy does not include group policies.

<u>Exemptions (Term Life Insurance)</u>

Multiple commenters recommended that, if the Department did not exclude life insurance sales altogether from the regulation, sales of term life insurance should be excluded. The main asserted rationale for the recommended exclusion was the notion that term life insurance sales do not include an "investment component" and therefore there is little to no risk of producers making recommendations that are not in the best interest of the consumer and that the cost of complying with a best interest standard will suppress sales of term life insurance. The Department rejects this contention. While term life insurance does not include an "investment component," these policies do allow significant variability in their construction, often offer a variety of other features, and, importantly, contain the same compensation incentives as other life insurance and annuity products subject to this regulation. For instance, many insurers in New York offer a wide variety of term life insurance products, ranging from yearly renewable term to level premium varieties ranging from 5 to 35 years; other companies offer term life products with level term periods that last to a single specified year selected by the applicant (e.g., 17 years);

and further still insurers offer variations such as those with increasing or decreasing coverage amounts. Additionally, many term products approved for sale in New York include optional riders for additional cost or other features, such as a waiver of premium, children or spousal coverage, an accelerated death benefit rider, return of premium options and various conversion options. In response to previous comments, the Department reduced the suitability criteria necessary for considerations to eliminate those that would almost never be relevant to a term life insurance sale. This allows for greater simplicity of forms and processes that producers and insurers could utilize to facilitate term life sales. Additionally, the Department added the recommended "some or all" language to further clarify that the suitability criteria are to be analyzed with respect to their relevance and materiality to a particular consumer's situation and needs.

The lack of an "investment component" in these products does not eliminate the need for a best interest standard of care for producers or insurers offering term life insurance. Producers often can choose from many different carriers, creating thousands of iterations of a term life policy. In the Department's view, the argument that a best interest standard and term life suitability criteria are not necessary as a guide to narrow down these many iterations to a final, best interest recommendation is patently self-serving and contrary to the interest of the consumer. The Department believes that producers should be required to recommend the type and design of the product that is in the best interest of the consumer. For instance, a consumer whose budget might only allow for around $400 dollars per year for a term life insurance premium could, as an example, purchase a 30-year level term policy for a $100,000 face amount with a waiver of premium benefit; as an alternative, that same consumer could instead purchase a 10-year level term policy without a waiver of premium benefit and have a face amount of $400,000 (these numbers are generalized based on quotes from multiple insurers assuming a male, age 45, preferred risk class). The Department expects producers, as part of a best interest analysis, to generally weigh the various trade-offs between price, coverage amount, duration of coverage, robustness of features and the financial strength of the issuing company in making a recommendation to a consumer, something which is not required today and a concept that is also written into the regulation in Section 224.4(c) in response to commenters who suggested it. Without the best interest requirement and specific suitability criteria for term life sales, which include the “financial time horizon and the duration of any liabilities and obligations” and “financial situation and needs, including financial resources used for funding the policy,” producers would not be required to consider trade-offs when recommending a term life product to a consumer, which the Department believes would be contrary to the purpose of the regulation. Moreover, many of the existing suitability criteria, including “age,” “annual income,” “intended use of the policy, including riders attached thereto,” and “existing assets, including investment and insurance holdings” are already captured on existing term life insurance applications and therefore would not create any additional administrative burden or cost.

To not include term life insurance in an existing best interest standard would lessen its standards relative to the products it is generally sold alongside. Many sales of permanent life insurance are made in conjunction with term life insurance and one commenter who submitted two comment letters related to term life insurance has a business model in which term life insurance is sold alongside mutual funds under a “buy term and invest the difference” model. Under the proposed SEC regulation, those mutual funds would be held to a best interest standard as defined in that regulation; the Department sees no reason why a similar standard of care should not be given to consumers with respect to the life insurance policy. In fact, almost 19% of the Department’s year-to-date 2018 life insurance complaints arose from term life insurance, an increase from 14% the year prior and an increase from 13% in 2016.

Section 224.3 – Definitions

Several commenters requested narrowing the definition of “Consumer” to be retail consumers or natural persons. The Department has not revised the definition because the Department believes the breadth of the definition is appropriate and should not be further narrowed. The Department did however address this concern specifically as it relates to a practice referred to as "wholesaling" or product support based on generic client information, to provide that such practice does not constitute participating in the making of a recommendation.

One commenter requested clarifying the definitions of "Recommendation," "Transaction," "Sales Transaction," and "In-force Transaction," by including examples. The Department has not revised the definitions further to include examples because the Department believes the definition provides sufficient clarity.

Several commenters requested narrowing the definition of "Recommendation" or "Transaction" further to exclude in-force transactions completely from application of the best interest standard regardless of whether new compensation is generated. The Department did not narrow the definition to exclude in-force transactions completely because it has already been narrowed in scope based on prior comments to those transactions that generate new sales compensation and is not subject to any requirements other than application of a best-interest standard and a reasonable belief the consumer has been reasonably informed of the relevant features of the policy and consequences of the transaction, both favorable and unfavorable.

Several commenters requested additional tailoring and/or narrowing of the definition of "Recommendation." The Department has not revised the definition further because the Department believes the breadth of the definition is appropriate and should not be further narrowed or limited.

Several commenters requested further tailoring of the definition of "Suitability Information" beyond term insurance and all other products. Some commenters requested excluding term insurance entirely, shortening the list of suitability factors, or adding "some or all" to the introductory language before the suitability items. In response, the Department added the language "some or all" to the introductory language for clarification.

Section 224.4 – Duties of Insurers and Producers with Respect to Sales Transactions

Many commenters requested that the language "shall not be considered in any respect in making the recommendation" in Section 224.4(b)(1) be deleted or replaced. In response, the Department replaced the language to further address concerns and to acknowledge that producer compensation and incentives are permitted as a general matter provided they do not influence the specific recommendation. However, as stated in the assessment of public comment on the initial proposal, the Department did not replace the language with a standard that simply places the interests of the consumer above or ahead of those of the producer or where a recommendation is simply "not based on" the financial interests of the producer. Under such standards, producers could consider their own financial interests when making a recommendation and therefore the Department does not believe that such transactions would be in the best interest of the consumer. The requested revisions are inconsistent with the Department's goal of implementing a true best interest standard.

A few commenters requested a revision to clarify that a recommendation in the best interest of the consumer does not require that the recommendation be the least expensive product available. This is a repeat of a comment received on the initial proposal. As previously stated in the assessment of public comment on the initial proposal, the Department agrees that best interest does not necessarily mean the least expensive product available. The Department has considered the comments, and in response has added a new section to clarify that a producer may weigh multiple factors that differentiate products or insurers that are relevant to the best interests of the consumer. The weighing of these factors in recommending a product makes clear that best interest does not necessarily mean the least expensive product available. Best interest is an evaluation process resulting in a recommendation in the consumer's best interest rather than the one singular product that is in the consumer's best interest.

A few commenters requested that the prudent person standard in section 224.4(b)(1) be either deleted or clarified. The Department considered the comments but believes that a prudent person standard is appropriate. However, the Department did make a revision to clarify that the standard is based on the circumstances "then prevailing". In response to comments received on the initial proposal, a revision was previously made to the revised proposal to clarify that the evaluation of the relevant suitability information reflects that of a prudent person "acting in a like capacity".

One commenter suggested a clarification of the terms “favorable” and “unfavorable” in section 224.4(b)(3)(i). While no revision was made and the Department believes that the terms are sufficiently clear, the terms refer to the potential consequences that are advantageous and disadvantageous to the consumer.

A few commenters requested a revision to section 224.4(b)(3)(i) to clarify that the producer’s duty to reasonably inform the consumer of any differences in fee-based and commission-based versions of the policy is only applicable if the producer is authorized to offer both versions of the policy. The Department did not make any changes in response, as it believes that the provision is sufficiently clear. The Department agrees that the duty to inform the consumer of any differences in fee-based and commission-based versions of the policy does not apply to a producer who is only authorized to sell either the fee-based or commission-based version.

A few commenters requested a revision to section 224.4(d)(2) to replace “suitable” with “reasonable”. The Department did not make any changes in response, as it believes that suitable is the appropriate standard. The insurer’s suitability obligation is based only on information actually known to the insurer at the time of the transaction.

Some commenters requested that the duty to disclose all relevant suitability considerations and product information be revised to add the word “reasonable” and to allow the disclosure to be provided in a summary format. The Department considered the comments and revised the section such that the disclosure may be provided in a reasonable summary format but did not change the requirement to disclose all relevant suitability information considerations. Commenters also requested that the requirement to obtain a consumer signed statement be deleted. In response, the Department deleted the requirement, as the signature was intended to protect the producer and the insurer. A few commenters requested that the disclosure requirement be deleted altogether or to delete “all relevant”. This is a repeat comment provided on the initial proposal and as previously stated, the Department believes the requirement is appropriate and that all suitability considerations relevant to the recommendation should be disclosed to the consumer.

One commenter requested that the requirement that a producer have a reasonable basis to believe the consumer has the financial ability to meet the financial commitment under the policy be deleted. This is a repeat comment provided on the initial proposal. As previously stated in the assessment of public comment on the initial proposal, the Department believes it is important for consumers to be recommended policies with financial obligations they are able to meet. The Department believes that a "reasonable basis to believe" standard adequately addresses any legitimate concern and is appropriate. In addition, the Department believes it is sufficiently clear that the requirement applies only to the extent of the financial commitment under the policy. In addition, this requirement is already required by FINRA Rule 2111.06 and is consistent with other regulatory regimes.

Some commenters requested revisions or clarification with respect to the requirement that a producer have a specific certification or professional designation if stating or implying that a recommendation is financial planning, financial advice or other related services. Some of these are repeat comments from the initial proposal. The Department considered the comments and in response made further changes to acknowledge that the sale of insurance may be a component of a financial plan. However, as previously stated in the assessment of public comment on the initial proposal, the revisions reflect the Department's concern over a producer who states or implies that a recommendation is comprehensive financial planning or advice when the producer is not specifically certified or licensed in either of those areas. While some commenters requested clarification regarding the list of acceptable designations, the Department decided not to set forth a specific list of acceptable certifications or designations so to avoid a list that may be unintentionally exclusive. In addition, the Department's revisions make clear that the use of such titles and designations is not appropriate if the producer does not actually sell securities or other non-insurance financial services. It is the Department's view that producers, even if certified or licensed as a financial planner, financial advisor or other similar title, should not hold themselves out as such if all they actually sell are insurance products.

Some commenters requested revisions or clarification with respect to producers involved in a transaction who do not have direct contact with the consumer. The Department considered the comments and made certain revisions in response. Except with respect to product wholesaling or product support based on general client information, or the provision of education or general marketing material, the regulation is intended to apply to all producers who materially participate in making the recommendation and receive compensation as a result of the transaction. As previously stated, it is not necessary that the producer have any direct contact with the consumer.

Some commenters requested revisions to move the compensation section 224.4(k) to the beginning of the Regulation and to clarify that compensation paid to a producer can be in the form of cash or non-cash compensation. In response, the Department made a revision to explicitly provide for such cash and non-cash compensation. However, the Department believes that the compensation language is appropriately placed in section 224.4.

Several commenters requested revisions with respect to producers who sell proprietary products. The Department considered the comments but believes the current language in the revised proposal is appropriate. The current language affords a producer selling proprietary products based on a captive or affiliation agreement with a particular insurer the ability to limit the policies it recommends if the nature and limitations of the agreement are properly disclosed to the consumer. A proprietary producer who provides the proper disclosure to each and every consumer does not have to make products available that are outside the producer's captive or affiliation agreement with the insurer. The disclosure is required to set forth the circumstances under which a producer will and will not limit recommendations. The disclosure requirement does not apply to proprietary producers who offer the products of only one insurer because such producers are not limiting the availability of the products that they are able to offer.

<u>Section 224.5 – Duties of insurers and producers with respect to in-force transactions</u>

A number of commenters recommended that the regulation not apply to in-force transactions. These commenters claimed that requiring a best interest standard for recommendations to enter into an in-force transaction would increase the cost of providing advice to consumers and reduce the willingness of producers to provide advice to consumers. The Department disagrees with these commenters. The Department believes that it is an important public policy objective that all recommendations to consumers be in the consumer's best interest and free from the conflicts of the producer. The Department recognizes that producers provide valuable advice to consumers after policies are sold and that agents may provide recommendations related to policies that they themselves did not sell. Moreover, the Department is aware of many insurers and producers who assign in-force policies sold by an agent that is no longer with the company to other agents, often new agents, to provide servicing. It is for these reasons that recommendations related to in-force transactions remain subject to the regulation. In light of the comments received, the Department in prior revisions greatly reduced the requirements for recommendations related to in-force transactions, including eliminating the requirement to conduct a full suitability analysis and eliminating the requirement to document and disclose the basis of the recommendation. Producers must act prudently and in such a manner that the recommendation is solely in the consumer's interest. Producers must also have a reasonable basis to believe that the consumer has been informed of all of the relevant considerations and potential consequences – both positive and negative – of a given in-force transaction. These prior changes should greatly reduce, if not eliminate, any costs from the regulation for producers or insurers providing in-force recommendations to consumers.

Based on comments received, the Department amended the definition of Sections 224.3(j) and 224.3(k) in order to clarify that renewal compensation paid on ongoing payments made to life insurance and annuity products (even if classified as "first-year commission" in the insurer's compensation program) does not constitute the type of compensation that would make the recommendation applicable to those related to new sales transactions. The Department agrees that these ongoing payments are fundamental to the ongoing and long-term nature of life insurance and annuity products and are often made pursuant to the original recommendation to purchase the product. Furthermore, given that the Department did not make the recommended changes to remove applicability to in-force transactions, producers are still required to act in the best interest of the consumer with respect to any recommendations related to these subsequent payments, which the Department believes provides sufficient protection for consumers.

A number of commenters recommended that the Department make clear that insurers are not required to supervise producers' recommendations related to in-force transactions. The Department clarified Section 224.6 Insurer Responsibility and Supervision to clarify that the insurer's supervisory responsibilities generally only apply to new sales transactions with respect to the insurer's own policies. This clarification is necessary given the fact that insurers generally have little to no knowledge of a producer's actions with respect to recommendations related to in-force transactions and, in many cases, the recommendation may be made by a new producer who did not sell the original policy. In one instance, the insurer's supervisory responsibility is applicable to in-force transactions. Section 224.6(b)(3) requires an insurer to take reasonable steps in the event it receives a complaint from a consumer about the actions of a producer with respect to a recommendation, whether related to either a new sales transaction or an in-force transaction.

Section 224.6 – Insurer Responsibility and Supervision

Some commenters requested clarification that receipt of compensation, both cash and non-cash, by the producer is acceptable, and further clarification that an insurer may maintain within and across product lines variations in compensation or other incentives. The Department added this clarification as this accords with the intent of the proposal.

Some commenters asserted that insurers should not be held to a suitability standard with respect to transactions where no recommendation is made. The Department did not make any changes in response, as the Department believes an insurer should not effectuate any transaction if it actually knows that such transaction is not suitable. The insurer's suitability obligation is based only on information actually known to the insurer at the time of the transaction.

Some commenters asked that the insurer be explicitly permitted to contract with third parties to establish and maintain a system of supervision. The Department made the revision as it was not the intent of the proposal to disallow this practice.

Some commenters requested clarification that insurers need only evaluate their own products for suitability. This clarification was made as this accords with the intent of the proposal.

Section 224.9 – Effective Date

Several commenters requested delays to the effective date. To address industry concerns, the Department further revised the effective date of the proposal to August 1, 2019. New Section 224.9 requires that insurers and producers comply with the requirements as to annuities on the effective date, and the requirements as to life insurance within six months from the effective date. The Department believes this time frame will ensure consumers are treated fairly and provide sufficient time for compliance.

SAPA Documents

Regulatory Impact Statement

Several commenters assert that the Regulatory Impact Statement (RIS) should include reports or studies that evidence the need for the proposal. SAPA Sec. 202-a(3)(b) requires "a statement setting forth the purpose of, necessity for, and benefits derived from the rule, 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…" and item 3 of the RIS format on the New York State Department of State website (https://www.dos.ny.gov/info/pdfs/FMT-RIS.pdf) requires a citation for each study used. However, SAPA Sec. 202-a(3)(b) does not impose an affirmative duty on an agency to conduct scientific or statistical studies. The Department references, as part of its discussion of its monitoring of the market and the activities at the federal DOL and SEC level, that the DOL and SEC have identified in their rule making materials that conflicted advice is causing harm to consumers. The Department also notes that according to a fact sheet published by the White House Council of Economic Advisers on April 6, 2016, conflicts of interest in retirement advice cost America's families an estimated $17 billion a year. However, those materials did not serve as the basis of this regulation. In the absence of action by the DOL or SEC and in the absence of the fact sheet by the White House Council of Economic Advisers, the Department would still have promulgated this amendment. A regulation is needed to prevent insurers and producers from recommending a transaction that is properly disclosed and determined to be suitable for a consumer, but that is otherwise not in the best interest of that consumer and is designed to maximize compensation to the sellers. This continues to be a problem. The Department has and continues to examine multiple insurers for annuity and life insurance replacements, which were clearly not in the best interest of consumers but were nonetheless justified on the basis of the existing suitability standard for annuities, or were not required to be justified at all due to a lack of an existing standard for life insurance. This is exactly why this regulation is necessary for consumer protection. In response to these comments, the Department has clarified the Needs and Benefits section to clarify why regulatory action is necessary.

Based on commenters stating that the RIS did not identify deficiencies in the current regulatory scheme demonstrating a need for the proposal, the Department also made certain revisions to the Needs and Benefits section of the RIS to further set forth the need for this proposal. When Insurance Regulation 187 was promulgated in 2013, the regulation was based on the NAIC Suitability in Annuity Transactions Model Regulation ("NAIC Model"). Since then, the Department has been monitoring the market and application of the regulation and identified certain areas where additional protections need to be established. This amendment addresses those additional protections. Consumers have always relied on the recommendations they receive when making important purchasing decisions regarding both life insurance and annuities. The purchase of annuities and life insurance have become ever more complex financial transactions, offering a wider range of available products for purchase and made to address the financial planning and life insurance and retirement needs of New York consumers. The role of insurer or producer recommendations has become increasingly important and has resulted in a greater need for consumers to rely on professional advice and assistance in understanding available life insurance and annuity products, making purchasing decisions, and ensuring a financial outcome in their best interest. Also, Department investigations, examinations, and observations since 2013, mentioned throughout this assessment, have demonstrated the need for a best interest standard of care for life insurance and annuity sales. The Department believes, in light of all of the facts and its expertise, that a regulation is needed to prevent insurers and producers from recommending a transaction that is properly disclosed and determined to be suitable for a consumer, but that is otherwise not in the best interest of that consumer and is designed to maximize compensation to the sellers.

One commenter asserted that the RIS relied on the DOL Rule when drafting the proposal, but that the DOL Rule was recently vacated by the 5th Circuit Court of Appeals so should no longer be a basis for promulgating this amendment. The commenter further stated that waiting for the NAIC and SEC would be better for consumers. The Department clarified in the Needs and Benefits section of the RIS that the Department has followed developments at the federal DOL and SEC level. First proposed in 2010, the U.S. Department of Labor ("DOL") issued 29 C.F.R. 2510 (the "Rule") which expanded the federal definition of investment advice and requires financial advisors to adhere to enhanced standards of conduct. The Rule made the sale of certain insurance products involving qualified money subject to a fiduciary standard. As an alternative, an exemption existed under the Best Interest Contract Exemption (26 C.F.R. 2550), where the producer would still be required to act in the best interest of the consumer. While cognizant of the recent 5th Circuit Court of Appeals decision vacating the Rule, the Department believes that the best interest standard is an important consumer protection and intends to pursue this protection for New York consumers as to the life insurance and annuity products within its own purview. Indeed, vacating the DOL Rule makes it even more important for New York to implement its rule.

According to the DOL's Regulatory Impact Analysis, conflicted advice causes harm to consumers; disclosure alone would not remedy the harm. This has been and continues to be consistent with the Department's own observations in New York. On April 18, 2018, the SEC released a draft proposal applicable to broker-dealers for certain sales. If ultimately promulgated and implemented, any resulting final rule would be applicable to only a subset of products that are under the Department's purview. Further, the SEC draft rule does not contain a definition of best interest and relies primarily on disclosure of conflicted advice. The Department believes that its regulation imposes a consistent standard of care across life insurance and annuity product lines and protects consumers from conflicted recommendations.

Further, one significant need being addressed by this amendment is the need for a definition of "suitable," not present in the NAIC Model or the existing version of the New York regulation. In implementing this regulation, the Department had found that there is uncertainty under the current regulation as to what it means to be suitable. Another need being addressed by this amendment is the need to establish and incorporate a "best interest" standard into the suitability standard of care for all investment products to ensure fair treatment of consumers purchasing all annuity and life insurance products. The NAIC Model and the current New York regulation do not currently directly address what is expected of a producer when deciding among several suitable products to recommend to the consumer. The best interest standard addresses this need. The best interest standard makes it clear that a producer, when recommending from among suitable products, must base the recommendation on what is in the best interest of the consumer not what is most financially beneficial to the producer. The Department believes that this goes to the heart of what it means to be competent and trustworthy. Also, a uniform standard of care across all types of investment transactions, including both annuity and life insurance transactions, provides consistent consumer protection and a consistent regulatory framework to ensure fair treatment regardless of product choice.

A few commenters asserted that the proposal is not necessary given the existing consumer protections. In response, the Needs and Benefits section was further revised to address the benefits derived from the rule. Specifically, this regulation is expected to increase transparency in insurance transactions, promote a healthier marketplace and consumer confidence in producers, insurers and the marketplace, reduce misunderstanding and miscommunication, ensure that advice is based on what is in consumers' best interests rather than what is most financially beneficial to the producer or insurer, and increase the purchase of products that better meet consumers' needs, objectives and expectations. This regulation provides critical consumer protections in all annuity and life insurance sales for products delivered or issued for delivery in the state of New York.

Two commenters stated that the Department has not identified any harm that provides a compelling reason to include term life insurance in the proposal. Specifically, one commenter asserted that the RIS fails to identify, analyze or weigh costs of imposing a best interest standard for term insurance and that such best interest standard is arbitrary and capricious when used with term insurance. The RIS has been amended to indicate why the Department rejected a different standard for term life insurance. While term life insurance does not include an "investment component," these policies do allow significant variability in their construction, often offer a variety of other features, and contain the same compensation incentives as other life insurance and annuity products. For instance, many insurers in New York offer a wide variety of term life insurance products, ranging from yearly renewable term to level premium varieties ranging from 5 to 35 years, other companies offer term life products with level term periods that last to a single specified year selected by the applicant (*e.g.*, 17 years) and further still insurers offer variations such as those with increasing or decreasing coverage amounts. Additionally, many term products approved for sale in New York include optional riders for additional cost or other features, such as a waiver of premium, children or spousal coverage, accelerated death benefit rider, return of premium options and various conversion options.

In addition, in response to previous comments, the Department reduced the suitability criteria necessary for considerations to eliminate those that would not likely be relevant to a term life insurance sale. This allows for greater simplicity of forms and processes that producers and insurers could utilize to facilitate term life sales. Additionally, the Department added the recommended “some or all” language in the proposal to further emphasize that the suitability criteria are to be analyzed with respect to their relevance and materiality to a particular consumer’s situation and needs.

The lack of an “investment component” in these products does not eliminate the need for a best interest standard of care for producers or insurers offering term life insurance. Producers often can choose from many different carriers, creating thousands of iterations of a term life policy. In the Department’s view, the argument that a best interest standard and term life suitability criteria are not necessary as a guide to narrow down these many iterations to a final, best interest recommendation is patently self-serving and counter to the interest of the consumer. The Department believes that producers should be required to recommend the type and design of the product that is in the best interest of the consumer. For instance, a consumer whose budget might only allow for around $400 dollars per year for a term life insurance premium could, as an example, purchase a 30-year level term policy for a $100,000 face amount with a waiver of premium benefit; as an alternative, that same individual could instead purchase a 10-year level term policy without a waiver of premium benefit and have a face amount of $400,000 (these numbers are generalized based on quotes from multiple insurers assuming a male, age 45, preferred risk class). The Department expects producers, as part of a best interest analysis, to generally weigh the various trade-offs between price, coverage amount, duration of coverage, robustness of features and even the financial strength of the issuing company in making a recommendation to a consumer, a concept that is not required currently but that is also included under Section 224.4(c) in response to commenters who suggested it. Without the best interest requirement and specific suitability criteria for term life sales, which include the “financial time horizon and the duration of any liabilities and obligations” and “financial situation and needs, including financial resources used for funding the policy," producers would not be required to consider trade-offs when recommending a term life product to a consumer. Moreover, many of the existing suitability criteria, including "age," "annual income," "intended use of the policy, including riders attached thereto," and "existing assets, including investment and insurance holdings" are already captured on existing term life insurance applications and therefore would not create any additional administrative burden or cost.

To exclude term life insurance in an existing best interest standard would lessen its standards relative to the products it is generally sold alongside. Many sales of permanent life insurance are made in conjunction with term life insurance and one commenter who submitted two comment letters related to term life insurance has a business model in which term life insurance is sold alongside mutual funds under a "buy term and invest the difference" model. Under the proposed SEC regulation, those mutual funds would be held to a best interest standard as defined in that regulation; the Department sees no reason why a similar standard of care should not be given to consumers with respect to the life insurance policy. Just under 19% of the Department's year-to-date 2018 life insurance complaints arose from term life insurance, an increase from 14% the year prior and an increase from 13% in 2016.

Some commenters asserted that the Costs section of the RIS should include citations of studies or quantitative analysis that directly addresses estimated costs of the proposed regulation. Further, these commenters offered that the Department has underestimated the cost of people and systems needed to implement the proposal. Some industry commenters offered the Department extremely high estimates as part of their argument that the Department should take no regulatory action at all. However, these estimates were not supported by any specifics as to how these high estimates were calculated or which amounts in the estimates were attributable to which requirements in the amendment. The Department believes these to be gross overestimations provided as a strategy to dissuade the Department from taking actions rather than a good faith attempt to estimate actual costs. Other commenters, however, in discussions with the Department identified areas of the amendment that they believed represented greater potential compliance cost than other areas. While these commenters did not provide any specific estimates or breakdowns of costs attributable to specific sections of the amendment, they did provide explanations of why certain areas of the amendment posed implementation challenges and therefore could represent higher potential compliance costs.

The Department found many of these explanations persuasive and made significant changes from the initial proposal to the revised proposal. For example, considering the potential costs and lower potential for conflicted advice for many types of in-force transactions, the Department significantly scaled back the requirements related to in-force transactions in the revised proposal, including eliminating the requirement to conduct a full suitability analysis and eliminating the requirement to document and disclose the basis of the recommendation. The Department also revised the insurer responsibility and supervision section so that the insurer's supervisory responsibilities generally only apply to new sales transactions with respect to the insurer's own policies. These prior changes should greatly reduce, if not eliminate, any costs from the regulation for producers or insurers providing in-force recommendations to consumers. The Department also eliminated the requirement that the producer or insurer obtain a signed statement from the consumer when the consumer refuses to provide suitability information to the producer or consumer. Also, the regulation significantly reduced insurers' supervisory responsibility from what was included in the initial proposal, in response to comments from insurers about the potential compliance costs associated with in-force transactions.

The Department added clarification in the Costs section of the RIS in light of the changes made to the regulation outlined in the paragraph above in response to industry comments to reduce compliance costs. Even if industry commenters' high compliance cost estimates were true, the benefits of the proposal far outweigh the overestimated costs. Benefits include an increase in transparency in insurance transactions, a reduction of misunderstandings and miscommunications, advice that is based on consumers' best interests rather than what is most financially beneficial to the producer, and the purchase of products that more likely meets consumers' needs, objectives and expectations.

To address the comment that the Costs section of the RIS should include studies that directly address the cost of the proposal, the commenter has asked the Department to measure the immeasurable. A monetary, quantifiable dollar amount cannot always be associated with the benefits of financial regulation; for example, one cannot quantify the benefits of investor confidence, the avoidance of unexpected financial loss due to conflicted advice, the choosing of a certain product, the payment of a death benefit to a widow and her children, the survival of a small business upon sudden death of a key employee, etc. Likewise, a monetary, quantifiable dollar amount cannot always be associated with the costs of conflicted advice. The choosing of a product that is not in the best interests of the consumer could result in a survivor losing home, the inability to provide for a child's college education, the loss of retirement income, etc. The severity of these losses depends on the financial situation of the consumer. Such devastating consequences cannot always be measured into an amount of money that the wrong product (i.e., a product not in the consumer's best interest) will cost the consumer. However, the Department strongly believes that preventing consumer harm far outweighs any administrative costs imposed by this regulation.

A few commenters rejected the Department's statements in the Costs section of the RIS that the proposal's costs can be minimal. These commenters fail to recognize the flexibility of the proposal. The proposal takes a principle-based approach to compliance. Unlike the DOL or SEC, the proposal does not impose any particular systems, forms, or procedures for meeting the requirements of the regulation. Rather, producers and insurers are free to leverage existing systems and procedures. The proposal requires producers to (1) document and disclose why a certain recommendation is being made and (2) refrain from making a recommendation that is not in the best interest of the consumer. The cost of compliance here can be minimal. For example, to comply with (1), most producers already have systems and procedures in place to document information about their clients and to document their interaction or conversations with their clients. These existing systems and procedures can be leveraged to document the client's suitability information and the basis for the producer's recommendation to the consumer. The Department is not imposing any particular form or method that must be used to document the recommendation. For example, the producer can disclose the basis of the recommendation to the consumer by emailing the consumer on the producer's current email system, by printing out the producer's notes on the current file system, or by placing the notes in an established online consumer portal. To comply with (2), producers who already act in the best interest of the consumer will incur no cost. This requirement will only affect those producers who are not acting in the consumer's best interest and the cost could be lost compensation paid for a product that is not in the best interest of the consumer (which is exactly what this proposal is aiming to address). Moreover, lost compensation from sale of products that are not in the best interests of consumers is not a relevant "cost" for purposes of SAPA analysis.

This proposal requires insurers to (1) develop procedures to monitor its workforce and (2) educate and train producers to prevent conflicted advice. Again, unlike the approach taken by the DOL and SEC, the Department is not prescribing any specific procedures, systems or forms that must be used. One commenter, for example, states that they will be forced to reorganize their filing system into a consumer-based system (instead of a file-based system), but the Department does not require this at all. The cost of (1) and (2) should be minimal since many insurers already have procedures in place to monitor their sales force and provide education on regulatory requirements. Also, many insurers were already preparing to implement the DOL Rule and new SEC requirements, which contain a subset of life insurance products, by making changes to processes, procedures and technology. Although, very recent conflicting court decisions have left uncertainty about the implementation of the DOL Rule, much of the work has already been done. Some producers have indicated an intention to move forward with implementing a best interest standard regardless of what happens with the DOL Rule. Several commenters stated that producers already act in the best interests of their consumers. While there will likely be some up-front cost associated with this regulation, the Department believes that there will, over time, be a cost savings to insurers and producers that are able to apply the same standards across all life insurance and annuity product types and potentially avoid maintaining separate systems for separate product lines.

One commenter asserted that the Alternatives section of the RIS does not contain supporting analysis for the need to implement this proposal and failed to consider true alternatives. The commenter stated that doing nothing is not a viable alternative and that an acceptable viable alternative would be limiting the proposal to annuities. SAPA Sec. 202-a(3)(g) requires "a statement indicating whether any significant alternatives to the rule were considered…" and item 8 of the RIS format on the New York State Department of State website (https://www.dos.ny.gov/info/pdfs/FMT-RIS.pdf) states, "If there were no significant alternatives to be considered, state that fact." Therefore, SAPA contemplates that no significant alternatives may have been considered, and advises the Department to so state if true. The Department believes that doing nothing (i.e., waiting for other entities to take action) was an acceptable alternative and is, in fact, a preferred alternative as stated by several commenters. The Alternatives section of the RIS explains doing nothing, or waiting for other entities to act, was not a viable alternative because of the importance of bringing a best interest standard of care to New York State. New York has always been a strong leader in financial services regulation and will continue to lead on this issue. New York consumers should not be denied the protections of this proposal because other regulators in other jurisdictions have not adopted similar protections within their areas of authority. Moreover, the Department is the sole regulator for the overwhelming majority of insurance activities occurring in New York State. Federal agencies such as the DOL and SEC or self-regulatory agencies such as FINRA have only concurrent jurisdiction with the Department over only those products that are both insurance products and securities; the regulation of all other life insurance and annuity products and sales is within the sole purview of the Department. In response to the comment, changes were made to the Alternatives section of the RIS to address other alternatives that were considered and rejected by the Department, such as having different standards for life insurance or different standards depending on the complexity of the product or transaction. The Department rejected those alternatives because it believes that a uniform standard of care across all types of investment transactions, including both annuity and life insurance transactions, provides consistent consumer protection and a consistent regulatory framework to ensure fair treatment regardless of product choice. The Department maintains unique expertise related to comprehensive insurance markets and products that makes it appropriate for the Department to lead on issues of insurance regulation. A shortcoming of federal regulations, either by the DOL or the SEC, is that those entities' limited jurisdiction would create a two-tiered standard of conduct for different types of annuities and life insurance products which would be harmful and confusing for consumers and producers alike.

Several commenters expressed concern with the compliance schedule of the proposal to life insurance and annuity transactions. In response, the Department revised the Compliance Schedule within the RIS. The amendment will take effect on August 1, 2019 for any transaction with respect to an annuity contract and February 1, 2020 for any transaction with respect to a life insurance contract.

<u>Regulatory Flexibility Analysis for Small Businesses and Local Governments</u>

Two commenters asserted that the Regulatory Flexibility Analysis for Small Businesses and Local Governments does not adequately address the adverse economic impact on small businesses. In response, clarifications were added to the Costs sections of the Regulatory Flexibility Analysis for Small Businesses and Local Governments and the Rural Area Flexibility Analysis that are consistent with the changes made in the Regulatory Impact Statement.

Several commenters representing producers and insurers stated that producers have been committed to operating in their clients' best interests for years. As explained above, the proposal requires producers to (1) document and disclose why a certain recommendation is being made and (2) refrain from recommending insurance that is not in the best interest of the consumer. The cost of compliance here should be minimal because most producers already have procedures in place to document information about and conversations with their clients. For example, existing systems can be used to add a file note with suitability information, email the consumer the basis of the recommendation, etc. The Department is not imposing any particular form or method that must be used to document the recommendation. Likewise, the cost of acting in the best interest of the consumer will be nothing additional to those producers already acting in the best interest (which, according to several comments, is already occurring). Although producers who are not acting in the consumer's best interest may receive reduced commissions in the future when they no longer sell policies that are not in the best interest of their customers, this reduced income is not a "cost" of the rule and, in any event, is equal to or more than offset by the benefit to consumers who will no longer be indirectly paying the commissions through policies with excessive premiums. Given that most producers already have systems and procedures in place to document information about their clients and to document their interaction or conversations with their clients, any impact on small businesses is expected to be minimal.