February 26, 2018

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

Re: Comments on Proposed First Amendment to Insurance Regulation 187
Suitability in Life Insurance and Annuity Transactions

By electronic mail

Dear Deputy Superintendent Regalbuto:

The signatories below are writing in response to the New York State Department of Financial Services' request for comment on its proposal to create a best interest standard for life insurance and annuities recommendations. We appreciate your leadership in seeking to adopt a best interest standard for these recommendations that matches the strong protections provided by the U.S. Department of Labor's conflict of interest rule for retirement accounts. In particular, we strongly support your decision to apply the strengthened standard to all life insurance products, not just annuities, as well as your proposal of a best interest standard that generally matches the wording of both the DOL rule and Section 913 of the Dodd-Frank Act. Despite these and other significant improvements over the NAIC's proposal, however, we are concerned that, as currently drafted, your proposed rule may not fully achieve your stated goal of requiring that insurance producers consistently recommend those life insurance and annuities products that are best for the investor, rather than those that are most profitable to the seller. Accordingly, we are suggesting several changes to help ensure that the proposed standard achieves its intended purpose.

The Rule Should More Clearly Define Acting in the Customer's Best Interests

The term "best interest" has been appropriated by industry groups advocating a regulatory approach that doesn't actually include any obligation to recommend the best available option for the investor. In its recent comment letter to the Securities and Exchange Commission, for example, the American Council of Life Insurers suggested that, "A constructive best interest standard would require financial professionals to put a consumer's interest first by (i) acting with reasonable care, skill, prudence, and diligence in gathering and evaluating information regarding the consumer that is used to make the recommendation; (ii) making no misleading statements; (iii) providing full and fair disclosure of the recommended product's features, fees, and charges; (iv) fairly disclosing how and by whom the financial professional is compensated; and (v) avoiding, disclosing, or otherwise reasonably managing material conflicts of interest."[1]

[1] Letter from Carl B. Wilkerson, Vice President and Chief Counsel, Securities and Litigation, American Council of Life Insurers to Brent J. Fields, Secretary, Securities and Exchange Commission regarding SEC Chairman's Request

Similarly, Fidelity recently suggested in its SEC comment letter that the existing FINRA suitability rule is a "highly effective best interest standard of conduct that … is appropriately tailored to a broker-dealer business model."[2] And even the SEC itself, in enforcing the fiduciary standard under the Investment Advisers Act, has too often permitted advisers to engage in conduct that is clearly inconsistent with clients' best interests as long as they disclose their conflicts of interest.[3] This sort of disclosure-based best interest standard in name only is clearly what some industry groups have in mind when they claim to support a best interest standard.

As a result, if you are to achieve your stated goal of ensuring that insurance producers consistently recommend those life insurance and annuities products that are best for the investor, you must more clearly articulate what you mean when you state that producers and insurers must act in the customer's best interests. You have made a good start by including in your best interest standard a requirement to act "without regard to the financial or other interests of the producer, insurer, or any other party." This suggests, consistent with the DOL rule, that it is not enough for producers and insurers simply to disclose their conflicts of interest, they must also adopt procedures to manage those conflicts in order to ensure that conflicts aren't permitted to influence their recommendations. Your proposal also improves on the NAIC proposal by clarifying that, in order to meet their obligations under the standard, the producer must conduct an analysis based on what "a prudent person familiar with such matters would use under the circumstances." This avoids a fatal weakness in the NAIC's proposal, which suggests the best interest standard would be satisfied as long as the producer follows a reasonable process and believes the resulting recommendation is in the customer's best interests, regardless of how far outside the norms of accepted practice that recommendation and the underlying assumptions on which it is based might be.

In order to eliminate any ambiguity on this point, we encourage you to take three additional steps. First, we urge you to amend the language describing the purpose of the regulation to clarify this point. Specifically, the first sentence in Section 224.0 (b) should be revised along the following lines: "This Part clarifies the duties and obligations of insurers, including fraternal benefit societies, by requiring them to establish standards and procedures for recommendations to consumers with respect to policies delivered or issued for delivery in this state so that any transaction with respect to those policies is in the best interest of the consumer and **represents the best available option to address the insurance needs and financial objectives** of the consumer at the time of the transaction." A similar change should be made in Section 224.0 (c). In adopting this approach, the Department should make clear, as DOL has done, that producers are not required to seek out and recommend the single best option available

for Information on Standards of Conduct for Investment Advisers and Broker-Dealers, Oct. 3, 2017 http://bit.ly/2Dz1CfR. (Note that ACLI's proposed approach would allow conflicts to be addressed exclusively through disclosure with no accompanying obligation to ensure that they don't influence recommendations.)

[2] Letter from Marc R. Bryant, Senior Vice President and Deputy General Counsel, Fidelity Investments to The Honorable Jay Clayton, Chairman, Securities and Exchange Commission regarding Standards of Conduct for Investment Advisers and Broker-Dealers, Aug. 11, 2017 http://bit.ly/2wLJSKh.

[3] Press Release, Securities and Exchange Commission, J.P. Morgan to Pay $267 Million for Disclosure Failures, Dec. 18, 2015 http://bit.ly/1PKkkjO.

anywhere in the market, but rather to recommend the best option from among those products the producer has available to recommend within his or her particular business.

Second, the Department should reinforce this point by adding language to this effect to the requirements the producer or insurer must meet to satisfy the best interest standard. Currently, Section 224.4 suggests that the standard is met when the producer or insurer follows a prudent process and makes a suitable recommendation. We urge you to amend this language to require, not simply that the recommendation is suitable, but that, the producer recommends, from among the available options, the product that a prudent expert would determine best meets the insurance needs and financial objectives of the consumer at the time of the transaction. In addition, Section 224.4 (b)(3)(ii) should be revised to state: "certain features of the policy, such as tax-deferred growth, annuitization or death or living benefit are in the best interests of the consumer." And, in each instance in Section 224.4 where the term "suitable" is used, it should be replaced by "in the best interests of the customer."[4] In this way, the Department can make clear that it is adopting a true best interest standard, and not simply tweaking the existing suitability standard.

Finally, we urge the Department to strengthen the rule's documentation requirements to reinforce the best interest standard. As currently drafted, the proposal requires the producer or insurer to disclose to the consumer "all relevant suitability considerations and product information, whether favorable or unfavorable, that provide the basis for any recommendations." It also requires the producer or insurer to document "any recommendation" subject to the standard. We urge you to revise this to clarify that the producer or insurer must document the facts, assumptions, and analysis that led the producer to conclude that the particular policy recommended is the best of the available options for the customer, taking into account costs, performance, liquidity, and other relevant product features, as well as a customer's particular circumstances. This proposed revision serves several purposes. It further clarifies that producers are required to recommend the best available option and must have a reasonable basis for that recommendation. It also makes it easier for both supervisors and regulators to determine whether the best interest standard has been met. Finally, it helps to ensure that the rule's disclosure and documentation requirements don't devolve into a check-the-box exercise with little practical benefit.

If the Department were to make these changes, we could enthusiastically endorse the proposal as creating a true best interest standard.

Additional Requirements are Needed to Reduce the Harmful Impact of Conflicts

We are concerned that the proposal does not adequately address the harmful impact of conflicts of interest, which are all too likely to undermine compliance with the best interest standard. We understand that this reflects, in part, the fact that "reasonable compensation" for insurance sales is dealt with in statute in New York. Even within these constraints, however, we believe there is more that the Department can and should do to rein in conflicts of interest. As

[4] This includes Section 224.4 (b)(3), (d), and (e)(2).

you are doubtless aware, practices (such as single product sales contests) have been tolerated in the insurance market that are prohibited under FINRA's suitability standard, much less a true fiduciary best interest standard. These practices can create an unhealthy incentive to recommend one product over another based on the producer's own financial interests, even where the amount of compensation received does not exceed the statutory limits. To address these conflicts, we urge the Department to strengthen the proposal's supervision requirements for insurers.

As currently drafted, the rule proposal requires insurers to "establish a supervision program system that is reasonably designed to achieve the insurer's and producers' compliance with this Part." Separately, insurers are required to establish and maintain procedures "designed to prevent financial exploitation and abuse." While a good start, these provisions fall well short of requiring oversight that supports compliance with a best interest standard.

We urge you to add a requirement, modeled on the DOL rule, that insurers "establish and comply with written policies and procedures reasonably and prudently designed to ensure that producers adhere to the best interest standard."[5] In keeping with the DOL standard, "these written policies and procedures should ensure that insurers do not use or rely upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause producers to make recommendations that are not in the best interest of the investor." As the DOL stated, "[the] adopt[ion] and adhere[ence] to stringent anti-conflict policies and procedures [is] aimed at ensuring advice that is in the best interest of the retirement investor and avoiding misaligned financial incentives. These protective conditions serve as strong counterweights to the conflicts of interest associated with complex investment products, such as variable and indexed annuities."

Moreover, we urge you to make clear that insurers' supervision programs must be designed to ensure that recommendations are based on reasonable assumptions and a thorough evaluation of both the consumer's needs and the product features. In short, supervision programs should be designed not just to prevent financial exploitation and abuse, but to ensure that producers have a reasonable basis to conclude that their recommendation represents the best available option for the consumer. Adopting such an approach should improve compliance with the standard and provide regulators with additional tools to hold insurers and producers accountable when they fail to live up to their best interest obligations.

The Rule Should Retain Its Appropriately Broad Scope

Among the most notable differences between this proposal and the NAIC proposal is the New York proposal's much broader scope, which we strongly support. This is achieved both through a broader definition of recommendations that are subject to the best interest standard and the application of the standard to all life insurance policies, not just annuities. The proposed definition of recommendation, which includes statements that would reasonably be perceived as

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[5] Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters, 81 Fed. Reg. 21147, 21154 (April 8, 2016), http://bit.ly/2Ev22p3.

advice by consumers, is consistent with both the FINRA definition of recommendation and the DOL definition of investment advice. As such, it promotes regulatory consistency as well as consumer protection. The proposal's inclusion of recommendations regarding both proposed and in-force policies helps to ensure that recommendations made after the point of sale are also subject to the best interest standard. We urge the Department to retain these provisions as currently drafted.

We particularly applaud the Department's decision to include all life insurance policies, and not just annuities, in its best interest standard. As we noted when commenting on the NAIC proposal, many life insurance policies include investment components that are every bit as complex, opaque, costly, and beset by conflicts of interest as annuities can be. For this reason, the same standard of conduct should apply. A uniform standard of care across all types of insurance products means both consistent consumer protection and a level regulatory framework, which is needed to prevent regulatory arbitrage and a shift in sales to less regulated, less consumer-friendly products.

Conclusion

Consumers who turn to financial professionals for advice need and deserve advice that serves their best interests. The Department of Labor has shown that it is possible to adopt such a standard, but its authority is limited to retirement accounts. For consumers to receive comprehensive protections, the same strong standards should be extended to non-retirement accounts. Currently, that is not the case. And industry groups are working over-time to try to ensure that this doesn't occur – lobbying for a watered down, disclosure-based standard under insurance and securities laws that could be used to conduct an end-run around the DOL's stronger protections. Unfortunately, the NAIC's proposed "best interest" standard plays into industry's anti-consumer strategy. We applaud you for taking a different approach and seeking to adopt a standard for insurance recommendations that matches the strong protections afforded by the DOL rule. We urge you to adopt the changes advocated above so that your proposal can have its intended of effect of requiring insurance producers to consistently recommend those life insurance and annuities products that are best for the investor, rather than those that are most profitable to the seller.

Respectfully submitted,

<u>Organizations</u>
AARP New York
Alliance for Retirement Americans
Americans for Financial Reform
Better Markets
Center for Economic Justice
Committee for the Fiduciary Standard
Consumer Action
Consumer Federation of America
Consumers Union

Fund Democracy
National Employment Law Project
PIABA
Woodstock Institute

Individuals
Joseph M. Belth, Professor Emeritus of Insurance, Kelley School of Business, Indiana University
Brendan Bridgeland, Center for Insurance Research and NAIC Consumer Representative
Bonnie Burns, Policy Specialist, California Health Advocates
Tom Callahan, Massachusetts Affordable Housing Alliance and NAIC Consumer Representative
Brenda J. Cude, NAIC Consumer Representative
Karrol Kitt, NAIC Consumer Representative
Daniel Schwarcz, Professor, University of Minnesota Law School
Lynn Turner, Former Chief Accountant, Securities and Exchange Commission