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June 15, 2018

Via E-Mail

The Honorable Maria T. Vullo
Superintendent
New York State Department of Financial Services
One State Street
New York, NY 10004-1511
Via email to: james.regalbuto@dfs.ny.gov

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

Dear Superintendent Vullo:

On behalf of the Committee of Annuity Insurers (the "Committee") and its 32 member insurance companies that represent over 80% of the annuity business in the United States, we are writing in response to the revised proposed First Amendment ("Revised Proposal") to 11 NYCRR 224 (Insurance Regulation 187) ("Regulation 187"), proposed to be renamed "Suitability in Life Insurance and Annuity Transactions," issued by the New York State Department of Financial Services (the "Department") on April 27, 2018. The Revised Proposal updates the original proposed First Amendment ("Original Proposal") issued by the Department on December 27, 2017. The Committee appreciates the opportunity to provide comments on the Revised Proposal. Our comments below begin with an overview of the Committee and then turns to the Committee's general and specific concerns with the Revised Proposal.

OVERVIEW OF THE COMMITTEE

The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of federal and state policy with respect to regulatory and tax issues affecting the annuity industry. The Committee's members offer annuities through affiliated and unaffiliated distribution channels, including broker-dealers. A list of the Committee's member companies is attached as <u>Appendix A</u>. For over 35 years, the Committee has been involved in shaping and commenting upon many elements of the regulatory framework applicable to annuity products. In particular, as relevant to the Revised Proposal, the Committee over many years has been actively involved in standard of conduct and suitability-related initiatives of the U.S. Department of Labor ("DOL"), the Financial Industry Regulatory Authority, Inc. ("FINRA") and the U.S. Securities and Exchange Commission ("SEC"). (While Committee member companies issue life insurance products, the Committee's mandate is limited to annuity products and, accordingly, the comments discussed below are focused on the impact of the Revised Proposal on annuity recommendations.)

REVISED PROPOSAL FAILS TO MEET KEY PRINCIPLES FOR ENHANCED STANDARD OF CARE REGULATORY INITIATIVES

As stated in the Committee's comment letter on the Original Proposal (the "Committee's Letter"), the Committee has supported and continues to support an enhanced standard of care for financial intermediaries when providing advice or recommendations to their customers regarding the purchase or replacement of annuities. The Committee's Letter urged the Department, if it moved forward with the First Amendment, to follow four key principles, which can be summarized as follows:

- An enhanced standard of care regulatory initiative must be in harmony to the greatest extent possible with similar initiatives being considered or pursued by other regulators with jurisdiction over financial and investment products offered to retail consumers;

- The standard must be clearly articulated and be workable;

- The regulatory initiative must make maximum use of *existing* operational, compliance and transaction review structures to minimize the costs ultimately borne by consumers; and

- The implementation date for the regulatory initiative must be coordinated with other regulators to facilitate a holistic, consistent program.

These key principles best align the interests of all affected constituencies – consumers, regulators and industry – by facilitating a harmonized, consistent approach regardless of the financial or investment product under consideration or the jurisdiction in which the consumer is located. Unfortunately, for the reasons set forth below, the Revised Proposal fails to meet these key principles.

REVISED PROPOSAL FAILS TO ADDRESS RECENT DEVELOPMENTS

There have been significant developments since the close of the comment period for the Original Proposal that have not been taken into account in the Revised Proposal and that we urge you to consider before finalizing and adopting the First Amendment. In particular:

- In March 2018, the DOL's investment advice fiduciary definitional rule and related prohibited transaction exemptions (collectively, the "DOL rule")[1] were vacated in their entirety by the Fifth Circuit. The Best Interest Contract ("BIC") Exemption included in the DOL rule, on which the Original Proposal and Revised Proposal are based, is no longer in effect. Instead, the regulatory framework that had been in effect before the implementation of the DOL rule for the retirement market has now been reinstated. Consequently, the Revised Proposal no longer aligns with the regulatory framework now in effect for the retirement market.

- In April 2018, the SEC issued its proposed Regulation Best Interest ("SEC Reg BI"), which if adopted as proposed will be applicable to broker-dealers selling annuities treated as securities under the federal securities laws.[2]

- In March 2018, the NAIC Annuity Suitability Working Group ("Working Group"), which had solicited comment on proposed revisions to the NAIC model suitability rule to potentially incorporate enhanced standard of care requirements, indicated that it would reconsider its approach in light of the DOL rule vacatur and SEC Reg BI. The Working Group held meetings on the model suitability rule on May 31 and June 1, 2018, and appeared to settle on revising the model regulation in a manner that would call for best interest "equivalency" that would deem a recommendation to be suitable if it is made with fair dealing and reasonable competence, trustworthiness, diligence, care, prudence and skill, without placing the financial or other interests of the producer ahead of the consumer.

In short, the DOL's "best interest" standard with which the Department sought to align the Original Proposal is no longer a baseline for harmonization. Given these developments, the Committee urges the Department not to move forward with any revisions to Regulation 187 at

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[1] See DOL release, 82 F. Reg. 16902, et seq. (April 7, 2017).
[2] See SEC release, 83 F. Reg. 21574 (May 9, 2018).

this time and instead allow time for a commonly agreed upon standard of care to gain traction across the regulatory regimes that apply to sales of insurance products and other consumer financial and investment products.

Perhaps most importantly, insurers, producers and consumers in New York will be significantly disadvantaged if the Department adopts and implements a "best interest" standard only for insurance products issued to New York consumers, at a time when best interest standards are not in effect in other states or for other types of investment products that compete with insurance products. There has never been a greater need for the guaranteed lifetime income solutions that annuity products uniquely can provide. But, applying comparatively onerous requirements on annuity sales will serve only to discourage those intermediaries who can offer other investments to consumers from recommending annuities – even where annuities may be the better fit for, and better meet the needs of, the consumer. Further, the additional information gathering and disclosure requirements that would become applicable to annuities under the Revised Proposal – but not other investments or products recommended to consumers such as mutual funds – could very likely foster a negative consumer perception of annuities. This could have an adverse impact on consumer access to important products and services that, in fact, serve consumer interests.

REVISED PROPOSAL FAILS TO DEFINE CRITICAL NEW TERMS AND CONCEPTS

Both the Original Proposal and the Revised Proposal have borrowed terms and concepts from other regulatory regimes that have not been fully or explicitly adapted to the insurance distribution context. While the Committee offers comments on certain of these below, we wish to underscore our overarching concern that the new terms, concepts and requirements have little or no history in insurance law and regulation, will be new not only for the insurance industry but also for insurance consumers and regulatory examiners, and are vague and unclear. Without careful consideration and explication of the meaning and intent of these terms and concepts in the insurance distribution context, not only will there be considerable confusion in implementing changes, but also significant risk of litigation as courts (and other arbiters) are called upon to interpret the new terms and concepts.

COMMENTS ON SPECIFIC PROVISIONS

The following paragraphs discuss our comments on specific provisions of the Revised Proposal, reiterating a number of comments in the Committee's Letter that have not been fully addressed.

1. The "No Consideration of Financial Interest" Standard in Section 224.4 is a Legal Impossibility

Section 224.4(b)(1) of the Original Proposal would have required a recommendation to be made "without regard to" the financial interests of the producer, insurer or any other party. The Committee's Letter objected to this phrase, noting, among other things, that it was inconsistent with the BIC Exemption (which had not yet been vacated) and absent further clarification could be interpreted to require a recommendation to be limited to the "best available" or "cheapest" option. Sections 224.4(b) and 224.5(b) of the Revised Proposal replace the "without regard to" phrase with the requirement that the "financial interests of the producer, insurer, or any other party shall not be considered in any respect in making the recommendation."

Committee Comment. The substitute text fails to address the original concerns outlined in the Committee's Letter, and further confuses the issue. It is not possible to demonstrate compliance with the requirement imposed by the Revised Proposal in the case of a transaction in which sales compensation will be paid. For example, even if a producer recommends a particular annuity because the producer will receive less sales compensation than if he or she recommends another annuity, the producer still will have considered his or her financial interest. Conversely, if the annuity recommended by a producer happens to pay more sales compensation than another, a regulatory examiner is likely to assert that the producer must have "considered" his or her financial interests. Perhaps more importantly, because a producer can recommend only those annuities he or she is authorized to sell, the producer necessarily can recommend only those annuities in which he or she has a "financial interest." In short, it does not appear possible to demonstrate that financial interests were not "considered" when a recommendation is made if any sales compensation is paid. Given this impossibility, the substitute text should be deleted. If it is not deleted, every producer will be exposed to potential liability for failing to meet this requirement. The impossibility of compliance with this requirement is highlighted when considered from the perspective of an insurer who would be required to supervise for compliance with it or the regulatory examiner who would be expected to examine records to determine that this requirement was met: how does a producer create a record to document that the producer did not consider his or her financial interests? As an alternative, in the interest of harmonization, the Department should consider the approach taken in SEC Reg BI, which would prohibit a broker-dealer from putting its own interest ahead of its customer's.[3]

2. The Terms "Care, Skill, Prudence and Diligence" and "Prudent Person" Standard used in Sections 224.4 and 224.5 Must Be Defined

Sections 224.4(b)(1) and 224.5(b)(1) of the Revised Proposal, like Section 224.4(b)(1) of the Original Proposal, would require a recommendation to be based on a producer's or insurer's evaluation of the suitability information of the consumer that reflects the "care, skill, prudence, and diligence that a prudent person" would use.

Committee Comments. The terms "care, skill, prudence and diligence" have not been commonly used in New York's insurance statutes or regulations to describe the duties of producers and insurers, nor have those statutes or regulations described a producer's or insurer's duties in relation to a "prudent person" standard in the insurance distribution context. The Revised Proposal, like the Original Proposal, provides no context or explanation of what the terms mean in the insurance distribution context and thus continues to use terms that are vague and undefined. These terms and the "prudent person" standard should be used only if the following two conditions are met:

- There is guidance within Regulation 187 regarding what these terms and the standard mean in the insurance distribution context. As every recommendation would be measured against these terms, it is essential that they be defined in a manner that is suited to insurance distribution – and not a trustee relationship – and can be easily documented.
- Interested parties are given an opportunity to comment on this guidance *before* the First Amendment becomes effective. The importance of this condition cannot be overemphasized. Before insurers and producers undertake to implement the processes, procedures and documentation that will evidence compliance with these terms, they need to know what such terms mean.

In this regard, the SEC, which uses the phrase "care, skill, prudence and diligence," in describing best interest for broker-dealers in SEC Reg BI, has specifically requested comment on the appropriate interpretation of the terms, particularly "prudence,"[4] reflecting its recognition that the terms are new to broker-dealers and warrant further explication before they are adopted.

3. The Best Interest Requirement in Sections 224.4 and 224.5 Should Not Apply to Modification, Election and Hold Recommendations for "In-Force" Policies

By virtue of the definitions of "Recommendation," "Transaction," "Sales Transaction" and "In-force Transaction" in Sections 224.3(e), (i), (j) and (k) of the Revised Proposal, the Revised Proposal, like the Original Proposal, continues to apply the best interest requirement, now in both Sections 224.4 and 224.5, to recommendations of not only purchase and replacement

[3] See Subsection (a) of SEC Reg BI included in SEC Reg BI Release at 21682.
[4] See SEC Reg BI Release at 21616.

transactions, but also recommendations regarding a conversion, modification or election of a contractual provision with respect to a proposed or in-force policy. In addition, the Revised Proposal, like the Original Proposal, continues to apply the best interest requirement to a recommendation to "refrain" from entering into a transaction and thus would encompass a "no-action" recommendation by a producer. The Committee's Letter urged the Department to remove the provisions that would have expanded Regulation 187 to cover the modification or election of contractual provisions for in-force policies, or "no-action" recommendations. The requested changes were not made. Instead, the Revised Proposal differentiates between transactions for in-force policies where sales compensation is paid and where it is not, and appears to impose "best interest-lite" requirements on transactions for in-force policies where no sales compensation is paid.

Committee Comments. The changes reflected in the Revised Proposal have created additional concerns. With regard to the key principles referenced above, the Revised Proposal, in extending Regulation 187 to cover conversions, modifications and elections, would depart from the approach taken by FINRA and the NAIC. FINRA's variable annuity suitability rule, Rule 2330, applies only to variable annuity purchases and replacements. The NAIC Model Annuity Suitability Regulation also applies only to annuity purchases and replacements (and enhancements currently under consideration would continue to limit its application to purchases and replacements). Of even greater concern, the Department still has not explained what a "modification" or "election of a contractual provision" is considered to be. It is critical that these concepts be clearly explained so that producers and insurers know the circumstances that would be covered.

In addition, imposing even best interest-lite requirements on situations where no sales compensation is paid (referred to as "in-force transactions" in the Revised Proposal) will likely discourage producers from providing any assistance in those situations due to the burdensome information-gathering and disclosure requirements and potential for liability. This would not be beneficial to consumers. This provision is of even greater concern in the case of call centers maintained by insurers to service policyholders, given that Section 224.5 would appear to apply to call centers if call center personnel provide assistance to policyholders that could "be interpreted by a consumer to be advice" under the Revised Proposal's definition of a recommendation. The risk of triggering best interest requirements could have a chilling effect on call center operations, a consequence also not likely to be beneficial for consumers. Given the likely consequences here, the Committee urges the Department to delete Section 224.5.

4. "Participating" Producers for Purposes of Section 224.4(j) Should Exclude Wholesaling Activities and Supervisory Functions

The Original Proposal would have applied the requirements applicable to producers to "every producer in the transaction" regardless of whether they had direct contact with the consumer. The Committee's Letter urged the Department to delete this provision given various interpretive, operational and harmonization concerns. Section 224.4(j) of the Revised Proposal reflects some changes made in response to comments, and now states that the requirements would apply to "every producer who has participated in the making of a recommendation and received compensation as a result of the sales transaction, regardless of whether the producer has any direct contact with the consumer."

Committee Comments. While we appreciate the Department's effort to respond to the Committee's concerns, the modified provision still leaves important and significant questions unresolved. The meaning of the phrase "participated in the making of a recommendation" is vague and undefined, as this is not a phrase that has been generally used in New York insurance statutes and regulations. At a minimum, the Committee requests that the Department confirm, through an exclusion or exemption, that this phrase would not include:

- Routine and customary wholesaling activities, such as the generation of annuity illustrations at the request of the producer interacting with a consumer, or provision of information about an annuity at the request of another producer for presentation to the producer's customer; or

- Supervisory functions of persons designated as supervisors of producers for regulatory, compliance or operational purposes.

5. Section 224.6 Should Clarify That a Supervision System Need Not Cover Producer Recommendations under Section 224.5

As discussed above, Section 224.5 imposes "best interest-lite" requirements on in-force transactions, defined in the Revised Proposal as a modification or election of a contractual provision with respect to an in-force policy that does not generate new sales compensation. Section 224.6 requires an insurer to maintain a supervision system. It is not entirely clear whether an insurer's supervision system needs to cover producer recommendations under Section 224.5.

Committee Comments. Our comments above urge the Department to delete provisions of the Revised Proposal that would apply to recommendations of modifications or elections of contractual provisions and "no-action" recommendations, particularly in the case of in-force transactions. If those provisions are nonetheless retained, the Committee requests that the Department clarify that an insurer has no obligation to supervise a producer's recommendations of in-force transactions. As stated in the Committee's Letter, it will not be operationally feasible for insurers to obtain information to supervise these recommendations, particularly in the case of "no-action" recommendations.

6. Section 224.6 Should Not Require a Supervision System to Prohibit Incentives Outright

Section 224.6 of the Revised Proposal significantly expands the requirements for an insurer's supervision system, adding a requirement in clause (b)(4) that the supervision system include standards and procedures for "the prevention of incentives that are intended or would reasonably be expected to cause producers to make recommendations that are not in the best interest of the consumer." The new provision does not mention the use of disclosure or conflict mitigation measures as alternatives to outright "prevention."

Committee Comments. The Revised Proposal's requirement for an outright prohibition of incentives is inconsistent with the approaches by other regulators considering best interest standards for consumer financial products and investments. It is also inconsistent with existing New York Law, which permits non-cash compensation programs subject to certain conditions as well as differential compensation based on product type. In this respect, it conflicts with Section 224.4(j), which provides: "Nothing in the regulation shall be construed to prohibit the payment of any type of compensation otherwise permitted under the Insurance Law . . ." Other regulators have recognized the benefits that incentive programs can offer and have permitted or, as exemplified by SEC Reg BI, are proposing to permit the use of mitigation measures and/or disclosure for incentive programs, rather than outright prohibition. Given common approaches in the distribution of financial and investment products, the Committee urges the Department to modify Section 224.6(b)(4) to explicitly acknowledge the use of disclosure and mitigation measures for the supervision of incentive programs.

7. Section 224.6 Must Allow Insurers to Contract Supervision Functions to Third Parties

The Original Proposal had retained the longstanding provisions of Regulation 187 permitting an insurer to contract with third parties to establish and maintain a system of supervision with respect to producers and had not proposed any changes to this provision. The key provision, which would have been codified as Section 224.4(h) of the Original Proposal, has been deleted in the Revised Proposal, creating an ambiguity regarding whether insurers are able to contract with third parties.

Committee Comment. Given current insurance distribution arrangements in which insurers routinely contract with third parties, such as broker-dealers, for the solicitation and sale of their insurance products, it is important that insurers be able to delegate supervision system functions to these third parties. While other provisions of the Revised Proposal arguably acknowledge the permissibility of contracting arrangements, in the interest of resolving any ambiguity, the Committee believes that the Department should restore the original provisions in Regulation 187 confirming that insurers can contract with third parties in connection with their supervision systems.

8. Section 224.4(*l*)'s Separate Disclosure Requirements for Career Producers Should Be Combined with Other Disclosure Requirements

Section 224.4(*l*) of the Revised Proposal adds a new disclosure requirement for the situation in which a producer limits the range of policies recommended based on a captive or affiliation agreement with a particular insurer. In that case, the Revised Proposal requires the producer to *prominently* disclose to each consumer in writing, prior to a recommendation in a form acceptable to the New York superintendent, the nature of the agreement and the circumstances under which the producer will and will not limit the producer's recommendations.

Committee Comment. The requirement for a separate disclosure will only serve to confuse consumers. The information would be better disclosed in the context of the information required to be provided in response to Section 224.4(b)(3)(i) and should be included with other disclosures relevant to the producer's services and capacity. Singling out a career producer relationship as a situation warranting special or heightened disclosure will create an unlevel playing field between independent and career producers.

9. Section 224.4(b)'s Requirement to Disclose Recommendation Basis Provides No Benefit to Consumers

Section 224.4(f) of the Original Proposal would have required a producer to disclose to a consumer the basis for a recommendation. The Committee's Letter urged the Department to eliminate this requirement, noting that such a requirement would not be in harmony with FINRA rules or the DOL rules (then in effect) and would likely result in a "check-the-box" practice providing no meaningful information to consumers. The Department was not responsive to the Committee's comments, and retained the disclosure requirement in Section 224.4(e)(1) of the Revised Proposal. The Revised Proposal also includes a new provision in Section 224.4(b)(3)(i) requiring consumer disclosure of any "differences in features among fee-based and commission-based versions of the policy and manner in which the producer is compensated for the sale and servicing of the policy."

Committee Comments. We reiterate that the requirement to disclose the basis for a recommendation will not provide meaningful or useful information to consumers and urge the Department to eliminate this requirement. FINRA does not impose a similar requirement, and the SEC is not proposing a similar requirement in the context of SEC Reg BI. Imposing a requirement on sales of annuity products when a similar requirement will not apply in New York to competing investment products will place an additional burden on intermediaries that will chill sales of annuity products in New York.

It also is not clear why the Department believes that disclosure of the differences among fee-based and commission-based versions of the policy would be helpful to consumers. Moreover, this disclosure requirement could require a producer to provide information about products and product features that the producer is not duly qualified or authorized to discuss. Absent a clearer articulation of the purpose for this disclosure, the Committee urges the Department to discard the proposed new requirement to disclose differences between fee-based and commission-based versions of a product.

10. Section 224.4 of Regulation 187 Should Exempt All Types of Insurance Products for the Institutional Market

Clauses (b)(6), (c), (d) and (e) of Sections 224.2 of the Revised Proposal would add exemptions for pension risk transfer contracts, corporate- or bank-owned policies and life settlement transactions. We support these changes, which are responsive to the Committee's Letter.

Committee Comments. While supportive of the exemptions added to Section 224.2, the Committee again urges the Department to consider adding a broader exemption for all insurance products sold in the institutional market (i.e., to a non-natural person), such as stable value, BOLI wraps, structured settlements, guaranteed investment contracts and funding agreements. Best interest requirements are not relevant to the institutional markets.

11. The Effective Date for the First Amendment Should Be Deferred

The Original Proposal had indicated that the effective date for the First Amendment would be ninety (90) days after the publication of the final version in the State Register. The Committee's Letter had strongly urged the Department to defer the effective date of the final version for at least 24 months after adoption. The Revised Proposal indicates that the effective date for the First Amendment would be March 1, 2019, far short of the 24-month implementation period advocated by the Committee.

Committee Comments. The Committee urges the Department to defer further action on the First Amendment until there is greater traction among regulators regarding the scope and applicability of "best interest" requirements. If, however, the Department continues moving forward with the Revised Proposal, more time for implementation efforts is needed than would be available with a March 1, 2019 effective date. The Revised Proposal will require insurers and producers to create and implement large-scale changes in the way they do business with consumers and process transactions. The Revised Proposal will require building out new forms, documentation, disclosures and business processes. In addition, there will be a need to educate and train all the affected parties related to annuity transactions on the changes necessitated by the First Amendment. As a result, we continue to believe that a two-year implementation period is required. We are aware, however, that the Department is considering a request by others that the enactment date for annuities be 12 months after promulgation. That alternative, while not ideal, would be far preferable to the March 1, 2019 effective date in the Revised Proposal.

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The Committee appreciates the opportunity to comment on the Revised Proposal. Please do not hesitate to contact Cliff Kirsch (212.389.5052 or cliffordkirsch@eversheds-sutherland.com); Susan Krawczyk (202.383.0197 or susankrawczyk@eversheds-sutherland.com); Eric Arnold (202.383.0741 or ericarnold@eversheds-sutherland.com); or Maureen Adolf, Senior Policy Adviser/Insurance (212.389.5028 or maureenadolf@eversheds-sutherland.com) with any questions or to discuss this comment letter. The Committee would be happy to provide any additional information to the Department or discuss any of the issues or concerns identified in this letter if that would be helpful.

Respectfully submitted,

Eversheds Sutherland (US) LLP

Eversheds Sutherland (US) LLP

FOR THE COMMITTEE OF ANNUITY INSURERS

Cc: Laura Evangelista, Executive Deputy Superintendent, Insurance Division
Nathaniel Dorfman, Deputy Superintendent and Special Counsel for Legislative & Regulatory Affairs
James V. Regalbuto, Deputy Superintendent for Life Insurance

Appendix A

THE COMMITTEE OF ANNUITY INSURERS
MEMBER LIST

AIG
Allianz Life
Allstate Financial
Ameriprise Financial
Athene USA
AXA Equitable Life Insurance Company
Brighthouse Financial, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Global Atlantic Financial Group
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Lincoln Financial Group
Massachusetts Mutual Life Insurance Company
Metropolitan Life Insurance Company
National Life Group
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
Sammons Financial Group
Symetra Financial Corporation
Talcott Resolution
The Transamerica companies
TIAA
USAA Life Insurance Company
Voya Financial, Inc.