Agenda

CEFLI Compliance & Ethics Committee Meeting
Wednesday, July 15, 2020
2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Dial In: (800) 239-9838
Passcode: 5690858

I. Welcome and Introduction. **Donald J. Walters**

A. Antitrust Statement.

II. Approval of Minutes – June 17, 2020 Meeting. **The Committee**

III. Issues for Review. **The Committee**

A. Coronavirus (COVID-19).

CEFLI's COVID-19 Networking Forum continues to meet every two weeks to explore various compliance-related issues associated with the COVID-19 pandemic. Our thanks to various members of the COVID-19 Networking Forum including Chad Eslinger of Voya Financial, Jason Brassard of American National and Laura Bullard of Foresters for their willingness to serve as moderators for our recent Networking Forum discussions.

The next meeting of the COVID-19 Networking Forum is scheduled to take place on Thursday, July 16 at 3 PM EDT. Please contact Nancy Perez (NancyPerez@cefli.org) to let us know if you or your colleagues may be interested in participating in the COVID-19 Networking Forum.

Members of the Networking Forum have raised a variety of different issues for discussion. Recent questions have pertained to issues associated with the issuance of bulletins by various jurisdictions establishing a moratorium on cancellation of policies for non-payment of premium and the operational issues that may arise accordingly. For example, members of the Networking Forum discussed whether companies may be sending out new grace/lapse notices following the "end date" of bulletins issued by several states. Also, members of the Networking Forum discussed whether they will execute a "standard" approach or a state-by state strategy with respect to how they may handle client requests for extensions of time to submit payment.

The Networking Forum also continues to discuss "return to work" strategies to allow individuals who may have been working from home to return to the office to support their normal pre-COVID-19 routines.

CEFLI Affiliate Member Wolters Kluwer provides a free daily email that outlines significant COVID-19 related regulatory changes. For those who may be interested, the link to sign up is: http://www.wolterskluwerfs.com/COVID-19-updates.aspx?wkcid=20.04_AM_CS_EN_WKFS_RCM

The Committee will be asked to discuss any operational compliance challenges associated with issues arising out of the COVID-19 pandemic. Also, the Committee will be asked to discuss whether their companies have announced plans regarding "return to work" strategies over the weeks and months ahead.

B. New Mexico OSI Bulletin - 2020 – 013.

Earlier this year, the New Mexico Office of the Superintendent of Insurance (OSI) issued Bulletin 013 related to the marketing of limited benefit/supplemental health products in New Mexico. (See copy attached.)

The Bulletin applies broadly to what OSI deems "deceptive" marketing practices by producers selling supplemental products. Among its provisions, the Bulletin requires producers to provide their National Producer Number (NPN) to prospective buyers and demands that all producers offering supplemental products furnish a four-page advertisement for the New Mexico Affordable Care Act (ACA) product to every prospective purchaser.

The Bulletin also indicates that "printed advertising media that has not been approved by OSI" is automatically deemed deceptive and subject to enforcement.

The Committee will be asked to discuss their interpretation of the New Mexico OSI Bulletin 2020 – 013; especially, with respect to the last few paragraphs in the Bulletin and their implication for practices associated with offering supplemental products in the state of New Mexico.

C. Reviewing and Monitoring Recommended Transactions - NAIC Suitability in Annuity Transactions Model Regulation.

Under both the current and revised version of the NAIC Suitability in Annuity Transactions Model Regulation, life insurers have a responsibility to review recommendations to determine whether certain recommended transactions may not be in compliance with the requirements of the Model Regulation.

To achieve this objective, insurers may deploy an array of monitoring controls such as systematic customer surveys, rules-based electronic review tools, producer interviews, consumer interviews, confirmation letters, producer statements or attestations, or other forms of internal monitoring to identify transactions for further review prior to issue or after issue.

The Committee will be asked to discuss their company's practices for reviewing and monitoring recommended transactions and what steps may be taken in the event certain transactions are deemed not to be in compliance with the requirements of the Model Regulation.

D. Anti-Money-Laundering and Antifraud Policies - Producer Acknowledgment.

Life insurance companies have instituted a range of various anti-money-laundering and antifraud policies and procedures designed to detect potentially fraudulent transactions. These policies and procedures are communicated to a company's producers so they can comply with these requirements.

However, company practices may differ with respect to their requirements to have producers acknowledge their receipt and knowledge of company anti-money-laundering and antifraud policies and procedures.

Accordingly, a question has been presented attempting to determine company practices for managing producer acknowledgment of company anti-money-laundering and antifraud policies. Specifically, questions have been presented as follows:

- *What approach does your company take with respect to receiving an acknowledgment from producers that they understand your company's anti-money-laundering and antifraud policies and procedures?*

- *How frequently are such acknowledgments required to be sent to producers?*

The Committee will be asked to discuss their company's practices for managing producer acknowledgments of company anti-money-laundering and antifraud policies.

E. Impact of *AMICA v. Wertz* on Company Practices with Respect to Filing Products for Approval by the COMPACT.

Earlier this year, the Committee reviewed the *AMICA v. Wertz* decision in which a conflict between a Colorado statute and the standards of the Interstate Insurance Product Regulatory Commission (IIPRC) (the "COMPACT") was

resolved by the Colorado Supreme Court in favor of a Colorado statute (one-year suicide exclusion) that conflicted with the standards implemented by the COMPACT (two-year suicide exclusion). (See copy attached.)

Since the decision, it was anticipated that several insurers would be evaluating the potential implications of filing products for approval by the COMPACT in light of the *AMICA v. Wertz* decision.

A question has been presented to the Committee to determine what impact, if any, the *AMICA v. Wertz* decision may have upon company strategies to submit products for approval by the COMPACT. Specifically, are companies filing their product approval requests earlier in anticipation of longer product approval timelines in light of the *AMICA v. Wertz* decision?

The Committee will be asked to discuss the implications of submitting products for approval by the COMPACT in light of the AMICA v. Wertz decision by the Colorado Supreme Court and whether companies may be adding additional filing times to the submission of their product approval request to the COMPACT.

F. FINRA Proposes Temporary Extension of Time to Conduct Office Inspections under FINRA Rule 3110 (Supervision) until March 31, 2021.

FINRA recently filed with the SEC a proposed rule change to allow a temporary extension of time to conduct office inspections under FINRA Rule 3110 (Supervision) until March 31, 2021. (See copy attached.)

This temporary extension of time is being proposed in light of the operational challenges faced by various firms in light of COVID-19 and changes that have prompted firms to allow employees to pursue work at home arrangements.

In doing so, FINRA did not provide relief for firms to conduct such inspections virtually.

However, FINRA has previously requested comments on a proposal outlined within Regulatory Notice 17-38 to allow firms to conduct a remote inspection of a “qualifying office.” Specifically, proposed Rule 3110.15(a) outlined within Regulatory Notice 17-38 would require a firm that conducts remote inspections to have policies and procedures reasonably designed to determine whether a location is eligible for remote inspection as a "qualifying office" and to assess whether a remote inspection of any such office is reasonable.

These developments raise several questions for consideration, including:

- *Will firms elect to pursue virtual inspections of branch office locations prior to March 31, 2021 or will they wait until conditions under the pandemic have improved to allow firms to conduct in-person inspections prior to March 31, 2021?*

- *Have firms developed policies and procedures to determine what may constitute a "qualifying office" to be eligible to qualify for remote inspections?*

- *Will firms moved to register employees working from home as a branch office location within the next several months?*

The Committee will be asked to discuss their strategies with respect to conducting FINRA office inspections in light of the proposed rule to provide a temporary extension of time until March 31, 2021 to complete such inspections.

G. Training Requirements for Producers Receiving Sales Compensation.

Life insurance companies appoint producers to promote sales of their annuity products. These producers work directly with clients to recommend the purchase of a specific annuity products.

However, as part of these transactions, producers (other than the primary producer who sold the product), may also be eligible to receive compensation associated with the transaction.

Therefore, a question has been presented as follows:

- *In addition to the primary producer who solicited the annuity sale, do you require other producers who will receive compensation to complete regulatory and product training specified under state adoptions of the NAIC Suitability in Annuity Transactions Model Regulation?*

The Committee will be asked to discuss their company's practices with respect to whether they require producers (other than the primary producer) who may be receiving compensation as a result of the transaction to undergo regulatory and product training as outlined within the NAIC Suitability in Annuity Transactions Model Regulation.

IV. Reporting Items. CEFLI Staff.

A. SEC Regulation Best Interest Exams.

The SEC's Regulation Best Interest became effective on June 30, 2020.

In a Risk Alert issued on April 7, 2020 by the SEC's Office of Compliance Inspections and Examinations, the SEC indicated that:

> …[its] "initial examinations, which will likely occur during the first year after the compliance date, are designed primarily to evaluate whether firms have established policies and procedures reasonably designed to achieve compliance with Regulation Best Interest. OCIE will also evaluate whether firms have made reasonable progress in implementing those policies and procedures as necessary or appropriate, including making such modifications as may be necessary or appropriate, in light of information gained from the implementation process and other facts and circumstances."

However, we have received anecdotal reports that several firms have already received a Regulation Best Interest exam request from the SEC that may be part of an initial Regulation Best Interest "sweep." Moreover, reports of initial exam requests indicated an interest in obtaining transaction data over the past 12 months.

CEFLI will be conducting a webinar on Regulation Best Interest tomorrow, July 16 at 1 PM EDT/12 Noon CDT in which these and other developments will be discussed. (See infra.)

B. DOL Proposes New Version of Fiduciary Rule.

On June 29, 2020, the US Department of Labor (DOL) proposed its new version of a Fiduciary Rule. The new version of the Fiduciary Rule is designed to comport with the requirements of the SEC's Regulation Best Interest. (See Fact Sheet attached.)

Several key elements of the proposal include:

- Implementing the "5-part test" to determine ERISA investment advice fiduciary status;
- Issuing new guidance with respect to whether rollover advice will be deemed to be fiduciary in nature;
- Establishing a new prohibited transaction exemption designed to comport with current compensation structures including both transaction-based and fee-based compensation; and
- Introduction of an impartial conduct standards which embodies the "best interest" concepts embedded within the SEC's Regulation Best Interest.

Comments on the new proposed Fiduciary Rule are due on August 6, 2020.

C. NAIC to Develop "Guidance" on NAIC Suitability In Annuity Transactions Model Regulation Revisions.

Ohio Director Jillian Froment, Chair of the NAIC Life Insurance and Annuities (A) Committee, recently announced that the Annuity Suitability (A) Working Group will begin to develop guidance for states to adopt the revisions to the NAIC Suitability in Annuity Transactions Model Regulation.

Iowa Commissioner Doug Ommen has agreed to chair the Annuity Suitability (A) Working Group effort to develop such guidance.

D. FINRA Amendments Suitability and Non-Cash Compensation Rules - SEC's Regulation Best Interest.

In Regulatory Notice 20-18, FINRA announced that it has amended its suitability rule and rules governing non-cash compensation to comply with and avoiding consistencies with the SEC's Regulation Best Interest.

FINRA indicated that its Suitability Rule (FINRA Rule 2111) will no longer apply to recommendations to retail customers subject to Regulation Best Interest.

However, FINRA also confirmed that it did not eliminate its Suitability Rule as certain types of transactions such as institutional transactions would not be subject to Regulation Best Interest. In addition, the Regulatory Notice acknowledged that other FINRA rules that have a suitability or suitability like component such as FINRA Rule 2330 (Responsibilities Regarding Deferred Variable Annuities) will not be impacted by these rule changes and will remain in place.

In addition, FINRA amended its non-cash compensation rules to ensure that non-cash compensation arrangements must also be consistent with Regulation Best Interest's Conflict of Interest Obligation and other applicable requirements of Regulation Best Interest.

E. US Department of Justice Guidance - Evaluation of Corporate Compliance Programs.

The US Department of Justice recently issued updated guidance that can be used by corporations to evaluate their compliance programs. (See copy attached.)

The guidance informs prosecutors of various factors to consider when determining whether to bring charges or negotiating plea or other agreements with corporations. Moreover, the US Sentencing Guidelines advice that

consideration be given to whether a corporation had in place at the time of the misconduct an effective compliance program for purposes of calculating the appropriate fine or penalty.

Given that these guidelines can be used by all organizations to evaluate their compliance programs, a copy of the updated Department of Justice guidance is provided for reference purposes.

F. US Court of Appeals for the Second Circuit Upholds Regulation Best Interest.

During last month's Committee meeting, we discussed that several media outlets suggested that a lawsuit filed by seven states and the District of Columbia challenge the implementation of Regulation Best Interest and its requirements for broker-dealers and investment advisers.

On June 26, 2020, the US Court of Appeals for the Second Circuit rejected the lawsuit challenging Regulation Best Interest and upheld Regulation Best Interest (a few days before its June 30, 2020 effective date). (See copy attached.)

V. CEFLI Activities.

A. Joint Webinar - *SEC Regulation Best Interest - The Past, The Present and The Future* - CEFLI/Deloitte – TOMORROW - Thursday, July 16 - 1 PM EDT/12 Noon CDT/11 AM MDT/10 AM PDT.

CEFLI will be conducting the next installment in its Educational Webinar series through a Joint Webinar with CEFLI Affiliate Member organization Deloitte on the *SEC Regulation Best Interest - The Past, The Present and The Future* TOMORROW, Thursday, July 16 at 1 PM EDT/12 Noon CDT/11 AM MDT/10 AM PDT.

The webinar will be moderated by George Hanley, Managing Director of the Insurance Practice at Deloitte who will be joined by Jim Puhala of MassMutual and Phil Pescatore of The Guardian Life Insurance Company of America as they examine the challenges confronted to comply with Regulation Best Interest as well as the challenges that lie ahead.

Registration is still open for this important session.

We hope you will be able to join us!

B. CEFLI COVID-19 Networking Forum – Thursday, July 16 and Thursday, July 30 – 3 PM EDT/2 PM CDT/1 PM MDT/12 Noon PDT.

The next meetings of CEFLI's new Networking Forum to explore COVID-19 operational issues will take place on Thursday, July 16 and Thursday, July 30 at 3 PM EDT/2 PM CDT/1 PM MDT/12 Noon PDT. Please contact Nancy Perez (NancyPerez@cefli.org) if you or your colleagues would like to be added to the new COVID-19 Networking Forum.

C. Joint Webinar - *Market Conduct* - CEFLI/Wolters Kluwer - Wednesday, July 29 - 1 PM EDT/12 Noon CDT/11 AM MDT/10 AM PDT.

CEFLI plans to conduct a Joint Webinar with Affiliate Member organization, Deloitte, to discuss *Market Conduct*.

Please mark your calendars and plan to join us on Wednesday, July 29 at 1 PM EDT/12 Noon CDT/11 AM MDT/10 AM PDT.

VI. Next Meeting.

Please note that there have been date changes for the next two Compliance & Ethics Committee meetings as noted (in highlighting) below.

The next meeting of the Committee is scheduled to take place:

Wednesday, August 12 ~~19~~, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT

Please mark your calendar and plan to join us!

The remaining Committee meeting dates for 2020 will be as follows:

Wednesday, September 16, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, October 14, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
Wednesday, November 12, 2020 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST
Wednesday, December 16, 2020 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

VII. Other Business.

The Committee will be asked to identify and discuss any other business to be brought before the Committee.

DRAFT

Minutes
Meeting of the
CEFLI Compliance & Ethics Committee
June 17, 2020

A meeting of the CEFLI Compliance & Ethics Committee (the "Committee") was held via conference call on Wednesday, June 17 at 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT.

The following CEFLI member company representatives participated in the meeting:

Marcie Allen, Texas Life
Shannon Aussieker, Country Life
Jenna Austin, Guggenheim Life and Annuity Company
Lauren Barbaruolo, Oxford Life Insurance
Chad Batterson, Athene
Ann Binzer, The Cincinnati Life
Nicole Blakney, State Farm
Kate Blalock, Western & Southern
Bryan Brewster, Wilton Re
Emmanuelle Brooks, Pacific Life
Donna Brown, Lombard International
Vickie Bulger, Primerica
Amy Burggraff, Securian Financial
Nancy Campbell, Symetra
George Cash, Protective Life
Matthew Chisholm, Erie Insurance
Deb Cooper, Securian Financial
Steve Corbly, The Cincinnati Life
Jennifer Cox, Protective Life
Jacquie Crader, CUNA Mutual
Scott Creutzmann, Protective Life
John Cunningham, Fidelity Investments
Michele Kulish Danielson, American Enterprise
Tony Dowling, Jackson National
Jill Fiddler, Assurity Life
Kris Fischer, Thrivent
Barbara Fitch, National Life
Paula Gentry, The Cincinnati Life
Jim Golembiewski, Sagicor Life
Meagan Gonzales, Oxford Life

Andrew Hill, Protective Life
Lisa Holland, State Farm
Lindsey Hughes, Western & Southern
Nathan Huss, Sammons
Isabelle Jacobs, Lombard International
Jill Jones, Bankers Fidelity
Martin Karp, Oxford Life
De Keimach, Delaware Life
Chin Kim, Pacific Life
Jennifer Knabe, Ohio National
Hannah Krone, Western & Southern
Ben Kuebbing, Western & Southern
Mark Lasswell, RiverSource
Dan LeBlanc, SBLI
Laurie Lewis, Amica Life
Tiffany MacLean, Penn Mutual
Ryan Meehan, RiverSource
Dave Milligan, American Equity
Valerie Murray, Lombard International
Ryan Meehan, Ameriprise Financial
Morgan Milner, Modern Woodmen of America
Rosemary Morgan, Brighthouse Financial
Valerie Murray, Lombard International
Deb Naegele, The Cincinnati Life
Jim Odland, Thrivent
Liza Perry, USAA Life
Megan Phillips, Principal Life
Michelle Ross, Lombard International
Sally Roudebush, Lincoln Heritage
Heather Russo, Illinois Mutual
Keith Schroeder, American Amicable
Michael Schwallie, Ohio National
Cathy Schweitzer, Western & Southern
Ryan Schwoebel, Protective Live
John Sharp, Assurity Life
Stephen Smith, Protective Life
Alison Soderberg, Lombard International
Joe Spada, Lincoln Financial
Heidi Stenberg, Symetra
Cindy Stubblefield, The Cincinnati Life
Kevin Sullivan, Protective Life
Nancy Sweet, CNO Financial
Angelea Taul, Western & Southern
Kristen Thomas, Jackson Life
Brandon Trudell, VOYA Financial
Bill Turner, American Fidelity

Bart Vitou, Jackson Life
Larry Welch, Citizens
Stacey White, American National
Christopher Wilkie, Baltimore Life
Jay Forest (unknown affiliation)

Donald J. Walters, President & CEO, Carla Strauch, Vice President - Compliance & Ethics, and Mallory Hart, Director of Member Relations, Communications and Meetings, also attended the meeting.

I. Welcome and Introduction.

The meeting began with a recitation of CEFLI's anti-trust statement.

II. Approval of Minutes – May 13, 2020.

On motion, duly made and seconded and unanimously carried, the Committee: RESOLVED, that, the Minutes of the May 13, 2020 meeting are hereby approved.

III. Issues for Review.

A. Coronavirus (COVID-19).

CEFLI thanked Chad Eslinger of Voya Financial, Jason Brassard of American National and Laura Bullard of Foresters for their willingness to serve as moderators during recent Networking Forum discussions.

Committee members were reminded that the next meeting of the COVID-19 Networking Forum is scheduled to take place on Thursday, June 18 at 3 PM EDT. Anyone interested in joining the group may contact Nancy Perez (NancyPerez@cefli.org).

CEFLI reported that members of the Networking Forum have raised a variety of different issues for discussion. Recent questions have pertained to issues associated with the issuance of bulletins by various jurisdictions establishing a moratorium on cancellation of policies for non-payment of premium and the operational issues that may arise accordingly. The subject of company "return to work" strategies has also been a common Forum discussion topic.

Committee members were informed that CEFLI Affiliate Member Wolters Kluwer provides a free daily email that outlines significant COVID-19 related regulatory changes. The link to sign up is included here.

The Committee was asked to discuss current compliance challenges associated with issues arising out of the COVID-19 pandemic and whether their companies have announced plans regarding “return to work” strategies over the weeks and months ahead.

With regard to operational impacts, Committee members noted continued efforts to manage grace period and lapse notices now that extended grace periods required by state bulletins are coming to an end.

A few companies noted their willingness to allow consumers, who ask, additional time to pay premiums. Very few consumers, however, have asked for additional time. A few companies also noted their lapse experience (based on contracts that would have lapsed if it were not for the extended grace period) has not materially changed as a result of the COVID-19 pandemic.

One insurer noted its efforts to conduct a facultative reinsurance review to ensure contracts were not at risk with respect to reinsurance matters. A few companies noted the manual process associated with managing the grace period efforts now that insurers are moving away from a blanket approach to a more state-specific approach based on current regulatory requirements that remain in some states.

With regard to return to work plans, most companies reported the majority of their staff continue to work from home. Committee members noted plans to slowly, in waves, have staff return to the office. Some companies have started that process already, while others anticipate implementing their plans in early fall. Many Committee members noted that employees are allowed to return to work on a voluntary basis.

B. Notice - Decrease in Credited Interest Rate - Universal Life Policies.

In 2019, the Texas Legislature passed HB 207 which included provisions requiring companies to provide notice to insureds when the credited interest rate on a universal life insurance policy may decrease. Section 1101.205 of the bill identifies the requirements of the written notice to the policy owner required under Texas law.

Questions were presented to the Committee concerning the manner in which life insurers may be providing the required notice under Section 1101.205 of HB 207. Specifically:

- *Will your company incorporate the information required in the notice as part of their annual statements?*

- *Will your company create a new notice to be included along with the annual statement?*

- *Will your company create a separate notice that will be sent to the policy owner before/after the annual statement?*

- *Or, is your company considering a different strategy to provide the required notice to the policy owner?*

Committee members noted they were currently reviewing the bill and that they had not made decisions regarding any changes to their operational procedures.

C. Anti-Money-Laundering - Policy Withdrawals, Loans and Surrenders.

Life insurers are required to monitor policy/contract transactions to determine whether potential anti-money-laundering issues may arise that may require the life insurer to submit Suspicious Activity Reports (SARs) to FinCEN.

Under the terms of many life insurance company products, policyowners have the right to request large withdrawals or loans from their policy/contract or may elect to surrender their policy/contract for its surrender value. In these instances, insurers may not know the reason why a policyholder may request such a transaction thereby making it difficult to determine whether a given transaction is suspicious.

The Committee was asked to discuss their company strategies related to AML transaction monitoring efforts specific to policy withdrawals, loans and surrenders and they were asked to share insights regarding the information they request from policyowners at the time such transactions are requested.

Committee members noted their efforts to focus on a pattern of activity rather than on a specific transaction, sometimes following up with the producer to understand why certain transactions were requested. To the extent prudent, a Suspicious Activity Report (SAR) is filed. One Committee member noted efforts to monitor not-taken contracts and to trace the source of funds used to issue such contracts as another means to identify potentially suspicious activities.

D. Advertising Review Processes.

Insurance regulators require the review and approval of an insurance company's advertising materials prior to use of such materials. Some insurance companies conduct their advertising materials reviews in-house, while other insurers rely on the services of a vendor or outside consultant to conduct advertising materials reviews on the insurer's behalf. Additionally, some companies require in-house counsel's review of advertising materials

The Committee was asked to discuss the extent to which companies require in-house counsel to review advertising materials as part of the review process. The Committee was also asked to discuss the extent to which their companies' contract with a third party for purposes of conducting advertising reviews and, if so, to share their experience with such processes and any lessons learned.

Committee members noted they rely on the use of inhouse counsel for advertising reviews on an as-needed basis, often for more complex materials (e.g., unique tax information, product specific information related to contract features and benefits, etc.). One Committee member noted they rely on preapproved advertising materials vetted by their legal counsel and that if changes are requested to such materials, a media advisory team (made up on nonlegal members and attorneys) must review and approve the changes.

With regard to the use of third parties for conducting advertising reviews, a few Committee members noted they use external resources only occasionally, for quality assurance purposes or for unique needs, such as new product launches when the subject matter is new to the company.

E. Gifts & Entertainment.

Several questions related to corporate policies pertaining to Gifts & Entertainment were submitted for review, including:

- *Does your company limit the dollar amount of gifts (e.g., not to exceed $100) received from third parties?*
- *Is entertainment considered a gift?*
- *Is there a different limit on the value of entertainment (versus a gift)?*
- *Does your company allow exceptions to its Gifts & Entertainment policy?*
- *If approval for exceptions is required, is the approval provided by the Chief Compliance Officer or a delegate?*
- *Are employees required to log gifts received/given?*
- *If so, how is this tracked/reviewed?*

The Committee was asked to discuss their company policies with respect to Gifts & Entertainment.

One Committee member noted that FINRA had recently taken the position that food and beverage provided for virtual meetings should be treated as a gift, not as entertainment.

With respect to gifts received by employees, one Committee member noted that preapproval, by the employee's manager, is required for gifts over $50.

F. *Patronis v. United insurance Company of America, et al*.

In 2016, several life insurance companies challenged the retroactive application of three 2016 amendments to the Florida Disposition of Unclaimed Property Act. In 2018, a trial court decision ruled in favor of the life insurance companies.

On June 3, 2020, Florida's First District Court of Appeal issued a decision in *Patronis v. United Insurance Company of America, et al*. thereby reversing the 2018 trial court decision and ruling that the 2016 amendments may operate retroactively. The decision becomes final on June 18. The insurers may request a rehearing or a rehearing en banc or may seek review of the decision in the Florida Supreme Court.

The Committee was asked to discuss the implications of the decision in Patronis v. United Insurance Company of America, et al. for their unclaimed property practices in the state of Florida going forward.

Committee members discussed the retroactive (back to 1992) nature of the decision, and the need to consider what action they will need to take, in response to the recent court decision.

IV. Reporting Items. CEFLI Staff.

A. Arizona Becomes Second State to Adopt Revisions to NAIC Suitability in Annuity Transactions Model Regulation.

Arizona Governor Doug Ducey recently signed Senate Bill 1557 which enacts into law Arizona's version of the recent revisions to the NAIC Suitability in Annuity Transactions Model Regulation.

Arizona becomes the second State (following Iowa) to adopt the recent revisions to the NAIC Suitability in Annuity Transactions Model Regulation. The effective date of the Arizona law is December 31, 2020.

B. FINRA Regulatory Notice 20-16 - Transition/Supervision Practices in a Remote Work Environment.

FINRA recently issued Regulatory Notice 20-16 to share common themes FINRA observed through discussions with small, midsize and large firms about the steps they reported taking to transition and supervise their employees in a remote work environment.

The information may be helpful to life insurers as they evaluate their practices regarding work at home arrangements and explore ways to enhance their supervisory systems and compliance programs.

C. SEC Regulation Best Interest Lawsuits.

Media reports suggested that the judges hearing oral arguments in the US Court of Appeals for the Second Circuit on Tuesday, June 2 appeared to be skeptical of arguments in consolidated lawsuits suggesting that the SEC exceeded its authority by issuing Regulation Best Interest.

It is likely that the Second Circuit may issue a ruling on the expedited hearing prior to the June 30 effective date for implementation of Regulation Best Interest.

D. DOL Fiduciary Rule Sent to OMB for Review.

The US Department of Labor (DOL) sent its revised Fiduciary Rule designed to align with the SEC's Regulation Best Interest to the Office of Management and Budget (OMB) for review.

Media reports suggest that the revised Fiduciary Rule may comprise a prohibited transaction exemption intended to replace the Best Interest Contract Exemption in the prior version of the Rule that was vacated by the Fifth Circuit Court of Appeals. The revised Fiduciary Rule may be designed to cover advisers who are not covered by the SEC's Regulation Best Interest.

E. Rhode Island and Oklahoma Will Require State-Registered Advisers to Attach Form CRS.

Most state securities regulators are not requiring advisors to attach Form CRS (which was issued in conjunction with the SEC's rulemaking package relative to Regulation Best Interest). However, two states, Rhode Island and Oklahoma will require state-registered advisors to

attach Form CRS to their Form ADV Part 2.

F. FINRA Report - Artificial Intelligence in the Securities Industry.

FINRA just recently issued a report regarding how artificial intelligence technologies transforming the financial services industry.

While the report focuses attention on the use of artificial intelligence in the securities industry, the concepts identified within the report may have application more broadly across the financial services industry.

V. CEFLI Activities.

A. Joint Webinar - *Compliance's Role in Adapting to the New Business as Usual - Balancing Oversight with Agility* - CEFLI/Guidehouse (formerly Navigant) - Wednesday, June 10 - 1 PM EDT/12 Noon CDT/11 AM MDT/10 AM PDT.

CEFLI recently conducted a Joint Webinar with CEFLI Affiliate Member organization Guidehouse (formerly Navigant) on the subject of *Compliance's Role in Adapting to the New Business as Usual - Balancing Oversight with Agility*.

A recording of the webinar is available via CEFLI's website (www.cefli.org) under Events/Webinars/Past Webinars.

B. CEFLI **COVID-19 Networking Forum.**

The next meetings of CEFLI's new Networking Forum to explore COVID-19 operational issues will take place on Thursday, June 18 and Thursday, July 1 at 3 PM EDT/2 PM CDT/1 PM MDT/12 Noon PDT (*Note: this date was changed from July 2, to July 1, as of 06/22/20*).

Please contact Nancy Perez (NancyPerez@cefli.org) if you or your colleagues would like to be added to the new COVID-19 Networking Forum.

C. Joint Webinar - *SEC Regulation Best Interest - What's Next For Life Insurance Companies?* CEFLI/Deloitte - Thursday, July 16 - 1 PM EDT/12 Noon CDT/11 AM MDT/10 AM PDT.

CEFLI plans to conduct a Joint Webinar with Affiliate Member organization, Deloitte, to discuss *SEC Regulation Best Interest -*

What's Next For Life Insurance Companies? following the June 30, 2020 compliance date.

Please mark your calendars and plan to join us on Thursday, July 16 at 1 PM EDT/12 Noon CDT/11 AM MDT/10 AM PDT.

VI. Next Meeting.

Please note that there have been date changes for the next two Compliance & Ethics Committee meetings as noted below.

The next meeting of the Committee is scheduled to take place:

- Wednesday, July 15, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT (*Note: This is a date change.)*

Please mark your calendar and plan to join us!

The remaining Committee meeting dates for 2020 will be as follows:

- Wednesday, August 12, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT (*Note: This is a date change.)*
- Wednesday, September 16, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
- Wednesday, October 14, 2020 - 2 PM EDT/1 PM CDT/12 Noon MDT/11 AM PDT
- Wednesday, November 12, 2020 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST
- Wednesday, December 16, 2020 - 2 PM EST/1 PM CST/12 Noon MST/11 AM PST

VII. Other Business.

There being no additional business the meeting was adjourned.

STATE OF NEW MEXICO
OFFICE OF SUPERINTENDENT OF INSURANCE

SUPERINTENDENT OF INSURANCE
Russell Toal

DEPUTY SUPERINTENDENT
Robert E. Doucette, Jr.

BULLETIN 2020-013

MAY 20, 2020

TO: ALL INSURERS AND PRODUCERS AUTHORIZED TO SELL EXCEPTED BENEFIT PLANS

RE: DECEPTIVE MARKETING AND ADVERTISING PRACTICES

The New Mexico Office of Superintendent of Insurance ("OSI") is charged with protecting New Mexicans from misleading and deceptive practices connected to the marketing and advertising of excepted health benefit plans, i.e., limited benefit plans that do not offer the full coverage required by the Affordable Care Act ("ACA"). In Docket No. 20-00017-COMP-LH, OSI ordered companies that issue certain excepted benefit products to inform current and prospective purchasers that those products do **not** provide major medical coverage. Any marketing or advertising practice that suggests otherwise is deceptive, misleading and, thus, prohibited by Sections 59A-16-4, 59A-16-5 and 59A-16-20, NMSA 1978.

This bulletin identifies some specific deceptive and misleading marketing and advertising practices of which OSI has become aware and will take action against. These include:

- Representing that an excepted benefit plan provides benefits that it does not.

- Selling, or offering to sell, multiple excepted benefit plans to an individual as part of a single transaction without providing a written disclosure that the combined products are not a substitute for major medical coverage.

- Using terms such as "bronze," "silver," "gold," "platinum" or "essential health benefits" to describe the coverage or benefits included in an excepted benefit plan that are associated with an ACA-compliant plan,.

- Using terms to describe the coverage or benefits included in an excepted benefit plan that are associated with comprehensive major medical coverage, such as "PPO", "network," "copay," "coinsurance," "direct pay to providers" or "dollar first plan".

- Selling an excepted benefit plan through an association or group, unless the group is in compliance with Sections 59A-23-3, 59A-23-8 and 59A-23-9, NMSA 1978 and approved by OSI, or selling association or group memberships in conjunction with the sale of excepted benefit products.

- Failing to explain to a prospective purchaser the difference between comprehensive major coverage and the limited coverage provided by an excepted benefit plan.

- Failing to deliver to each prospective purchaser of an excepted benefit product (excluding excepted benefit products offered to members of groups identified in Sections 59A-23-(A)(1)-(3), NMSA 1978) the Coverage Options Flyer attached hereto.

- "Spoofing" phone numbers on a call recipient's caller ID display to pose as another caller to market insurance, especially if the number spoofed appears to be from another carrier, healthcare provider, or government agency.

- Providing a false name or National Producer Number (NPN).

- Soliciting sales of excepted benefit products through a website, printed advertisement, text message, or phone call without identifying the producer.

- Using printed advertising media that has not been approved by OSI.

To aid OSI's monitoring and enforcement operations, the superintendent directs every producer or producer representative offering excepted benefit products (excluding products offered to members of groups identified in Sections 59A-23-(A)(1)-(3), NMSA 1978) to include the producer's name and NPN on every advertisement for health insurance or an excepted benefit product. In such advertisements or other printed materials, the producer's name and NPN must be clearly visible in no less than 12-point font type or in print type equal to the second largest print type in the advertisement. These disclosure and font requirements also apply to any text message, email or website intended to solicit sales in New Mexico. Any producer who contacts a prospective purchaser of any health insurance or excepted benefit product shall disclose this information at the start of the contact. A producer who contacts a prospective purchaser by phone, but fails to connect with that contact, shall leave a voice message, if that option is available, that includes the producer's name and NPN.

Any producer who markets an excepted benefit product using a form of advertisement previously approved by OSI shall include the producer's name and NPN on that advertisement, but shall not make any other change to the advertisement. For previously approved print advertisements, a producer can comply with this requirement by affixing the required disclosure to the printed material in any manner that is likely to remain attached, and include the associated SERFF tracking number.

Insurers have a duty to ensure that the advertising and marketing of their excepted benefit plans are not deceptive or misleading. OSI deems all unapproved forms to be deceptive and misleading and will hold plan issuers responsible for both direct marketing and indirect marketing through producers of such forms as well as misrepresentation of the coverage and benefits provided under approved forms. The marketing or sale of any plan using a deceptive practice subjects both the producer and issuer to fines and penalties, including the revocation of a producer license or certificate of authority.

If you have questions regarding this bulletin, please contact the Life and Health Product Filing Bureau at (505) 827-4601 or LHRFF.osi@state.nm.us.

ISSUED this 20th day of May, 2020.

RUSSELL TOAL
Superintendent of Insurance

In these difficult times, you can get health coverage.

We are here to help.

During the Pandemic, EVERYONE QUALIFIES for coverage. We will help you get covered for free or at a low-cost to you.

Start Here

Do you qualify for Medicaid?

Depending on your income and family size, you may qualify for Medicaid. To apply, call 1-855-637-6574 or apply online at the YES New Mexico portal.

1-855-637-6574
yes.state.nm.us

Are you eligible to enroll in a plan through beWellnm?

If you don't qualify for Medicaid, you **may now qualify** for no or low-cost private insurance through beWellnm. **If you have recently lost your job or seen a reduction in your income, call 1-833-862-3935 to see if you qualify for coverage.**

1-833-862-3935
bewellnm.com

Another option:

The New Mexico Medical Insurance Pool

If you don't qualify for Medicaid or coverage through beWellnm, **everyone in New Mexico** can get coverage through the New Mexico Medical Insurance Pool. To request an application call 1-844-728-7896 or visit www.nmmip.org.

1-844-728-7896
nmmip.org

No matter what, you can get covered.

MEDICAID HUMAN SERVICES DEPARTMENT

be well nm®

New Mexico Medical Insurance Pool

be well nm®

THE PLACE TO SHOP, COMPARE AND BUY HEALTH INSURANCE. *Affordably.*

How to qualify for coverage.

Federal Poverty Level (FPL), is a measure of income used to determine eligibility for Medicaid and the Children's Health Insurance Program (CHIP), as well as premium subsidies and cost-sharing reductions (cost-sharing subsidies) in the exchange, and other federal programs.

Light Blue = Could qualify for a discounted premium.
Blue = Could qualify for a premium tax credit and cost-sharing reduction.
Dark Blue = Could qualify for Medicaid coverage.

What is your monthly household income? (FPL = Federal Poverty Level)

New Mexico Medical Insurance Pool	**New Mexico Insurance Pool** Coverage available if you cannot get covered through Medicaid or beWellnm Discounted premiums available for individuals with incomes under 400% FPL						
be well nm	**beWellnm** (Lawfully present immigrants who do not qualify for Medicaid)		**beWellnm** with Premium Assistance				**beWellnm** without Premium Assistance
MEDICAID HUMAN SERVICES DEPARTMENT	**Medicaid** for Kids (age 0-5)						
	Medicaid for Kids (age 6-18)						
	Medicaid for Adults (age 19-64)						
How many people are in your household?	**0-100% FPL**	**138% FPL**	**139% FPL**	**240% FPL**	**300% FPL**	**400% FPL**	**Over 400% FPL**
Individuals	$1,064	$1,468	$1,469	$2,552	$3,190	$4,256	$4,256+
Family of 2	$1,437	$1,983	$1,984	$3,449	$4,311	$5,748	$5,748+
Family of 3	$1,810	$2,498	$2,499	$4,344	$5,430	$7,240	$7,240+
Family of 4	$2,184	$3,013	$3,015	$5,240	$6,550	$8,736	$8,736+
Family of 5	$2,557	$3,529	$3,530	$6,137	$7,671	$10,228	$10,228+
Family of 6	$2,930	$4,044	$4,045	$7,032	$8,790	$11,720	$11,720+

The FPL amounts are valid through March 31, 2021. If you think you qualify or are unsure what you qualify for, give us a call so we can help!

MEDICAID HUMAN SERVICES DEPARTMENT
1-855-637-6574
yes.state.nm.us

be well nm
1-833-862-3935
bewellnm.com

New Mexico Medical Insurance Pool
1-844-728-7896
nmmip.org

NMHX 001 04/20

En estos tiempos difíciles, puede obtener cobertura de salud.

Estamos aquí para ayudar.

Durante la pandemia, TODOS CALIFICAN para la cobertura.

Le ayudaremos obtener una cobertura gratuita o de bajo costo para usted.

Comience aquí

¿Califica para Medicaid?

Dependiendo de sus ingresos y el tamaño de su familia, puede calificar para Medicaid. Para aplicar, llame al 1-855-637-6574 o llene una solicitud en la pagina web de YES New Mexico.

1-855-637-6574
yes.state.nm.us

¿Es usted elegible para inscribirse en un plan a través de beWellnm?

Si no califica para Medicaid, ahora puede calificar para un seguro privado gratuito o de bajo costo a través de beWellnm. **Si recientemente perdió su trabajo o vio una reducción en sus ingresos, llame al 1-833-862-3935 para ver si califica para cobertura.**

1-833-862-3935
bewellnm.com

Otra opción:

The New Mexico Medical Insurance Pool

Si no califica para Medicaid o cobertura a través de beWellnm, **todos en Nuevo México** pueden obtener cobertura a través de The New Mexico Medical Insurance Pool. Para obtener una solicitud, llame al 1-844-728-7896 o visite www.nmmip.org.

1-844-728-7896
nmmip.org

Pase lo que pase, usted puede estar cubierto.

MEDICAID HUMAN SERVICES DEPARTMENT

be well nm®

New Mexico Medical Insurance Pool

be well nm®

THE PLACE TO SHOP, COMPARE AND BUY HEALTH INSURANCE. *Affordably.*

Cómo calificar para la cobertura.

El Nivel Federal de Pobreza (FPL) es una medida de ingresos utilizada para determinar la elegibilidad para Medicaid y el Programa de Seguro Médico para Niños (CHIP), así como subsidios de primas y reducciones de costos compartidos (subsidios de costos compartidos) en el intercambio, y otros programas federales.

Azul claro = Podría calificar para una prima con descuento.
Azul = Podría calificar para un crédito fiscal premium y una reducción de costos compartidos.
Azul Oscuro = Podría calificar para la cobertura de Medicaid.

¿Cuál es el ingreso mensual de su hogar? (FPL = Nivel de pobreza federal)

New Mexico Medical Insurance Pool	**New Mexico Insurance Pool** Cobertura disponible si no puede obtenerla a través de Medicaid o beWellnm Primas con descuento disponibles para personas con ingresos inferiores al 400% del FPL						
be well nm	**beWellnm** (inmigrantes legalmente presentes que no califican para Medicaid)		**beWellnm** con Asistencia Premium				**beWellnm** sin Asistencia Premium
MEDICAID HUMAN SERVICES DEPARTMENT	**Medicaid** para niños (age 0-5)						
	Medicaid para niños (age 6-18)						
	Medicaid para Adultos (age 19-64)						
¿Cuántas personas hay en su hogar?	**0-100% FPL**	**138% FPL**	**139% FPL**	**240% FPL**	**300% FPL**	**400% FPL**	**Over 400% FPL**
Individuos	$1,064	$1,468	$1,469	$2,552	$3,190	$4,256	$4,256+
Familia de 2	$1,437	$1,983	$1,984	$3,449	$4,311	$5,748	$5,748+
Familia de 3	$1,810	$2,498	$2,499	$4,344	$5,430	$7,240	$7,240+
Familia de 4	$2,184	$3,013	$3,015	$5,240	$6,550	$8,736	$8,736+
Familia de 5	$2,557	$3,529	$3,530	$6,137	$7,671	$10,228	$10,228+
Familia de 6	$2,930	$4,044	$4,045	$7,032	$8,790	$11,720	$11,720+

Los montos de FPL son válidos hasta el 31 de marzo del 2021. Si cree que califica o no está seguro para qué califica, llámenos para que podamos ayudarlo!

MEDICAID HUMAN SERVICES DEPARTMENT
1-855-637-6574
yes.state.nm.us

be well nm
1-833-862-3935
bewellnm.com

New Mexico Medical Insurance Pool
1-844-728-7896
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NMHX 001 04/20

DATE FILED: April 27, 2020
CASE NUMBER: 2019SA143

ADVANCE SHEET HEADNOTE
April 27, 2020

2020 CO 29

No. 19SA143 *Amica Life Insurance Company v. Wertz*—Non-Delegation Doctrine—Interstate Compacts—Suicide Exclusion Policies.

This case requires the supreme court to answer the following certified question from the Tenth Circuit Court of Appeals:

> May the Colorado General Assembly delegate power to an interstate administrative commission to approve insurance policies sold in Colorado under a standard that differs from Colorado statute?

Answering the certified question narrowly, the supreme court now concludes that the General Assembly did not have the authority to delegate to the Interstate Insurance Product Regulation Commission the power to issue a standard authorizing the sale of life insurance policies in Colorado containing a two-year suicide exclusion when a Colorado statute prohibits insurers doing business in Colorado from asserting suicide as a defense against payment on a life insurance policy after the first year of that policy.

The Supreme Court of the State of Colorado
2 East 14th Avenue • Denver, Colorado 80203

2020 CO 29

Supreme Court Case No. 19SA143
Certification of Question of Law
United States Court of Appeals for the Tenth Circuit Case No. 18-1455

Plaintiff Counter Defendant-Appellee:

Amica Life Insurance Company,

v.

Defendant Counterclaimant-Appellant:

Michael P. Wertz.

Certified Question Answered
en banc
April 27, 2020

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JUSTICE GABRIEL delivered the Opinion of the Court.

¶1 This case requires us to answer the following certified question from the Tenth Circuit Court of Appeals:

> May the Colorado General Assembly delegate power to an interstate administrative commission to approve insurance policies sold in Colorado under a standard that differs from Colorado statute?

¶2 The certified question arises from a dispute in which plaintiff Amica Life Insurance Company seeks a declaratory judgment that it is not required to pay defendant Michael P. Wertz benefits under a life insurance policy naming Wertz as the beneficiary. The policy, which was issued in compliance with a standard enacted by the Interstate Insurance Product Regulation Commission (the "Commission"), contained a two-year suicide exclusion, and the insured committed suicide more than one year but less than two years after Amica had issued the life insurance policy to him. Wertz contends, however, that the policy's two-year suicide exclusion is unenforceable because it conflicts with a Colorado statute, section 10-7-109, C.R.S. (2019), which provides:

> The suicide of a policyholder after the first policy year of any life insurance policy issued by any life insurance company doing business in this state shall not be a defense against the payment of a life insurance policy, whether said suicide was voluntary or involuntary, and whether said policyholder was sane or insane.

Wertz asserts that the Colorado General Assembly could not properly delegate to the Commission the authority to enact a standard that would effectively override this statute.

¶3 We agree with Wertz. Accordingly, answering the certified question narrowly, we conclude that the General Assembly did not have the authority to delegate to the Commission the power to issue a standard authorizing the sale of life insurance policies in Colorado containing a two-year suicide exclusion when a Colorado statute prohibits insurers doing business in Colorado from asserting suicide as a defense against payment on a life insurance policy after the first year of that policy.

I. Facts and Procedural History

¶4 In 2004, the Colorado General Assembly passed legislation to join with other states to establish the Interstate Insurance Product Regulation Compact, section 24-60-3001, C.R.S. (2019) (the "Compact"). The Compact's purpose is, among other things, to create the Commission and to "develop uniform standards for insurance products covered under the Compact." *Id*. at art. I, §§ 2, 6.

¶5 As pertinent here, the Compact authorized the Commission to promulgate rules, to establish uniform standards governing the form of insurance policies covered under the Compact, and to review and approve such insurance policies. *Id*. at art. IV, §§ 1–3. Under the Compact, such rules, standards, and complying policies are given "the force and effect of law and shall be binding in the Compacting States." *Id.*

¶6 In accordance with the foregoing authority, the Commission established certain Individual Term Life Insurance Policy Standards, IIPRC-L-04-I (2016) ("Standards"). As pertinent here, one of these Standards provides, "The suicide exclusion period shall not exceed two years from the date of issue of the policy." *Id*. at § 3(Y)(3).

¶7 Pursuant to this Standard, the Commission authorized the sale of life insurance policies containing a two-year suicide exclusion in Compacting States like Colorado. *Id*. In Colorado, however, by statute, insurers doing business in this state may not assert suicide as a defense against payment of a life insurance policy after the first year of that policy. *See* § 10-7-109. Thus, this case presents a scenario in which the policy at issue complied with the Commission's suicide-exclusion Standard but in which enforcement of that Standard amounts to the assertion of a defense that is precluded under Colorado statutory law.

¶8 Specifically, on January 28, 2014, Amica issued a ten-year convertible level term life insurance policy (with an annual renewable term provision) to Martin Fisher. The policy was in the face amount of $500,000 and named Wertz as the beneficiary. Pursuant to the Commission's Standards, the policy included a suicide-exclusion section that provided, "Suicide of the Insured, while sane or insane, within two (2) years from the Date of Issue is not covered under this policy."

¶9 Thereafter, on March 12, 2015—that is, more than one year but less than two years after the policy was issued—Fisher committed suicide. Wertz then submitted a claim for the death benefit under the policy, but Amica denied that claim, relying on the policy's two-year suicide exclusion. *Amica Life Ins. Co. v. Wertz*, 272 F. Supp. 3d 1239, 1244 (D. Colo. 2017).

¶10 Recognizing the imminent dispute between the parties, Amica filed suit in the United States District Court for the District of Colorado, seeking a declaratory judgment that it had properly denied Wertz's claim. *Id.* Wertz responded that the two-year suicide exclusion in the policy violated Colorado state law and should be declared unenforceable. *Id.* In addition, he filed counterclaims for reformation of the policy, breach of contract, and common-law bad faith breach of insurance contract. *Id*. Amica then moved for summary judgment, asserting that, as a matter of law, the Standards control over section 10-7-109. *Id.* at 1245.

¶11 The district court determined that to decide the summary judgment motion before it, it could not avoid the question of the validity of the Compact under the Colorado Constitution. *Id.* at 1247. In particular, after observing that an administrative regulation that is inconsistent with or contrary to a statute is void, the court noted Amica's argument that interstate compacts "operate in a different legal dimension, where things can happen that normally do not happen." *Id.* at

1247–48. Finding that the authorities on which Amica relied did not establish this principle, the court certified the following question to us:

> Does the Colorado Constitution empower the Colorado Legislature to enter into the Interstate Insurance Product Regulation Compact, Colo. Rev. Stat. § 24-60-3001, considering that: (a) the Compact will not be approved by the United States Congress; (b) the Compact creates an administrative body with power to promulgate rules and regulations with the force of law in Colorado; and (c) such rules and regulations supersede any Colorado statute to the extent of a conflict between the rule or regulation and the Colorado statute?

Id. at 1248, 1255.

¶12 We declined to accept this certified question, and the district court ultimately concluded, "to its surprise," that "the Colorado Legislature may validly delegate to an administrative agency the power to promulgate a regulation that modifies a statute." *Amica Life Ins. Co. v. Wertz*, 350 F. Supp. 3d 978, 982 (D. Colo. 2018). The court thus concluded that there was no barrier to the legislature's delegation of authority to the Commission here and therefore the two-year suicide exclusion was valid and Amica had properly denied payment of the death benefit. *Id.*

¶13 Wertz then appealed to the Tenth Circuit. That court subsequently certified its own question to us, and, reframing that question, we agreed to decide whether the Colorado General Assembly may delegate power to an interstate

administrative commission to approve insurance policies sold in Colorado under a standard that differs from Colorado statute.

II. Analysis

¶14 We begin by discussing our jurisdiction under C.A.R. 21.1 and the applicable standard of review. Next, we set forth the pertinent principles underlying the non-delegation doctrine. Last, we apply those principles to the facts presented here and conclude that the General Assembly did not have the authority to delegate to the Commission the power to adopt the Standard at issue, which effectively overrides section 10-7-109 for Commission-approved policies sold in Colorado by insurers authorized to do business here.

A. Jurisdiction and Standard of Review

¶15 Under C.A.R. 21.1, we may answer questions of law certified to us by a federal court if the proceeding before that court involves "questions of law of this state which may be determinative of the cause then pending in the certifying court and as to which it appears to the certifying court that there is no controlling precedent in the decisions of the supreme court." We agreed to answer the certified question from the Tenth Circuit here because it involves a significant question of first impression as to the reach of the non-delegation doctrine in Colorado, and it appears that our answer to this question may be determinative of the underlying dispute.

¶16 The matter before us presents a question of law, and we review such questions de novo. *See Hernandez v. Ray Domenico Farms, Inc.*, 2018 CO 15, ¶ 5, 414 P.3d 700, 702.

B. The Non-Delegation Doctrine

¶17 Of our three branches of government, only the General Assembly has the power to make law. *See* Colo. Const. art. III ("The powers of the government of this state are divided into three distinct departments, —the Legislative, Executive and Judicial; and no person or collection of persons charged with the exercise of powers properly belonging to one of these departments shall exercise any power properly belonging to either of the others, except as in this Constitution expressly directed or permitted."); *id.* at art. V, § 1(1) ("The legislative power of the state shall be vested in the general assembly. . . ."); *id.* at art. V, § 17 ("No law shall be passed except by bill, and no bill shall be so altered or amended on its passage through either house as to change its original purpose.").

¶18 Accordingly, it has long been settled that the legislature may not delegate its legislative power to another agency or person. *People v. Lowrie*, 761 P.2d 778, 781 (Colo. 1988); *see also People ex rel. Dunbar v. Giordano*, 481 P.2d 415, 416 (Colo. 1971) ("It is a general rule of law that a legislative body may not delegate the power to make a law or define a law, but it may delegate the power to determine some fact or state of things to effectuate the purpose of the law.").

¶19 This so-called non-delegation doctrine derives from the constitutional separation of powers. *Lowrie*, 761 P.2d at 781. It does not, however, absolutely preclude the legislature from delegating certain kinds of authority to an administrative agency. In particular, we have long recognized a distinction between the power to make law, which is non-delegable, and the authority to execute a law, which the legislature may properly delegate to an administrative agency. *See, e.g.*, *Swisher v. Brown*, 402 P.2d 621, 627 (Colo. 1965); *see also People v. Lepik*, 629 P.2d 1080, 1082 (Colo. 1981) ("Although the power to make a law may not be delegated, the power to determine a state of facts upon which the law depends may be delegated.").

¶20 Explaining the limits of the legislature's power to delegate to an administrative agency the authority to execute a law, in *Cottrell v. City and County of Denver*, 636 P.2d 703, 709 (Colo. 1981), we stated that the legislature may delegate power to an administrative agency as long as "there are sufficient statutory standards and safeguards and administrative standards and safeguards, in combination, to protect against unnecessary and uncontrolled exercise of discretionary power." Absent such standards, the delegation will be deemed to violate the constitutionally required separation of powers. *Lepik*, 629 P.2d at 1082.

¶21 Although the foregoing principles are easily stated, the line between the non-delegable power to make a law and the delegable authority to execute a law

is not readily susceptible of concise definition. Our case law, however, provides some direction.

¶22 In *Lepik*, 629 P.2d at 1082, for example, we made clear that the legislature cannot delegate to an administrative agency the authority to declare an act a crime. The statute at issue in that case prohibited the introduction into a detention facility of "contraband." *Id.* at 1081. The statute, however, effectively delegated to the administrative head of the detention facility the authority to define the term "contraband." *Id.* at 1081–82. We concluded that because the statute effectively gave unbridled discretion to the administrative head to define the crime, the statute violated the basic principle of law that only the legislature may declare an act a crime. *Id.*; *see also Casey v. People*, 336 P.2d 308, 309 (Colo. 1959) ("Only the legislature may declare an act to be a crime. That precious power cannot be delegated to others not elected by or responsible to the People.") (citation omitted).

¶23 Similarly, we have consistently concluded that the legislature may not delegate to another person or agency the authority to impose statewide taxes. *See, e.g.*, *Miller Int'l, Inc. v. State Dep't of Revenue*, 646 P.2d 341, 345 (Colo. 1982); *see also Cohen v. State Dep't of Revenue*, 593 P.2d 957, 961 (Colo. 1979) ("It is elemental that only the General Assembly may originate taxes."). In *Miller*, 646 P.2d at 343, for example, the Department of Revenue promulgated a regulation that mandated how certain income and sales of a multi-state corporation are to be allocated for

tax purposes. We determined, however, that this regulation was inconsistent with the state apportionment statutes. *Id.* at 345. Accordingly, we concluded that in passing such a regulation, the Department had effectively amended and expanded existing tax laws. *Id.* Because the Department lacked that authority, we declared the regulation void. *Id.*

¶24 And perhaps most pertinent here, we have struck down administrative regulations that circumvented the clear terms of a statute. *See, e.g.*, *Graham Furniture Co. v. Indus. Comm'n of Colo.*, 331 P.2d 507, 510 (Colo. 1958). In *Graham Furniture*, for example, an administrative regulation afforded participants in a union election certain rights to challenge the rights of others to vote in the election. *Id.* In our view, however, this regulation contradicted a statute that set forth how one attains the status of an eligible voter. *Id.* Accordingly, we struck down the regulation, concluding, "When a statute clearly provides a method for accomplishing a desired result, it follows that an administrative commission cannot set up a regulation which is contrary thereto. Its regulations must fit within the framework of the statute itself." *Id.* We added, "To hold that the clear words of the statute can be circumvented by a regulation adopted by the Commission is to ignore their plain meaning and confer legislative powers on the Commission." *Id.*

¶25 In contrast to the foregoing lines of authority, we have observed that the legislature does not improperly delegate its lawmaking function when it establishes a definite framework for the law's operation and then delegates "the details of rulemaking to an administrative agency to carry out that operation." *Lowrie*, 761 P.2d at 781. Thus, in *Lowrie*, we upheld a statutory delegation of authority to the Executive Director of the Department of Revenue, who was designated as the state licensing authority for the Colorado Liquor Code, to make such rules and regulations as were necessary for the proper regulation and control of alcohol sales and the enforcement of the state's liquor laws. *Id.* at 779, 783.

¶26 In *Lowrie*, the statute at issue required that all rules and regulations adopted by the Director be "reasonable and just," and it identified the types of subjects that the rules and regulations could validly address. *Id.* at 779. In accordance with this statutory authority, the Director issued regulations prohibiting establishments that served alcohol from serving intoxicated persons, allowing employees or patrons to expose certain parts of their bodies, or providing entertainment that involved certain forms of actual or simulated sexual conduct. *Id.* at 779–80. The defendant, who owned a nightclub in which topless dancing was offered as entertainment, was charged with violating certain of these regulations, and she moved to dismiss the charges, claiming that the Liquor Code unconstitutionally delegated to the Director the legislative authority to define criminal conduct. *Id.*

We ultimately rejected this argument, concluding that the Liquor Code had (1) provided sufficient standards and safeguards to protect against the unreasonable exercise of the Director's power and (2) placed limits on the Director's authority to make rules and regulations and therefore did not vest him with unbridled discretion as to rulemaking. *Id.* at 783.

¶27 The question before us requires us to apply the foregoing principles to decide whether the legislature's delegation to the Commission of the authority to create uniform standards properly included the authority to adopt the Standard at issue, which effectively overrides Colorado statutory law precluding an insurer doing business in this state from asserting suicide as a defense to payment on an insurance policy after the first year of that policy. We turn next to that question.

C. The Suicide-Exclusion Standard

¶28 As an initial matter, we note that no one disputes that the Compact authorized the Commission to adopt regulations with the force and effect of law that would be binding on the compacting states, including Colorado. *See* § 24-60-3001, art. IV, § 1. The question before us, however, is whether the Colorado legislature could properly delegate to the Commission the power to adopt a suicide-exclusion Standard that effectively overrides a Colorado statute. We conclude that the legislature could not do so.

¶29 Section 10-7-109 "reflects a longstanding public policy in Colorado that disfavors suicide exclusions." *Renfandt v. N.Y. Life Ins. Co.*, 2018 CO 49, ¶ 44, 419 P.3d 576, 584. Thus, although the statute allows the assertion of suicide as a defense to payment on life insurance policies, it limits the right to assert that defense to the first year of the policy. § 10-7-109.

¶30 The Commission's suicide-exclusion Standard, however, expands this limitation and allows insurers who sell Commission-approved policies in Colorado to assert suicide as a defense to payment for the first two years of the policy. Standards, at § 3(Y)(3). In this way, the Standard effectively overrides Colorado statutory law for insurers doing business here.

¶31 In our view, delegating to the Commission the authority to adopt a Standard that so circumvents the clear language of section 10-7-109 is to confer legislative powers on the Commission, and pursuant to the authorities discussed above, the General Assembly may not properly do this. *See, e.g.*, *Graham Furniture*, 331 P.2d at 510 ("To hold that the clear words of the statute can be circumvented by a regulation adopted by the Commission is to ignore their plain meaning and confer legislative powers on the Commission."). And this is so even though, under the Compact, the Colorado Commissioner of Insurance is a member of the Commission and may have voted in favor of the Standard. If the Commissioner believes that the Commission should enact a regulation that conflicts with

Colorado statutory law, then he must request action from the Colorado General Assembly because only that body may legislatively override one of its own enactments.

¶32 In reaching this conclusion, we are not persuaded by Amica's and its amici's various arguments to the contrary. We address these arguments in turn.

¶33 First, we disagree with Amica's assertion that because the Compact provided a means for the General Assembly to opt out of any Standard enacted by the Commission, *see* § 24-60-3001, art. VII, §§ 3–6, the legislature did not improperly delegate its legislative authority to the Commission. As an initial matter, we note that the facts here present a legitimate question as to whether the Compact's opt-out provisions were effective, given that the Commission could give notice of a proposed Standard and the Standard could take effect while the legislature was not in session. *See id.* We need not address this question, however, because even if the opt-out provisions were effective, we have seen no applicable authority excusing an improper delegation of legislative authority merely because the legislature could adopt or reject an administrative agency's legislative action after the fact, and neither Amica nor its amici cite any such authority. Indeed, in our view, the General Assembly's after-the-fact opt-out could not excuse the Commission's improper legislative action here because the opt-out would apply only prospectively, *see id.* at art. VII, § 5, thus leaving in place the improper

Standard in the period between its adoption and the General Assembly's decision to opt out.

¶34 Second, neither *Estate of Liebhardt v. Tasher*, 290 P.2d 1107 (Colo. 1955), nor *People v. Peterson*, 734 P.2d 118, 119–21 (Colo. 1987), on which Amica relies, authorizes the General Assembly to delegate to an administrative agency the power to adopt regulations that override a state statute.

¶35 In *Liebhardt*, 290 P.2d at 1108, we stated, "Rules and regulations adopted by a department of government, unless expressly or impliedly authorized by statute, are without force or effect if they add to, change or modify existing statutes." Relying on this language, Amica contends that our General Assembly can, in fact, delegate to an administrative agency the authority to alter a statute. Amica, however, reads our statement in *Liebhardt* out of context and fails to recognize how the principle set forth in that case has been consistently applied.

¶36 In *Liebhardt*, Liebhardt's aunt died, leaving a large portion of her estate to him. *Id.* at 1107. Within three years of the aunt's death, however, Liebhardt also died, leaving as his sole heirs his widow and son. *Id.* At the time, a Colorado statute provided for a credit on taxes to be paid upon the transfer of certain property (in *Liebhardt*, to the widow and son) if, within the prior three years, the transferor (Liebhardt) had paid taxes on the same property when the property was transferred to him. *Id.* at 1108. Although the statute reflected a clear legislative

intent to allow credit for the full amount of the tax imposed if the previously imposed tax exceeded that amount, the Colorado Inheritance Tax Commissioner had devised a formula of his own to compute the tax credit, and this formula resulted in a reduction of the credit due under the statute. *Id.* at 1108–09. We concluded that the Commissioner lacked the authority to enforce the regulation adopting his formula, stating:

> Rules and regulations adopted by a department of government, unless expressly or impliedly authorized by statute, are without force or effect if they add to, change or modify existing statutes. To permit such a proportionate reduction as that made by the Commissioner in the instant case would in effect give legal sanction to a power he does not possess, viz.: authority to amend or add to legislative enactments concerning inheritance and succession taxes.

Id. at 1108.

¶37 Accordingly, *Liebhardt* does not allow an agency to alter a statute, as Amica contends. Indeed, it concluded the opposite. Moreover, when read in context, the language on which Amica relies reflects nothing more than the fact that administrative agencies have the power to implement legislative standards if the legislature authorizes them to do so. And the cases that followed *Liebhardt*, which Amica also cites, simply reiterate this point. *See, e.g., Graham Furniture*, 331 P.2d at 510 (citing *Liebhardt* and concluding that an administrative commission cannot set up a regulation that is contrary to a clear statutory mandate); *Adams v. Colo. Dep't of Soc. Servs.*, 824 P.2d 83, 86, 89 (Colo. App. 1991) (referencing the *Liebhardt*

standard and concluding that the regulatory scheme at issue was not in conformity with the agency's enabling statute and was therefore without force and effect); *Lorance v. Colo. State Bd. of Exam'rs of Architects*, 532 P.2d 382, 384 (Colo. App. 1974) (citing *Liebhardt* and concluding that the regulatory board at issue had exceeded its authority by expanding the statutory definition of fraud and deceit to encompass conduct not covered by the statute).

¶38 Similarly, in *Peterson*, 734 P.2d at 119–21, a statute allowed the State Department of Highways to set multiple speed limits applicable to various vehicle types or weights if the Department determined, on the basis of a traffic investigation or study, that the speed specified was greater or less than was "reasonable or safe" under the road and traffic conditions. *Id.* at 120 (quoting the statute now codified at section 42-4-1102(1)(a), C.R.S. (2019)). The pertinent question before us was whether such a provision constituted an improper delegation of legislative authority to the Department. *Id.* We concluded that it did not because we believed, based on the authority discussed above, that the delegation to the Department contained adequate standards and safeguards to protect against the uncontrolled exercise of discretionary power by it. *Id.* at 120–21. In particular, the statute required that the alternative speed limits be "reasonable and safe" and provided that the Department could only act after traffic surveys and investigations established that an alteration of the speed limit

was necessary. *Id.* at 121. Accordingly, *Peterson* did not allow an administrative agency to adopt a regulation in conflict with a state statute. Instead, the statute at issue set forth certain standards and delegated to the Department the authority to implement such standards. As set forth above, we have long permitted such delegations of authority. *See, e.g.*, *Cottrell*, 636 P.2d at 709; *Lepik*, 629 P.2d at 1082.

¶39 Third, we are not persuaded that because the Standard only applies to Commission-approved policies, whereas section 10-7-109 would continue to apply to policies approved by the Colorado Commissioner of Insurance, the Commission's suicide-exclusion Standard does not conflict with the statute. As noted above, section 10-7-109 applies to "*any* life insurance policy issued by *any* life insurance company doing business in this state." (Emphases added.) Accordingly, whether approved by the Commission or by the Colorado Commissioner of Insurance, the statute applies as long as the policy was issued by an insurer doing business here. The Commission's suicide-exclusion Standard therefore conflicts with section 10-7-109.

¶40 Fourth, we reject Amica's contention that the interstate nature of the Commission here distinguishes this case from the above-described authorities regarding intrastate delegations of authority to administrative agencies. Although, to be sure, regulations adopted pursuant to an interstate compact can at times override conflicting state law, the cases that have so concluded have

involved interstate compacts that were approved by acts of Congress, and these cases have relied on federal preemption or supremacy clause principles. *See, e.g.*, *Frontier Ditch Co. v. Se. Colo. Water Conservancy Dist.*, 761 P.2d 1117, 1123 (Colo. 1988) (noting that the Compact at issue was part of federal law, having been approved by an act of Congress, and was thus preemptive of any conflicting state law on the same subject). These cases do not assist Amica here, however, because Congress has not approved the Compact at issue, and Amica cites no law supporting its apparent position that *any* interstate compact can supersede conflicting state law. To the contrary, all of the cases on which Amica relies to support its argument involved congressionally approved compacts and thus implicated federal preemption principles. *See, e.g.*, *Port Auth. Trans-Hudson Corp. v. Feeney*, 495 U.S. 299, 301 (1990) (concerning a congressionally approved compact between New York and New Jersey); *State ex. rel Dyer v. Sims*, 341 U.S. 22, 24–25 (1951) (concerning a congressionally approved compact among eight states to control pollution in the Ohio River); *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*, 304 U.S. 92, 95 (1938) (concerning a congressionally approved river compact between Colorado and New Mexico); *Frontier Ditch*, 761 P.2d at 1123 (concerning a congressionally approved river compact between Colorado and Kansas). Thus, we are not persuaded that the legislature has the authority to

delegate to interstate agencies powers that it cannot constitutionally delegate to intrastate agencies.

¶41 Finally, we are unpersuaded by Amica's argument that our conclusion here would limit the effectiveness of interstate compacts that are not approved by Congress. In this case, we conclude only that, in the context of an interstate compact that has not been approved by Congress, the Colorado legislature may not delegate to an interstate administrative agency the power to adopt regulations that conflict with Colorado statutory law because under longstanding Colorado law, such a delegation amounts to the improper delegation of legislative power. We express no opinion on any other form of interstate compact.

III. Conclusion

¶42 For the foregoing reasons, we conclude that in the context of an interstate compact that has not been approved by Congress, the General Assembly may not delegate to an interstate administrative agency the authority to adopt regulations that effectively override Colorado statutory law. Under longstanding Colorado law, such action would amount to the improper delegation of legislative authority.

¶43 Accordingly, answering the certified question before us narrowly, we conclude that the General Assembly did not have the authority to delegate to the Commission here the power to adopt a Standard authorizing the sale of insurance policies in Colorado containing a two-year suicide exclusion when a Colorado

statute prohibits insurers doing business in Colorado from asserting suicide as a defense against payment on a life insurance policy after the first year of that policy.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to adopt temporary Supplementary Material .16 (Temporary Extension of Time to Complete Office Inspections) under FINRA Rule 3110 (Supervision) that, in light of the operational challenges member firms are facing due to the outbreak of the coronavirus disease (COVID-19), would extend the time by which member firms must complete their calendar year 2020 inspection obligations under Rule 3110(c) (Internal Inspections) to March 31, 2021.[2]

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are bracketed.

* * * * *

3000. SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS

* * * * *

3100. Supervisory Responsibilities

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3110. Supervision

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1 15 U.S.C. 78s(b)(1).

2 The proposed rule change will automatically sunset on March 31, 2021. If FINRA seeks to provide additional temporary relief from the rule requirement identified in this proposal beyond March 31, 2021, FINRA will submit a separate rule filing to further extend the temporary extension of time.

* * * * *

(a) through (f) No Change.

• • • Supplementary Material: ----------

.01 through .15 No Change.

.16 Temporary Extension of Time to Complete Office Inspections. Each member obligated to complete an inspection of an office of supervisory jurisdiction, branch office or non-branch location in calendar year 2020 pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110, shall be deemed to have satisfied such obligation if the applicable inspection is completed on or before March 31, 2021.

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(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The Chief Legal Officer of FINRA authorized the filing of the proposed rule change with the SEC pursuant to delegated authority. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so that FINRA can implement the proposed rule change immediately.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

FINRA is closely monitoring the impact of the COVID-19 pandemic on member firms, investors, and other stakeholders. FINRA recognizes that firms are experiencing operational challenges with much of their personnel working from home due to shelter-in-place orders, restrictions on businesses and social activity imposed in various states, and adhering to other social distancing guidelines consistent with the recommendations of public health officials.[3] FINRA believes that these ongoing extenuating circumstances warrant sensible and tailored accommodations for member firms to meet their inspection obligations under Rule 3110(c) for calendar year 2020.

Rule 3110(c) requires on-site inspections of offices of supervisory jurisdiction ("OSJs") and supervisory branch offices at least annually (on a calendar-year basis), non-supervisory branch offices at least every three years, and non-branch locations on a regular periodic schedule, presumed to be every three years.[4] As a result of the compelling health and welfare concerns stemming from the COVID-19 pandemic, firms are facing potentially significant disruptions to their normal business operations that may include staff absenteeism, the increased use of remote offices or telework arrangements, travel or transportation limitations, and technology interruptions or slowdowns. These circumstances make it impracticable for firms in most cases to reach and conduct an on-site inspection of office locations. To provide firms an opportunity to better manage these operational challenges and the resources attendant to fulfilling these supervisory

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[3] See, e.g., Centers for Disease Control and Prevention, How to Protect Yourself & Others, https://www.cdc.gov/coronavirus/2019-ncov/prevent-getting-sick/prevention.html (last visited June 17, 2020).

[4] See Rule 3110(c)(1)(A), (B), and (C). See also Rule 3110.13 (General Presumption of Three-Year Limit for Periodic Inspection Schedules).

obligations during these pressing times, FINRA is proposing to adopt Rule 3110.16 that would extend the time by which inspections must be completed in accordance with Rule 3110(c) for calendar year 2020 to March 31, 2021.[5] FINRA emphasizes that this extension of time does not relieve firms from the on-site inspection requirement of branch offices and non-branch locations currently prescribed by the rule. FINRA also notes that this proposed extension of time would create further efficiencies for firms by aligning with the Municipal Securities Rulemaking Board's ("MSRB") temporary extension for meeting the inspection requirements of offices set forth under MSRB Rule G-27 (Supervision) to March 31, 2021.[6]

FINRA believes that this proposed extension of time is tailored to address the needs and constraints on a firm's operations during the COVID-19 pandemic, without significantly compromising critical investor protection. FINRA believes that potential risks that may arise from providing firms additional time to comply with their inspection obligations due in calendar year 2020 are mitigated by firms' ongoing supervisory obligations, off-site monitoring, and the temporary nature of the extension. FINRA will continue to monitor the situation and engage with member firms, other financial regulators, and governmental authorities to determine whether additional regulatory relief or guidance related to this rule may be appropriate. In particular, FINRA will consider

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5 See supra note 2.

6 See Securities Exchange Act Release No. 88694 (April 20, 2020), 85 FR 23088 (April 24, 2020) (Notice of Filing and Immediate Effectiveness of File No SR-MSRB-2020-01). See also MSRB Notice 2020-09 (MSRB Amends Certain Rules to Provide Regulatory Relief During COVID-19 Pandemic) (April 9, 2020).

whether additional relief may be warranted to address any backlog of 2020 inspections that may continue to exist in light of ongoing public health and safety concerns.

As noted in Item 2 of this filing, FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change immediately.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[7] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change is intended to provide firms additional time to comply with their Rule 3110(c) inspection obligations due in calendar year 2020 to March 31, 2021, and does not relieve firms from completing those obligations or from maintaining, under the circumstances, a reasonably designed system to supervise the activities of their associated persons to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules that directly serve investor protection. In a time when faced with unique challenges resulting from the COVID-19 pandemic, FINRA believes that the proposed rule change is a sensible accommodation that will afford firms the ability to observe the recommendations of public health officials to provide for the health

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[7] 15 U.S.C. 78o-3(b)(6).

and safety of its personnel, while continuing to serve and promote the protection of investors and the public interest in this unique environment.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is intended solely to provide temporary relief given the impacts of the COVID-19 pandemic crisis.[8] As a result of the temporary nature of the proposed relief, an abbreviated economic impact assessment is appropriate.

Economic Impact Assessment

A. Regulatory Objective

FINRA is proposing Rule 3110.16 to address an issue that has arisen due to the impacts of the coronavirus outbreak and restrictions related to health and safety concerns. In addition to social distancing requirements that have been implemented across the United States to benefit the health and welfare of the populace, firms are facing potentially significant business disruptions that may include staff absenteeism, increased use of remote offices or telework arrangements, travel or transportation limitations, and technology interruptions or slowdowns. These limitations pose significant challenges for firms to satisfy the on-site inspection component of Rule 3110(c), which requires travel to visit offices and non-branch locations. In recognition of these circumstances, the proposed rule change would provide temporary relief by extending the date by which firms must complete their 2020 inspections.

B. Economic Baseline

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[8] See also FINRA Regulatory Notice 20-08.

The Economic Baseline of the proposed temporary relief is the obligation under Rule 3110(c), as described above, and the current number and types of FINRA member locations that require inspections.

C. Economic Impact

Proposed Rule 3110.16 is intended solely to provide an accommodation from the timing requirements set forth under Rule 3110(c) (as applicable to year 2020) due to the current pandemic-related limitations in place across the United States to benefit the health and welfare of the populace. FINRA believes that the proposed rule change will not impose any new costs on member firms. Moreover, the proposed rule change would align with similar temporary relief provided by the MSRB (as discussed above), and such coordination among regulators will provide for greater clarity and the efficient use of resources by firms during this public health crisis.

FINRA notes that even in the current environment, member firms have an ongoing obligation to supervise the activities of their associated persons at their branch offices and non-branch locations in a manner reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Any risks that may arise from providing firms additional time to comply with their Rule 3110(c) inspection obligations due in calendar year 2020 are mitigated by firms' ongoing supervisory obligations, off-site monitoring, and the temporary nature of the extension. As noted above, the proposed rule change would be limited in time, and in place to March 31, 2021, or until the conclusion of any extension thereof.[9]

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

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[9] See supra note 2.

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3) of the Act[10] and paragraph (f)(6) of Rule 19b-4 thereunder,[11] in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days after filing or such shorter time as the Commission may designate.

FINRA requests that the Commission waive the requirement that the rule change, by its terms, not become operative for 30 days after the date of the filing as set forth in Rule 19b-4(f)(6)(iii),[12] so that the proposed rule change may become operative immediately. Waiver of the operative delay would allow the proposed change to be in effect on the date of filing to provide immediate temporary relief to firms during these unique circumstances resulting from the COVID-19 pandemic. In accordance with Rule 19b-4(f)(6),[13] FINRA submitted written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five

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[10] 15 U.S.C. 78s(b)(3).

[11] 17 CFR 240.19b-4(f)(6).

[12] 17 CFR 240.19b-4(f)(6)(iii).

[13] 17 CFR 240.19b-4(f)(6).

business days prior to the date of filing, or such shorter time as the Commission may designate, as specified in Rule 19b-4(f)(6)(iii) under the Act.[14]

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

[14] 17 CFR 240.19b-4(f)(6)(iii).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2020-019)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Temporarily Extend the Time to Complete Office Inspections under FINRA Rule 3110 (Supervision)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on , Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 under the Act,[3] which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt temporary Supplementary Material .16 (Temporary Extension of Time to Complete Office Inspections) under FINRA Rule 3110 (Supervision) that, in light of the operational challenges member firms are facing due to the outbreak of the coronavirus disease (COVID-19), would extend the time by which

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 17 CFR 240.19b-4(f)(6).

member firms must complete their calendar year 2020 inspection obligations under Rule 3110(c) (Internal Inspections) to March 31, 2021.[4]

Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

3000. SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS

* * * * *

3100. Supervisory Responsibilities

* * * * *

3110. Supervision

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(a) through (f) No Change.

• • • Supplementary Material: ----------

.01 through .15 No Change.

.16 Temporary Extension of Time to Complete Office Inspections. Each member obligated to complete an inspection of an office of supervisory jurisdiction, branch office or non-branch location in calendar year 2020 pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110, shall be deemed to have satisfied such obligation if the applicable inspection is completed on or before March 31, 2021.

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4 The proposed rule change will automatically sunset on March 31, 2021. If FINRA seeks to provide additional temporary relief from the rule requirement identified in this proposal beyond March 31, 2021, FINRA will submit a separate rule filing to further extend the temporary extension of time.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA is closely monitoring the impact of the COVID-19 pandemic on member firms, investors, and other stakeholders. FINRA recognizes that firms are experiencing operational challenges with much of their personnel working from home due to shelter-in-place orders, restrictions on businesses and social activity imposed in various states, and adhering to other social distancing guidelines consistent with the recommendations of public health officials.[5] FINRA believes that these ongoing extenuating circumstances warrant sensible and tailored accommodations for member firms to meet their inspection obligations under Rule 3110(c) for calendar year 2020.

Rule 3110(c) requires on-site inspections of offices of supervisory jurisdiction ("OSJs") and supervisory branch offices at least annually (on a calendar-year basis), non-

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[5] See, e.g., Centers for Disease Control and Prevention, How to Protect Yourself & Others, https://www.cdc.gov/coronavirus/2019-ncov/prevent-getting-sick/prevention.html (last visited June 17, 2020).

supervisory branch offices at least every three years, and non-branch locations on a regular periodic schedule, presumed to be every three years.[6] As a result of the compelling health and welfare concerns stemming from the COVID-19 pandemic, firms are facing potentially significant disruptions to their normal business operations that may include staff absenteeism, the increased use of remote offices or telework arrangements, travel or transportation limitations, and technology interruptions or slowdowns. These circumstances make it impracticable for firms in most cases to reach and conduct an on-site inspection of office locations. To provide firms an opportunity to better manage these operational challenges and the resources attendant to fulfilling these supervisory obligations during these pressing times, FINRA is proposing to adopt Rule 3110.16 that would extend the time by which inspections must be completed in accordance with Rule 3110(c) for calendar year 2020 to March 31, 2021.[7] FINRA emphasizes that this extension of time does not relieve firms from the on-site inspection requirement of branch offices and non-branch locations currently prescribed by the rule. FINRA also notes that this proposed extension of time would create further efficiencies for firms by aligning with the Municipal Securities Rulemaking Board's ("MSRB") temporary extension for meeting the inspection requirements of offices set forth under MSRB Rule G-27 (Supervision) to March 31, 2021.[8]

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6 See Rule 3110(c)(1)(A), (B), and (C). See also Rule 3110.13 (General Presumption of Three-Year Limit for Periodic Inspection Schedules).

7 See supra note 4.

8 See Securities Exchange Act Release No. 88694 (April 20, 2020), 85 FR 23088 (April 24, 2020) (Notice of Filing and Immediate Effectiveness of File No SR-MSRB-2020-01). See also MSRB Notice 2020-09 (MSRB Amends Certain Rules to Provide Regulatory Relief During COVID-19 Pandemic) (April 9, 2020).

FINRA believes that this proposed extension of time is tailored to address the needs and constraints on a firm's operations during the COVID-19 pandemic, without significantly compromising critical investor protection. FINRA believes that potential risks that may arise from providing firms additional time to comply with their inspection obligations due in calendar year 2020 are mitigated by firms' ongoing supervisory obligations, off-site monitoring, and the temporary nature of the extension. FINRA will continue to monitor the situation and engage with member firms, other financial regulators, and governmental authorities to determine whether additional regulatory relief or guidance related to this rule may be appropriate. In particular, FINRA will consider whether additional relief may be warranted to address any backlog of 2020 inspections that may continue to exist in light of ongoing public health and safety concerns.

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change immediately.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[9] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change is intended to provide firms additional time to comply

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[9] 15 U.S.C. 78o-3(b)(6).

with their Rule 3110(c) inspection obligations due in calendar year 2020 to March 31, 2021, and does not relieve firms from completing those obligations or from maintaining, under the circumstances, a reasonably designed system to supervise the activities of their associated persons to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules that directly serve investor protection. In a time when faced with unique challenges resulting from the COVID-19 pandemic, FINRA believes that the proposed rule change is a sensible accommodation that will afford firms the ability to observe the recommendations of public health officials to provide for the health and safety of its personnel, while continuing to serve and promote the protection of investors and the public interest in this unique environment.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is intended solely to provide temporary relief given the impacts of the COVID-19 pandemic crisis.[10] As a result of the temporary nature of the proposed relief, an abbreviated economic impact assessment is appropriate.

Economic Impact Assessment

A. Regulatory Objective

FINRA is proposing Rule 3110.16 to address an issue that has arisen due to the impacts of the coronavirus outbreak and restrictions related to health and safety concerns. In addition to social distancing requirements that have been implemented across the

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[10] See also FINRA Regulatory Notice 20-08.

United States to benefit the health and welfare of the populace, firms are facing potentially significant business disruptions that may include staff absenteeism, increased use of remote offices or telework arrangements, travel or transportation limitations, and technology interruptions or slowdowns. These limitations pose significant challenges for firms to satisfy the on-site inspection component of Rule 3110(c), which requires travel to visit offices and non-branch locations. In recognition of these circumstances, the proposed rule change would provide temporary relief by extending the date by which firms must complete their 2020 inspections.

B. Economic Baseline

The Economic Baseline of the proposed temporary relief is the obligation under Rule 3110(c), as described above, and the current number and types of FINRA member locations that require inspections.

C. Economic Impact

Proposed Rule 3110.16 is intended solely to provide an accommodation from the timing requirements set forth under Rule 3110(c) (as applicable to year 2020) due to the current pandemic-related limitations in place across the United States to benefit the health and welfare of the populace. FINRA believes that the proposed rule change will not impose any new costs on member firms. Moreover, the proposed rule change would align with similar temporary relief provided by the MSRB (as discussed above), and such coordination among regulators will provide for greater clarity and the efficient use of resources by firms during this public health crisis.

FINRA notes that even in the current environment, member firms have an ongoing obligation to supervise the activities of their associated persons at their branch

offices and non-branch locations in a manner reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Any risks that may arise from providing firms additional time to comply with their Rule 3110(c) inspection obligations due in calendar year 2020 are mitigated by firms' ongoing supervisory obligations, off-site monitoring, and the temporary nature of the extension. As noted above, the proposed rule change would be limited in time, and in place to March 31, 2021, or until the conclusion of any extension thereof.[11]

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act[12] and Rule 19b-4(f)(6) thereunder.[13]

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the

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[11] See supra note 4.

[12] 15 U.S.C. 78s(b)(3)(A).

[13] 17 CFR 240.19b-4(f)(6).

Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2020-019 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2020-019. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2020-019 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[14]

Jill M. Peterson
Assistant Secretary

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[14] 17 CFR 200.30-3(a)(12).

U.S. Department of Justice
Criminal Division

Evaluation of Corporate Compliance Programs

(Updated June 2020)

Introduction

The "Principles of Federal Prosecution of Business Organizations" in the Justice Manual describe specific factors that prosecutors should consider in conducting an investigation of a corporation, determining whether to bring charges, and negotiating plea or other agreements. JM 9-28.300. These factors include "the adequacy and effectiveness of the corporation's compliance program at the time of the offense, as well as at the time of a charging decision" and the corporation's remedial efforts "to implement an adequate and effective corporate compliance program or to improve an existing one." JM 9-28.300 (citing JM 9-28.800 and JM 9-28.1000). Additionally, the United States Sentencing Guidelines advise that consideration be given to whether the corporation had in place at the time of the misconduct an effective compliance program for purposes of calculating the appropriate organizational criminal fine. *See* U.S.S.G. §§ 8B2.1, 8C2.5(f), and 8C2.8(11). Moreover, the memorandum entitled "Selection of Monitors in Criminal Division Matters" issued by Assistant Attorney General Brian Benczkowski (hereafter, the "Benczkowski Memo") instructs prosecutors to consider, at the time of the resolution, "whether the corporation has made significant investments in, and improvements to, its corporate compliance program and internal controls systems" and "whether remedial improvements to the compliance program and internal controls have been tested to demonstrate that they would prevent or detect similar misconduct in the future" to determine whether a monitor is appropriate.

This document is meant to assist prosecutors in making informed decisions as to whether, and to what extent, the corporation's compliance program was effective at the time of the offense, and is effective at the time of a charging decision or resolution, for purposes of determining the appropriate (1) form of any resolution or prosecution; (2) monetary penalty, if any; and (3) compliance obligations contained in any corporate criminal resolution (e.g., monitorship or reporting obligations).

Because a corporate compliance program must be evaluated in the specific context of a criminal investigation, the Criminal Division does not use any rigid formula to assess the effectiveness of corporate compliance programs. We recognize that each company's risk profile and solutions to reduce its risks warrant particularized evaluation. Accordingly, we make a reasonable, individualized determination in each case that considers various factors including, but not limited to, the company's size, industry, geographic footprint, regulatory landscape, and other factors, both internal and external to the company's operations, that might impact its compliance program. There are, however, common questions that we may ask in the course of making an individualized determination. As the Justice Manual notes, there are three "fundamental questions" a prosecutor should ask:

U.S. Department of Justice
Criminal Division

Evaluation of Corporate Compliance Programs

(Updated June 2020)

1. "Is the corporation's compliance program well designed?"
2. "Is the program being applied earnestly and in good faith?" In other words, is the program adequately resourced and empowered to function effectively?
3. "Does the corporation's compliance program work" in practice?

See JM 9-28.800.

In answering each of these three "fundamental questions," prosecutors may evaluate the company's performance on various topics that the Criminal Division has frequently found relevant in evaluating a corporate compliance program both at the time of the offense and at the time of the charging decision and resolution.[1] The sample topics and questions below form neither a checklist nor a formula. In any particular case, the topics and questions set forth below may not all be relevant, and others may be more salient given the particular facts at issue and the circumstances of the company.[2] Even though we have organized the topics under these three fundamental questions, we recognize that some topics necessarily fall under more than one category.

I. Is the Corporation's Compliance Program Well Designed?

The "critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct." JM 9-28.800.

Accordingly, prosecutors should examine "the comprehensiveness of the compliance program," JM 9-28.800, ensuring that there is not only a clear message that misconduct is not tolerated, but also policies and procedures – from appropriate assignments of responsibility, to training programs, to systems of incentives and discipline – that ensure the compliance program is well-integrated into the company's operations and workforce.

A. Risk Assessment

The starting point for a prosecutor's evaluation of whether a company has a well-designed compliance program is to understand the company's business from a commercial perspective, how the company has identified, assessed, and defined its risk profile, and the degree to which the program devotes appropriate scrutiny and resources to the spectrum of risks. In short, prosecutors should endeavor to understand why the company has chosen to set up the compliance program the way that it has, and why and how the company's compliance program has evolved over time.

Prosecutors should consider whether the program is appropriately "designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business" and "complex regulatory environment[]." JM 9-28.800.[3] For example, prosecutors should consider whether the company has analyzed and addressed the varying risks presented by, among other factors, the location of its operations, the industry sector, the competitiveness of the market, the regulatory landscape, potential clients and business partners, transactions with foreign governments, payments to foreign officials, use of third parties, gifts, travel, and entertainment expenses, and charitable and political donations.

Prosecutors should also consider "[t]he effectiveness of the company's risk assessment and the manner in which the company's compliance program has been tailored based on that risk assessment" and whether its criteria are "periodically updated." *See, e.g.*, JM 9-47-120(2)(c); U.S.S.G. § 8B2.1(c) ("the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement [of the compliance program] to reduce the risk of criminal conduct").

Prosecutors may credit the quality and effectiveness of a risk-based compliance program that devotes appropriate attention and resources to high-risk transactions, even if it fails to prevent an infraction. Prosecutors should therefore consider, as an indicator of risk-tailoring, "revisions to corporate compliance programs in light of lessons learned." JM 9-28.800.

- **Risk Management Process** – What methodology has the company used to identify, analyze, and address the particular risks it faces? What information or metrics has the company collected and used to help detect the type of misconduct in question? How have the information or metrics informed the company's compliance program?

- **Risk-Tailored Resource Allocation –** Does the company devote a disproportionate amount of time to policing low-risk areas instead of high-risk areas, such as questionable payments to third-party consultants, suspicious trading activity, or excessive discounts to resellers and distributors? Does the company give greater scrutiny, as warranted, to high-risk transactions (for instance, a large-dollar contract with a government agency in a high-risk country) than more modest and routine hospitality and entertainment?

- **Updates and Revisions** – Is the risk assessment current and subject to periodic review? Is the periodic review limited to a "snapshot" in time or based upon continuous access to operational data and information across functions? Has the periodic review led to updates in policies, procedures, and controls? Do these updates account for risks discovered through misconduct or other problems with the compliance program?

- **Lessons Learned** – Does the company have a process for tracking and incorporating into its periodic risk assessment lessons learned either from the company's own prior issues or from those of other companies operating in the same industry and/or geographical region?

B. Policies and Procedures

Any well-designed compliance program entails policies and procedures that give both content and effect to ethical norms and that address and aim to reduce risks identified by the company as part of its risk assessment process. As a threshold matter, prosecutors should examine whether the company has a code of conduct that sets forth, among other things, the company's commitment to full compliance with relevant Federal laws that is accessible and applicable to all company employees. As a corollary, prosecutors should also assess whether the company has established policies and procedures that incorporate the culture of compliance into its day-to-day operations.

- **Design** – What is the company's process for designing and implementing new policies and procedures and updating existing policies and procedures, and has that process changed over time? Who has been involved in the design of policies and procedures? Have business units been consulted prior to rolling them out?

- **Comprehensiveness** – What efforts has the company made to monitor and implement policies and procedures that reflect and deal with the spectrum of risks it faces, including changes to the legal and regulatory landscape?

- **Accessibility** – How has the company communicated its policies and procedures to all employees and relevant third parties? If the company has foreign subsidiaries, are there linguistic or other barriers to foreign employees' access? Have the policies and procedures been published in a searchable format for easy reference? Does the company track access to various policies and procedures to understand what policies are attracting more attention from relevant employees?

- **Responsibility for Operational Integration** – Who has been responsible for integrating policies and procedures? Have they been rolled out in a way that ensures employees' understanding of the policies? In what specific ways are compliance policies and procedures reinforced through the company's internal control systems?

- **Gatekeepers** – What, if any, guidance and training has been provided to key gatekeepers in the control processes (*e.g.*, those with approval authority or

certification responsibilities)? Do they know what misconduct to look for? Do they know when and how to escalate concerns?

C. Training and Communications

Another hallmark of a well-designed compliance program is appropriately tailored training and communications.

Prosecutors should assess the steps taken by the company to ensure that policies and procedures have been integrated into the organization, including through periodic training and certification for all directors, officers, relevant employees, and, where appropriate, agents and business partners. Prosecutors should also assess whether the company has relayed information in a manner tailored to the audience's size, sophistication, or subject matter expertise. Some companies, for instance, give employees practical advice or case studies to address real-life scenarios, and/or guidance on how to obtain ethics advice on a case-by-case basis as needs arise. Other companies have invested in shorter, more targeted training sessions to enable employees to timely identify and raise issues to appropriate compliance, internal audit, or other risk management functions. Prosecutors should also assess whether the training adequately covers prior compliance incidents and how the company measures the effectiveness of its training curriculum.

Prosecutors, in short, should examine whether the compliance program is being disseminated to, and understood by, employees in practice in order to decide whether the compliance program is "truly effective." JM 9-28.800.

- **Risk-Based Training** – What training have employees in relevant control functions received? Has the company provided tailored training for high-risk and control employees, including training that addresses risks in the area where the misconduct occurred? Have supervisory employees received different or supplementary training? What analysis has the company undertaken to determine who should be trained and on what subjects?

- **Form/Content/Effectiveness of Training** – Has the training been offered in the form and language appropriate for the audience? Is the training provided online or in-person (or both), and what is the company's rationale for its choice? Has the training addressed lessons learned from prior compliance incidents? Whether online or in-person, is there a process by which employees can ask questions arising out of the trainings? How has the company measured the effectiveness of the training? Have employees been tested on what they have learned? How has the company addressed

employees who fail all or a portion of the testing? Has the company evaluated the extent to which the training has an impact on employee behavior or operations?

- **Communications about Misconduct** – What has senior management done to let employees know the company's position concerning misconduct? What communications have there been generally when an employee is terminated or otherwise disciplined for failure to comply with the company's policies, procedures, and controls (*e.g.*, anonymized descriptions of the type of misconduct that leads to discipline)?

- **Availability of Guidance** – What resources have been available to employees to provide guidance relating to compliance policies? How has the company assessed whether its employees know when to seek advice and whether they would be willing to do so?

D. Confidential Reporting Structure and Investigation Process

Another hallmark of a well-designed compliance program is the existence of an efficient and trusted mechanism by which employees can anonymously or confidentially report allegations of a breach of the company's code of conduct, company policies, or suspected or actual misconduct. Prosecutors should assess whether the company's complaint-handling process includes proactive measures to create a workplace atmosphere without fear of retaliation, appropriate processes for the submission of complaints, and processes to protect whistleblowers. Prosecutors should also assess the company's processes for handling investigations of such complaints, including the routing of complaints to proper personnel, timely completion of thorough investigations, and appropriate follow-up and discipline.

Confidential reporting mechanisms are highly probative of whether a company has "established corporate governance mechanisms that can effectively detect and prevent misconduct." JM 9-28.800; *see also* U.S.S.G. § 8B2.1(b)(5)(C) (an effectively working compliance program will have in place, and have publicized, "a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation").

- **Effectiveness of the Reporting Mechanism** – Does the company have an anonymous reporting mechanism and, if not, why not? How is the reporting mechanism publicized to the company's employees and other third parties? Has it been used? Does the company take measures to test whether employees are aware of the hotline and feel comfortable using it? How has the company assessed the seriousness of the

allegations it received? Has the compliance function had full access to reporting and investigative information?

- **Properly Scoped Investigations by Qualified Personnel** – How does the company determine which complaints or red flags merit further investigation? How does the company ensure that investigations are properly scoped? What steps does the company take to ensure investigations are independent, objective, appropriately conducted, and properly documented? How does the company determine who should conduct an investigation, and who makes that determination?

- **Investigation Response** – Does the company apply timing metrics to ensure responsiveness? Does the company have a process for monitoring the outcome of investigations and ensuring accountability for the response to any findings or recommendations?

- **Resources and Tracking of Results** – Are the reporting and investigating mechanisms sufficiently funded? How has the company collected, tracked, analyzed, and used information from its reporting mechanisms? Does the company periodically analyze the reports or investigation findings for patterns of misconduct or other red flags for compliance weaknesses? Does the company periodically test the effectiveness of the hotline, for example by tracking a report from start to finish?

E. Third Party Management

A well-designed compliance program should apply risk-based due diligence to its third-party relationships. Although the need for, and degree of, appropriate due diligence may vary based on the size and nature of the company, transaction, and third party, prosecutors should assess the extent to which the company has an understanding of the qualifications and associations of third-party partners, including the agents, consultants, and distributors that are commonly used to conceal misconduct, such as the payment of bribes to foreign officials in international business transactions.

Prosecutors should also assess whether the company knows the business rationale for needing the third party in the transaction, and the risks posed by third-party partners, including the third-party partners' reputations and relationships, if any, with foreign officials. For example, a prosecutor should analyze whether the company has ensured that contract terms with third parties specifically describe the services to be performed, that the third party is actually performing the work, and that its compensation is commensurate with the work being provided in that industry and geographical region. Prosecutors should further assess whether the

company engaged in ongoing monitoring of the third-party relationships, be it through updated due diligence, training, audits, and/or annual compliance certifications by the third party.

In sum, a company's third-party management practices are a factor that prosecutors should assess to determine whether a compliance program is in fact able to "detect the particular types of misconduct most likely to occur in a particular corporation's line of business." JM 9-28.800.

- **Risk-Based and Integrated Processes** – How has the company's third-party management process corresponded to the nature and level of the enterprise risk identified by the company? How has this process been integrated into the relevant procurement and vendor management processes?

- **Appropriate Controls** – How does the company ensure there is an appropriate business rationale for the use of third parties? If third parties were involved in the underlying misconduct, what was the business rationale for using those third parties? What mechanisms exist to ensure that the contract terms specifically describe the services to be performed, that the payment terms are appropriate, that the described contractual work is performed, and that compensation is commensurate with the services rendered?

- **Management of Relationships** – How has the company considered and analyzed the compensation and incentive structures for third parties against compliance risks? How does the company monitor its third parties? Does the company have audit rights to analyze the books and accounts of third parties, and has the company exercised those rights in the past? How does the company train its third party relationship managers about compliance risks and how to manage them? How does the company incentivize compliance and ethical behavior by third parties? Does the company engage in risk management of third parties throughout the lifespan of the relationship, or primarily during the onboarding process?

- **Real Actions and Consequences** – Does the company track red flags that are identified from due diligence of third parties and how those red flags are addressed? Does the company keep track of third parties that do not pass the company's due diligence or that are terminated, and does the company take steps to ensure that those third parties are not hired or re-hired at a later date? If third parties were involved in the misconduct at issue in the investigation, were red flags identified from the due diligence or after hiring the third party, and how were they resolved? Has a similar third party been suspended, terminated, or audited as a result of compliance issues?

F. Mergers and Acquisitions (M&A)

A well-designed compliance program should include comprehensive due diligence of any acquisition targets, as well as a process for timely and orderly integration of the acquired entity into existing compliance program structures and internal controls. Pre-M&A due diligence, where possible, enables the acquiring company to evaluate more accurately each target's value and negotiate for the costs of any corruption or misconduct to be borne by the target. Flawed or incomplete pre- or post-acquisition due diligence and integration can allow misconduct to continue at the target company, causing resulting harm to a business's profitability and reputation and risking civil and criminal liability.

The extent to which a company subjects its acquisition targets to appropriate scrutiny is indicative of whether its compliance program is, as implemented, able to effectively enforce its internal controls and remediate misconduct at all levels of the organization.

- **Due Diligence Process** – Was the company able to complete pre-acquisition due diligence and, if not, why not? Was the misconduct or the risk of misconduct identified during due diligence? Who conducted the risk review for the acquired/merged entities and how was it done? What is the M&A due diligence process generally?

- **Integration in the M&A Process** – How has the compliance function been integrated into the merger, acquisition, and integration process?

- **Process Connecting Due Diligence to Implementation** – What has been the company's process for tracking and remediating misconduct or misconduct risks identified during the due diligence process? What has been the company's process for implementing compliance policies and procedures, and conducting post-acquisition audits, at newly acquired entities?

II. Is the Corporation's Compliance Program Adequately Resourced and Empowered to Function Effectively?

Even a well-designed compliance program may be unsuccessful in practice if implementation is lax, under-resourced, or otherwise ineffective. Prosecutors are instructed to probe specifically whether a compliance program is a "paper program" or one "implemented, reviewed, and revised, as appropriate, in an effective manner." JM 9-28.800. In addition, prosecutors should determine "whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts." JM 9-28.800. Prosecutors should also determine "whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's

commitment to it." JM 9-28.800; *see also* JM 9-47.120(2)(c) (criteria for an effective compliance program include "[t]he company's culture of compliance, including awareness among employees that any criminal conduct, including the conduct underlying the investigation, will not be tolerated").

A. Commitment by Senior and Middle Management

Beyond compliance structures, policies, and procedures, it is important for a company to create and foster a culture of ethics and compliance with the law at all levels of the company. The effectiveness of a compliance program requires a high-level commitment by company leadership to implement a culture of compliance from the middle and the top.

The company's top leaders – the board of directors and executives – set the tone for the rest of the company. Prosecutors should examine the extent to which senior management have clearly articulated the company's ethical standards, conveyed and disseminated them in clear and unambiguous terms, and demonstrated rigorous adherence by example. Prosecutors should also examine how middle management, in turn, have reinforced those standards and encouraged employees to abide by them. *See* U.S.S.G. § 8B2.1(b)(2)(A)-(C) (the company's "*governing authority* shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight" of it; "[*h*]*igh-level personnel* … shall ensure that the organization has an effective compliance and ethics program" (emphasis added)).

- **Conduct at the Top** – How have senior leaders, through their words and actions, encouraged or discouraged compliance, including the type of misconduct involved in the investigation? What concrete actions have they taken to demonstrate leadership in the company's compliance and remediation efforts? How have they modelled proper behavior to subordinates? Have managers tolerated greater compliance risks in pursuit of new business or greater revenues? Have managers encouraged employees to act unethically to achieve a business objective, or impeded compliance personnel from effectively implementing their duties?

- **Shared Commitment** – What actions have senior leaders and middle-management stakeholders (*e.g.*, business and operational managers, finance, procurement, legal, human resources) taken to demonstrate their commitment to compliance or compliance personnel, including their remediation efforts? Have they persisted in that commitment in the face of competing interests or business objectives?

- **Oversight** – What compliance expertise has been available on the board of directors? Have the board of directors and/or external auditors held executive or private sessions with the compliance and control functions? What types of information have

the board of directors and senior management examined in their exercise of oversight in the area in which the misconduct occurred?

B. Autonomy and Resources

Effective implementation also requires those charged with a compliance program's day-to-day oversight to act with adequate authority and stature. As a threshold matter, prosecutors should evaluate how the compliance program is structured. Additionally, prosecutors should address the sufficiency of the personnel and resources within the compliance function, in particular, whether those responsible for compliance have: (1) sufficient seniority within the organization; (2) sufficient resources, namely, staff to effectively undertake the requisite auditing, documentation, and analysis; and (3) sufficient autonomy from management, such as direct access to the board of directors or the board's audit committee. The sufficiency of each factor, however, will depend on the size, structure, and risk profile of the particular company. "A large organization generally shall devote more formal operations and greater resources . . . than shall a small organization." Commentary to U.S.S.G. § 8B2.1 note 2(C). By contrast, "a small organization may [rely on] less formality and fewer resources." *Id.* Regardless, if a compliance program is to be truly effective, compliance personnel must be empowered within the company.

Prosecutors should evaluate whether "internal audit functions [are] conducted at a level sufficient to ensure their independence and accuracy," as an indicator of whether compliance personnel are in fact empowered and positioned to "effectively detect and prevent misconduct." JM 9-28.800. Prosecutors should also evaluate "[t]he resources the company has dedicated to compliance," "[t]he quality and experience of the personnel involved in compliance, such that they can understand and identify the transactions and activities that pose a potential risk," and "[t]he authority and independence of the compliance function and the availability of compliance expertise to the board." JM 9-47.120(2)(c); *see also* JM 9-28.800 (instructing prosecutors to evaluate whether "the directors established an information and reporting system in the organization reasonably designed to provide management and directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law"); U.S.S.G. § 8B2.1(b)(2)(C) (those with "day-to-day operational responsibility" shall have "adequate resources, appropriate authority and direct access to the governing authority or an appropriate subgroup of the governing authority").

- **Structure** – Where within the company is the compliance function housed (e.g., within the legal department, under a business function, or as an independent function reporting to the CEO and/or board)? To whom does the compliance function report? Is the compliance function run by a designated chief compliance officer, or another executive within the company, and does that person have other roles within the company? Are compliance personnel dedicated to compliance responsibilities, or do

they have other, non-compliance responsibilities within the company? Why has the company chosen the compliance structure it has in place? What are the reasons for the structural choices the company has made?

- **Seniority and Stature** – How does the compliance function compare with other strategic functions in the company in terms of stature, compensation levels, rank/title, reporting line, resources, and access to key decision-makers? What has been the turnover rate for compliance and relevant control function personnel? What role has compliance played in the company's strategic and operational decisions? How has the company responded to specific instances where compliance raised concerns? Have there been transactions or deals that were stopped, modified, or further scrutinized as a result of compliance concerns?

- **Experience and Qualifications** – Do compliance and control personnel have the appropriate experience and qualifications for their roles and responsibilities? Has the level of experience and qualifications in these roles changed over time? How does the company invest in further training and development of the compliance and other control personnel? Who reviews the performance of the compliance function and what is the review process?

- **Funding and Resources** – Has there been sufficient staffing for compliance personnel to effectively audit, document, analyze, and act on the results of the compliance efforts? Has the company allocated sufficient funds for the same? Have there been times when requests for resources by compliance and control functions have been denied, and if so, on what grounds?

- **Data Resources and Access** – Do compliance and control personnel have sufficient direct or indirect access to relevant sources of data to allow for timely and effective monitoring and/or testing of policies, controls, and transactions? Do any impediments exist that limit access to relevant sources of data and, if so, what is the company doing to address the impediments?

- **Autonomy** – Do the compliance and relevant control functions have direct reporting lines to anyone on the board of directors and/or audit committee? How often do they meet with directors? Are members of the senior management present for these meetings? How does the company ensure the independence of the compliance and control personnel?

- **Outsourced Compliance Functions** – Has the company outsourced all or parts of its compliance functions to an external firm or consultant? If so, why, and who is responsible for overseeing or liaising with the external firm or consultant? What level of access does the external firm or consultant have to company information? How has the effectiveness of the outsourced process been assessed?

C. Incentives and Disciplinary Measures

Another hallmark of effective implementation of a compliance program is the establishment of incentives for compliance and disincentives for non-compliance. Prosecutors should assess whether the company has clear disciplinary procedures in place, enforces them consistently across the organization, and ensures that the procedures are commensurate with the violations. Prosecutors should also assess the extent to which the company's communications convey to its employees that unethical conduct will not be tolerated and will bring swift consequences, regardless of the position or title of the employee who engages in the conduct. *See* U.S.S.G. § 8B2.1(b)(5)(C) ("the organization's compliance program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct").

By way of example, some companies have found that publicizing disciplinary actions internally, where appropriate and possible, can have valuable deterrent effects. At the same time, some companies have also found that providing positive incentives – personnel promotions, rewards, and bonuses for improving and developing a compliance program or demonstrating ethical leadership – have driven compliance. Some companies have even made compliance a significant metric for management bonuses and/or have made working on compliance a means of career advancement.

- **Human Resources Process** – Who participates in making disciplinary decisions, including for the type of misconduct at issue? Is the same process followed for each instance of misconduct, and if not, why? Are the actual reasons for discipline communicated to employees? If not, why not? Are there legal or investigation-related reasons for restricting information, or have pre-textual reasons been provided to protect the company from whistleblowing or outside scrutiny?

- **Consistent Application** – Have disciplinary actions and incentives been fairly and consistently applied across the organization? Does the compliance function monitor its investigations and resulting discipline to ensure consistency? Are there similar instances of misconduct that were treated disparately, and if so, why?

- **Incentive System** – Has the company considered the implications of its incentives and rewards on compliance? How does the company incentivize compliance and ethical behavior? Have there been specific examples of actions taken (*e.g.*, promotions or awards denied) as a result of compliance and ethics considerations? Who determines the compensation, including bonuses, as well as discipline and promotion of compliance personnel?

III. Does the Corporation's Compliance Program Work in Practice?

The Principles of Federal Prosecution of Business Organizations require prosecutors to assess "the adequacy and effectiveness of the corporation's compliance program at the time of the offense, as well as at the time of a charging decision." JM 9-28.300. Due to the backward-looking nature of the first inquiry, one of the most difficult questions prosecutors must answer in evaluating a compliance program following misconduct is whether the program was working effectively at the time of the offense, especially where the misconduct was not immediately detected.

In answering this question, it is important to note that the existence of misconduct does not, by itself, mean that a compliance program did not work or was ineffective at the time of the offense. *See* U.S.S.G. § 8B2.1(a) ("[t]he failure to prevent or detect the instant offense does not mean that the program is not generally effective in preventing and deterring misconduct"). Indeed, "[t]he Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees." JM 9-28.800. Of course, if a compliance program did effectively identify misconduct, including allowing for timely remediation and self-reporting, a prosecutor should view the occurrence as a strong indicator that the compliance program was working effectively.

In assessing whether a company's compliance program was effective at the time of the misconduct, prosecutors should consider whether and how the misconduct was detected, what investigation resources were in place to investigate suspected misconduct, and the nature and thoroughness of the company's remedial efforts.

To determine whether a company's compliance program is working effectively at the time of a charging decision or resolution, prosecutors should consider whether the program evolved over time to address existing and changing compliance risks. Prosecutors should also consider whether the company undertook an adequate and honest root cause analysis to understand both what contributed to the misconduct and the degree of remediation needed to prevent similar events in the future.

For example, prosecutors should consider, among other factors, "whether the corporation has made significant investments in, and improvements to, its corporate compliance program and internal controls systems" and "whether remedial improvements to the compliance program and internal controls have been tested to demonstrate that they would prevent or detect similar misconduct in the future." Benczkowski Memo at 2 (observing that "[w]here a corporation's compliance program and controls are demonstrated to be effective and appropriately resourced at the time of resolution, a monitor will not likely be necessary").

A. Continuous Improvement, Periodic Testing, and Review

One hallmark of an effective compliance program is its capacity to improve and evolve. The actual implementation of controls in practice will necessarily reveal areas of risk and potential adjustment. A company's business changes over time, as do the environments in which it operates, the nature of its customers, the laws that govern its actions, and the applicable industry standards. Accordingly, prosecutors should consider whether the company has engaged in meaningful efforts to review its compliance program and ensure that it is not stale. Some companies survey employees to gauge the compliance culture and evaluate the strength of controls, and/or conduct periodic audits to ensure that controls are functioning well, though the nature and frequency of evaluations may depend on the company's size and complexity.

Prosecutors may reward efforts to promote improvement and sustainability. In evaluating whether a particular compliance program works in practice, prosecutors should consider "revisions to corporate compliance programs in light of lessons learned." JM 9-28.800; *see also* JM 9-47-120(2)(c) (looking to "[t]he auditing of the compliance program to assure its effectiveness"). Prosecutors should likewise look to whether a company has taken "reasonable steps" to "ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct," and "evaluate periodically the effectiveness of the organization's" program. U.S.S.G. § 8B2.1(b)(5). Proactive efforts like these may not only be rewarded in connection with the form of any resolution or prosecution (such as through remediation credit or a lower applicable fine range under the Sentencing Guidelines), but more importantly, may avert problems down the line.

- **Internal Audit** – What is the process for determining where and how frequently internal audit will undertake an audit, and what is the rationale behind that process? How are audits carried out? What types of audits would have identified issues relevant to the misconduct? Did those audits occur and what were the findings? What types of relevant audit findings and remediation progress have been reported to management and the board on a regular basis? How have management and the board followed up? How often does internal audit conduct assessments in high-risk areas?

- **Control Testing** – Has the company reviewed and audited its compliance program in the area relating to the misconduct? More generally, what testing of controls, collection and analysis of compliance data, and interviews of employees and third parties does the company undertake? How are the results reported and action items tracked?

- **Evolving Updates** – How often has the company updated its risk assessments and reviewed its compliance policies, procedures, and practices? Has the company undertaken a gap analysis to determine if particular areas of risk are not sufficiently addressed in its policies, controls, or training? What steps has the company taken to determine whether policies/procedures/practices make sense for particular business segments/subsidiaries? Does the company review and adapt its compliance program based upon lessons learned from its own misconduct and/or that of other companies facing similar risks?

- **Culture of Compliance** – How often and how does the company measure its culture of compliance? Does the company seek input from all levels of employees to determine whether they perceive senior and middle management's commitment to compliance? What steps has the company taken in response to its measurement of the compliance culture?

B. <u>Investigation of Misconduct</u>

Another hallmark of a compliance program that is working effectively is the existence of a well-functioning and appropriately funded mechanism for the timely and thorough investigations of any allegations or suspicions of misconduct by the company, its employees, or agents. An effective investigations structure will also have an established means of documenting the company's response, including any disciplinary or remediation measures taken.

- **Properly Scoped Investigation by Qualified Personnel** – How has the company ensured that the investigations have been properly scoped, and were independent, objective, appropriately conducted, and properly documented?

- **Response to Investigations** – Have the company's investigations been used to identify root causes, system vulnerabilities, and accountability lapses, including among supervisory managers and senior executives? What has been the process for responding to investigative findings? How high up in the company do investigative findings go?

C. Analysis and Remediation of Any Underlying Misconduct

Finally, a hallmark of a compliance program that is working effectively in practice is the extent to which a company is able to conduct a thoughtful root cause analysis of misconduct and timely and appropriately remediate to address the root causes.

Prosecutors evaluating the effectiveness of a compliance program are instructed to reflect back on "the extent and pervasiveness of the criminal misconduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including, for example, disciplinary action against past violators uncovered by the prior compliance program, and revisions to corporate compliance programs in light of lessons learned." JM 9-28.800; *see also* JM 9-47.120(3)(c) ("to receive full credit for timely and appropriate remediation" under the FCPA Corporate Enforcement Policy, a company should demonstrate "a root cause analysis" and, where appropriate, "remediation to address the root causes").

Prosecutors should consider "any remedial actions taken by the corporation, including, for example, disciplinary action against past violators uncovered by the prior compliance program." JM 98-28.800; *see also* JM 9-47-120(2)(c) (looking to "[a]ppropriate discipline of employees, including those identified by the company as responsible for the misconduct, either through direct participation or failure in oversight, as well as those with supervisory authority over the area in which the criminal conduct occurred" and "any additional steps that demonstrate recognition of the seriousness of the misconduct, acceptance of responsibility for it, and the implementation of measures to reduce the risk of repetition of such misconduct, including measures to identify future risk").

- **Root Cause Analysis** – What is the company's root cause analysis of the misconduct at issue? Were any systemic issues identified? Who in the company was involved in making the analysis?

- **Prior Weaknesses** – What controls failed? If policies or procedures should have prohibited the misconduct, were they effectively implemented, and have functions that had ownership of these policies and procedures been held accountable?

- **Payment Systems** – How was the misconduct in question funded (*e.g.*, purchase orders, employee reimbursements, discounts, petty cash)? What processes could have prevented or detected improper access to these funds? Have those processes been improved?

- **Vendor Management** – If vendors were involved in the misconduct, what was the process for vendor selection and did the vendor undergo that process?

- **Prior Indications** – Were there prior opportunities to detect the misconduct in question, such as audit reports identifying relevant control failures or allegations, complaints, or investigations? What is the company's analysis of why such opportunities were missed?

- **Remediation** – What specific changes has the company made to reduce the risk that the same or similar issues will not occur in the future? What specific remediation has addressed the issues identified in the root cause and missed opportunity analysis?

- **Accountability** – What disciplinary actions did the company take in response to the misconduct and were they timely? Were managers held accountable for misconduct that occurred under their supervision? Did the company consider disciplinary actions for failures in supervision? What is the company's record (*e.g.*, number and types of disciplinary actions) on employee discipline relating to the types of conduct at issue? Has the company ever terminated or otherwise disciplined anyone (reduced or eliminated bonuses, issued a warning letter, etc.) for the type of misconduct at issue?

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[1] Many of the topics also appear in the following resources:

- Justice Manual ("JM")
  - JM 9-28.000 Principles of Federal Prosecution of Business Organizations, Justice Manual ("JM"), *available at* https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations.
  - JM 9-47.120 FCPA Corporate Enforcement Policy, *available at* https://www.justice.gov/jm/jm-9-47000-foreign-corrupt-practices-act-1977#9-47.120.
- Chapter 8 – Sentencing of Organizations - United States Sentencing Guidelines ("U.S.S.G."), *available at* https://www.ussc.gov/guidelines/2018-guidelines-manual/2018-chapter-8#NaN.

- Memorandum entitled "Selection of Monitors in Criminal Division Matters," issued by Assistant Attorney General Brian Benczkowski on October 11, 2018, *available at* https://www.justice.gov/criminal-fraud/file/1100366/download.
- Criminal Division corporate resolution agreements, *available at* https://www.justice.gov/news (the Department of Justice's ("DOJ") Public Affairs website contains press releases for all Criminal Division corporate resolutions which contain links to charging documents and agreements).
- A Resource Guide to the U.S. Foreign Corrupt Practices Act ("FCPA Guide"), published in November 2012 by the DOJ and the Securities and Exchange Commission ("SEC"), *available at* https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf.
- Good Practice Guidance on Internal Controls, Ethics, and Compliance, adopted by the Organization for Economic Co-operation and Development ("OECD") Council on February 18, 2010, *available at* https://www.oecd.org/daf/anti-bribery/44884389.pdf.
- Anti-Corruption Ethics and Compliance Handbook for Business ("OECD Handbook"), published in 2013 by OECD, United Nations Office on Drugs and Crime, and the World Bank, *available at* https://www.oecd.org/corruption/Anti-CorruptionEthicsComplianceHandbook.pdf.
- Evaluation of Corporate Compliance Programs in Criminal Antitrust Investigations, published in July 2019 by DOJ's Antitrust Division, *available at* https://www.justice.gov/atr/page/file/1182001/download.
- A Framework for OFAC Compliance Commitments, published in May 2019 by the Department of the Treasury's Office of Foreign Assets Control ("OFAC"), *available at https://www.treasury.gov/resource-center/sanctions/Documents/framework_ofac_cc.pdf.*

[2] Prosecutors should consider whether certain aspects of a compliance program may be impacted by foreign law. Where a company asserts that it has structured its compliance program in a particular way or has made a compliance decision based on requirements of foreign law, prosecutors should ask the company the basis for the company's conclusion about foreign law, and how the company has addressed the issue to maintain the integrity and effectiveness of its compliance program while still abiding by foreign law.

[3] As discussed in the Justice Manual, many companies operate in complex regulatory environments outside the normal experience of criminal prosecutors. JM 9-28.000. For example, financial institutions such as banks, subject to the Bank Secrecy Act statute and regulations,

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require prosecutors to conduct specialized analyses of their compliance programs in the context of their anti-money laundering requirements. Consultation with the Money Laundering and Asset Recovery Section is recommended when reviewing AML compliance. *See* https://www.justice.gov/criminal-mlars. Prosecutors may also wish to review guidance published by relevant federal and state agencies. *See* Federal Financial Institutions Examination Council/Bank Secrecy Act/Anti-Money Laundering Examination Manual, *available at* https://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_online.htm).

United States Court of Appeals for the Second Circuit

August Term, 2019

(Argued: June 2, 2020 Decided: June 26, 2020)

Docket Nos. 19-2886-ag(L), 19-2893-ag(CON)

XY PLANNING NETWORK, LLC, FORD FINANCIAL SOLUTIONS, LLC, STATE OF NEW YORK, STATE OF CALIFORNIA, STATE OF CONNECTICUT, STATE OF DELAWARE, STATE OF MAINE, DISTRICT OF COLUMBIA, STATE OF NEW MEXICO AND STATE OF OREGON,

Petitioners,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, WALTER CLAYTON, IN HIS OFFICIAL CAPACITY AS CHAIRMAN OF THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondents.

Before:

SULLIVAN, PARK, AND NARDINI, *Circuit Judges*.

In 2019, the Securities and Exchange Commission promulgated Regulation Best Interest, which creates new standards of conduct for broker-dealers providing investment services to retail customers. Petitioners XY Planning Network, LLC, Ford Financial Solutions, LLC, and a group of states and the District of Columbia filed petitions for review under the Administrative Procedure Act, 5 U.S.C. § 706(2), claiming that Regulation Best Interest is unlawful under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. We hold that: (1) Ford

Financial Solutions has Article III standing to bring its petition for review, (2) Section 913(f) of the Dodd-Frank Act authorizes Regulation Best Interest, and (3) Regulation Best Interest is not arbitrary and capricious. **DENIED**.

Judge Sullivan concurs in part and dissents in part in a separate opinion.

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PARK, *Circuit Judge*:

Investment advisers and broker-dealers both offer financial services to retail customers. Under federal law, investment advisers owe a fiduciary duty to their clients, but broker-dealers do not. The traditional distinctions between the services offered by the two types of firms have blurred in recent decades, raising questions about this standard-of-care framework. As a result, in 2019, the

1 Securities and Exchange Commission ("SEC") adopted Regulation Best Interest,
2 which imposes a new "best-interest obligation" on broker-dealers.

3 Petitioners—an organization of investment advisers, an individual
4 investment adviser, seven states,[1] and the District of Columbia—now challenge
5 Regulation Best Interest as unlawful under the Administrative Procedure Act
6 ("APA"), 5 U.S.C. § 706(2). They argue that the 2010 Dodd-Frank Wall Street
7 Reform and Consumer Protection Act ("Dodd-Frank Act") requires the SEC to
8 adopt a rule holding broker-dealers to the same fiduciary standard as investment
9 advisers. But Section 913(f) of the Dodd-Frank Act grants the SEC broad
10 rulemaking authority, and Regulation Best Interest clearly falls within the
11 discretion granted to the SEC by Congress. Although Regulation Best Interest may
12 not be the policy that Petitioners would have preferred, it is what the SEC chose
13 after a reasoned and lawful rulemaking process.

14 We thus hold that: (1) the individual investment-adviser petitioner has
15 Article III standing to bring its petition for review, but the state petitioners do not;
16 (2) Section 913(f) of the Dodd-Frank Act authorizes the SEC to promulgate

[1] California, Connecticut, Delaware, Maine, New Mexico, New York, and Oregon.

Regulation Best Interest; and (3) Regulation Best Interest is not arbitrary and capricious under the APA.

For these reasons, we deny the petitions for review.

I. BACKGROUND

A. Regulatory Background

Broker-dealers effect securities transactions for customers, for which they typically charge a commission or other transaction-based fee. *See* 15 U.S.C. §§ 78c(a)(4)(A) (defining brokers), 78c(a)(5)(A) (defining dealers). In connection with their services, broker-dealers often provide advice and make recommendations about securities transactions and investment strategies. When doing so, they are generally subject to a "suitability" standard of care, which arises from the federal securities laws, Financial Industry Regulatory Authority ("FINRA") rules, and SEC precedent. This standard requires broker-dealers to "have a reasonable basis to believe that a recommended transaction or investment strategy . . . is suitable for the customer." FINRA Rule 2111(a).

Investment advisers, on the other hand, provide advice and other discretionary services on an ongoing basis, for which they typically charge recurring fees based on a percentage of the assets they manage. Investment

advisers are regulated under the Investment Advisers Act of 1940 ("IAA") and owe a fiduciary duty to their clients. *See* 15 U.S.C. § 80b-2(a)(11)(C) (defining investment adviser); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963) (describing "an affirmative duty of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading . . . clients" (internal quotation marks omitted)). The IAA's definition of investment adviser has a "broker-dealer exemption," which excludes "any broker or dealer whose performance of such services is [1] solely incidental to the conduct of his business as a broker or dealer and [2] who receives no special compensation therefor." 15 U.S.C. § 80b-2(a)(11)(C). A business may register as both an investment adviser and a broker-dealer.[2]

B. The Dodd-Frank Act

In 2010, Congress authorized the SEC to promulgate new standards of conduct for broker-dealers and investment advisers under the Dodd-Frank Act,

[2] Although in theory broker-dealers and investment advisers "play distinct roles," "in practice, trends in financial services markets since [at least] the early 1990s have blurred the boundaries between these financial professionals." Brian Scholl et al., SEC Office of the Investor Advocate & RAND Corp., *The Retail Market for Investment Advice* ("*RAND study*") 4 (2018), *available at* https://www.sec.gov/comments/s7-07-18/s70718-4513005-176009.pdf.

Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824–30. Section 913(b) of the Dodd-Frank Act directed the SEC to study "the standards of care for brokers, dealers, [and] investment advisers." *Id*. at 1824–25. Sections 913(f) and (g), the main provisions at issue here, concern the SEC's rulemaking authority.

Section 913(f) states that the SEC "may commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers . . . to address the legal or regulatory standards of care for brokers, dealers, [and] investment advisers." *Id*. at 1827. In doing so, the SEC "shall consider the findings[,] conclusions, and recommendations" of the Section 913(b) study. *Id.* at 1828.

Section 913(g)(1) states that the SEC "may promulgate rules to provide that, with respect to [broker-dealers], when providing personalized investment advice about securities to a retail customer[,] . . . the standard of conduct for such [broker-dealers] . . . shall be the same as the standard of conduct applicable to an investment adviser . . . ." *Id*. Section 913(g)(2) provides that the SEC "may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers[,] . . . shall be to act in the best interest of the customer

without regard to the financial or other interest of the broker, dealer or investment adviser providing the advice . . . . [S]uch standard of conduct shall be no less stringent than the standard applicable to investment advisers under [the IAA]." *Id.*

In 2011, SEC staff issued the Section 913(b) study and recommended that the SEC adopt a "uniform fiduciary standard . . . regardless of the regulatory label (broker-dealer or investment adviser) of the professional providing the advice." App'x at 328.

C. Regulation Best Interest

In June 2019, the SEC adopted Regulation Best Interest, which establishes a new standard of care for broker-dealers serving retail customers.[3] *Regulation Best Interest*, 17 C.F.R. § 240.15*l*-1 (2019). Specifically, Regulation Best Interest imposes a "best-interest obligation" on broker-dealers, requiring them to "act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the [broker-dealer] . . . ahead of the interest of the retail customer." *Id*. The best-interest obligation has four components: (1) a "disclosure obligation," requiring broker-dealers to disclose any material facts

[3] Retail customers are individuals who "receive[] personalized investment advice . . . primarily for personal, family, or household purposes." 124 Stat. at 1824.

relating to the scope and terms of the relationship with the customer, as well as all material conflicts of interest related to their investment recommendations; (2) a "care obligation," requiring broker-dealers to "[h]ave a reasonable basis to believe that the recommendation is in the best interest of" the customer; (3) a "conflict of interest obligation," requiring broker-dealers to identify, mitigate, and disclose conflicts of interest and to "[p]revent" conflicts that would cause them to "make recommendation[s] that place [their own] interest ahead of the" customers'; and (4) a "compliance obligation" requiring broker-dealers to adopt policies and practices "reasonably designed to achieve compliance with Regulation Best Interest." *Id*.

The SEC proposed an initial version of the rule in 2018, and after an extensive notice-and-comment process, it adopted a final version of Regulation Best Interest, along with an interpretive rule clarifying the meaning of "solely incidental" in the broker-dealer exemption to the IAA. Notice of Proposed Rulemaking, *Regulation Best Interest*, 83 Fed. Reg. 21,574 (May 9, 2018); *Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser* ("*Solely Incidental Interpretation*"), 84 Fed. Reg. 33,681 (July 12, 2019). During the comment period, the SEC received "over 6,000

1 comment letters" from individual investors, trade groups, and financial firms, and
2 held a series of "investor roundtables" to solicit in-person feedback on the
3 proposed rule. *Regulation Best Interest: The Broker-Dealer Standard of Conduct*
4 ("Adopting Release"), 84 Fed. Reg. 33,318, 33,320.

5 The SEC responded to these comments in a 173-page Adopting Release
6 explaining why it chose the best-interest standard. *Id*. at 33,318–33,491. It
7 considered and rejected a uniform fiduciary standard for investment advisers and
8 broker-dealers, explaining that "a 'one size fits all' approach would risk reducing
9 investor choice" and that a uniform fiduciary standard "would [not] provide any
10 greater investor protection (or, in any case, that any benefits would [not] justify
11 the costs imposed on retail investors in terms of reduced access to services . . .)."
12 *Id*. at 33,322. The Adopting Release also explicitly noted that the SEC was relying
13 on Section 913(f)'s broad grant of rulemaking authority to promulgate Regulation
14 Best Interest. *Id*. at 33,330.

15 **D. Petitioners**

16 Two groups of petitioners brought suit claiming that Regulation Best
17 Interest is unlawful: (1) an investment-adviser interest group, XY Planning
18 Network, LLC, and one of its members, Ford Financial Solutions, LLC (together,

1 "XYPN"); and (2) a group of states and the District of Columbia (collectively,
2 "State Petitioners").

3 XYPN contends that Regulation Best Interest will injure investment advisers
4 by making it more difficult for them to differentiate their standard of care from
5 that of broker-dealers in advertising to attract customers. Julie Ford, owner of
6 Ford Financial Solutions, LLC (together, "Ford"), attests that Ford "currently
7 attract[s] and retain[s] clients by, in part, highlighting [the] firm's fiduciary duty
8 to clients," in contrast to the less stringent suitability standard governing broker-
9 dealers. XYPN Add. at 5. Ford claims that under Regulation Best Interest, broker-
10 dealers will be able to advertise that they must act in their clients' "best interests"
11 just as Ford does, even though they will face "comparatively fewer regulatory
12 obligations, lower compliance costs, and less legal exposure." *Id.*

13 The State Petitioners claim that Regulation Best Interest will diminish their
14 tax revenues from investment income by allowing broker-dealers to provide
15 conflicted investment advice to customers, which would be prohibited under a
16 uniform fiduciary standard. The State Petitioners cite expert evidence claiming
17 that "[t]he loss of retail investment returns due to conflicted financial advice
18 causes harm to states by lowering their tax revenues." States' Add. at 6.

III. DISCUSSION

A. Article III Standing

As an initial matter, the SEC argues that Petitioners lack Article III standing to challenge Regulation Best Interest. We conclude that Ford has standing to bring its petition based on the impairment of its current ability to attract customers by touting the fiduciary duties it owes its clients. In other words, by enabling broker-dealers to advertise their new best-interest obligation, Regulation Best Interest will put Ford and other investment advisers at a competitive disadvantage compared to the status quo. The State Petitioners, on the other hand, lack Article III standing because their claim that Regulation Best Interest will cause a decline in state revenue is entirely speculative.

To show Article III standing, Petitioners "must have (1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision." *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1547 (2016). "The petitioner's burden of production . . . is . . . the same as that of a plaintiff moving for summary judgment[:] . . . it must support each element of its claim to standing 'by affidavit or other evidence.'"

1 *Sierra Club v. EPA*, 292 F.3d 895, 899 (D.C. Cir. 2002) (quoting *Lujan v. Defenders of*
2 *Wildlife*, 504 U.S. 555, 561 (1992)).

3 1. Ford's Standing

4 Ford has established Article III standing under the "well-established
5 concept of competitors' standing." *Schulz v. Williams*, 44 F.3d 48, 53 (2d Cir. 1994).
6 This doctrine recognizes "that economic actors 'suffer an injury in fact when
7 agencies . . . allow increased competition' against them." *Sherley v. Sebelius*, 610
8 F.3d 69, 72 (D.C. Cir. 2010) (cleaned up). Ford meets this standard because its
9 principal attests that Regulation Best Interest will impair its ability to differentiate
10 its services from broker-dealers' based on its higher duty of care.[4]

11 A party has standing to sue over a regulation that unlawfully "bestows
12 upon their competitors 'some competitive advantage.'" *Citizens for Responsibility*
13 *& Ethics in Wash. v. Trump* ("*CREW*"), 953 F.3d 178, 190 (2d Cir. 2019) (quoting
14 *Fulani v. League of Women Voters Educ. Fund*, 882 F.2d 621, 626 (2d Cir. 1989)).[5] The
15 "basic requirement" of competitor standing is that "the complainant show an

[4] Because Ford has standing, we need not address XYPN's argument that the organization itself may sue on behalf of its investment-adviser members or that Regulation Best Interest will deter firms from registering as investment advisers and joining XYPN as dues-paying members.

[5] Petitioners also must show "that they personally compete in the same arena as the unlawfully benefited competitor," which is undisputed here. *CREW*, 953 F.3d at 190 (cleaned up).

actual or imminent increase in competition." *Am. Inst. of Certified Pub. Accountants v. IRS*, 804 F.3d 1193, 1197 (D.C. Cir. 2015) (citation omitted). The party suing need not "identify specific customers who switched to [its] competitors" as long as the allegedly unlawful regulation "increases competition or aids the plaintiff's competitors." *CREW*, 953 F.3d at 190 (quoting *Canadian Lumber Trade All. v. United States*, 517 F.3d 1319, 1332 (Fed. Cir. 2008)). "The form of [this] injury may vary; for example, a seller facing increased competition may lose sales to rivals, or be forced to lower its price or to expend more resources to achieve the same sales, all to the detriment of its bottom line." *Sherley*, 610 F.3d at 72.

Here, Ford currently attracts customers by "highlighting [the] firm's fiduciary duty to clients"—one of the firm's "hallmarks"—in contrast to the lower standard of suitability owed by broker-dealers. XYPN Add. at 4–5. Ford states that Regulation Best Interest will create "a significant risk that clients will not be able to effectively differentiate the fiduciary duty that [Ford] owe[s] them from the lower duty that broker-dealers owe their clients," which will "harm [Ford's] ability to attract customers through . . . highlighting the increased standard of loyalty and care" that it owes to its clients. *Id*. at 5; *see also* Angela A. Hung et al., RAND Corp., *Investor Testing of Form CRS Relationship Summary* 46–48 (2018) (discussing

1 evidence of consumer confusion), *available at* https://www.sec.gov/about/
2 offices/investorad/investor-testing-form-crs-relationship-summary.pdf.

3 Because Ford has identified an impairment to a specific business practice, it
4 has made a "concrete showing that it is in fact likely to suffer financial injury" from
5 Regulation Best Interest. *KERM, Inc. v. FCC*, 353 F.3d 57, 60 (D.C. Cir. 2004). The
6 harm to Ford's "ability to attract customers" by "highlighting [its] fiduciary duty
7 to clients," XYPN Add. at 5, means that it will "be forced to lower its price[s] or to
8 expend more resources to achieve the same sales, all to the detriment of its bottom
9 line."[6] *Sherley*, 610 F.3d at 72. Thus, Ford has shown, based on both "economic
10 logic" and "actual market experience," that Regulation Best Interest will hurt its
11 business. *Canadian Lumber*, 517 F.3d at 1333 (citation omitted). This is enough for
12 competitor standing here.

[6] Ford's claim is distinguishable from cases involving more "speculative" attempts to "challenge a regulation that merely imposes enhanced regulatory burdens on [a] competitor" because Ford has identified a specific harm to its ability to attract customers. *See, e.g.*, *State Nat'l Bank of Big Spring v. Lew*, 795 F.3d 48, 55 (D.C. Cir. 2015) (holding that a plaintiff could not sue over a regulation that imposed a "*greater* regulatory burden" on its competitors because the harm identified—the "reputational benefit" conferred on the competitor—was "simply too attenuated and speculative to show the causation necessary to support standing"). To be sure, Ford also states that its broker-dealer competitors will be subject to "comparatively fewer regulatory obligations, lower compliance costs, and less legal exposure," XYPN Add. at 5, but that is not the basis on which we conclude that Ford has standing.

2. State Petitioners' Standing

Unlike Ford, the State Petitioners do not have Article III standing because they have failed to establish a direct link between Regulation Best Interest and their tax revenues. A state has Article III standing to challenge a federal regulation if it can show "a direct injury in the form of a loss of specific tax revenues." *Wyoming v. Oklahoma*, 502 U.S. 437, 448 (1992); *accord Wyoming v. U.S. Dep't of Interior*, 674 F.3d 1220, 1232 (10th Cir. 2012). A "fairly direct link" is required because "the unavoidable economic repercussions of virtually all federal policies . . . suggest to us that impairment of state tax revenues should not, in general, be recognized as sufficient injury in fact to support state standing." *Pennsylvania v. Kleppe*, 533 F.2d 668, 672 (D.C. Cir. 1976).

Here, the State Petitioners have not shown a direct link between Regulation Best Interest and their tax revenues, relying instead on a causal chain that is too attenuated and speculative to support standing. Even assuming the State Petitioners are correct that Regulation Best Interest will allow for more conflicted advice than a uniform fiduciary standard would, and that such conflicted advice would lead to lower returns on certain investments, the State Petitioners' theory of injury further depends on even more assumptions to arrive at a "concrete and

1 particularized" harm to the State Petitioners' budgets, as opposed to one that is
2 "conjectural or hypothetical." *Spokeo*, 136 S. Ct. at 1548 (citation omitted).

3 The ultimate annual pool of taxable capital gains in a state is driven by
4 countless variables, from the performance of the broader economy to the
5 composition of individual investor portfolios in the state. The State Petitioners'
6 theory also assumes away the potential downsides of a uniform fiduciary
7 standard, such as investor losses due to higher costs and reduced consumer choice
8 if broker-dealers are driven from the marketplace for investment advice. As a
9 result, we find that the State Petitioners' theory of injury rests too heavily on
10 "conclusory statements and speculative economic data" concerning the long-term
11 effects of Regulation Best Interest on state budgets, *Wyoming*, 674 F.3d at 1232–33,
12 and we thus conclude that the State Petitioners lack Article III standing.

13 Nonetheless, because Ford has standing, we have jurisdiction to proceed to
14 the merits of the petitions for review. *See Town of Chester v. Laroe Estates, Inc.*, 137
15 S. Ct. 1645, 1651 (2017) ("At least one plaintiff must have standing to seek each
16 form of relief requested . . . .").

1 **B. Legality under the Dodd-Frank Act**

2 The Dodd-Frank Act authorizes the SEC to promulgate Regulation Best
3 Interest. Congress stated that the SEC "*may* commence a rulemaking, as necessary
4 or appropriate in the public interest and for the protection of retail customers . . .
5 to address the legal or regulatory standards of care for" broker-dealers. Dodd-
6 Frank Act § 913(f) (emphasis added). This broad grant of permissive rulemaking
7 authority encompasses the best-interest rule adopted by the SEC. Contrary to
8 Petitioners' argument, Section 913(g) does not narrow the scope of Section 913(f)
9 but rather provides a separate grant of rulemaking authority.

10 The key language in each of the provisions at issue is "may," which is
11 permissive and reflects Congress's grant of discretionary rulemaking authority to
12 the SEC. *See id.* § 913(f) ("The Commission may commence a rulemaking . . ."); *id*.
13 § 913(g)(1) ("the Commission may promulgate rules . . ."); *id*. § 913(g)(2) ("The
14 Commission may promulgate rules . . ."). Congress gave the SEC the authority to
15 promulgate rules under any of these sections—or to make no rule at all. With
16 Regulation Best Interest, the SEC chose to proceed under Section 913(f), not
17 Sections 913(g)(1) or (g)(2).

1 In addition to the word "may," the permissive nature of Congress's grant of
2 authority in Section 913(f) is reinforced by discretionary language allowing the
3 SEC to act "*as necessary or appropriate* in the public interest . . . [to] *address* the legal
4 or regulatory standards of care . . . ." *Id.* § 913(f) (emphases added). Congress
5 delegated to the SEC broad, discretionary authority, which the SEC lawfully
6 exercised by promulgating Regulation Best Interest.

7 Petitioners contend that this reading of Section 913(f) would render the
8 narrower authorizations in Section 913(g) superfluous. Although there is some
9 "[o]verlap" among the three provisions, Section 913(g) is not superfluous because
10 it clarifies that the SEC could have promulgated a uniform fiduciary standard. *See*
11 *Skilling v. United States*, 561 U.S. 358, 413 n.45 (2010) ("Overlap with other federal
12 statutes does not render [a statutory provision] superfluous.").

13 In 2007, the D.C. Circuit struck down an SEC rule broadening the exemption
14 for broker-dealers under the IAA. *Fin. Planning Ass'n v. SEC*, 482 F.3d 481, 488
15 (D.C. Cir. 2007). When Congress was debating the Dodd-Frank Act,
16 commentators expressed concern that the courts might similarly strike down any
17 new SEC regulation that subjected broker-dealers to the same fiduciary standard

that is applicable to investment advisers.[7] By including Section 913(g), Congress ensured that the SEC had explicit (but discretionary) authorization to create a standard of conduct for broker-dealers that is the "same as the standard of conduct applicable to an investment adviser" or to require that both broker-dealers and investment advisers act in the "best interest of the [retail] customer without regard to the financial or other interest of the broker, dealer, or investment adviser." Dodd-Frank Act § 913(g). So even if Section 913(g) provides no additional grant of authority beyond Section 913(f), it does "a small amount of additional work" by clarifying that the IAA's broker-dealer exemption did not prevent the SEC from imposing a fiduciary obligation on broker-dealers if it so chose. *Scheidler v. Nat'l Org. for Women, Inc.*, 547 U.S. 9, 22 (2006).[8]

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[7] *See, e.g.*, *Enhancing Investor Protection and the Regulation of Securities Markets: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 136 (2009) (statement of Damon A. Silvers, Associate General Counsel, AFL-CIO) ("[P]art of what must be done in this area is to determine whether the proper regulatory approach will require Congressional action in light of the D.C. Circuit opinion.").

[8] Although "reliance on legislative history is unnecessary in light of the statute's unambiguous language," *Mohamad v. Palestinian Auth.*, 566 U.S. 449, 458 (2012) (citation omitted), the context of the Dodd-Frank Act supports this conclusion. The House and Senate versions of the bill each granted the SEC rulemaking authority over standards of care, but in different ways. *See* Br. of Amici Curiae Representative Ann Wagner et al. at 21–26 (discussing legislative history). The House bill contained a mandatory version of Section 913(g), requiring that the SEC "shall promulgate rules" making the standard of conduct for broker-dealers and investment advisers "the same." H.R. 4173, § 7103, 111th Cong. (as passed by the House, Dec. 11, 2009). The Senate bill, however, more closely resembled Section 913(f), stating that if the SEC found regulatory

1 Petitioners propose their own interpretation of Section 913—that Section
2 913(f) is a procedural authorization to commence rulemaking only and that Section
3 913(g) provides the substantive content for any such rulemaking. But this reading
4 is inconsistent with the plain meaning of the text, which specifies that the
5 rulemaking should "address the legal or regulatory standards of care for brokers,
6 dealers, [and] investment advisers . . . ." Section 913(f). Petitioners' approach
7 would render meaningless the substantive portions of Section 913(f) that follow
8 the broad grant of rulemaking authority.

9 We thus hold that the SEC lawfully promulgated Regulation Best Interest
10 pursuant to Congress's permissive grant of rulemaking authority under Section
11 913(f) of the Dodd-Frank Act.

12 **C. Arbitrary and Capricious Review**

13 Finally, Petitioners contend that Regulation Best Interest is arbitrary and
14 capricious because (1) it relies on an incorrect interpretation of the broker-dealer

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"gaps or overlap," it "shall . . . commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers, to address such regulatory gaps and overlap." S. 3217, § 913(f)(1), 111th Cong. (as amended by the Senate, May 20, 2010). The final bill retained both the House and Senate language as Sections 913(g) and (f), respectively, but substituted the word "may" for the word "shall" to indicate that the SEC had the option, but not the obligation, to make rules under each provision. 124 Stat. at 1827–29. The independent origins of Sections 913(f) and (g) thus support the interpretation that they are freestanding grants of rulemaking authority, not interdependent provisions that limit one another.

exemption to the IAA, and (2) the SEC did not adequately address evidence of consumer confusion. We reject both arguments and hold that Regulation Best Interest is not arbitrary and capricious.

"[W]e will set aside the agency's decision only if it is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Nat. Res. Def. Council, Inc. v. FAA*, 564 F.3d 549, 555 (2d Cir. 2009) (internal quotation marks omitted). "Under this deferential standard of review, we may not substitute our judgment for that of the agency," and we "must be reluctant to reverse results supported by a weight of considered and carefully articulated expert opinion." *Cty. of Westchester v. U.S. Dep't of Housing & Urban Dev.*, 802 F.3d 413, 430–31 (2d Cir. 2015) (internal quotation marks omitted).

The SEC "crafted Regulation Best Interest to draw on key principles underlying fiduciary obligations . . . while providing specific requirements to address certain aspects of the relationships between broker-dealers and their retail customers." 84 Fed. Reg. at 33,320. It considered several thousand comments, explicitly rejected proposed alternatives, and concluded that the best-interest obligation "will best achieve the [SEC's] important goals of enhancing retail investor protection and decision making, while preserving, to the extent possible,

1 retail investor access (in terms of choice and cost) to differing types of investment
2 services." *Id*. at 33,320–23.

3 At bottom, Petitioners' preference for a uniform fiduciary standard instead
4 of a best-interest obligation is a policy quarrel dressed up as an APA claim. The
5 SEC carefully considered and rejected a fiduciary rule based on its findings that
6 the fiduciary duties owed by investment advisers are "not appropriately tailored
7 to the structure and characteristics of the broker-dealer business model (*i.e.*,
8 transaction-specific recommendations and compensation)." 84 Fed. Reg. at 33,322.
9 "For example, an investment adviser's fiduciary duty generally includes a duty to
10 provide ongoing advice and monitoring, while Regulation Best Interest imposes
11 no such duty and instead requires that a broker-dealer act in the retail customer's
12 best interest *at the time* a recommendation is made." *Id.* at 33,321 (footnote
13 omitted). We are "reluctant to reverse" such a "considered and carefully
14 articulated" policy decision. *Cty. of Westchester*, 802 F.3d at 431 (citation omitted).

15 1. <u>Interpretation of the Broker-Dealer Exemption</u>

16 Petitioners claim that Regulation Best Interest is arbitrary and capricious
17 because it is based on an incorrect interpretation of the "solely incidental" and
18 "special compensation" prongs of the broker-dealer exemption from the IAA. *See*

1 15 U.S.C. § 80b-2(a)(11)(C) (exempting from the definition of investment adviser
2 "any broker or dealer whose performance of such services is [1] solely incidental
3 to the conduct of his business as a broker or dealer and [2] who receives no special
4 compensation therefor"); *Prill v. NLRB*, 755 F.2d 941, 948 (D.C. Cir. 1985) ("If a
5 regulation is based on an incorrect view of applicable law, the regulation cannot
6 stand as promulgated." (citation omitted)).

7 We conclude that the SEC's interpretation of the scope of the broker-dealer
8 exemption is not so "fundamental" to Regulation Best Interest as to make the rule
9 "arbitrary, capricious, or otherwise not in accordance with law." *Safe Air for*
10 *Everyone v. EPA*, 488 F.3d 1088, 1101 (9th Cir. 2007) (citation omitted). The SEC
11 issued an interpretative rule on the phrase "solely incidental" along with
12 Regulation Best Interest. *Solely Incidental Interpretation*, 84 Fed. Reg. 33,681. But
13 Petitioners have not challenged that rule, nor do they argue that they are permitted
14 to do so.[9] And the phrase "special compensation" is not even mentioned in
15 Regulation Best Interest or the adopting release. *See generally Regulation Best*
16 *Interest*, 84 Fed. Reg. 33,318. Petitioners thus fail to explain how the SEC's

[9] We reject Petitioners' contention that Regulation Best Interest fundamentally relies on the Solely Incidental Interpretation. The Adopting Release contains only a few passing references to the Interpretation for the limited purpose of providing regulatory context. *See, e.g.*, 84 Fed. Reg. at 33,321, 33,336 n.166.

interpretation of the broker-dealer exemption to the IAA could make Regulation Best Interest arbitrary and capricious.

2. Consideration of Evidence of Consumer Confusion

Petitioners also argue that Regulation Best Interest is arbitrary and capricious because the SEC failed adequately to address the "significant evidence that consumers are not meaningfully able to differentiate between the standards of conduct owed by broker-dealers and investment advisers even with the assistance of disclosure forms."[10] XYPN Br. at 53 (citing, *inter alia*, *RAND Study* at 13). But the SEC considered evidence of consumer confusion and found that the benefits of decreased costs and consumer choice favored adopting the best-interest obligation. This decision was not arbitrary and capricious.

"When a petitioner challenges the procedure by which an agency engaged in rulemaking, . . . we defer to [the] agency's determinations so long as the agency 'gives adequate reasons for its decisions,' in the form of a 'satisfactory explanation

[10] The State Petitioners also assert that the SEC provided inadequate economic analysis, but the cases they cite require the agency to give only a "reasoned explanation" for its decision, not necessarily a quantitative one. *See, e.g.*, *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1169 & n.46 (D.C. Cir. 1987); *accord Defenders of Wildlife v. Zinke*, 856 F.3d 1248, 1263–64 (9th Cir. 2017) (rejecting the claim that an agency's "failure to quantify" some of the effects of its decision made that decision "arbitrary and capricious"); *Lindeen v. SEC*, 825 F.3d 646, 658 (D.C. Cir. 2016) ("We do not require the [SEC] 'to measure the immeasurable' and we do not require it to 'conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so.'" (citation omitted)).

1 for its action including a rational connection between the facts found and the
2 choice made.'" *Nat. Res. Def. Council, Inc. v. EPA* ("*NRDC*"), 961 F.3d 160, 170 (2d
3 Cir. 2020) (cleaned up) (quoting *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117,
4 2125 (2016)). "An agency's factual findings must be supported by 'substantial
5 evidence,'" meaning "such relevant evidence as a reasonable mind might accept
6 as adequate to support a conclusion." *Fund for Animals v. Kempthorne*, 538 F.3d 124,
7 132 (2d Cir. 2008) (citations omitted).

8 In the Adopting Release, the SEC explicitly recognized that a uniform
9 standard of care may "reduce retail investor confusion as it would ensure that
10 investors are provided the same standard of care and loyalty regardless of what
11 type of financial professional they engage." 84 Fed. Reg. at 33,462. But the SEC
12 weighed these benefits against the "significant compliance costs" for broker-
13 dealers that could cause "retail customers [to] experience an increase in the cost of
14 obtaining investment advice" and lead to "the potential exit of broker-dealers from
15 the market." *Id*. at 33,462; *id.* at 33,464 n.1351 (citing Vivek Bhattacharya et al.,
16 *Fiduciary Duty and the Market for Financial Advice* (Working Paper, Apr. 2019)
17 (discussing possible exit by broker-dealers)); 84 Fed. Reg. at 33,464 n.1354 (citing
18 Diane Del Guercio & Jonathan Reuter, *Mutual Fund Performance and the Incentive to*

1 *Generate Alpha*, 69 J. Fin. 1673, 1682 (2014) (discussing the lower costs offered by
2 broker-dealers)); *see also* Br. for Amici Curiae SIFMA et al. in support of
3 Respondents at 14–20 (surveying evidence in support of the SEC's analysis).

4 Thus, Regulation Best Interest was not arbitrary and capricious because the
5 SEC gave "adequate reasons for its decision[]" to prioritize consumer choice and
6 affordability over the possibility of reducing consumer confusion, and it
7 supported its findings with "substantial evidence." *NRDC*, 961 F.3d at 170
8 (citation omitted); *Fund for Animals*, 538 F.3d at 132 (citation omitted).

9 **IV. CONCLUSION**

10 For the reasons set forth above, the petitions for review are denied.

RICHARD J. SULLIVAN, *Circuit Judge*, concurring in part and dissenting in part:

I agree with the majority that the State Petitioners lack standing to bring their petition. I also happen to agree with the majority's analysis of Regulation Best Interest and its rejection of the investment advisers' challenge on the merits. Nevertheless, because I am convinced that XY Planning Network, LLC and Ford Financial Solutions, LLC (together, the "XYPN Petitioners") also lack standing to challenge Regulation Best Interest, I would dismiss the petitions in their entirety, without reaching the merits of petitioners' regulatory arguments.

In order to establish Article III standing, petitioners "must have (1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision." *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1547 (2016). The XYPN Petitioners offer a grab bag of standing theories, most of which are easily brushed aside for failing to establish one or more of the three requirements articulated in *Spokeo*.

For example, Ford asserts that it has standing to challenge Regulation Best Interest because the rule will subject Ford's broker-dealer competitors to "comparatively fewer regulatory obligations, lower compliance costs, and less legal exposure, giving them a competitive advantage." XYPN Br. Add. at 5. But

Ford cannot establish that Regulation Best Interest is the *cause* of these alleged injuries, since the XYPN Petitioners concede that the competitive imbalance between investment advisers and broker-dealers predated the rule. *See* XYPN Br. at 11 (explaining the "reality of the retail market for investment advice, in which broker-dealers . . . regularly provide personalized financial advice alongside investment advisers without registering themselves under the Investment Advisers Act"); *id.* at 17 (acknowledging that Regulation Best Interest "preserved the regulatory gap between broker-dealers and investment advisers in the market for personalized investment advice"). If anything, Regulation Best Interest will actually lessen the competitive disadvantage faced by investment advisers since it in fact *increases* the regulatory obligations, compliance costs, and legal exposure borne by broker-dealers. So even if Ford is correct in asserting that it remains at a disadvantage because the SEC did not equalize the duties and obligations of investment advisers and broker-dealers, that injury "cannot tenably trace" to Regulation Best Interest. *Cal. Ass'n of Physically Handicapped, Inc. v. FCC*, 778 F.2d 823, 827 (D.C. Cir. 1985). Moreover, a favorable judicial decision in this action would not redress the investment advisers' alleged injuries, since vacatur of the regulation would restore the status quo, leaving broker-dealers with even fewer

obligations and a more pronounced competitive advantage over investment advisers.

For its part, XY Planning contends that it has standing because the rule's failure to impose a uniform fiduciary standard on both broker-dealers and investment advisers "reduces the likelihood that broker-dealers will register as investment advisers," thereby "resulting in a loss of business" from broker-dealers who might otherwise be induced to join XY Planning as dues-paying members. XYPN Br. at 31. But in addition to being wholly speculative, this theory again fails to establish a causal relationship between the regulation and the alleged injury. At bottom, XY Planning does not claim that Regulation Best Interest will cause it to lose business; it merely complains that the rule does not do more to mitigate a preexisting competitive injury. But that is not enough to establish injury-in-fact or causation. And since the SEC is under no statutory mandate to impose an equalizing fiduciary standard on broker-dealers, a favorable result in this litigation – vacatur of Regulation Best Interest – will do nothing to redress that preexisting harm. To the contrary, vacatur will ensure that broker-dealers continue to enjoy a more pronounced competitive advantage – and have even less incentive to join XY

Planning as dues-paying members – than would be the case under Regulation Best Interest.

Notwithstanding the inadequacies of the XYPN Petitioners' principal standing arguments, the majority purports to find a winning theory of standing at the very bottom of the bag. That theory – which might be characterized as "the client marketing theory" – posits that Ford and similarly situated investment advisers meet the requirements of *Spokeo* because "Regulation Best Interest will impair [Ford's] ability to differentiate its services from broker-dealers' based on its higher duty of care." Maj. Op. at 14. Accepting at face value the affidavit of Ford's principal, the majority concludes that (1) Ford attracts customers by touting its fiduciary duty to clients, in contrast to the lower suitability standard that broker-dealers owe to their clients, and (2) Regulation Best Interest poses "a significant risk that clients will not be able to effectively differentiate the fiduciary duty that [Ford] owe[s] them from the lower duty that broker-dealers owe their clients." *Id.* at 15 (internal quotation marks omitted). According to the majority, Regulation Best Interest threatens to impair Ford's ability to market its higher fiduciary duty as a way of differentiating itself from broker-dealer competitors. Put another way, the majority concludes that Ford uses this tactic to attract customers, but will no

longer be able to do so if broker-dealers can advertise that they too must act in their customers' "best interests" by virtue of the new regulation.

But surely more is required to establish an injury-in-fact for standing purposes. Under this theory, anyone would be able to challenge a regulation that imposes duties on third parties simply because the challenger chose to adopt a marketing strategy that made reference to the existence or non-existence of such regulations. Consider, for example, a not-far-fetched scenario involving the Food and Drug Administration's ("FDA") food labeling requirements. Under current regulations, food manufacturers are required to list the ingredients and pertinent nutritional information on the labels of their products. However, the FDA exempts small manufacturers from complying with those requirements so long as fewer than 100,000 units of a product are sold annually in the United States and the manufacturer employs fewer than 100 people. 21 C.F.R. § 101.9(j)(18). Imagine that a major food brand launched an ad campaign designed to increase its market share at the expense of small food manufacturers by highlighting its obligation to post ingredients on its labels ("read all about it") in contrast to the exemptions that allow gourmet food shops to stay silent ("who knows?"). If the FDA proposed a regulation change that would lift the labeling exemptions on small manufacturers,

would the major food brand have standing to challenge the new regulation merely because its catchy ad campaign would no longer be relevant?

To my mind, the impairment of a marketing tactic based on a competitor's characterization of government regulations simply cannot rise to the level of a legally cognizable injury-in-fact for standing purposes. As the Supreme Court has recognized, where a party is not "the object of the [challenged] government action," its standing is "substantially more difficult" to establish. *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 562 (1992) (internal quotation marks omitted). In those circumstances, "much more is needed," *id.*, namely, a "concrete, particularized, and actual or imminent" injury, *Clapper v. Amnesty Int'l USA*, 568 U.S. 398, 409 (2013) (internal quotation marks omitted).

Here, Ford's diminished ability to market its fiduciary duty as a differentiating factor from its broker-dealer competitors does not satisfy this requirement. Neither the hypothetical food brand nor the actual petitioners here have a property interest in characterizing competitors as un- or under-regulated. And while they may have a limited First Amendment right to make such statements in the marketplace, they certainly don't have Article III standing to

challenge a regulation simply because it threatens to alter the regulatory status quo and render their marketing strategy less compelling.

For all these reasons, I am convinced that the XPYN Petitioners lack standing to challenge Regulation Best Interest, and that we are compelled to dismiss their petitions outright without reaching the merits of the challenge.