

To be Argued by:
JAMES C. KEIDEL, ESQ.
(Time Requested: 15 Minutes)

New York Supreme Court

Appellate Division—Third Department

Case No.: 530047

In the Matter of the Application of,

INDEPENDENT INSURANCE AGENTS AND BROKERS OF NEW YORK, INC. and TESTA BROTHERS, LTD.,

Petitioners-Appellants,

– and –

PROFESSIONAL INSURANCE AGENTS OF NEW YORK STATE, INC. and GARY SLAVIN,

Petitioners,

For Judgment Pursuant to CPLR Article 78

– against –

THE NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES and MARIA T. VULLO, in her official capacity as Superintendent of the New York State Department of Financial Services,

Respondents-Respondents.

(For Continuation of Caption See Inside Cover)

BRIEF FOR PETITIONERS-APPELLANTS

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Albany County Clerk's Index No. 907005/18

In the Matter of the Application of,

THE NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS – NEW YORK STATE, INC. and DONALD DAMICK,

Plaintiffs-Respondents,

– against –

THE NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES and MARIA T. VULLO, in her official capacity as Superintendent of the New York State Department of Financial Services,

Defendants-Respondents.

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PRELIMINARY STATEMENT

Petitioners/Appellants Independent Insurance Agents and Brokers of New York, Inc. ("Big I NY") and Testa Brothers, Ltd. are, respectively, a New York Not-for-Profit organization representing the interests of over 1,750 member insurance agencies and brokerages and their 13,000 employees in this state, and one individual member agency. Appellants appeal from the Decision and Order of the Honorable Henry F. Zwack, entered August 7, 2019, upholding the constitutionality and validity of an insurance regulation imposing a "best interest" standard on New York agents and brokers (sometimes referred to collectively as "producers" or "intermediaries").

Appellants' own interests aside, they are a proxy for all agents and brokers, and their customers, statewide, whose interests are or will be severely harmed by the creation and implementation of an unconstitutional regulation that established an unenforceable and unworkable standard of conduct concerning the sale of life insurance and annuities in this state. It is the promulgation of that regulation, known as "First Amendment to 11 N.Y.C.R.R. 224 (Insurance Regulation 187) Suitability and Best Interests in Life Insurance and Annuity Transactions" (hereafter the "Regulation"), that prompted the Article 78 Petition and decision thereon that is now before the Court.

Appellants respectfully submit that the lower court decision upholding the Regulation rests on wrongful assumptions and reaches a faulty conclusion which fails to grasp the Regulation's impact on the insurance industry. Indeed, the decision overlooks or sidesteps the essential thrust of the Regulation, which is designed at its core to alter the relationship between an insurance producer and a customer. That relationship, historically recognized as arms-length both by statute and case law, is now radically reshaped under this new Regulation in ways never divined by courts nor contemplated by New York lawmakers. In an abrupt departure from that gradual precedent, this reshaping was imposed merely by fiat by the New York State Department of Financial Services ("DFS")[1] without any proper legislative authority.

The Regulation has many flaws, chief among them being lack of legislative authority for this audacious leap taken by DFS in creating a "best interest" standard. The best interest standard fundamentally transforms insurance intermediaries engaging in arms-length sales transactions into quasi-fiduciaries, and subjects them to a new unworkable and unwarranted standard ordinarily reserved for advisors, trustees, lawyers, board members, and those in other such legally-recognized special relationships involving extraordinary control and trust.

[1] Respondents DFS and the Superintendent are referred to interchangeably as DFS in this brief. The Superintendent who originally championed the Regulation, Maria T. Vullo, has been replaced by current Superintendent Linda A. Lacewell.

The lower court, brushing aside the import and gravity of these new best interest requirements, held the Regulation "does not necessarily entail a relationship of trust . . . . it merely requires job proficiency." Record ("R.") 47. Nothing could be further from the truth. It is this erroneous holding, glaringly qualified with a "not necessarily" which the Court uses to justify the Regulation as fine-tuning by a regulatory agency within the scope of their powers, rather than the full-blown policymaking (which should be reserved to lawmakers) that it really is. While New York insurance laws are replete with requirements that agents and brokers engage in honest and ethical practices, nowhere in any New York statute is there any requirement that insurance intermediaries act solely in the "best interest" of their customers. While these two concepts seem to be identical, they are not. There is a fine line distinction, with the former being generally advisable good business practice, and the latter being a legally enforceable standard of conduct without clearly identifiable or understood parameters. Such DFS rulemaking which turns insurance agents and brokers into quasi-fiduciaries entails the very kind of judgments and choices among broad policy goals that this Court has reserved to the legislature and that is not to be entrusted to regulatory agencies.

In promulgating the Regulation, DFS's purported goal was to protect consumers by heightening the legal standard of care governing the conduct of insurance agents and brokers. However, as originally proposed, with the existence of the federal Department of Labor's ("DOL") Fiduciary Rule, the Regulation sought consistent sales standards for <u>all</u> annuities in New York and, for the first time applied these enhanced sales standards to life insurance. The controversial DOL Fiduciary Rule sought to reclassify financial intermediaries as fiduciaries in the sale of individual retirement accounts (IRAs) or tax-qualified plans by forcing them to enter into "Best Interest Contracts" to satisfy prohibited transaction exemption requirements. However, the regulation met with heavy resistance from the financial services industry and ultimately was struck down for exceeding Congressional authority. With direct parallels to the case now before this Court, the Fifth Circuit Court of Appeals found the U.S. Labor Department had overreached, saying: had "Congress intended to abrogate both the cornerstone of fiduciary status – the relationship of trust and confidence – and the widely shared understanding that financial salespeople are not fiduciaries absent that special relationship, one would reasonably expect Congress to say so." <u>Chamber of Commerce v. U S. Dep't of Labor</u>, 885 F.3d 360, 376 (5th Cir. 2018). Congress did not say so, nor has the New York legislature here.

While DFS claims the Regulation will protect consumers, Appellants and other interested parties argue the opposite: that the Regulation will ultimately harm consumers through contraction of the marketplace as insurers and their intermediaries recoil from an unworkable regulation. The law prior to the

Regulation required agents and brokers to abide by high standards of honesty and transparency, including an obligation to ensure the suitability of any annuity recommended to a consumer. The lower court's attempt to summarize the purported justification for this Regulation citing to perennial industry issues like product complexity, policy lapses, surrender penalties, and replacements, completely overlooks the fact that DFS already had ample power and authority to address these concerns within its existing regulatory framework (and has done so through regulations properly covering licensing, suitability, replacements, and compensation). The Regulation departs from the authorized regulatory models in favor of an extreme measure unauthorized by the legislature.[2]

Contrary to the holding of the lower court, DFS does not have the power to fundamentally change the way brokers and agents sell insurance without actual legislative authority and without any meaningful and data-driven analysis of the subject costs. Indeed, when alerted to overwhelming evidence that the economic costs of such regulation will be substantial and cause significant negative market consequences, the lower court held that Respondents' conclusory statement of minimal costs is sufficient to pass muster. Appellants disagree. Certainly, the lower

[2] The term "quasi-fiduciary" is used here because the Regulation makes agents and brokers functionally equivalent to fiduciaries. That is, the Regulation establishes a fiduciary standard even if it does not use the term "fiduciary". DFS has never claimed otherwise and openly represents the Regulation as replicating the abandoned DOL Fiduciary Rule.

court gave short shrift to the cost implications of the Regulation, essentially ignoring all but the administrative costs and failing to follow well-established rulemaking standards concerning cost estimates. DFS underestimated and largely ignored the potential for true harm to businesses and consumers via direct and indirect costs stemming from the significant new burdens and risks created by the Regulation.

Contrary to statutory and constitutional dictates, DFS failed to conduct any serious study or analysis of the costs and impacts of these new heightened standards imposed upon insurance producers in dealing with consumers. Instead, DFS merely claimed costs would be minimal because the Regulation utilizes a principles-based approach, in theory meaning insurers are given latitude on how to implement and comply, without providing any real justification for its conclusion of minimal costs. This subterfuge merely disguises improper administrative rulemaking. The lack of even the semblance of a best estimate projection of the impact of the Regulation on New York businesses and on the availability and cost of insurance and annuity products for New York consumers thwarts any meaningful analysis of the Regulation as required by the New York State Administrative Practices Act ("SAPA") and agency authority precedent established by the Court of Appeals.

DFS has failed to provide a measurement or analysis of the costs to New York consumers. Thus, we are left with a regulation with a stated purpose of benefiting consumers that will likely lead to less product choice, increased consumer cost, reduced access to advice, and a weakened market for life insurance and annuity products as a whole; the sum total of which is never measured against supposed benefits as they impact consumers and the entire State of New York. Product availability will most certainly dwindle, and many producers will be driven out of a contracted marketplace plagued by second-guessing and litigation, all of which adds up to less competition and less choice for consumers. Less options for consumers result in higher costs, which will ultimately be passed on to the consumer, thereby making procuring coverage more prohibitive, especially for lower-income individuals. The point here – however – is not to inventory the ill effects of this Regulation but to underscore that the Regulation entails important societal tradeoffs from a public policy standpoint that require proper deliberation by the legislature, or at a minimum, an actual cost assessment and examination by DFS, which is completely lacking here.

In fact, neither DFS nor the lower court could persuasively explain why this radical departure from existing precedent is necessary and proper through administrative action, as opposed to legislative process, especially when DFS already has expansive powers to license all insurers and producers, approve life insurance policy and annuity forms, regulate market conduct, and investigate and address consumer grievances as necessary.

The Regulation and its adoption are infirm in other ways, too. At a basic level, the very language of the Regulation is fatally flawed. The Regulation is impossibly vague and lacks a clear and identifiable uniform standard of conduct, resulting in questions for agents and brokers as to how they are expected to comply, and how the DFS can enforce the Regulation, resulting in an unworkable standard. This Regulation confuses the role of agents versus brokers who function differently and yet this Regulation fails to recognize those differences. The Regulation will seep into civil litigation giving both regulators and consumers unprecedented causes of action against brokers and agents that will approach or amount to strict liability. In short, while DFS may have the power to regulate the trustworthiness of insurance producers in the marketplace, it does not have the power to fundamentally change the longstanding relationship between an insurance producer and customer and in doing so, cause tremendous disruption and cost to the public beyond the scope of its broad supervisory power and violative of existing regulatory law.

This Regulation is inconsistent with both governing law and the economic realities of the life insurance industry, suffers from vagueness, and is the result of arbitrary, capricious, irrational and unconstitutional rulemaking on the part of DFS. For all these reasons, the Regulation represents improper regulatory overreach and must be annulled.

QUESTIONS PRESENTED

Q. Does adoption of a regulation that transforms the life insurance industry in ways deeply affecting agents, brokers, insurers, New York consumers, and the New York economy at large, deprive the legislative branch of its authority and responsibility to properly consider and balance the advantages and disadvantages of redefining standards of conduct for the insurance industry; or put simply, did DFS usurp legislative authority in adopting the Regulation? The lower court found it did not.

Q. Does a regulation adopted without (1) any meaningful estimate of cost, (2) any justification for exceeding federal standards, and (3) any true analysis of the harm on small businesses violate the SAPA? The lower court found it did not.

Q. Does promulgation of a regulation adopted upon a record containing virtually no specific factual support, employing amorphous standards, conflicting with existing statutes and caselaw, and creating irreconcilable duties for affected parties, constitute arbitrary and capricious rulemaking? The lower court found it did not.

Q. Does a regulation containing provisions lacking in clarity to provide notice of conduct that is permitted or prohibited violate the constitutional doctrine of vagueness? The lower court found it did not.

STATEMENT OF FACTS

In its original form, prior to adoption of the DFS amendment, Regulation 187 applied solely to annuities, and created a suitability standard for insurance producers similar to what exists in other states. R. 138-149.

In April 2016, the United States DOL introduced its "Fiduciary Rule" which expanded the federal definition of investment advice and required financial advisors to adhere to enhanced standards of conduct. The DOL Fiduciary Rule sent shock waves through the financial services industry and resulted in litigation. R. 352-384. Pursuant to its provisions, to earn commissions, deemed "conflicted compensation," a provider needed to satisfy a Prohibited Transaction Exemption by entering into a Best Interest Contract with the consumer agreeing, among other things, to act in the best interest of the consumer to meet fiduciary obligations. R. 358.

The New York DFS followed suit in December 2017, unveiling its amendment to Regulation 187 adopting a best interest standard. R. 203-206.

The DOL Fiduciary Rule was overturned by the U.S. Fifth Circuit Court of Appeals in March 2018. R. 352-380. Unphased, in May 2018, DFS republished the Amended Regulation with minimal changes and it took effect July 17, 2018, becoming effective for annuities in August 2019 and February 2020 for life insurance. R. 149, 233-237, 280-285.

While DFS tries to portray the costs and consequences of Regulation 187 as nominal, the factual record suggests otherwise. During rulemaking, the American Council of Life Insurers and the Life Insurance Council of New York conducted a survey covering 63% of New York licensed companies showing an initial estimated aggregate cost of implementation to be $208M and continuing estimated annual cost of $66.6M. R. 1383. That could be conservative. When the DOL Fiduciary Rule was proposed, the DOL estimated that "compliance costs imposed on the regulated parties might amount to $31.5 billion over ten years with a 'primary estimate' of $16.1 billion." R. 357.

In fact, as late as August 2018, DFS continued to be dismissive of others' cost estimates while failing to provide its own. R. 313-319. For example, in its Assessment of Public Comments, DFS stated: "To address the comment that the Costs section of the RIS [Regulatory Impact Statement] should include studies that directly address the cost of the proposal, the commenter has asked the Department to <u>measure the immeasurable</u>." R. 347 (emphasis added). Without any actual estimate of the costs, DFS definitively claimed "the Department strongly believes that preventing consumer harm far outweighs <u>any</u> administrative costs imposed by this regulation." R. 347 (emphasis added). In an extremely myopic analysis of the costs, both DFS and the lower court focused solely on the costs associated with the recordkeeping function of the Regulation.

The record is replete with examples of broader, far-reaching costs extending beyond administrative recordkeeping, which remain unaddressed and overlooked. See R. 151-165 (Affidavits of Gary Slavin and Steven Testa); R. 1364 (Association for Advanced Life Underwriting ("AALU") letter stating: "added procedural hurdles will serve no consumer protection purpose, but will increase costs and compliance complexity, ultimately paid for by consumers."); R. 1402 (U.S. Chamber of Commerce warning proposal will significantly increase the cost and complexity of purchasing life insurance for consumers); R. 1218-1335 (series of emails reflecting increase in costs). There is no evidence that DFS measured the costs to New York consumers due to the significant market changes, less product availability and reduced access to trusted advice. R. 166-321.

Furthermore, DFS provided no estimate nor any explicit discussion of costs for those who only sell life insurance and not annuities. As one company warned: "The extension of best interest standard *[sic]* to life insurance is a sea change in insurance regulation and the current Proposed Amendment is virtually certain to increase costs, decrease life insurance protection obtained by consumers, and limit consumer access to advice and information… [i]t would be incorrect to presume that existing infrastructure, operations, and supervision and controls applicable to annuities easily and inexpensively can be modified for life insurance. To the contrary, it will be difficult and costly." R. 1350 (USAA Life Insurance Company of New York letter). DFS has ignored these warnings, clinging to the view that any costs associated with this regulation are "minimal," and focusing only on those who sell both federally regulated annuities and life insurance. See R. 204-205, 234-235, 281.

PROCEDURAL HISTORY

Appellants filed their petition in the Albany County Supreme Court on November 16, 2018. R. 74-384. Later that day, the National Association of Insurance and Financial Advisers filed its petition in New York County (R. 395-487); which it amended two weeks later. R. 488-621. Upon motion, the petitions were consolidated in the Albany County action, and assigned to Acting Supreme Court Justice Henry F. Zwack. On July 31, 2019, Justice Zwack issued his Decision and Order dismissing each petition on the merits. R. 10-53. The Decision and Order was filed with the Albany County Clerk on August 7, 2019 and served with notice of entry by mail on August 12, 2019. R. 8- 10. A notice of appeal was served and filed on September 10, 2019. R. 5-7. On February 27, 2020, this Court extended the time to perfect the appeal to May 11, 2020.

STANDARD OF REVIEW

It is well established that "[i]n a nonjury case where the evidence is sufficient as a matter of law to support a dispositive determination, this Court has the power 'to grant the judgment which upon the evidence should have been granted by the trial court.'" Maisto v. State, 154 A.D.3d 1248, 1253 (3d Dep't 2017), (internal citations omitted). It is especially true where, as here, the lower court's determination is not based on perceived credibility of witnesses. Nationstar Mtge., LLC v. Davidson, 116 A.D.3d 1294, 1295 (3d Dep't 2014). This case is appropriate for appellate de novo review, as the lower court, with all due respect, ignored the transformative and deleterious impact of the adopted regulatory scheme which usurps legislative function, violates the State Administrative Procedures Act and was arbitrary and capricious. Upon fresh review, this Court should reverse the lower court's decision and annul the regulation.

ARGUMENTS

POINT I
THE DEPARTMENT EXCEEDED ITS AUTHORITY

It is elementary that no branch of New York – executive, legislative, or judicial – may arrogate unto itself "powers residing wholly in another branch." Nicholas v. Kahn, 47 N.Y.2d 24, 30 (1979). If an agency promulgates a rule beyond the power it was granted by the legislature, "it usurps the legislative role and violates the doctrine of separation of powers." Matter of LeadingAge N.Y., Inc. v. Shah, 32 N.Y.3d 260 (2018). Any regulation promulgated in conflict or contravention to a law is beyond the authority of the agency, rendering such regulation unenforceable and a nullity. Sullivan Financial Group, Inc. v. Wrynn, 30 Misc.3d 366 (Sup. Ct.

Albany, 2010) *aff'd.*, 94 A.D.3d 90 (3d Dep't 2012). Nor can an agency override governing common law by regulatory fiat. See People ex rel. Cuomo v. First Am. Corp., 18 N.Y.3d 173, 179 (2011) (holding that power to preempt relevant common law lies with the legislature).

Here, the actions of DFS in promulgating the Regulation are not only contrary to existing law, but are purely legislative in that DFS, without legislative guidance, engaged in the very kind of policymaking, entailing fundamental choices among broad social and public policy goals, that resides exclusively with the legislature. The Regulation promulgated by DFS finds no support in the insurance code, and seeks to resolve a complex issue at the heart of a raging national debate by imposing an unworkable standard which deeply affects myriad interests among numerous parties across the state economy, and reverses decades of common law. Notwithstanding DFS's efforts to mask the effects and import of this Regulation, it is a game changer without comparison, except perhaps the discredited and abandoned DOL Fiduciary Rule.

To determine whether an administrative agency usurped legislative functions in New York, courts are guided by criteria laid out in Boreali v. Axelrod, 71 N.Y.2d 1 (1987). As explained more recently by the Court of Appeals, the Boreali criteria include four factors:

> whether (1) the agency did more than balanc[e] costs and benefits according to preexisting guidelines, but instead

> made value judgments entail[ing] difficult and complex choices between broad policy goals to resolve social problems; (2) the agency merely filled in details of a broad policy or if it wrote on a clean slate . . .; (3) the legislature has unsuccessfully tried to reach agreement on the issue . . .; and (4) the agency used special expertise or competence in the field to develop the challenged regulation.

Matter of LeadingAge, 32 N.Y.3d at 261-62.

The Court of Appeals instructs the Boreali criteria should not be rigidly applied but rather be treated as "overlapping, closely related factors that, viewed together, may signal that an agency has exceeded its authority" (internal quotes omitted). Id. at 261. The Court of Appeals explains how to apply these criteria in New York Statewide Coalition of Hispanic Chambers of Commerce v. New York City Department of Health and Mental Hygiene, 23 N.Y.3d 681, 696-697 (2014):

> Boreali sets out four "coalescing circumstances" present in that case that convinced the Court that the difficult-to-define line between administrative rule-making and legislative policymaking had been transgressed. We explained that while none of these circumstances, standing alone, is sufficient to warrant the conclusion that the Public Health Council has usurped the Legislature's prerogative, all of these circumstances, when viewed in combination, paint a portrait of an agency that has improperly assumed for itself the open-ended discretion to choose ends that is the prerogative of a Legislature.
>
> As the term "coalescing circumstances" suggests, we do not regard the four circumstances as discrete, necessary conditions that define improper policymaking by an agency . . . . Consequently, respondents may not counter petitioners' argument merely by showing that one *Boreali* factor does not obtain. (Internal quotes, brackets and citations removed.)

The Court of Appeals further explains the focus of this analysis:

> Any *Boreali* analysis should center on the theme that it is the province of the people's elected representatives, rather than appointed administrators, to resolve difficult social problems by making choices among competing ends. The focus must be on whether the challenged regulation attempts to resolve difficult social problems in this manner.

Id. at 697. (Citation omitted.)

By declaring that insurance agents and brokers, who for decades have acted as salespeople in arm's length transactions, must now act purely in the best interest of consumers, DFS has taken a matter into its own hands that has wide ranging social, political, and economic implications. DFS is stepping into an unknown world where insurance agents and brokers are expressly required to consider *only* what is in the "best interest" of a consumer, a vague and unworkable standard which has no existing analogue other than genuine fiduciaries such as ERISA administrators and bank trustees. As noted in Boreali, wisdom of the agency action is not the focus; rather the issue is whether the agency engaged improperly in policymaking to address a complex social issue. Id. at 692. Appellants submit that is exactly what DFS has done here.

The first factor of Boreali concerns whether the agency made value judgments involving tough tradeoffs among socially desirable ends. Value judgments lie at the heart of the best interest controversy that has been in play for decades – i.e., should society alter and elevate the longstanding standard of care required of insurance producers at the risk of upsetting existing delivery systems, adding costs for consumers and industry, and curtailing freedom of choice for consumers in the marketplace? In parallel developments in the securities industry, the issue has spawned endless studies, lawsuits and lengthy intricate cost-benefit analyses by DOL for its Fiduciary Rule. Under the circumstances, these are monumental, multi-faceted decisions, crying out for legislative direction.

In the Hispanic Chambers of Commerce case, the Court of Appeals directed that lower courts, to apply the distinction between policymaking and rulemaking must:

> differentiate between levels of difficulty and complexity in the agency's task of weighing competing values. For example, when an agency regulates the purity of drinking water, or prohibits the use of interior lead paint, or requires guards in the windows of high-rise apartments housing children, it chooses among ends . . . but the choices are not very difficult or complex. This is because the connection of the regulation with the preservation of health and safety is very direct, there is minimal interference with the personal autonomy of those whose health is being protected, and value judgments concerning the underlying ends are widely shared.

Id. at 699.

Here, DFS inappropriately crossed the line between policymaking and rulemaking by taking it upon itself to make inherently difficult and complex societal choices, where the connection to consumer welfare is tenuous (i.e., there is no direct proof that the changing legal standards will produce better financial outcomes), consumer autonomy to choose among financial providers is displaced by a regulator's imposition of fiduciary or fiduciary-like standards, and making value judgments concerning underlying ends which are a source of deep division as evidenced by ongoing debate both nationally and in New York.

The tradeoffs at stake in adopting the Regulation were minimized by DFS in its Regulatory Impact Statement and testimony in the lower court proceeding. Indeed, DFS tries to have it both ways, explaining how important the Regulation is for consumers while also claiming it will have minimal impact on consumers and industry as to issues of authority or costs. In truth, its impact is substantial, and tradeoffs will be significant, but all of that is camouflaged by DFS, thus evading any real discussion of competing values. Given this subterfuge, it is understandable that the lower court missed the magnitude of these value judgments.

First, DFS disguises the rationale for adopting the Regulation, pointing to increased complexity of products and supposedly increased reliance on financial advice. This generic rationale is hardly compelling considering insurance and annuity products have long been regarded as complex. Indeed, those products are filed with and approved for sale by DFS itself. DFS already has ample authority to address the type of improper sales activities it identifies as the rationale for the Regulation within preexisting suitability rules and other laws (licensing, etc.).

Additionally, this ignores that financial advice services are now ubiquitous and readily available/accessible. Second, DFS downplays the impact of the Regulation by suggesting it parallels or piggybacks on the DOL Fiduciary Rule, reasoning that is rendered a non-sequitur given the demise of the DOL Fiduciary Rule. R. 204-205, 234-235. Third, DFS portrays the cost of the Regulation as nominal even though a comparable regulatory proposal like the DOL Fiduciary Rule was subject to rigorous cost-benefit analyses more realistically admitting to significant impact and cost.[3]

In reality, the Regulation forces insurance producers to identify and sell only products that are in the "best interest" of the customer, which may have benefits but also carry with them enormous costs and risks for consumers, insurance producers, and insurance companies. Therefore, the Regulation constitutes a value judgment more suitable to resolution, consideration, and evaluation as part of public policymaking reserved to the legislature.

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[3] In contrast to a dearth of pages addressing cost in the DFS Regulatory Impact Statement (R. 2041-2047), the Regulatory Impact Statement of the DOL Fiduciary Rule was a 382-page analysis of costs and benefits, (*Dept. of Labor, Regulating Advice Markets (April 2016),* available at *http://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/ria.pdf*). Contrary to the approach taken by DFS, summarily denying any substantial costs associated with best interest requirements, the federal agencies acknowledged and sought to substantiate the impact and costs resulting from changed standards of care across an entire industry. The wide disparity helps show DFS failed to adequately assess the real effects of Regulation 187.

The second Boreali factor considers whether the agency promulgated the rule on a clean slate. Here, there is little doubt, as DFS's Regulation is an extreme outlier well beyond the bounds of New York's insurance code. DFS clearly "wrote on a clean slate, creating its own comprehensive set of rules without benefit of legislative guidance" rather than "merely fill[ing] in the details of broad legislation describing the over-all policies to be implemented." Boreali, 71 N.Y.2d at 13.

Regulation 187 is also far beyond the interstitial rulemaking as referenced in Boreali and explained in Nicholas, 47 N.Y.2d at 31 ("the cornerstone of administrative law is derived from the principle that the Legislature may declare its will, and after fixing a primary standard, endow administrative agencies with the power to fill in the interstices in the legislative product by prescribing rules and regulations consistent with the enabling legislation"). In Nicholas, the Legislature set the standard, authorizing the Public Service Commission Chairman to adopt a code of ethics, and the Court upheld the resulting rules issued by the Chairman within that framework. In contrast, here, with no legislative involvement, DFS set its own standard for the insurance industry, rather than exercising authority "by promulgating rules within the boundaries of its legislative delegation." Id. at 28.

There is no question the Regulation operates contrary to existing statutes and goes far beyond even the broad regulatory authority given to DFS. The statutory language and structure of the New York Insurance Law do not authorize DFS to impose a best interest or fiduciary standard upon insurance producers under the guise to "implement" the intent of the legislature. See Jewish Home & Infirmary v. Commr. of N.Y. State Dep't of Health, 84 N.Y.2d 252, 262–63 (1994) (holding retroactive rate-making impermissible because "the statutory language and design do not support it"). Although DFS cites to a few provisions for its purported statutory authority, none contemplate the application of a "best interest" standard to sales and brokerage in the life insurance industry, especially without a comparable federal counterpart. The provisions cited by DFS only authorize the Superintendent to prescribe regulations generally, see N.Y. Fin. Servs. L. § 302, N.Y. Ins. L. ("NYIL") § 301; authorize the Superintendent to make inquiry of insurance producers and suspend their licenses for infractions, see NYIL §§ 308, 2110; and prohibit insurance producers from making misstatements, competing unfairly or deceptively, and discriminating, see id. §§ 2123, 2401-2409 (art. 24), 4224, 4226. If this Regulation is permitted to stand under these circumstances, there will essentially be no limitation to the ability of DFS to adopt regulations beyond those specifically authorized.

Rather, as should be the case within the proper framework of the law, the statutory scheme in fact acts *to preclude* implementing a broadly applied "best interest" standard through regulation. In all the provisions DFS cites, only one minor subsection expressly mentions a "best interest" standard, which relates to public adjusters. See N.Y. Insurance Law § 2110(a)(l5). Because the statute imposes a best interest standard in this limited circumstance, the standard necessarily *does not* apply to any other circumstance pursuant to the maxim *expressio unius est exclusio alterius*. Indeed, courts in this state have not hesitated to strike down regulations promulgated by DFS or its predecessor, the New York Insurance Department, for similar reasons. See Mazgulski v. Lewis, 118 Misc.2d 600, 606–07 (Sup. Ct. N.Y. Co. 1982) (addressing *expressio unius* argument and annulling regulation because "the Superintendent has forged a new policy not reasonably to be implied from the statutes and in contradistinction to the history of these statutes"), *aff'd*., 96 A.D.2d 1154 (1st Dep't 1983), *aff'd*., 63 N.Y.2d 992 (1984).

Other sections of the New York Insurance Law further underscore that the Regulation is impermissibly inconsistent with the governing statutory scheme. The New York Insurance law prescribes the standard of care for various discrete situations, such as investments made by life insurers, see N.Y. Ins. Law § 1405(c), or the fiduciary duty owed to policy owners by life settlement brokers, see Id. § 7813(*l*), but it does not provide for a best interest standard of care by producers who sell life insurance. See Jewish Home, 84 N.Y.2d at 262–63; cf. Russello v. United States, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another. . . it is presumed that Congress acts intentionally and purposely. . ."). The New York Insurance Law devotes an entire section to "Unfair Methods of Competition and Unfair and Deceptive Acts and Practices," consistent with a statutory scheme designed around fair and honest conduct, but nowhere is there any mention or granting of authority to create a "best interest" or fiduciary standard. See N.Y. Insurance Law §§ 2401-2409 (Article 24).

There is simply no evidence the legislature ever intended for DFS to implement a best interest standard of care regulating the sale of life insurance and annuities. Nor did it create any framework allowing DFS to "fill in the details" with a best interest standard of care. All existing statutes governing New York agents and brokers impose consistent standards of fairness and honesty upon insurance industry intermediaries within boundaries that fall well short of best interest, and thus DFS operates here on a clean slate. DFS impermissibly created its own "comprehensive set of rules" without any legislative guidance.

The third Boreali factor concerns whether the legislature tried unsuccessfully to address the issue, evidencing "the Legislature has so far been unable to reach agreement on the goals and methods that should govern in resolving a society-wide [health] problem." Boreali, 71 N.Y.2d at 13. Agency rulemaking is improper where there is "legislative indecisiveness on the policy issue." Health Ins. Ass'n v. Corcoran, 551 N.Y.S. 2d 615, 622 (3d Dep't 1990). Appellants submit this policy issue has already been the subject matter of such "indecisive" legislative attention –

which is very likely to increase in the future – thereby foreclosing agency action in the absence of legislative agreement.

For example, the New York State Assembly has considered—and failed to pass—a bill called the Investment Transparency Act to regulate the behavior of non-fiduciary advisors. See N.Y. Legis. Assemb. A2464A Reg. Sess. 2017-2018 (2017); N.Y. Legis. Assemb. A6933 Reg. Sess. 2015-2016 (2015). More recently, a companion bill was introduced in the Senate (Senate Bill S2872A). The bill amends the General Obligations Law and applies to any financial professional who holds out as a financial planner, financial consultant, retirement planner or any similar title. By its own terms, this would include insurance agents or brokers who hold themselves out in this fashion. The bill requires that specific disclosures must be given to consumers including that the professional is not a fiduciary and does not act in the best interest of the consumer.[4] The bill is based on a New York City Comptroller report titled "Safeguarding Our Savings: Protecting New Yorkers Through the Fiduciary Standard" issued in March 2015.

[4] The bill applies to "non-fiduciary investment advisors" defined to "include, but not be limited to individuals or institutions that identify themselves to consumers as 'brokers,' 'dealers,' investment advisors,' 'financial advisors', 'financial planners,' 'financial consultants,' 'retirement planners,' 'retirement brokers,' 'retirement consultants,' or any other term that is suggestive of investment, financial planning, or retirement planning knowledge or expertise." The terms are clearly intended to capture insurance agents and brokers who hold themselves out in this manner.

In fact, spanning the past three legislative sessions, the legislature engaged in a robust debate over this bill, and during this time it has passed committees, but never gained traction for passage by the entire legislature. As noted, the proposed law would require financial professionals to disclose they are not required to act in the customer's best interest, a more modest undertaking based on disclosure compared to the invasive approach taken by the Regulation. The lower court erroneously dismissed this legislation as irrelevant for purposes of this case because it was not "geared toward 'producers.'" R. 42. But clearly, by its own terms, it is.

Here, the legislature has yet to reach agreement on goals and methods that should govern financial professionals who are not otherwise subject to a fiduciary duty, including insurance intermediaries; yet DFS cuts the line and prematurely steps in with its own regulatory solution. <u>See</u> <u>Boreali</u>, 71 N.Y.2d at 13. DFS should not be allowed to surpass the legislature by imposing a best interest standard, which is not only unauthorized by the legislature, but which goes beyond what the legislature even considered. Indeed, the legislature could not even pass a law seeking disclosure, yet DFS claims it can force producers to become fiduciaries through regulatory fiat, clearly implicating the third of the <u>Boreali</u> factors.

Turning to the fourth and final <u>Boreali</u> factor, DFS used no special expertise or technical competence to adopt a best interest standard. Here the Court must look to whether DFS actually used its technical competence to "flesh out details of the broadly stated legislative policies embodied in" the state's insurance laws. Boreali 71 N.Y.2d at 14. There is nothing within the Regulation itself, nor the Regulatory Impact Statement, to evidence DFS used any such expertise. There is simply no discussion of any specialized knowledge used or possessed by DFS in a technical analysis of what best interest means, what are its elements, how it relates to fiduciary duty, whether there are differing levels of such duties, etc. It is worth noting that DFS does not regulate ERISA plans nor does it regulate securities brokers and investments advisers in New York. Thus, it lacks the depth of knowledge possessed by other agencies that have contended with issues of this nature over many years within their natural regulatory spheres. Although DFS claimed in its response to public comments that it "maintains unique expertise related to comprehensive insurance markets and products," such generalized knowledge is not the technical competency needed for an agency to venture into the complex realm of fiduciary duty. Instead, DFS took an improper and misguided shortcut by attempting to mimic the rejected and abandoned DOL Fiduciary Rule.

As a final note regarding Boreali analysis, it is worth emphasizing that under Boreali and its progeny, the Regulation is *de facto* improper legislative policymaking because DFS did more than merely adopt a discrete, properly tailored regulation. Like the health agency that adopted the ill-fated "portion cup rule" in Hispanic Chambers of Commerce, in this case too DFS wrestles with complex value judgments that, among other things, intrude into personal autonomy. Like that agency, DFS could have come up with targeted solutions, staying within legislative boundaries, such as warnings to consumers of potential conflicts of interest of their agents or brokers or possibly alerting consumers of their option to seek advice from fiduciaries such as investment advisers. Instead, DFS dove head-first into "difficult, intricate and controversial issues of social policy" through its Regulation. See Hispanic Chambers of Commerce, 23 N.Y.3d at 699. Specifically, DFS decided that it could institute a fundamental change to how life insurance is sold without legislative guidance, without analysis of the costs, and overturning years of case law precedent as explained below.

While DFS may have broad domain as the insurance regulator in New York, DFS does not have a blank check and steps out of bounds where it acts in a legislative capacity. DFS exceeded its authority in promulgating the Regulation and the result of the lower court must be reversed.

POINT II

THE REGULATION VIOLATES THE STATE ADMINISTRATIVE PROCEDURES ACT

How much does DFS believe the Regulation will cost? We have no idea because DFS failed to comply with mandatory requirements of the State Administrative Procedure Act ("SAPA"), which is designed to prevent promulgation of flawed regulations, no matter how well meaning. The purpose of SAPA is "to ensure that regulators will adopt rules 'for the purely practical purpose of attempting to make a legislative program work.'" (Citations omitted.) Matter of Medical Soc'y. v. Levin, 185 Misc.2d 536, 545 (Sup. Ct. N.Y. Co. 2000), *aff'd.*, 280 A.D.2d 309 (1st Dep't 2001). SAPA's legislative purpose statement says it "guarantees that the actions of administrative agencies conform with sound standards developed in this state and nation since their founding . . ." SAPA § 100. The inadequate record in support of the DFS Regulation fails to satisfy basic SAPA requirements and thus renders the Regulation unsound and invalid.

A. DFS Failed to Comply with SAPA § 202-a(3).

SAPA § 202-a (3) requires that the Regulatory Impact Statement contain the following information:

> A statement detailing the projected costs of the rule, which shall indicate:
>
> (i) the costs for the implementation of, and continuing compliance with, the rule to regulated persons;
>
> (ii) the costs of implementation of, and continued administration of, the rule to the agency and to the state and its local governments; and
>
> (iii) the information, including the source or sources of such information, and methodology upon which the cost analysis is based; or
>
> (iv) where an agency finds that it cannot fully provide a statement of such costs, a statement setting forth its best estimate, which shall indicate the information and methodology upon which such best estimate is based and

> the reason or reasons why a complete cost statement cannot be provided.

(Emphasis added.)

DFS failed to make any estimate. As explained above, whereas comparable federal rulemaking proposals establishing new legal standards for financial professionals contain extensive cost-benefit analysis, including cost projections, DFS has nothing. DFS is in violation of the above statutory mandate, which, *at a minimum*, requires a statement setting forth a best estimate, the information and methodology upon which such estimate is based, and the reason or reasons why a complete cost statement cannot be provided. NY SAPA § 202-a (3)(c)(iv).

DFS did not even do this. Their Regulatory Impact Statement in all of its various iterations glaringly lacks the statutorily required cost information demanded by SAPA. Instead, DFS offers only unsubstantiated one-dimensional conclusions that any costs will be minimal and any impact insubstantial. The analysis contains a hodgepodge of information that is contradictory on its face, fails to address costs beyond glossing over administrative compliance, and is fatally defective in its lack of numerical estimates to gauge the ultimate cost impact of this Regulation on affected parties.

The superficiality of the DFS Regulatory Impact Statements is plainly visible throughout its various iterations[5] which are replete with comments such as:

> *"The amendment takes a principle-based approach to compliance . . . which is expected to greatly minimize cost."*
>
> *"Many insurers were already preparing to implement the DOL Rule . . ."*
>
> *"[M]ost insurers need only incur minimal additional costs to comply with the requirements of this rule."*
>
> R. 234, 348, 317.

These statements are not only misleading on their face, but they are fatally undocumented, unquantified, and unsupported by any semblance of facts and figures. Instead, hedge words like "many," "most", and "greatly" are unacceptably imprecise under SAPA. No sources or methodologies are cited in support of these findings as required by SAPA. These are merely sweeping amorphous statements that conveniently allow DFS to reach the conclusion that it desires.

Remarkably, DFS proclaimed regardless of the fate of the DOL Fiduciary Rule, it believed the Regulation was "necessary for the protection for New York consumers," and claimed the then-proposed SEC regulation was not "desirable" because it "relies primarily on disclosure of conflicted advice." R. 310-311. In fact, the DOL itself recognized its rule was costly to implement, and even DFS

[5] The Regulatory Impact Statement was initially released with the rule proposal on December 27, 2017, updated with the re-issued proposal on May 16, 2018, then updated again on adoption August 1, 2018. R. 1204-1205.

acknowledged that substantial costs were incurred by insurers to comply with the DOL Fiduciary Rule. Despite this, DFS again attempted to piggyback around its SAPA duty claiming "many insurers were already preparing to implement the DOL Rule . . . by making changes to processes, procedures, and technology," adding that "firms that already comply with the [DOL] Rule have minimal additional costs to comply with the [proposed] amendment." R. 234, 348. Seemingly unaware of its blatant inconsistency and egregious SAPA violation, DFS still somehow insists the insurance industry would incur virtually no cost to comply with its Regulation. This position does not make sense since the insurance industry obviously had been incurring substantial cost trying to come into compliance with its federal counterpart, the DOL Fiduciary Rule, and those costs have been expressly acknowledged by DFS. Certainly, with the DOL Fiduciary Rule overturned, it is hollow and self-serving for DFS to claim that all of the expected costs associated with its implementation magically evaporated.

Other faulty assumptions are strewn throughout the DFS analysis. It says "producers will already have in place standards and procedures that can be leveraged to comply with this amendment" – but best interest is a whole new paradigm different from suitability that requires insurers and intermediaries to establish systems and procedures to address the influence of compensation on sales. R. 235, 347-348. It says it anticipates "future costs may decrease over time by establishing one consistent best interest standard." This statement is pure speculation as there are currently no other federal or state standards equivalent to the Regulation. Id. At every turn, DFS wishes away tangible costs associated with the Regulation, and replaces them with imprecise vague qualifiers and hedge words without any citation to sources or attempt at quantification.

The DFS analysis also ignores the various effects of this Regulation beyond pure compliance costs. As stated previously, the record is replete with examples of broader, far-reaching costs extending beyond administrative recordkeeping, which remain unaddressed and overlooked. R. 151-165, 1364, 1402, 1218-1335. These too are costs, no doubt difficult to assess, but which DFS cannot simply ignore.

Paramount to the above defects in the Regulatory Impact Statement, is the complete lack of any dollar figures. SAPA does not allow this. The history of SAPA § 202-a(3)(c) shows the legislature purposely tightened the cost estimate requirements. R. 882-1101. In 1990, the legislature added the requirement of a "best estimate," as well as disclosure of information and methodology upon which the estimate is based. R. 870-876. The Executive Chamber Memorandum accompanying the 1990 legislation explained the purpose:

> "[s]trengthens the cost analysis component of the regulatory impact statement by requiring an agency, where it is not able to provide a complete analysis, to provide at least its best estimate of the costs of a new rule to regulated parties and the information and methodology upon which the estimate is based. The requirement of a best estimate

> does not mean that, in all cases, an agency must project an actual dollar figure. Rather, a best estimate could be a range within which the agency anticipates the actual cost will fall or a description of the formula employed by the agency in projecting costs, including the known and unknown cost variables."
>
> R. 895

No best estimate – not even a range, or description of a projection formula - is provided by DFS. Therefore, DFS failed to meet its obligations under SAPA.

The lower court inexplicably gave DFS a pass on its obligation to provide a cost estimate, saying only "the efforts of DFS in this regard are amply sufficient," and then turning the tables on Appellants by criticizing petitioner assertions as "vague and inconclusive." R. 38. This misses the point. It is not Appellants' obligation to provide a cost analysis. By statute, the burden is on DFS to supply an estimate of cost which it failed to do. In reversing the burden and accepting mere conclusory statements by DFS in lieu of true cost analysis, or even a minimal best estimate, the lower court erred in dismissing the petition.

B. <u>DFS Failed to Comply with SAPA § 202-a(3)(h).</u>

SAPA § 202-a(3)(h) requires DFS to provide a statement identifying whether the rule exceeds minimum federal standards, and if so, explain why the rule exceeds such standards. DFS failed to do this. Clearly the original justification was to mimic the DOL Fiduciary Rule. However, once the DOL Rule faltered, DFS's explanations in its Regulatory Impact Statement with respect to federal standards turned into nothing more than a mantra insisting DFS must carry forward requirements under a discredited federal regulation (indeed expanding its application to non-qualified products and life insurance), but providing conclusory statements lacking any cogent rationale or substantive commentary explaining why New York regulations should exceed federal standards and how that would impact industry and consumers in New York.

In support of its Regulation, DFS merely stated:

> Following the court's vacating of the DOL rule that applies a fiduciary duty to certain retirement funded transactions, the federal government is not appealing the decision and has let the rule die. An SEC proposed rule regarding suitability, applicable to variable products, has not been promulgated. The regulation would not be inconsistent with the SEC proposed rules but rather extend the protections afforded under the rules.

R. 320-321.

DFS fails to explain its rationale for implementing a radical, drastic change in standards for insurance producers once there was no federal counterpart. Its evolving explanation, with changing circumstances, amounted to nothing more than "the Department believes that the best interest standard is an important consumer protection and intends to pursue this protection for New York consumers . . ." R. 341.

Subsequent to the underlying petition, in June 2019 the United States Securities and Exchange Commission ("SEC") adopted Regulation Best Interest, or

"Reg BI", taking effect in June 2020. It established a standard of conduct for securities firms and brokers "to act in the best interest of the retail customer at the time a recommendation is made without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer." The SEC rule does not apply to insurance-only transactions or to most insurance producers (unless dually licensed as security agents).

While ostensible similarities may exist between the SEC's Reg BI and DFS's Regulation 187, it is the differences that stand out and expose the overreach of Regulation 187. Reg BI was expressly authorized by Congress in the Dodd-Frank Act.[6] Regulation 187 came from improper policymaking by DFS. Reg BI contains specific "obligations" that give meaning and boundaries to a best interest standard. Regulation 187 is open-ended allowing for the most far-reaching meaning to attach to its best interest standard.

Moreover, when DFS invoked the SEC Proposed Rule in its Regulatory Impact Statement, it described the Regulation as "not inconsistent" with then-emerging SEC requirements. However, recent events have proven that description to be false. Following the lower court's decision herein, the New York Attorney General sued the SEC in the United States District Court for the Southern District of

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[6] In the decision striking down the DOL Fiduciary Rule, the Court recognized Congress gave authority to the SEC to adopt regulations on standards of care, but not to DOL. Chamber of Commerce, 885 F.3d 386; R. 370.

New York (Docket No. 1:19-cv-08365) claiming the SEC regulation is deficient. New York joins several other states in contending the SEC did not go far enough, alleging the SEC regulation fails to establish standards for brokers equivalent to those applicable to investment advisers (i.e., fiduciary duty). The lawsuit specifically criticizes language within the regulation saying broker-dealers must act in the best interest of the retail customer "without placing the financial or other interest of the broker-dealer . . . ahead of the interest of the retail customer." The lawsuit contends Reg BI should instead say "without regard to the financial or other interest of the broker-dealer" to satisfy the authority granted by Congress in the Dodd-Frank Act. That verbiage, which is given such significance by the Attorney General - not coincidentally - is equivalent to Regulation 187 provisions saying an agent may "only" consider the interests of the customer. The New York Attorney General's position therein proves Appellant's very points here, i.e., best interest regulations vary, best interest regulations may amount to fiduciary duty, and legislative authority controls. Yet despite this, Regulation 187 remains undisturbed as a quasi-fiduciary rule never authorized by the New York legislature.

Thus, the Regulation exceeds federal standards, fails to provide reasons for doing so and fails to address their resulting impact in violation of SAPA.

C. DFS Failed to Comply with SAPA § 202-b.

SAPA requires DFS to "consider utilizing approaches that will accomplish the objectives of applicable statutes while minimizing any adverse economic impact of the rule on small businesses." Once again, the Regulatory Impact Statement consists of conclusory statements which disregard valid concerns raised by and on behalf of agencies and brokerages severely impacted by these new requirements.

As such, by providing only cursory examination of the Regulation's effect it is evident that DFS turned a deaf ear to small businesses. When presented with concerns about the cost and impact of the Regulation on small business owners, the Department stated:

> Some 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 that these gross overestimations were a strategy to dissuade the Department from taking action rather than a good faith attempt to estimate actual costs. R. 282.

While DFS has discretion to weigh the information it receives from interested parties, it cannot dismiss input and information from small businesses without offering its own estimate of cost and impact. DFS resolutely refuses to address *bona fide* concerns about this Regulation voiced by small businesses, clinging to an overly narrow and unrealistic view that the Regulation's only effect will be to require extra administrative paperwork. As explained elsewhere herein, the Regulation will have far deeper effects on insurance producers, their product offerings, manner of doing business, risks, and costs. Yet once again, the Regulatory Impact Statement, fails to address the concerns of small businesses and fails to consider less harmful alternatives, thereby violating SAPA. Indeed, the lower court's decision and order seems to address the costs to "insurers" alone and not the specific expenses sustained by producers, who are primarily small businesses. In doing so, the lower court not only condoned a clear SAPA violation, but also failed to consider the Regulation's impact on the constituency to which it most directly applies. R. 39-40.

For all the foregoing reasons, the Regulatory Impact Statement in support of the Regulation is deficient under SAPA, and the lower court decision must be reversed and the Regulation annulled.

POINT III

THE REGULATION IS ARBITRARY AND CAPRICIOUS

Alternatively, even if DFS had the authority to promulgate the Regulation, it can only be upheld if it has a rational basis and is not unreasonable, arbitrary, or capricious. Grossman v. Baumgartner, 17 N.Y.2d 345, 349 (1966); Levine v. Whalen, 39 N.Y.2d 510 (1976). Administrative rules are "not judicially reviewed pro forma in a vacuum but scrutinized for genuine reasonableness and rationality in the specific context." New York State Ass'n of Counties v. Axelrod, 78 N.Y.2d 158, 166 (1992) (internal citations omitted).

To stand, the regulation must have "adequate record support or correlation to the reasons" for promulgation. Id. at 167. This requires "a rational, documented, empirical determination," and not merely unsubstantiated "theory and assumption" arrived at without "empirical documentation, assessment and evaluation." Id. at 167-68. Absent an "adequate predicate" in the administrative record, the Regulation must be annulled. Matter of Jewish Memorial Hosp. v. Whalen, 47 N.Y.2d 331, 336 (1979).

Regulations must also not be irrational on their face. Kelly v. Kaladjian, 589 N.Y.S. 2d 730 (N.Y. Sup. Ct. 1992) (finding regulation "patently absurd as theory"). If so, they are arbitrary and capricious and must be annulled. Siegel and Connors, New York Practice § 561, at 1077 (Sixth Edition 2018) (arbitrary and capricious "is action 'without sound basis in reason and . . . without regard to the facts.'. . . [T]he determination is 'arbitrary and capricious' if the court finds that the conclusion drawn from them, or the administrative action taken based on them, is untenable as a matter of law.") (quoting Pell v. Board of Education, 34 N.Y.2d 222, 231 (1974)).

Here, without the benefit of legislative guidance on how to undertake its task, as discussed *supra*, DFS veered far from its regulatory purpose and mission, approaching the matter in an arbitrary and irrational manner. This led to a Regulation devoid of any meaningful cost-benefit analysis, in conflict with the established statutory framework and basic common law principles, and containing irrational elements such as conflicts for insurance agents now required to serve two masters (customer and insurer). Given all the above, the explanations supplied by DFS for adoption of the Regulation do not withstand scrutiny.

Indeed, DFS seemingly sought to emulate the DOL Fiduciary Rule as a beacon of enlightened regulation, despite the inappropriateness of broadly applying such standards of care to insurance intermediaries who sell annuities and life insurance and its demise on a national level. In this setting, there is no meaningful explanation why comparable requirements should be adopted for New York insurance agents and brokers. Although the DOL Fiduciary Rule had its own flaws and was struck down, it was built from the ground up, a culmination of years of study and rulemaking, accompanied by lengthy justifications and documented cost-benefit analysis. DFS, in contrast, set its sights on a best interest standard from the start and the record reflects this flawed "reverse" approach, starting with a desired outcome and working backwards to justify and create the Regulation.

When compared to the in-depth cost-benefit analysis done by the Department of Labor together with voluminous explanations, DFS did next to nothing.[7] The Court of Appeals has explained "the promulgation of regulations necessarily

[7] DOL first proposed an expanded fiduciary rule in 2010 (75 FR 65263), but after receiving over 300 comments and holding public hearings, withdrew the rule, revised it, and re-released a package of regulations in 2015 amounting to over 1000 pages which collectively is the Fiduciary Rule.(80 FR 21928). Following more public hearings, thousands of comment letters, and additional studies, DOL released its final rule in 2016 (81 FR 20945) which was followed by several delays before being overturned in court. R. 352-380.

involves an analysis of societal costs and benefits. Indeed, cost-benefit analysis is the essence of reasonable regulation; if an agency adopted a particular rule without first considering whether its benefits justify its societal costs, it would be acting irrationally." Hispanic Chambers of Commerce, 23 N.Y.3d at 697. DFS did no such analysis, offering only conclusory findings on benefits and costs, the kind found objectionable by the Court of Appeals in Ass'n of Counties, 78 N.Y.2d at 168 and the First Department in Matter of New York State Land Tit. Assn., Inc. v New York State Dept. of Fin. Servs., 169 A.D.3d 18 (1st Dep't 2019). DFS was derelict in its regulatory duty as its perfunctory "analysis" lacked any disciplined review of advantages and disadvantages, pros and cons, benefits and costs, or alternatives of the Regulation.

Specifically, without any attempt to quantify costs to consumers and regulated parties, DFS adopted an unparalleled, unworkable standard, inarguably one that goes beyond any other state or federal standards for insurance sales professionals, ushering New York into completely uncharted territory without any meaningful measure of its impact. Thumbing its nose at administrative rulemaking requirements (as explained above), which are particularly needed for such far-afoul regulations such as this. DFS dismissed industry survey findings and agent affidavits addressing consumer cost and requests for cost studies, forging ahead undeterred towards its preordained conclusion, i.e., cost is minimal and any adverse impact inconsequential.

Absent that, it is difficult to think of any actual justification for DFS's claim that it was being asked "to measure the immeasurable" and declaration that "preventing consumer harm far outweighs <u>any</u> administrative costs imposed by the Regulation." R. 347. (Emphasis added.) Even if both were true, which Appellants dispute, DFS still has an obligation to understand the impact of its rulemaking and seek in earnest to weigh benefits against costs, addressing questions such as: How much will compliance cost? What will happen to product cost and how will that impact performance? What will happen to product availability? How will the delivery system be impacted? How many jobs will be affected? How will extension of these standards to life insurance affect that segment of the market? DFS did not even feign an attempt to do so, and thereby engaged in arbitrary and capricious rulemaking.

Not only are costs of the Regulation unexplored, but its supposed benefits are equally questionable. Without any quantification or specifics, DFS contends that purchase of annuities and life insurance has become a more complex financial transaction, resulting in a greater reliance on financial advice. R. 309, 340. It adds – without any details or identification of actual marketplace problems – that a number of "investigations, examinations, and observations" since 2013 "demonstrated the need" that regulation is necessary "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." R. 309, 340. This is quite an indictment of the insurance industry, yet there is not a shred of real evidence in the record to support it. Typical throughout, DFS's justifications are entirely built on inferences and lack any specificity whatsoever.

To be clear, DFS fails to explain how existing suitability and other compliance requirements are insufficient, and how adoption of a best interest standard would benefit consumers (beyond giving DFS a potent weapon to wield at will against whomever it chooses). As to life insurance specifically, DFS never explains why it could not merely extend existing suitability requirements to life products, rather than implementing the extreme best interest standard. In briefing below, echoed in the lower court decision, DFS cites "recent" issues and problems, creating the aura of crisis to support the Regulation. However, DFS is merely repurposing longstanding industry issues to serve its own end game. The fact is that DFS already has authority to investigate and remedy the very problems it conjures up. The "proliferation of life products and annuities" referenced by DFS mainly refers to products that entered the marketplace between the 1950s to early 2000s. The use of annuities and insurance as investments goes back decades; as do producer compensation practices including front-end commissions, which remain essentially unchanged. Likewise, life insurance lapse rates are not novel.[8]

As with costs, the record is barren of concrete facts to support purported benefits, relying on "theory and assumption" without "empirical documentation, assessment and evaluation" as demanded of rational rulemaking. Ass'n of Counties, 78 N.Y.2d at 167–168. DFS claims that there will be vast benefits from the Regulation, but it is pure conjecture, lacking even a modicum of analysis, documentation, evaluation, or explanation. As to annuities, DFS fails to demonstrate why prior suitability rules are deficient in addressing its repurposed concerns. As to life insurance, DFS fails to demonstrate that extension of suitability rules to life products would be inadequate. Instead, DFS jumps straight to its desired conclusion that the panacea is a best interest standard. Put simply, "its predicates are entirely

[8] In section III of the Regulbuto affidavit, DFS describes policies that combine life and long-term care insurance, term policies with return of premium riders, whole life insurance, participating versus non-participating policies, universal life, indexed universal life, and variable universal life insurance. R. 1180. This is a clear effort to create confusion and suggest that life insurance has become more complex due to the plethora of choices. However, all these kinds of policies have existed for years and in many cases decades. The same is true of different kinds of annuities mentioned by DFS, including immediate and deferred, indexed and variable, and add-on benefit riders. R. 1181. Importantly, the study referenced by DFS concerning lapse rates for life insurance covers years 2009 to 2013 and does not say lapse rates are increasing; in fact, the study indicates lapse rates in the 2009 to 2013 period *are lower than prior study periods*. R. 1186 n.3 and n.4. Lapse rates are also a red herring since many factors cause lapses and any issues at time of sale such as affordability are addressable by a suitability rather than a best interest framework. None of this supports the proposition advanced by DFS that the marketplace is suddenly more complex or has changed in adverse ways. It is another example of DFS using a lot of words to say very little of substance in order to camouflage its own deficiencies.

conclusory," which is why adoption of the Regulation is arbitrary and capricious. Ass'n of Counties, 78 N.Y.2d at 168.

The Regulation itself is also irreconcilable with governing law and irrational on its face with respect to insurance sales. As explained above, existing New York insurance statutes recognize that insurance agents and brokers sell insurance on an arm's length basis and command they do so in a manner that is fair and honest; but nowhere in the law are agents and brokers deemed to be fiduciaries, or held to a best interest standard wherein their own interests must be completely ignored. This is not by accident, but by design, in recognition that insurance agents and brokers have prescribed duties and responsibilities consonant with their profession as salespeople. As such, they solicit interest in and promote specified products, and cannot be reasonably expected to act *exclusively* in the interest of a consumer, to the detriment of their own profession, livelihood, and the insurance company they work for.

The Regulation mandates "only the interests of the consumer shall be considered." R. 142. Notwithstanding any efforts by DFS to relax this extreme requirement through after-the-fact interpretation (to save it from its own literal words), on its face, the Regulation presents an impossible standard to meet and invites DFS's unfettered discretion. Thus, even if a producer offers high quality products that satisfy consumer needs, and she tries her best to get the right policy, the producer faces an impossible task based on the nature of the transaction itself, which will either paralyze the sales process or render the producer perpetually vulnerable to legal action by customers seeking to rewrite their policies based upon changed circumstances. Liability exposure of insurance agents and brokers would be at the whim of their customers and DFS.

Therefore, the Regulation needlessly creates and exacerbates an insoluble conflict for agents. Due to its extreme demand that agents act *only* in the interests of the consumer, the Regulation puts an agent in an impossible dilemma, owing undivided loyalty to its principal, the insurer, while simultaneously owing undivided loyalty to the consumer. At the same time, the Regulation subjects insurers to vicarious liability for agents who violate their duty of loyalty to the consumer, even though the agent owes a duty of loyalty to the insurer too, creating a circle of confusion and disarray. Naturally, DFS does not (and it is submitted that they cannot) explain how the parties can reconcile these tensions to create certainty as to whose interests an agent must serve.

The scenario once again underscores the Regulation's failure to comport with the statutory framework. The same best interest standard here is applied to all producers without recognition that an agent, unlike a broker, under New York statutes is "an agent of an insurer" and not of the customer.[9] As such, the agent owes

[9] The Regulation's application to all insurance intermediaries —both agents and brokers—vitiates statutory distinctions. As set forth in Insurance Law § 2101, an "insurance broker" "solicit[s], negotiat[es] or sell[s]" insurance, "on behalf of an insured other than himself, herself or itself . . ."

its principal, "a duty of loyalty and an obligation to act in the best interests of the principal," Dubbs v. Stribling & Assocs., 96 N.Y.2d 337 (2001), as well as an "implied good faith obligation [to] use his best efforts to promote the principal's product." Griffin & Evans Cosmetic Mktg. v. Madeleine Mono, Ltd., 73 A.D.2d 957 (2d Dep't 1980). An agent's "duty is single, and he cannot serve two masters with antagonistic interests." Rabinowitz v. Kaiser-Frazer Corp., 111 N.Y.S.2d 539 (Sup.Ct. Kings Co. 1952);

It is admittedly impossible to foresee all circumstances where these competing obligations may clash. However, certain examples and scenarios are not difficult to fathom, considering the agent somehow represents *only* the interests of the consumer and *only* the interests of the insurer, i.e., buyer and seller in the same transaction. For example, if an agent acquires confidential knowledge in the course of a transaction, to whom would primary loyalty be owed?

DFS failed to address this issue at all, ignoring relevant and instructive lessons on the dichotomy between arms-length salespeople and fiduciary advisers pertaining to the securities industry. In its dubious attempt to harmonize standards across the financial services industry, DFS seeks to hold insurance agents and brokers to the

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In contrast, an "insurance agent" is the "agent of an insurer, who acts as such in the solicitation of, negotiation for, or sale of, an insurance contract, other than as a licensed insurance broker . . ." Also, the Regulation arguably puts the agent in the position of acting as an unlicensed insurance broker in violation of Insurance Law § 2102.

same standard of care historically applied to investment advisers. However, in doing so, DFS exhibits no awareness of well-recognized obstacles in pursuing that objective let alone how to address them. The Fifth Circuit struck down the DOL Fiduciary Rule largely because the agency blurred the distinction between advisers as fiduciaries and brokers as transaction-based intermediaries without proper authority or attention to these differences. See Chamber of Commerce, 885 F.3d at 376 ("that DOL contradicts its owns longstanding, contemporary interpretation of an 'investment advice fiduciary' and cannot point to a single contemporary source that interprets the term to include stockbrokers and insurance agents indicates that the Rule is far afield from its enabling legislation"). Similarly, DFS ignores these lessons and offers no insight on how its extreme rule can be reconciled with practical realities of insurance sales and existing statutes and case law.

Longstanding New York precedent supports and builds upon the premise there is no fiduciary standard in insurance law consistent with the underlying statutory framework. New York courts have long resisted claims against insurers and their intermediaries based on alleged extraordinary duties or higher standards of care, knowing the serious implications of departing from time-honored precedent holding salespeople are not fiduciaries. "The general rule [is] that the relationship between the parties to a contract of insurance is strictly contractual in nature" and "no special relationship of trust or confidence arises out of an insurance contract between the insured and the insurer" because "the relationship is legal rather than equitable." Batas v. Prudential Ins. Co. of Am., 281 A.D.2d 260, 264 (1st Dep't 2001).

In Murphy v. Kuhn, 90 N.Y.2d 273 (1997) the Court of Appeals warned of dire consequences if insurance producers were made fiduciaries:

> Insurance agents or brokers are not personal financial counselors and risk managers, approaching guarantor status id.).. . . [P]ermitting insureds to add such parties to the liability chain might well open flood gates to even more complicated and undesirable litigation.

Murphy, 90 N.Y.2d at 273.[10]

Although Murphy discussed property casualty insurance, the same concerns attach to life insurance, annuities, and all financial products. That is, imposing a fiduciary duty, "best interest" or any higher obligation is an open invitation for consumers to shift responsibility whenever a product does not perform as expected. As an example, with inclusion of life insurance in the Regulation, will insurance producers now be liable for policyholders who fail to purchase sufficient coverage for their families? Existing caselaw clearly says no, absent special circumstances, but this and many other questions concerning the quality of agent or broker

[10] While acknowledging the possibility of circumstances in which the relationship of the parties may give rise to liability, the unanimous Court expressed preference for determining liability case-by-case rather than under a sweeping rule ("the issue of whether such additional responsibilities should be recognized and given legal effect is governed by the particular relationship between the parties and is best determined on a case-by-case basis"). Murphy, 90 N.Y.2d at 272.

recommendations are now open to interpretation under the vague standards of this Regulation.

Thus, even if DFS had the authority to adopt a best interest standard, the Regulation itself and the process by which it was promulgated deviate radically and recklessly from existing insurance law, and ordinary common sense without adequate explanation. Thus, the Regulation lacks the rational and thoughtful underpinnings demanded of an administrative agency and is arbitrary and capricious, which is cause now for annulment.

POINT IV

THE REGULATION IS UNCONSTITUTIONALLY VAGUE

The Regulation is vague and inscrutable, lacking practical guidance from its issuing agency. At best, the "best interest" requirement is obscurely aspirational, and at worst, it is a trap for agents and brokers who are unable to navigate the Regulation's shadowy and contradictory explanations to ascertain its requirements for compliance. This does not pass constitutional muster and the Regulation is void for vagueness. In addressing vagueness challenges, courts have developed "a two-part test ... [F]irst[,] . . . the court must determine whether the statute in question is sufficiently definite to give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden by the statute. . . . Second, the court must determine whether the enactment provides officials with clear standards for enforcement." Turner v. Municipal Code Violations Bur., 122 A.D.3d 1376, 1378 (4th Dep't 2014) (internal citations omitted). A regulation fails the first prong where "the ordinance gives ordinary people virtually no guidance on how to conduct themselves in order to comply with it, and the language used in the ordinance makes it 'difficult for a citizen to comprehend' the precise conduct that is prohibited." Id. It fails the second prong where "the vague language of the ordinance does not provide clear standards for enforcement and, thus, a determination 'whether the ordinance has been violated 'leaves virtually unfettered discretion in the hands of' the [code enforcement officer].'" Id. The void for vagueness doctrine "embodies a rough idea of fairness" and "an impermissibly vague ordinance is a violation of the due process of law." Id. at 1377. Therefore, if the regulation fails either part of the test—vagueness from the perspective of the person whose conduct is affected by the regulation and from the perspective of the officials who must determine whether or not a person is in compliance—it is unconstitutional. Id. at 1378.

Here, by focusing solely on the Regulation's objectives, the lower court lost sight of the Regulation's practical effect which emphasizes several parts of the Regulation as unconstitutionally vague. For example, the Regulation's definition of "recommendation" is unconstitutionally vague. According to the Regulation, a "recommendation" means "one or more statements or acts by a producer, or by an insurer where no producer is involved, to a consumer that: (1) reasonably may be interpreted by a consumer to be advice and results in a consumer entering into a transaction in accordance with that advice; or (2) is intended by the producer, or an insurer where no producer is involved, to result in a consumer entering into or refraining from entering a transaction. . . ." 11 N.Y.C.R.R. § 224.3 (e). The definition provides certain specific exclusions from the definition of "recommendation," such as "general factual information" and "an interactive tool." Id. This definition fails both prongs of the vagueness standard articulated in Turner.

First, the Regulation itself contains words and phrases such as "may be interpreted by a consumer," which is a codification of an improperly subjective standard rejected by New York courts. See Chaim v. Benedict, 216 A.D.2d 347 (2d Dep't 1995) (plaintiff's request for a "top of the line" policy and to be "fully covered" was insufficient to establish liability). Second, no individual of ordinary intelligence would have the ability to know whether the specific pieces of information supplied to the customer are a "recommendation" as defined by the Regulation. For example, if an insurance agent or broker were to investigate different coverage options for a customer, and the agent or broker concludes that it would be appropriate to provide a proposal for a quote for only one of those products, under the subject Regulation, the same would very likely be considered a "recommendation."

It is difficult to imagine any possible offer of insurance by the insurance agent or broker that could not be "reasonably interpreted" as "advice." This would occur regardless of whether the insurance agent or broker intends to recommend any specific product because according to the Regulation, the relevant inquiry would improperly begin and end with the customer.

Similarly, a "recommendation" occurs whenever a statement or act of the insurance agent or insurance broker is intended to result in a consumer entering into or refraining from entering into a transaction. It is difficult to imagine any documentary material sent to a potential customer that would not be intended to secure a sale or transaction regardless of the exclusions for undefined "marketing materials" or "general factual information." Thus, every action or document provided by the agent or broker to the customer has the potential of being considered a "recommendation" within the meaning of the Regulation.

Third, the Regulation improperly provides the Superintendent with unfettered discretion to determine what constitutes a "recommendation' within the meaning of the Regulation without meaningful guidance and standards for the determination of the application of the Regulation. See Matter of Nicholas v. Kahn, 47 N.Y.2d 24 (1979). Unfortunately, as written, the Regulation with its principles-based approach designed to address consumer complaints, will provide DFS with unlimited power to punish non-fraudulent, non-abusive conduct by concluding virtually any insurance proposal to be a "recommendation," thereby subjecting the producer to administrative action. 11 N.Y.C.R.R. § 224.8.

Additionally, the "Best Interest" standard is vague as a general matter. On its face, it is an amorphous term lacking in any precision or objective standard. As such, under the Regulation, a "producer" does not know whose interests to consider because the "best interest" of the owner can be multi-layered and complicated, attributable to either the present financial interest of the owner or the future beneficial interest of the owner's beneficiaries, or both. The person of ordinary intelligence cannot possibly answer these questions with any certainty. The Regulation is silent on these important ambiguities and is therefore unconstitutionally vague.

Furthermore, if a "producer" falls within the Regulation, it is not clear what information must be compiled to make the appropriate assessment. According to the Regulation, "suitability information" means "information that is reasonably appropriate to determine the suitability of a recommendation commensurate with the materiality of the transaction to a consumer's financial situation at the time of the recommendation and the complexity of the transaction recommended . . ." 11 N.Y.C.R.R. § 224.3 (g). Then, it proceeds to list "some or all" specified information that may be relevant to the consumer. 11 N.Y.C.R.R. § 224.3 (g). With respect to term life insurance, there are nine pieces of information with varying levels of specificity. 11 N.Y.C.R.R. § 224.3 (g) (1). With respect to all other policies, there are 14 different pieces of information. 11 N.Y.C.R.R. § 224.3 (g) (2). There is specific information like age and annual income, but the Regulation also lists various amorphous factors as well, such as "financial situation and needs," "financial time horizon, including the duration of existing liabilities and obligations" and "financial objective," to just name a few. 11 N.Y.C.R.R. § 224.3 (g). Since none of these terms are defined or have concrete common or ordinary meanings, it is impossible for the "producer" to know whether she compiled the necessary information to comply with the Regulation. Further, since DFS claims it is taking a principles-based approach to the Regulation, enforcement will inevitably be ad hoc.

As with "best interest," another nebulous but common term "good character" was challenged in 164th Bronx Parking, LLC v. City of New York, 20 Misc. 3d 796, 803 (N. Y. Sup. Ct. 2008), leading the Court to observe:

> The words "good" and "character" both are widely used, but, consequently, are susceptible of multiple and varied meanings. The absence of interpretative statutory or regulatory provisions relegates the enforcers and their objects, license applicants, to the two words of the statue itself. While these two common words may set a comprehensible normative standard, they are so imprecise that it is as if no standard of conduct is specified at all. (Internal citations omitted.)

Troubled by this ambiguity, and lack of meaningful guidance, the Court found the Regulation in question unacceptably vague in violation of due process. Id. at 804. Analogous to "best interest," the "good character" standard failed because "infinite character flaws are easily imaginable, bearing no relation to an applicant's fitness for a business, yet providing a basis to deny a license under this statutory requirement and placing complete discretion in respondent's hands to impose that penalty against any entity in which respondents perceive such a flaw." Id. at 802 (internal citations omitted). Appellants submit DFS is accorded similar unfettered discretion here in enforcing a best interest standard against any "recommendation" it perceives as "flawed."

There is no surefire way to determine how much life insurance is in a person's "best interest." The requirement that agents and brokers disclose "all relevant suitability considerations and product information, both favorable and unfavorable" is an impossibility. How can one ever capture in writing *all* unfavorable considerations in any transaction? The requirement that insurers – especially those selling through independent agents representing multiple companies and products – must ensure agents are not influenced by compensation is impossible without insurers committing antitrust violations to control independent agent decisions and behaviors spanning across multiple carriers and their products and compensation.

DFS has created a mystery of what exactly is expected from an agent or broker seeking to comply with this Regulation and how it will be enforced, leaving thousands of agents and brokers uncertain on what is required to comply and at great risk for failure to do so. For the insurance industry, the stakes could not be higher, given this Regulation allows for DFS to impose steep fines and force firms to give restitution to policyholders.[11]

Finally, the Regulation's "suitability analysis" may compel those who do not want to provide any recommendations to do so prophylactically for fear of running afoul of the Regulation. Thus, the Regulation not only denies Due Process, it further denies the "Producers'" First Amendment rights by compelling the "Producer" speak, to make a recommendation and to provide advice when the "producer" merely prefers to sell a policy. See Brown v. Entertainment Merchants Ass'n, 564 U.S. 786 (2011).

Due to the plethora of ambiguities discussed herein, the Regulation is void for vagueness and simply does not pass muster under constitutional due process analysis.

CONCLUSION

The Regulation dramatically alters the fundamental relationship between insurance producers and their customers, yet was adopted with virtually no cost

[11] A recent example of enforcement is an action against six companies in September 2019 in which insurers in aggregate were fined $673,000 and required to provide restitution totaling $1.15 million. The firms were found to have violated suitability requirements under Regulation 187 and replacement requirements under Regulation 60. DFS Press Release September 24, 2019, available at *http://www.dfs.ny.gov/reports_and_publications/press_releases/pr1909241*. Regulation 187 deems violations unfair trade practices which carry monetary penalties plus provides that insurers must "take appropriate corrective action" for any consumer harmed by violations. This empowers DFS to levy severe sanctions including reversal of past sales that could be devastating for an insurer and its producers.

analysis of its wider impact on industry and consumers here in New York. It usurps powers of the legislature, contradicts existing law, and contains unworkable and unacceptably subjective standards, all in violation of proper regulatory rulemaking. For these reasons, the lower court decision should be reversed, and the Regulation invalidated.

Dated: White Plains, New York
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