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)

REPLY BRIEF FOR PETITIONERS-APPELLANTS

JAMES C. KEIDEL, ESQ.
HOWARD S. KRONBERG, ESQ.
ROBERT J. GRANDE, ESQ.
JUSTIN R. WAYTOWICH, ESQ.
KEIDEL, WELDON & CUNNINGHAM, LLP
Attorneys for Petitioners-Appellants
925 Westchester Avenue, Suite 400
White Plains, New York 10604
(914) 948-7000
Jkeidel@kwcllp.com
Hkronberg@kwcllp.com
Rgrande@kwcllp.com
Jwaytowich@kwcllp.com

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.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES AND OTHER AUTHORITIES

PRELIMINARY STATEMENT

Petitioners/Appellants Independent Insurance Agents and Brokers of New York, Inc. ("Big I NY") and Testa Brothers, Ltd. herein reply to the Respondents' Brief. Apparently, Respondents (collectively "DFS") believe the power of DFS to issue regulations controlling the conduct of insurance producers is virtually unlimited. This is evident in DFS's arguments that the most general granting of power to regulate equals the unfettered authority to completely overhaul how certain insurance is sold with no specific legislative guidance, or any realistic attempt to quantify and justify the costs of such disruptive regulatory action. DFS cannot cite to any case law or statute that reflects judicial acquiescence to administrative action in such a transformative manner. Nor can DFS provide credible evidence that it engaged in a real cost-benefit analysis to assess the actual value of such a radical change.

In justifying its amendment to Regulation 187 ("Regulation"), DFS infers that increasing product complexity and lapse rates are proof that consumers' interests are not being considered. Yet it neglects to acknowledge its own role in approving or disapproving rate and form filings for life insurance and annuities products, as well as possessing substantial existing authority to police producer conduct. Further, it fails to present even the most minimal quantitative evidence, for example, some specific evidence of an increase consumer complaints, to support such a drastic change in the standard of care.

However, as even the AARP amicus brief concedes, there are fundamental systemic failures by segments of the population to save properly for retirement. Such failures permeate beyond state borders and exist regardless of the conduct of insurance agents or brokers. Nevertheless, rather than take a measured response attacking the actual problems, DFS adopted, in all material respects, a heavily criticized Regulation, mirroring one abandoned by the federal government. The federal government is far more capable of addressing the systemic failures. In reality, the Regulation is more likely to make such products more costly, and thereby unavailable, to many of those who need them.

Through the Regulation, DFS seeks to drastically alter the relationship between insurance producers and their customers, in contravention of longstanding case law, saddling producers with the responsibility of divining their customers' minute preferences and turning innocent sharing of information into possibly punishable "recommendations." As such, the Regulation cannot stand.

RESPONSE TO STATEMENT OF FACTS

In their Statement of Facts, Respondents attempt to create confusion with unnecessary and unrelated information emphasizing how complicated life insurance and annuities can be for a purchaser. Presumably, Respondents hope that inundating the Court with the minutiae of life insurance will cause the Court to defer to DFS's improper administrative action. (Respondents' Brief p. 9-11, 14-16). Certainly, when the superfluous information is stripped away from Respondents' Statement of Facts, there can be no doubt of DFS's improper overreach.

Respondents cannot credibly claim that the Regulation ameliorates the alleged complexity of life insurance or the volume of choices with 44,624 different policy forms, presumably overwhelming for even the most knowledgeable insurance producers and regulators. (Respondents' Brief p. 14). If anything, the number of forms submitted to DFS for approval reflects DFS's administrative failure to limit the confusion caused by such diverse products.

Thus, DFS seeks to allow one segment of the market to offer limitless products but then shifts responsibility for understanding these products away from the person actually purchasing them, and onto a different segment of the market. Regardless of the time and effort placed in attempting to understand a consumer's preferences, a producer can never practically understand all of the issues that will be most important in the selection that will be in the customer's subjective "best interest." DFS claims it needed to act due to the increased marketing of life insurance and annuities as investment products, and the compensation structures for producers created incentives to act other than in the best interest of their customers. (Respondents' Brief p. 13-14). However, life insurance and annuities have always been intended as an investment. Insurance agents and brokers have been paid on a commission basis for decades, if not centuries, and the incentives DFS laments are capped as recognized by statute, (Insurance Law § 4228(d)) and mandated to be disclosed at the consumer's request through Insurance Regulation 194, 11 N.Y.C.R.R. 30.

DFS created a tag-along regulation designed to work in conjunction with the United States Department of Labor's ("DOL") adoption of a fiduciary rule related to certain annuities, which was ultimately struck down. Part of the justification for the Regulation was consistency of requirements among annuity and life insurance products. (R. 204). When the federal regulation was struck down, the rationale for the Regulation was substantially undercut.

DFS attempts to justify the Regulation by listing several attributes of producer compensation, such as the lack of compensation without a sale, and commissions proportional to the amount of the premium, which can potentially interfere with the objectivity of the producer. (Respondents' Brief p. 17-18). Nevertheless, none of this information would be surprising to an ordinary prudent person. No rational consumer expects a producer to be paid more for selling less, or that commissions will be higher for a cheaper product. Furthermore, producers are required to disclose their compensation at the request of the customer. 11 N.Y.C.R.R. 30.

On page 19 of Respondents' Brief, DFS suggests that it regularly observed instances of producers: (1) selling unaffordable policies to low-wealth consumers; (2) selling policies with terms contrary to the consumer's stated preferences as recorded by the producer, or incompatible with the purpose for which the consumer is buying the policy; (3) encouraging consumers to cancel their existing contracts and purchase new products that provide inferior benefits, apparently in an effort to generate new commissions. We have located no specific examples to analyze the merit of these claims. However, taken individually, none of these general examples reflect instances where the Regulation would have necessarily aided the consumer.

The first example is the prototypical consumer who cannot afford a luxury car but buys it anyway. There is no regulation possible by any regulator that can prevent a consumer from buying something that he cannot afford. Certainly, there is no way for any agency to rationally prevent a producer from a selling product that will pay the purchaser's beneficiaries greater benefits. While there is the possibility that the expensive policy will lapse, there is also the possibility that the insured will die soon after the purchase. Thus, it is impossible for a producer to truly know what product is in the "best interest" of the customer without clairvoyance.

Second, those producers who sell an annuity counter to a consumer's stated preference would have violated pre-existing suitability rules. Alternatively, in those instances where the producer did not comply with the appropriate request for coverage, New York common law rules would proscribe the relevant conduct and expose the producer to potential liability. See Murphy v. Kuhn, 90 N.Y.2d 266, 270 (1997).

Third, in those instances where a producer encourages the cancellation of an existing contract for the purchase of a policy with inferior benefits, we raise two points. Initially, DFS claims that producers have engaged in instances where they have sold insurance that is too expensive for the consumer. If that is the case, it would seem based upon DFS's own reasoning that a subsequent producer should seek to secure a different contract that the customer can afford, which may have inferior benefits. Second, if the alleged benefits are inferior through an objective standard, and the producer made efforts to replace the existing policy via fraudulent means, DFS would already have the power to punish such producer. Thus, these examples of alleged producer conduct provide no justification for the Regulation.

DFS cites to a lengthy administrative record related to its alleged consideration of the issues, but DFS completely ignored the complaints of interested parties affected by the Regulation who warned against the fundamental flaws in a "best interest" standard of conduct. Indeed, in its zeal to support the Regulation, on pages 25, 54 and 69 of its brief, DFS misleads the Court regarding the alleged "recognition" by the Fifth Circuit decision in Chamber of Commerce v. U.S. Dept. of Labor, 885 F.3d 360, 379 (5^{th} Cir. 2018) that the increased complexity of financial markets required DFS to act. In reality, the Fifth Circuit was extremely critical of the federal version of the "Fiduciary Rule" and the "Best Interest" standard. Otherwise, it would have served no purpose for the Court to note, at length, the costs and market consequences. Id. at 366, 368.

Yet, despite the decision striking down the federal Fiduciary Rule, and the fact that the Regulation was explicitly based on the federal rule, DFS decided to proceed with the Regulation and suggests that the Chamber of Commerce decision supports its administrative action. Far from supporting Congressional or regulatory action, the Fifth Circuit stated:

> Moreover, DOL's principal policy concern about the lack of fiduciary safeguards in Title II was present when the statute was enacted, but Congress chose not to require advisers to individual retirement plans to bear the duties of loyalty and prudence required of Title I ERISA plan fiduciaries. That times have changed, the financial market has become more complex, and IRA accounts have assumed enormous importance are arguments for Congress to make adjustments in the law, or for other appropriate federal or state regulators to act within their authority. A perceived "need" does not empower DOL to craft *de facto* statutory amendments or to act beyond its expressly defined authority.

Id. at 378-79. In other words, the extreme action undertaken by the federal DOL was erroneous and its argument of "perceived 'need'" was improperly pursued regardless of any alleged changed circumstances. Further at page 25 of its brief, Respondents use ellipses to gloss over the reference to legislative action and the deference paid by the Fifth Circuit to the legislative body on such issues prior to the

Court's discussion of any potential administrative action. The Respondents intentionally overlook such deference as a shortcut to validate their "need" to act.

Clearly, the evidence submitted by Gary Slavin and Stephen Testa is uncontradicted, and explains many of the same concerns that are apparent through DFS's action, including increased costs to customers, and a decrease in the availability of such products to lower and middle-income families. (R. 151-165). These substantive costs, including the indirect costs of lost business, and increased litigation surrounding the Regulation, are far greater than any of the procedural costs that seem to be the sole focus of Respondents.

ARGUMENTS

REPLY POINT I
THE DEPARTMENT EXCEEDED ITS AUTHORITY

DFS engaged in legislative policy making far different from any previously upheld through administrative action in the State of New York. DFS's Regulation does not foster competency, disclosure and honest business practices. Instead it fundamentally alters the relationship between insurance producers and their customers by implementing a vague and indefinite standard of care.

DFS cites to numerous statutes suggesting it has authority to regulate producers. We do not contest that DFS has some general regulatory powers. Furthermore, we do not disagree that its regulations do not have to completely mirror the statutes themselves. However, DFS does not have the unchecked authority that would be necessary to adopt the Regulation at issue. Courts may not defer to DFS in this circumstance where the degree of overreach contemplated would create a new policy related to arms-length transactions, which contradicts statutory provisions defining the powers of DFS to act, including removing the statutory distinctions between an insurance agent and broker. Insurance Law § 2101.

With respect to the first factor in the Boreali test, DFS cites to Garcia v. New York City Dept. of Health & Mental Hygiene, 31 N.Y.3d 601 (2018). However, Garcia relates to the power of New York City to compel children who attend city regulated programs to be vaccinated against the flu. There is no correlation between a regulation carefully tailored to address a specific health concern, which prescribes a specific remedy that will directly safeguard the health and safety of children, to a regulation designed to change how adults have bought and sold insurance for years.

The Regulation is much closer to the regulation addressed in Matter of LeadingAge N.Y., Inc. v. Shah, 100 N.Y.3d 249 (2018), cited in Respondents' Brief at p. 41-42, as it related to "soft caps" compensation limitations for health care executives that received state funds. In LeadingAge, there were two sets of limitations for executive compensation. The so-called "hard caps" related to a requirement that 75 percent (or 85 percent by 2015) of the covered operating expenses of a covered provider paid for with state funds or state-authorized payments shall be program services expenses rather than administrative expenses, such as executive compensation. Id. at 255. On the other hand, the so-called "soft caps" for executive compensation would subject a covered provider to a penalty if executive compensation exceeds $199,000 per year from any source of funding regardless of source. Id. The Court of Appeals juxtaposed the "hard caps" of the subject regulation, where there was a legitimate use of regulatory power to focus on the direct use of state health care funding, to the "soft caps", where the regulator sought to impose an overall cap on executive compensation regardless of the source. Id. at 268. The Court of Appeals concluded that the first two Boreali factors were the "most instructive" and held that the "soft caps" were an unauthorized excursion by the regulator beyond the parameters set by the legislature. Id.

Through the "soft caps", the Department of Health pursued a policy consideration – limited executive compensation – that is not clearly connected to the objectives outlined by the legislature but represented a distinct "value judgment." Id. "By attempting to control how an entity uses its private funding, [the Department of Health] ventured beyond legislative directives relating to efficient use of state funds and into the realm of broader public policy concerns." Id.

It is this type of attempted social policymaking by administrative action that has come under scrutiny in recent years, which has been readily found to be beyond the scope of administrative authority. For example, for all of the claimed power of DFS, the First Department held that DFS does not have the authority to impose an across the board cap on fees at 200% for ancillary searches. See Matter of New York State Land Title Ass'n, Inc. v. New York State Dept. of Fin. Servs., 169 A.D.3d 18, 31-32 (1st Dep't 2019). Certainly, DFS has the power to impose some regulations that foster adherence to well-established policies, but when regulators, including DFS, act without authority and fail to maintain a clear and unambiguous record of its efforts at a change in social policy, those regulations will be annulled. See Id.; New York State Coalition of Hispanic Chambers of Commerce v. New York City Dept. of Health & Mental Hygiene, 23 N.Y.3d 681 (2014); New York State Ass'n of Counties v. Axelrod, 78 N.Y.2d 158, 166 (1992). The legislature declared that insurers can pay agents and brokers as they see fit, except as limited by statute. Insurance Law § 4228(d).

On page 34 of Respondents' Brief, DFS claims that it does not understand the "deep divisions" over issues of consumer autonomy as a result of the Regulation. DFS further claims that it engaged in a cost-benefit analysis and determined that the costs associated with the Regulation weighed in favor of adoption. The record shows that DFS had no meaningful assessment of costs to support the need for the Regulation.

Respondents' position has no credibility and overlooks the controversy surrounding the federal government's original attempt to adopt a fiduciary rule, the litigation surrounding the same, and the continued resistance to the subject action, which resulted in amicus briefs by the United States Chamber of Commerce and AARP. The record shows that DFS had no empirical evidence and no actual assessment of costs to support the alleged need for the Regulation. (R. 204-205; 313-319).

DFS failed to fully contemplate the costs associated with the Regulation, and this hampers the required cost-benefit analysis that must occur to properly analyze the Regulation. While DFS tries to portray the costs and consequences of the Regulation as nominal, the objective factual record suggests otherwise. Essentially, DFS treats the adoption of the Regulation and the implementation of a "best interest" standard, as the addition of "one short document to the sales process." (R. 2043). As we previously noted, 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 measure the immeasurable." (R. 347). (Emphasis added.) Without any actual understanding of the costs, DFS could not rationally weigh whether the Regulation was prudent.

The record is replete with examples of broader, far-reaching costs extending beyond administrative recordkeeping, which remain unaddressed and overlooked as referenced on page 12 of Appellant's Brief. These additional costs include: 1) the costs of litigation (R. 154, 162); 2) the loss of product sellers who would market to middle income customers (R. 155-156, 160-161); and 3) direct increases in costs of life insurance and annuity products (R. 154-155). Indeed, Gary Slavin's discussion of New York rates in comparison to those in other states is very specific and disturbing.

For DFS to question the enormous costs associated with the Regulation that others have posited, without engaging in its effort to actually determine what those costs are, is irrational. While cost-benefit analyses support rational regulations, DFS does not demonstrate a willingness to consider the actual costs and merely dismisses the costs assigned by others, including the federal government, without meaningful analysis. Thus, it cannot be said this is merely a disagreement about costs and whether the Regulation is a wise undertaking based upon an analysis of all relevant factors.

DFS's inability to adequately explain its investigations and consideration of the costs of the Regulation to the regulated parties and the public is endemic throughout Respondents' Brief and the entire regulatory record, not just in application of the Boreali factors. For example, on page 67 of its brief, DFS claims that Appellants somehow "miss the point" related to its discussion of costs, claiming that the costs "had already been substantially incurred by the time that DFS proposed the amendment." However, unlike the DOL Fiduciary Rule, the subject standard did not apply to life insurance at all, only certain annuities. As such, how did life insurance agents and brokers, like Stephen Testa, and life insurance carriers for that matter, prepare for a Regulation related to different products that was never even within the scope of the federal regulation? Even if there was some measure of overlap of costs to some members of the insurance marketplace who sell both life insurance and annuities, it is apparent that DFS did nothing to consider the additional costs associated with applying the Regulation to life insurance agents and brokers in New York. (R. 164, ¶ 17).

At most, DFS relies upon anecdotes rather than substantive examples and data to support this Regulation. Despite stating myriad hypothetical scenarios, DFS has not given a single specific example of any past instances where these results occurred, and where they would have been avoided in the absence of the Regulation. These types of unproveable benefits together with the unknown (or known but concealed) exorbitant costs of the Regulation render any effort by DFS to claim that an actual cost-benefit analysis occurred clearly erroneous. The Regulation assumes the worst prejudices against insurance agents without citation to any specific evidence to support them, resulting in rhetoric without empirical data and facts.

The Regulation takes an unnecessary paternalistic approach to the selection of insurance, which acts contrary to the established differences between agents and brokers. Such fundamental changes are certainly beyond the authority of DFS, especially if it cannot even explain the anticipated costs of the Regulation.

With respect to the second Boreali factor, DFS further seeks to justify its regulatory action by claiming it is authorized to protect consumers, ensure transparent business practices and prevent unethical conduct. However, DFS is writing on a "clean slate." Until adoption of the Regulation, a producer considering her own self-interest in a sale was not unethical. Indeed, such conduct is typical in the vast majority of business ventures and serves as a guidepost in a free market economy.

In discussing the alleged benefits to the consumer, DFS claims "Consumers have always relied on the recommendations they receive when making important purchasing decisions regarding both life insurance and annuities." (R. 2037). However, this assumption contradicts the position of the Court of Appeals:

> Insurance agents or brokers are not personal financial counselors and risk managers, approaching guarantor status. . . . Insureds are in a better position to know their personal assets and abilities to protect themselves more so than general insurance agents or brokers, unless the latter are informed and asked to advise and act. . . . Furthermore, permitting insureds to add such parties to the liability chain might well open flood gates to even more complicated and undesirable litigation. Notably, in a different context, but with resonant relevance, it has been observed that '[u]nlike a recipient of the services of a doctor, attorney or architect … the recipient of the services of an insurance broker is not at a substantial disadvantage to question the actions of the provider of services.'

<u>Murphy</u>, 90 N.Y.2d at 273. In other words, insurance agents and brokers are not investment advisors expected to provide recommendations related to insurance. (R. 164 ¶ 17). Thus, it is, at best, an exaggeration to claim consumers have always relied upon the recommendations.

Undoubtedly, when a recommendation is given, the vast majority of problems for insureds are caused by the insured's own failure to heed such recommendation. As such, Appellants have concerns about a Regulation that will invite customers to second guess a "recommendation" that proves less advantageous at a later point in time, which ultimately conflicts with the insured's selection of insurance. (R. 162, ¶ 11).

DFS makes several faulty assumptions to justify the Regulation and takes a position directly contrary to the holdings of courts related to the duties and obligations of parties related to the selection of insurance. However, rather than cite to case law reflecting that DFS is not writing on a clean slate, it cites to several decisions that are materially different and do not support its position.

In Matter of Medical Society of State of New York v. Serio, 100 N.Y.2d 854, (2003), the Superintendent of Insurance merely adopted regulations related to no-fault deadlines and the timing for a claim in order to avoid fraudulent claims. Unlike here, the Court of Appeals held that such conditions precedent to the claims imposed by the Superintendent did not affect a "profound change in social and economic policy." Id. at 865.

Similarly, DFS contends that somehow it has regulated "almost every detail of operation" of the insurance industry and cites to Greater N.Y. Taxi Ass'n v. New York City Taxi & Limousine Comm'n, 25 N.Y.3d 600 (2015). However, unlike the power of the New York City Taxi and Limousine Commission, which had extremely broad power "to adopt and *establish an overall public transportation policy governing taxi . . . services* as it relates to the overall public transportation network of the city," DFS has cited no decision that suggests its power is so broad. At most, it has the general powers of Financial Services Law § 201(b). In fact, as set forth in Matter of New York State Land Title Ass'n, 169 A.D.3d at 31-32, the First

Department made clear that DFS does not have such broad-reaching powers as it claims to completely regulate the fees charged by those under its authority.

DFS claims on page 37 of its brief that Appellants somehow conceded that it was authorized to adopt this type of Regulation. DFS misstates the record. DFS previously adopted regulations, including the prior version of Regulation 187, permitting normal arms-length transactions in the sale of life insurance and annuities. The prior version of Regulation 187 made no effort to regulate life insurance at all, and merely conformed with federal regulations related to suitability.

DFS's claim that it has the authority to go beyond the statutory language does not gain support from the remainder of the cases referenced. In Matter of Acevedo v. New York State Dept. of Motor Vehs., 29 N.Y.3d 202, 221 (2017), the Court of Appeals held that the Department of Motor Vehicles had authority to restrict the reinstatement of recidivist drunk drivers who were jeopardizing public health. In Sullivan Financial Group v. Wrynn, 94 A.D.3d 90 (3rd Dep't 2012), the Third Department held that a disclosure requirement that perhaps went beyond the strict language of the statutory scheme was permissible. None of these actions went so far as to impose a vague standard of conduct contrary to existing law and normal free-market conduct. DFS is authorized to protect the public by assuring there is professionalism and maintenance of standards in the industry, not to rewrite how an insurance producer must act in fulfilling his long-recognized common law duties.

With respect to the third Boreali factor, the Respondents' arguments show its contradictory positions. Initially, as stated in Garcia, 31 N.Y.3d at 615, cited by Respondents, we acknowledge that "legislative inaction, because of its ambiguity, affords the most dubious foundation for drawing positive inferences." Nevertheless, when the inaction of the legislature is considered together with the extreme nature of Respondents' conduct, it is clear that even this factor acts in favor of Appellants.

On page 13-14 of its brief, Respondents acknowledge that life insurance and annuities have been marketed as "investment products." Nevertheless, Respondents suggest the Investment Transparency Act would not apply to producers, which is simply incorrect in at least some circumstances. With these three failed legislative actions, it is clear that the legislature considered the less onerous alternative of disclosure and failed to act.

Finally, DFS makes the extraordinary claim that the legislature acquiesced to DFS action because the prior version of Regulation 187 was adopted in 2010. Of course, this position ignores the facts that (1) the pre-existing regulation applied solely to annuities, which are also regulated under federal law with similar requirements; and (2) the legislature did not yield the issue to DFS through its willingness to consider its own action through the Investment Transparency Act. As discussed previously, the Greater New York Taxi case reflects a broader grant of authority to the agency and that the New York City Council stayed out of the specifications for taxis, as at issue therein, for over four decades. 25 N.Y.3d at 612.

With respect to the fourth Boreali factor, DFS presents nothing but generalizations and references to non-specific investigations to support the adoption of the Regulation. There is no evidence of specific research related to how the Regulation would change improper producer conduct or prevent the abuse that it has observed. Certainly, there are no similarities to Agencies for Children's Therapy Servs., Inc. v. New York State Dept. of Health, 136 A.D.3d 122 (3rd Dep't 2015) where the regulatory agency showed detailed research.

As part of its statutory duties, we would expect that DFS would conduct investigations of consumer complaints and find instances where some producer action was improper. However, rather than analyzing information based upon open-minded research related to costs, impact on the regulated parties and how the Regulation would benefit consumers in an intelligent way, DFS adopted a vague Regulation destined to harm the insurance market.

DFS claims that it is "puzzling" for Appellants to claim that DFS does not have the depth of knowledge to adopt this Regulation. Respectfully, DFS does not have the knowledge of the federal government related to ERISA plans or the Securities and Exchange Commission related to investment issues, where fiduciary standards are far more common, in order to understand the costs and benefits of this type of Regulation. If the federal government abandoned a substantially similar Regulation after all of its research and investigations, and without meaningful targeted research by DFS, the Regulation must fail for this reason as well.

REPLY POINT II
THE REGULATION IS ARBITRARY AND CAPRICIOUS

For the reasons described above, the Regulation is also arbitrary and capricious. Evidence in support of a Regulation must be credible and more than insubstantial. Matter of Brodsky v. Zagata, 222 A.D.2d 48, 51 (3rd Dep't), *lv. denied*, 89 N.Y.2d 803 (1996). Here, DFS claims that the costs of the Regulation will be minimal, but the federal government, who engaged in a legitimate cost study, concluded a similar Regulation would carry "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). On page 67 of its brief, DFS claims costs had already been substantially incurred. However, in support of the Regulation in its regulatory filings claimed "the DOL Rule only imposes a best interest standard of care and recordkeeping where the insurance producer is receiving a commission from the annuity transaction; the annuity is either a variable annuity or an equity indexed annuity. This Amendment, however, applies to all life insurance and annuity transactions in the State of New York." (R. 205).

DFS desired to enact a "best interest" standard, and would not depart from its course regardless of the lack of empirical data or specific support for this drastic decision. It made changes to certain aspects of the Regulation, but it refused to depart from a Regulation containing a "best interest" standard without addressing the costs of this standard in a credible way.

Indeed, DFS's own efforts to justify the Regulation show the irrational approach it took. Specifically, while DFS cites to the existence of Regulation 187 in its prior form applicable to annuities, there were never suitability rules applicable to life insurance. As such, there is no proof that suitability rules for life insurance are ineffective, thereby undercutting any justification for this drastic regulation. DFS merely compiled a large regulatory record, but cannot cite anything specific that explains the need for this type of action as it relates to life insurance, or in general.

Tellingly, on page 25 of its brief, DFS claims, "the rules [were] needed to prevent insurers and producers from recommending transactions that, while arguably suitable because they minimally further[ed] the needs and objectives of the consumer, were not otherwise in the best interest of that consumer because they were designed to maximize compensation to the sellers." Thus, rather than supply a real justification, DFS provides a vague example of a possible situation where an insurance producer helped a customer improve its existing product under suitability rules, but <u>DFS did not believe</u> the product was good enough for the customer.

This is precisely the type of unfettered discretion that concerns Appellants here, and the second guessing that the Regulation invites of insurance producers. Indeed, any time an insurance producer receives a commission, there will be a risk that there is some product that DFS may find among the 44,624 different policy forms sent to DFS for approval that might be better than the product purchased. (See R. 153, ¶ 7; 160, ¶ 6).

In footnote 9 of its brief, DFS suggests that it will not engage in hindsight. Like so many of its arguments, this is simply not credible. DFS is going to investigate consumer complaints. Those complaints will only occur if the product did not perform as was hoped. Thus, the Court is essentially called to determine whether the wisdom of the Court of Appeals in Murphy v. Kuhn warning against opening the floodgates of litigation by dissatisfied policyholders can be overturned by a regulatory action that did not fairly consider the costs of litigation.

There is no question that DFS's rule conflicts with existing law. On pages 55 and 56 of Respondents' Brief, DFS claims agents cannot do what is illegal for their insurers. However, the Regulation requires "recommendations" that are in the best interest of the insured by producers and "insurers where no producer is involved." 11 N.Y.C.R.R. § § 224.4 and 224.5. In other words, an insurer has no duty to act in the best interests of the insured, and potentially violate the law, except 1) when no producer is involved, and 2) only when the insurer is making a "recommendation."

Thus, the duties of an insurance agent to act solely in the best interest of its principal are directly challenged by the Regulation. The Insurance Law recognizes the existence of "insurance agents" and "insurance brokers," and any requirement that an insurance agent make a "recommendation" that conflicts with the interests of its insurer cannot stand on basic agent principles.

REPLY POINT III

THE REGULATION VIOLATES THE STATE ADMINISTRATIVE PROCEDURES ACT

The simplest argument supporting annulment of the Regulation is the failure to comply with SAPA requirements for a "best estimate." Based upon all of the foregoing discussion, it is clear that DFS did not fully and fairly analyze the cost of the Regulation, and specifically, the cost of a "best interest" standard of conduct. DFS contends that it substantially complied with the Regulation, but a review of the record reflects that is not true. As discussed specifically below, DFS's position relies upon a misstatement of the law. When the Court looks beyond the conclusory claims of alleged minimal costs associated with recordkeeping, its discussion completely ignores the costs of the "best interest" standard itself.

Contrary to page 63 of Respondents' Brief, DFS's case law does not support its position that merely the direct costs of paperwork must be considered. In fact, Matter of Industrial Liaison Comm. of Niagara Falls Area Chamber of Commerce v. Williams, 72 N.Y.2d 137, 145 (1988), which was decided before the changes to

SAPA requiring a "best estimate," made no mention of the need to consider only "direct" costs as DFS would contend. Certainly, many of the costs ignored by DFS will be direct due to the time necessary to comply with it, but there will also be clear, expected indirect costs as well. (R. 152-165).

In Matter of Lake George Chamber of Commerce v. New York State Dept. of Health, 205 A.D.2d 93, 95 (3rd Dep't 1994), the owners of temporary residences commenced a challenge to new regulations that would have imposed costly requirements to future owners, thereby decreasing their property values. However, while the matter was pending, the concerns about costs were rendered moot by new legislation. As such, with the new legislation, the economic impact of the regulation became speculative to the owners. Similarly, in Seneca Nation of Indians v. State of New York, 89 A.D.3d 1536, 1538 (4th Dep't 2011), *lv. denied*, 18 N.Y.3d 808 (2012), the Fourth Department addressed issues related to a regulation implementing quotas on tax-exempt cigarettes on Indian reservations. The Court dismissed concerns about a negative economic impact by the regulation because the economic impact raised by the petitioners was due to the legislation itself, which limited the supply of tax-exempt cigarettes, rather than the regulation.

Apparently, DFS claims that the costs referenced by Mr. Slavin and Mr. Testa, the federal government, and the various stakeholders who expressed concerns are speculative, but has no case law or evidence to support that assertion at all. Rather, DFS merely labels anything that does not conform with its position of minimal costs as speculation, including the well-founded estimates by those in the industry directly affected by the Regulation. The actions by DFS in dismissing the likely costs is exactly why there is a "best estimate" requirement.

Regardless, scaling back a regulation is not the equivalent of supplying a best estimate or analyzing all likely costs. DFS claims that it did not have to project an actual dollar figure. However, this assertion overlooks that the legislative history suggests that DFS was expected to provide a "range or a description of the formula employed by the agency in the projected costs, including known and unknown costs variables." (R. 895). That did not occur here. DFS made no estimates of expenses to life insurance agents at all, and completely dismissed the costs to the market for a new standard of care that the Court of Appeals itself suggested would open the floodgates of litigation (among the various other costs). See Murphy, 90 N.Y.2d at 273.

DFS relies upon the Court of Appeals decision in Matter of Med. Society, 100 N.Y.2d at 869. However, as discussed above, that case involved changes in no-fault procedures, not a change in the standard of care for an entire segment of the insurance market, which is certain to have increased cost of compliance, litigation expenses and a generally negative overall effect on the insurance market from a cost standpoint. Importantly, the new regulation did not effect "a profound change on social and economic policy." Id. at 865. This is understandable because, unlike here, the analysis of the costs in Matter of Med. Society was even-handed and considered the various costs to all interested parties. Furthermore, it is clear that the agency carefully studied the issues and enacted a regulation, after a failed prior attempt, that would directly counter the fraud created by delayed no-fault claims. Id. at 861-62.

DFS takes an 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.

REPLY POINT IV
THE REGULATION IS UNCONSTITUTIONALLY VAGUE

Respondents' arguments on vagueness are misguided and by necessity ignore Appellants' arguments. Respondents claim that an alleged use of an objective standard will save the Regulation from a vagueness challenge. However, there is no objective standard to determine what insurance product is in the best interest of the customer. Chaim v. Benedict, 216 A.D.2d 347 (2nd Dep't 1995). This is not a harassment statute applied to a mental patient; People v. Stack, 86 N.Y.2d 529 (1995); or noise ordinance where an objective standard can be reasonably applied. People v. Stephens, 28 N.Y.3d 307 (2016). It is a vague license to permit DFS to punish essentially any transaction it does not like in the realm of sales of annuities and life insurance if a possible "better" option exists.

DFS also suggests that a "best interest" standard is broadly recognized. This is not true. DFS fails to cite a single example where it is applicable to insurance. Instead, the concept is limited to certain specific legal areas, most notably a determination of what is in the "best interest of a child." Pacific Mutual Life Ins. Co. v. Haslip, 499 U.S. 1 (1991). Of course, the best interest of a child is by necessity a discretionary determination with far fewer possible options. On the other hand, applying such vague concepts to a previously recognized arms-length financial transaction with thousands of possible choices invites DFS to engage in unchecked decision-making related to producers. (R. 160).

Additionally, we note that in the current pandemic society, the existence of a "best interest" standard is extremely dangerous for the insurance market. Almost certainly, the pandemic materially changed the financial circumstances of countless customers, and the vague standard will invite 20-20 hindsight on what was originally a prudent insurance selection.

Finally, DFS has no response to Appellants' assertion that the Regulation compels speech in violation of the First Amendment, claiming that the issue is not raised below. A review of the record reflects that is untrue. (R. 126, 616). The issue was raised in the petition and memorandum of law with a citation to the same case, which supports Appellants' position. Briefly, the Regulation compels producers to make "recommendations" even if they want to simply sell requested products as they have always done.

Since this market conduct relates directly to producers of life insurance, who might have simply provided a quote in response to a request from a customer, it is not surprising that DFS has no response. It did not seriously consider the costs to life insurance agents when adopting the Regulation, who never had any obligation to comply with the pre-existing suitability rules. These concerns were addressed below by Stephen Testa. (R. 160-61).

CONCLUSION

For the foregoing reasons and those in the briefs of Appellants and the United States Chamber of Commerce, the lower court decision should be reversed, and the Regulation invalidated.

Dated: White Plains, New York
August 31, 2020

Respectfully submitted,

Justin R. Waytowich

James C. Keidel, Esq.
Howard S. Kronberg, Esq.
Robert J. Grande, Esq.
Justin R. Waytowich, Esq.
Keidel, Weldon & Cunningham LLP
925 Westchester Avenue, Suite 400
White Plains, NY 10604
Tel: (914) 948-7000
Fax: (914) 948-7010
Jkeidel@kwcllp.com
Hkronberg@kwcllp.com
Rgrande@kwcllp.com
Jwaytowich@kwcllp.com
Attorneys for Petitioners-Appellants
Independent Insurance Agents and
Brokers of New York, Inc. and
Testa Brothers, Ltd.

PRINTING SPECIFICATIONS STATEMENT

I hereby certify pursuant to 22 NYCRR §1250.8(j) that the foregoing brief was prepared on a computer using Microsoft Word.

Type: A proportionally spaced typeface was used, as follows:

Name of typeface: Times New Roman

Point Size: 14

Line Spacing: Double

Word Count: The total number of words in this brief, inclusive of point headings and footnotes and exclusive of pages containing the table of contents, table of citations, proof of service and this Statement is 6,846 words.

Dated: White Plains, New York
August 31, 2020

Justin R. Waytowich

James C. Keidel, Esq.
Howard S. Kronberg, Esq.
Robert J. Grande, Esq.
Justin R. Waytowich, Esq.
Keidel, Weldon & Cunningham LLP
925 Westchester Avenue, Suite 400
White Plains, NY 10604
Tel: (914) 948-7000
Fax: (914) 948-7010
Jkeidel@kwcllp.com
Hkronberg@kwcllp.com
Rgrande@kwcllp.com
Jwaytowich@kwcllp.com

Attorneys for Petitioners-Appellants
Independent Insurance Agents and
Brokers of New York, Inc., and
Testa Brothers, Ltd.