APPENDIX F

Gibson, Dunn & Crutcher LLP

January 15, 2000

MEMORANDUM

RE: N'ew Federal Privacy Requirements Affecting Any Company Engaged in "Financial" Business

The new federal financial services law – the Gramm-Leach-Bliley Act – imposes significant new consumer information privacy requirements on a wide range of companies that fall within the very broad definition of "financial" used in this law. This law applies to all such companies even if they do not own or are not affiliated with a bank or thrift.

This part of the new law (Title V) may take effect in November 2000. Affected companies should begin to take action to be ready to be in compliance. For banking, securities, and insurance firms, these requirements will be enforced by their existing primary regulators. All others will be subject to the Federal Trade Commission.

EXECUTIVE SUMMARY: A wide range of "financial" companies must:

- **protect and safeguard confidential customer information and records,**
- **adopt a privacy policy for "consumers,"**
- **disclose its policy to all consumer customers,**
- **provide an "opt-out" notice before sharing consumer information with third parties, and**
- **comply with new rules to be issued in 2000.**

A, WHO IS COVERED?

Any entity engaged in the business of providing "financial" services. This list will expand over time as the Fed adds to the "financial" activities list:

- A company that provides banking, lending, securities, insurance, or trust services.

Any company that finances the sale of products to consumers, through an extension of credit or a lease, also is likely to be covered.

- Any company that provides services to banking, lending, securities, insurance, or trust services providers is also likely to be covered. *Any "financial" company that collects consumer information from or about its customers is covered, and so is nny person or company that receives consumer financial information from a financial company.*

- Any company that may be owned by a banking organization is "financial" and any other company in the same line of business, *Data processing and financial software companies, travel agencies, as well as "outsource" service providers to any '(financial" company, are likely to be covered.*

- Any company that provides management, financial, economic, investment, employee benefits consulting or advisory services is likely to be covered.

B. WHAT COVERED COMPANIES MUST DO

1. All covered companies are subject to privacy standards that will be defined by regulations:

- All covered entities are subject to a broad federal legal duty to have physical, technical, and administrative safeguards to protect the privacy and confidentiality of customer information and records. New rules are to establish standards for carrying out this duty. "Customer" is not a defined term.

2. Any company that does business with "consumers" must have a privacy policy and disclose it to customers:

- All covered entities must have a privacy policy that must be provided to consumers when they become customers and annually thereafter.

- A "consumer" is any individual (or legal representative) who obtains from a covered entity financial products or services that are used "primarily" for personal, family, or household purposes. Nothing in the statute limits coverage to customers or consumers that are U. S. residents.

3. A company that discloses "nonpublic personal information" about consumers to an unaffiliated person (except as permitted under an exception) must allow them to "opt out",

- Before a company can provide nonpublic personal information to an unaffiliated third. party, the company must notify consumers of their ability to "opt-out." and allow opportunity to opt out.
- The Act does include a long list of exceptions that will permit disclosures to third parties without triggering the opt-out requirement.
- "Nonpublic personal information" is any personally identifiable financial information provided to a covered entity by a consumer or obtained by the entity as a result of a transaction with the consumer, service performed for the consumer, or otherwise acquired.
- An entity receiving nonpublic personal information from a third-party financial company must also comply with the new law.

D. When do the new obligations take effect?

November 12,200 (unless changed by rule). All covered companies should be in compliance at that time, Rules that will further explain and implement the new law are to be adopted in May 2000 by the SEC, federal banking regulators, state insurance commissioners and the FTC (whose regulations will apply to otherwise unregulated companies). These agencies also have enforcement responsibility for entities under their jurisdiction. These rules may specify other compliance requirements or deadlines.

F. Does compliance with this federal statute relieve a covered entity from complying with state privacy laws or the federal Fair Credit Reporting Act ("FCRA")?

No. Compliance with this federal law may also satisfy some state laws, B'UT any state law providing greater privacy protection is not preempted. Some states reportedly have already begun work on state laws that may impose additional requirements.

The Act calls for the federal banking agencies to adopt. rules under the FCRA, but does not supersede the FCRA provisions permitting affiliate information sharing.

G. Will compliance with these federal rules bring compliance with the EU Privacy Directive?

Recent statements from European Union officials suggest that the provisions of this new US. law are insufficient to satisfy the requirements of the EU Directive.

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PRIVACY COMPLIANCE TIMETABLE AND CHECKLIST

Nov. 12, 1999	Date of enactment of the Gramm-Leach-Bliley Act
January 2000	1. Begin internal assessment of collection, uses and distribution of customer and consumer information and collection of pertinent contracts and materials 2. Review existing privacy policy, or begin drafting a privacy policy, in light of the Act's requirements
Feb.-Mar. 2000	Release of proposed standards and rules by the SEC, FTC, federal banking agencies, and state insurance agencies.
May 12, 2000	Statutory date for final standards and rules by state and federal agencies.
May 31, 2000	Complete internal assessment of collection, use and distribution of customer information and related contracts and. documents.
May 31, 2000	Adopt privacy policy conforming to the Act's requirements.
June 2000	Complete analysis of third-party arrangements to determine: 1. consumer information uses under the Act, including prohibited uses; 2. potential "opt-out" disclosure obligations; 3. legal follow-up concerning information re-use by third parties and contract review; and 4. compliance as recipient of a consumer information from a third-party.
June 2000	1. Plan distribution of privacy policy to all consumers; 2. Plan distribution of "opt-out" notice (if required); and. 3. Implement changes in uses of consumer information (if required; e.g., modify 3rd party contracts, terminate prohibited uses).
Nov. 12, 2000	Statutory target date for compliance (may be modified by rules)

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THE *GRAMM-LEACH-BLILEY ACT*

Financial Services Modernization
Working Summary No. 4

The symbolism of enactment of major new financial services legislation on the verge the year 2000 is compelling. A new law for a new century. After almost two decades of attempts, the antiquated and outmoded Glass-Steagall Act of 1933 has been substantially replaced, and the Bank Holding Company ("BHC") Act of 1956 has been modernized. The enactment of the Gramm-Leach-Bliley Act (the "Act") is a landmark achievement.

The memorandum that follows sets forth the changes made by this new Act, both in its own terms and in the context of prior law. It attempts to lay out all of the Act's provisions topically and thus help to make its opportunities and issues more accessible to both executives and lawyers.

The long process that produced the Act also helps us understand its scope, purpose, and effects. Over the lust two decades, the case for modernization of Glass-Steagall and the BHC Act was often made: Technology and the ingenuity of business leaders and lawyers had su bstan tially eroded legal barriers between "banking " "securities," and "insurance." Securities and insurance firms were offering ban king or bank-substitute products and services, while commercial banking organizations increasingly penetrated the securities and insurance businesses. The existing legal framework was out-of-joint with marketplace reality. It distorted competition and caused inefficiencies.*

Even a short list of major developments since the Reagan Administration, proposed its modernization **bill in** *1983* **indicates the** *breadth of change since that time:*

- *securities, insurance, and retailing companies acquired "nonbank banks;"*
- *South Dakota and Delaware banks were authorized to engage in insurance underwriting;*
- *Section 20 a ffiliates of major banks engaged in investment banking;*
- *national banks began selling insurance out of "town of 5000" offices;*
- *Mellon Bank acquired the Dreyfus mutual fund complex;*
- *the* VALIC *and* Barnett *Supreme Court decisions validating regulatory authorization of national bank insurance activities resulted in an end to the "fortress insurance" opposition to reform;*
- *over 50 insurance and securities firms acquired thrifts and became "unitary" S&L holding companies; and*

- *Citigroup was created by a combination of Travelers/Salomon Smith Barney and Citicorp.*

The parallel legislative events are also telling. The 1983 Treasury Department proposal, which would have permitted a bank holding company to engage in full-service securities and insurance activities, was not seriously considered. Efforts focused instead on the possibility of a few new securities powers for banking organizations, and then stopping new "nonbank banks." The latter was achieved in 1987 legislation, even as bank expansion through regulatory action accelerated. The Bush Administration proposed a broad financial services restructuring bill in 1991. But in the aftermath of the S&L debacle and the wave of bank failures and in the face of deep industry divisions over expanded bank affiliations, this bill turned into the re-regulatory Federal Deposit Insurance Corporation Improvement Act.

The Act has direct lineage to the 1.995 bill introduced by Chairman Jim Leach, which permitted bunking, securities,, insurunce and other "financial" affiliations in a revised Bank Holding Company Act with the Federal Reserve us the preeminent "umbrella" regulator (and thus revived the 1983 Treasury bill concept, rather than the 199.1 Bush model). Although many specific changes have been made, the Act retains this framework. {It is perhaps noteworthy that except for the specter of Microsoft and the privacy provisions, issues of electronic commerce are not significant elements of the Act.)

*The stated goal was "financial services " modernization. Nevertheless, most participants in the legislative process viewed it from the perspective of their core industry -- banking, securities, or insurance. Two major industry compromises involved the drawing of regulatory lines between banking and securities and banking and insurunce that have the effect of limiting direct bank expansion. Parallel "functional regulation " amendments address the jurisdiction and roles of the SEC, the federal banking agencies, and the state insurunce commissioners. However, the Act dues contain in Section 104 significant tools for the development of integrated *financial services. Its federal preemption provisions contain broad language preempting any discriminatory or other state laws that may in terfere with the operation of integrated bunking and financial companies.*

Another major inter-industry issue concerned the ability of nonfinancial firms to provide banking products through a thrift in a unitary savings and loan holding company ("Unitary ") structure. This issue was given greater impetus by an application by Wal-Mart to acquire a thrift and by the fear that Microsoft or another major technology company might do so us well. While grandfathering existing Unitaries, the Act provides that no new Unitaries may be established -- and thus reinforces the line drawn in. the Act between financial and nonfinancial firms.

The other major issues addressed by the Act fall into two categories. The first is consumer and "public" issues associated with the Community Reinvestment Act ("CRA"), consumer protection, and, most important, privacy. The Act reaffirms CRA but calls for significant new disclosures by community group beneficiaries of that law. It also establishes a significant, new framework for privacy disclosures and protections by a very broad range of "financial" companies. The second category includes proposals that had been pending for some time and found a vehicle in the Act, notably, Federal Home Loan Bank system reforms and the interstate licensing of insurance agents and brokers.

Throughout 1999, the financial modernization bills had unprecedented momentum, moving from introduction to Senate and House passage in a matter of months. The actual fate of the Bill hung in the balance until the very end of the process, when the bank subsidiary and CRA compromises removed the threat of a presidential veto. In the end, the Act rested on a broad consensus both in Washington and among industry groups.

Seventy-two days after the year 2000 begins, the centerpiece affiliations provisions of the Act take effect and new, wide-ranging financial companies will be legally permissible. How quickly, and how many companies will develop a "financial services" perspective remains to be seen. In the meantime, the immediate efforts will focus on the many implementing regulations to be adopted and the prospects for new combinations. A new page is being turned.

Editor's Note:

This memorandum is organized topically, roughly following the order of the Act's major parts, but it does not follow the section-by-section order of the Act's text. As detailed in the table of contents, the order of major topics is as follows: the new financial holding company structure and activities, the supervision of financial holding companies by the Federal Reserve, the extent of preemption of state insurance and other law, the insurance and other financial activities of national banks and their opera ting subsidiaries, CEBA bunk amendments, foreign bank provisions, consumer protection and privacy, federal securities law amendmen ts, provisions concerning the Federal Home Loan Bank System, thrift provisions, insurer redomestication, the multi-state licensing of insurance agents, and various miscellaneous pro visions.

This memorandum updates our prior reports: Working Summary No. I (December 30, 1998), covering the Financial Services Act of 1998, the Senate version of H.R. 10, and H. R. 4870; Working Summary No. 2 (April 28, 1999), discussing H.R. 10 as passed by the House Banking Committee on March 23, 1999, and Working Summary No. 3 (September 30, 1999) discussing H.R. 10 and S. 900 in Conference.

We continue to regard this memorandum as a work in progress. The length and complexity of the Act mean that there are probably issues that we have not discussed that should be included. Further, although we have worked hard to make this memorandum an accurate discussion of this legislation, we may not have succeeded in every instance. Implementing regulations that will be released in the coming months will also expand the discussion of these issues and raise new ones, ACCORDINGL Y, WE WELCOME --INDEED INVITE --YOUR COMMENTS AND CRITICISMS. Our websites will allow you to access upda fed versions of this memorandum, and we encourage you to communicate your comments, corrections, and thoughts directly to us via e-mail at the addresses below. Or, of course, you may contact any of us the old-fashioned way: by telephone or by fax, at fhe numbers listed below, We look forward to hearing from you.

Our "Financial Modernization " site is accessible through the Gibson, Dunn & Crutcher UP webpages --

- *WORKING SUMMARY Website--www.gibsondunninstitute.com;* and
- *Gibson, Dunn & Crutcher LLP Webpage-- www.gdclaw.com {with link to WORKING SUMMARY).*

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THE GRAMM-LEACH-BLILEY ACT

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FINANCIAL SER VICES MODERNIZATION

Working Summary No. 4

WASHINGTON REPORT** ON **FINANCIAL INSTITUTIONS

Gibson, Dunn & Crutcher LLP
Financial Institutions Group
Washington? D.C.
www.gdclaw.com

December 16, 1999

SHORT FORMS USED IN SUMMARY NO. 4

1940 Act	Investment Company Act of 1940
Advisers Act	Investment Advisers Act of 1940
AFBA	appropriate federal banking agency
BHC	bank holding company
BHC Act	Bank Holding Company Act of 1956
CEBA	Competitive Equality Banking Act of 1987
CFI	community financial institution
CFTC	Commodity Futures Trading Commission
CRA	Community ‘Reinvestment Act of 1977
DI	depository institution
DIF	Deposit Insurance Fund
DOJ	Department of Justice
EFTA	Electronic Funds Transfer Act
Exchange Act	Securities Exchange Act of 1934
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
Fed	Board of Governors of the Federal Reserve System.
FHC	financial holding company
FHFB	Federal Housing Finance Board
FHLBA	Federal ‘Home Loan Bank Act
FHLBank	Federal ‘Home Loan Bank
FHLB System	Federal Home Loan ‘Bank System
FIPA	Financial Information Privacy Act of 1999
FR Act	Federal Reserve Act
FTC	Federal Trade Commission
GAO	General Accounting Office
Glass-Steagall Act	Glass-Steagall Act of 1933
HOLA	Home Owners’ Loan Act of 1933
House ‘Banking Committee	House Banking and Financial Services Committee
H.R. 10	Financial Services Act of 1999, as reported by the House Banking and Financial Services Committee (or the “Bill”)
HSR	Hart-Scott-Rodino
IB Act	International Banking Act of 1978
IBHC	investment bank holding company
NAIC	National Association of Insurance Commissioners
NARAB	National Association of Registered Agents and Brokers
NASD	National Association of Securities Dealers
NIB Act	N’ational ‘Bank Act
OCC	Office of the Comptroller of the Currency
OFHEO	Office of Federal Housing Enterprise Oversight
OTS	Office of Thrift Supervision
PCA	prompt corrective action

QTL .... qualified thrift lending
Revised Statutes .... Revised Statutes of the 'United States
RFC .... Resolution Funding Corporation
SAIF .... Savings Association Insurance Fund
Senate 'Banking Committee . . . Senate Banking, Housing and Urban Affairs
S&LHC Act .... Savings and Loan Holding Company Act
SEC .... Securities and 'Exchange Commission
s s .... Staff Side by Side Comparison of S. 900 and H.R. 10 (9/1/99)
Treasury .... Department of the Treasury
Unitary .... unitary savings and loan holding company
WFHC .... wholesale financial holding company
WFI .... wholesale financial institution

THE GRAMM-LEACH-BLILEY ACT:
AN INSURANCE INDUSTRY OVERVIEW

Michael W. Teichman'

February 4, 2000

On November 12, 1999, President Clinton signed into law legislation designed to lift long-standing restrictions on the activities of banks and bankholding companies, and to streamline the regulation of combined financial services entities. The purpose of this memorandum is to acquaint those in the insurance industry with the portions of this bill, the "Gramm-Leach-Bliley Act of 1999" ("GLB" or "the Act"), which have a direct bearing on their business, and to alert members of the industry as to potential threats and opportunities that have been created as a result of this legislation. This memorandum is, of course, not intended to be a discussion of all aspects of this bill, which spans four hundred pages, nor is it intended to be a comprehensive discussion of all of GLB's implications for insurers, agents, and brokers.

Introduction

Prior to the enactment of GLB, the structure of regulation, in this country, for the various sectors of the financial services industry was characterized by mandated segregation. This separation has its roots in the Great Depression, and was designed to prevent the failure of one element of the industry from spreading to others. This regulatory separation is not shared by European and Asian systems, and is considered both an anachronism and an impediment to efficient competition on a global scale. In recent years, some piecemeal legislation has been enacted in

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response to the changing nature of the financial services industry. More significantly however, federal agencies and courts have greatly expanded the insurance and securities powers available to banking institutions through expansive interpretations of federal banking laws.

As a result of the changing nature of the financial services industry and the direction taken by federal agencies and courts, various attempts to legislatively overhaul our system of regulating financial services have been offered, unsuccessfully, for over 20 years. The enactment of GLB ended the drought. This bill was the subject of intense debate and lobbying, and its provisions represent a patchwork of fragile compromise reached among numerous trade organizations and lawmakers who champion the cause of the various financial services constituencies. Many of the difficult regulatory concepts were left to the regulators, who must, cooperatively and at considerable speed, give these concepts both meaning and utility.

Fundamentally, GLB is designed to do the following:

- repeal portions of the Glass-Steagall Act separating securities underwriting and sales from banking;
- expand the financial activities that may be performed by a bank holding company to include investment banking, insurance activities (thereby allowing insurers to become financial holding companies), merchant banking and other financial activities;
- attempt to streamline and coordinate the regulation of such combined activities;
- to a limited degree, expand on the activities permissible for national banks and more clearly define those permissible activities;
- preempt discriminatory state laws regarding the insurance activity of bank affiliates;

- provide minimum privacy requirements to protect the financial information of customers of all financial institutions; and
- terminate expanded powers for new unitary thrift holding companies.

Financial Holding Companies

Sections 101 through 103. Prior to GLB, the Glass-Steagall Act prevented banks and bank holding companies from engaging in investment banking activities. This provision has been modified and liberally interpreted over time, however, banks and bank holding companies remained significantly restricted in their permissible investment banking activity. Section 101 of the bill repeals portions of the Glass-Steagall Act, and banks and bank holding companies may now engage, through affiliates and subsidiaries, in investment banking activities. Until now, insurers had greater flexibility in affiliating with investment bankers when compared to banks and bank holding companies. This advantage is eliminated.

Section 103. This section stands at the heart of GLB. Under pre-existing law, bank holding companies and their subsidiaries were prohibited, pursuant to Section 4 of the Bank Holding Company Act of 1956, from engaging in non-banking activities (with certain exceptions). Section 103 of the bill amends the Bank Holding Company Act to allow bank holding companies meeting certain criteria to become "financial holding companies." Such companies may engage in a broad array of financial activities including, but not limited to:

- lending, exchanging or safeguarding money;
- insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability or death; or providing or issuing annuities (as principal, agent, or broker);

- financial advisory services;
- underwriting, dealing in or making or marketing securities.

The Federal Reserve Board (the "Fed") may identify additional activities as "financial in nature," but the Treasury Department is given a right to "veto" this process, The result is likely to be joint rulemaking on new financial activities. Under this Section, financial holding companies may also engage in activities that are "incidental" to financial activities and, with Fed approval, may even engage in activities found to be "complimentary" to financial activities.

Importantly, Section 103 expressly preserves the right of an insurer, affiliated with a financial holding company, to make equity investments not otherwise permitted of a financial holding company. Such equity investments are limited to those made in the "ordinary course of business" and permitted by state law. Generally, the holding company is not permitted to engage in day-to-day management of the non-financial companies in which such investments are held, however this restriction will not apply if day-to-day management is necessary to preserve the value of the investment.

Consolidation with a bank holding company may provide significant advantages for insurers:

- Such consolidation will provide new opportunities for cross-marketing and co-branding of financial services products, as well as the development of hybrid bank/insurance products.
- Because banking institutions have historically been understood to be better capitalized and enjoyed greater return on equity and return on assets, in comparison to insurers, insurers consolidating with banking institutions will, broadly speaking, enjoy relatively greater financial strength.

- Realized earnings from a broad spectrum of financial products may also support highly competitive pricing of insurance products underwritten by insurers affiliated with a financial holding company.
- The absorption of regional insurers may create a perceived loss of customer sensitivity, fostering "niche" competitors.

These advantages, however, translate into disadvantages for insurers which presently enjoy premier market shares in discreet geographical regions. Such insurers will likely realize less advantage to affiliation than competing insurers which aggressively plan for growth into new markets.

Preemption of State Law

Section 104. While it is clear that Section 104 is designed to preempt state law, the extent to which it will do so is less than clear. Relevant to insurers, this section is broken down into two parts, the first purports to preempt state law with respect to bank/insurer affiliations, while the second purports to preempt certain state law with respect to activities conducted by bank insurer affiliates.

With respect to *affiliations,* this section preempts state law or action restricting a bank or bank affiliate from affiliating with an insurer, but only to the extent that such state law or action is discriminatory in its effect. This section does impose a 60-day time limit on state action, and also expressly allows a state to restrict the purchase of stock of a newly demutualized insurer. Simply stated, it appears that state insurance regulators employing the NAIC Model Holding Company Act in reviewing acquisitions of domiciled insurers may continue to do so when such acquisition is made

by a financial holding company. However, the state will be limited in its ability to impose any restriction or condition on the affiliation which might be characterized as discriminating against an affiliated bank. The Act does not specify any standards to be used in determining whether a state action is "discriminatory," leaving such determinations to the courts and regulators.

The provisions in Section 104 preempting state law over the *activities* of insurer affiliates of banks is itself divided into two distinct parts. As to *sales activity,* state law or action which significantly interferes with (as opposed to "restricts") the "sales, solicitation or cross-marketing" of insurance by a bank or bank affiliate will be preempted. Additional non-discrimination provisions will apply to state law or action affecting sales activity adopted or taken after September 3, 1999. This preemption of state regulation of sales activity is, however, subject to 13 "safe harbors" which preserve some state authority. These safe harbors are narrowly drawn and relate primarily to required disclosures by banks, licensing of agents, tying of insurance and bank products, and so forth (these 13 provisions are attached hereto as Appendix "A"). Because this section fails to define the scope of "sales, solicitation and cross-marketing" as a business activity, the potential exists for unintended preemption of state law that impacts the sales activity of affiliated insurers.

State law restricting (not "significantly interfering with") the *mm-sales activity* of an insurer affiliated with a bank will be preempted unless such state law or action:

- is enacted for the purpose of regulating the business of insurance, falls under a broadly written safe harbor, and the state law or action does not violate the non-discrimination provisions (irrespective of the date the state law or action was adopted or taken);

- applies only to persons that are not insured depository institutions, but that are directly engaged in the business of insurance;
- does not relate to or regulate sales, solicitation or cross marketing activity; and
- does not violate certain non-discrimination provisions (discussed below).

The non-discrimination tests in Section 104 act as an additional hurdle for state regulation of the activity of affiliated insurers (both sales and non-sales activity). Summarized, they are as follows:

- State law which, by its terms, distinguishes between banks and their affiliates, and other entities.
- State law which, although neutral on its face, has a substantially more adverse impact on banks or bank affiliates, as opposed to other entities.
- Effectively prevents a bank or bank affiliate from engaging in insurance activities.
- Conflicts generally with the intent of the GLB Act to permit affiliations.

The extent to which these vague tests will preempt state law or action will depend greatly upon the facts of the challenged transaction.

Functional Regulation

Sections 11 I through 116. Together these sections attempt to define, at least in skeletal form, the limits of authority that the Fed, other federal banking regulators, the Securities Exchange Commission, and state insurance regulators will have in regulating a financial holding company. No one can predict, with any certainty, how well these regulators will cooperate.

Section 1 I 1 authorizes the Fed, as umbrella regulator for financial holding companies, to require reports of and conduct examinations of functionally regulated subsidiaries (essentially, non-bank subsidiaries subject to regulation by the state insurance regulator or the Securities Exchange Commission). The Fed is restricted as to when it may demand such reports and perform such examinations, and is required to utilize the reports and examinations of state insurance regulators "to the fullest extent possible."

Section 112 allows the Fed to require holding company affiliates to provide assets to an affiliated bank. While this includes an affiliated insurer, the Fed is required to give written notice to the state insurance regulator. Upon receipt of such notice, the state has the opportunity to object to the Feds order. Upon such objection, the Fed is permitted to order the holding company to divest itself of the bank in questions. Importantly, this section also includes a "parity" provision which restricts the ability of any other federal banking regulator to impose requirements on, or make demands upon, any insurer or other functionally regulated subsidiary.

Section 113 imposes limits on the ability of the Fed to take action or engage in rulemaking with respect to functionally regulated subsidiaries. Any action taken must be necessary to address or prevent an unsafe or unsound practice which poses a material risk to a bank or the domestic or international payment system, and only when the Fed finds it cannot redress the risk by action against an affiliated bank.

Section 114 further empowers federal banking regulators to impose restrictions on transactions between banks, bank holding companies and non-bank subsidiaries.

Insurers which become affiliated with financial holding companies will now become subject to some degree of regulation by the Fed, and even the Federal Deposit Insurance Corporation. To

an uncertain degree, insurers so affiliated can expect to submit to reporting requirements and examinations, and in some cases, might find the Fed attempting to impose significant limits on their activities, notwithstanding the permissibility of such activities under state law. The extent to which any of this may occur is uncertain and will be given shape and form only through the rulemaking processes of the Fed and other federal banking regulators.

Financial Subsidiaries of National Banks.

Permissible activities for national banks and their subsidiaries became an important aspect of this legislation primarily because the Treasury Department, as parent agency to the Office of the Comptroller of the Currency ("OCC"), is directed by a cabinet level appointee of the President, whereas members of the Board of Governors of the Federal Reserve are appointed to 14 year terms, staggered at two year intervals. Therefore, as operating subsidiaries of national banks engage in expanded financial activities, the Administration acquires greater control over financial institutions because the OCC will remain the primary regulator for these activities.

In recent years, the OCC, has taken a progressive approach in the interpretation of both Section 24(Seventh)[2] and Section 92[3] of the National Bank Act, and thereby has significantly increased the authority of national banks to engage in activities beyond those traditionally thought of as "banking," including various aspects of the insurance business. GLB will largely put a stop to this practice simply because it expresses, in statutory form, those insurance powers available to national banks, as well as those not available.

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[2] Allows national banks to engage in banking and activities incidental thereto.

[3] Allows national banks to sell insurance products in places with less than 5000 residents.

Sections 121 and 122. These sections authorize national banks to form "financial subsidiaries" which may engage in activities similar to those permissible of a financial holding company affiliate. National banks seeking to form such subsidiaries must be well capitalized and are subject to certain ratings with respect to debt and CRA examinations.

By these provisions, the geographical restrictions of Section 92 of the National Bank Act, allowing national banks to engage in the sale of insurance products in towns of less than 5000 residents, become moot for national banks meeting the criteria provided in Section 121. Insurance underwriting, however, remains generally impermissible for national bank financial subsidiaries. Additionally, national bank financial subsidiaries may not invest in the kinds of investments permissible of an insurance company affiliated with a bank holding company. National bank financial subsidiaries are also prohibited from engaging in real estate development as well as merchant banking although, as to the latter, federal banking regulators are permitted to revisit the issue after five years.

Elsewhere in the bill, Section 302 also addresses limits on the insurance activities of national banks. Utilizing a cutoff date of January 1, 1999, national banks will be permitted to engage in any insurance underwriting activity found permissible by the OCC, or actually engaged in as of that date. National banks will not, however, be permitted to underwrite additional insurance products by seeking an approval from the OCC. Section 302 also provides a definition of insurance designed to prevent the OCC from labeling insurance products as "banking" products, thereby avoiding the limitations imposed by GLB. Essentially, this definition provides that "insurance" is whatever the state regulator says it is, with certain exceptions. Section 303 prohibits federally chartered banks from engaging in the underwriting or sale of title insurance. National banks may, however, sell title

insurance products, but only to the extent state chartered banks are authorized to do so under state law. Lawful title insurance activity engaged in as of the date of enactment of GLB is grandfathered. It is important to keep in mind that, while this bill limits the Comptroller of the Currency in further expansion of national bank powers, those powers which have previously been authorized for national banks by the OCC, or in fact engaged in by national banks, will be retained.[4] This is true for all national banks, not simply those national banks which possess written authorization for their particular activities.

Other Insurance Provisions

Title III of GLB addresses a number of unrelated insurance issues besides those dealing with the insurance powers of national banks. Among them are important provisions involving the mutual insurance holding company reorganizations and multi-state agent licensing.

Section 304. Judicial principles applied to the review of federal agency decisions accord great weight to the interpretation federal banking regulators give to the federal banking statutes that such agencies are charged with enforcing. Were such principles of "deference" to remain in place, states regulating insurers affiliated in a financial holding company would be at a great disadvantage, with respect to the federal banking regulators, should a dispute arise out of the meaning of federal banking law.

To correct for this, Section 304 provides for an expedited dispute resolution process when disputes arise between federal banking regulators and state insurance regulators. Such disputes are

[4] Thus, the existing authority of national banks to underwrite and reinsure credit related insurance products is preserved.

to be heard by Federal Circuit Courts of Appeal on an expedited, 60-day basis, and are subject to abbreviated 6 or 12 month statutes of limitations. Regardless of whether it is a state or federal statute which gives rise to the dispute, the court is charged with resolving the dispute "without unequal deference" afforded to either the state or federal regulator with respect to the state or federal agency's interpretation of state or federal law. Thus, to the extent a federal banking agency views federal law as preempting a state insurance code, the federal agency's interpretation of the federal statute in question will not be given the overwhelming weight it would otherwise enjoy.

In an attempt to preserve at least some of the deference formerly enjoyed by the OCC, Section 104(d)(2)(C)(i) provides that Section 304(e), which removes deference, will not apply with respect to state statutes, regulations, orders, interpretations or other action regarding state insurance sales, solicitations or cross-marketing activities, if such were issued, adopted or enacted before September 3, 1998. Because no federal agency is granted deference with respect to its interpretation of state law, the impact of this provision appears limited.

Section 305. Prior to enactment of this law, federal banking regulators left the regulation of retail insurance sales activities, by banks, largely to the states. Now, under Section 305, federal banking agencies ('jointly) are permitted to adopt consumer protection regulations which will apply to the retail insurance sales activities of banks, or to entities making sales on behalf of banks. Such regulations are to be adopted after "consultation" with state insurance regulators, and shall include anti-tying and anti-coercion rules, disclosure requirements, requirements concerning the separation of banking and non-banking activities, prohibitions on domestic violence discrimination, and so forth.

Inconsistent state laws shall override such federal regulation unless the federal banking agencies jointly issue notice indicating such agencies' position that the federal regulation in question provides greater protection than the corresponding state regulation. Such notice will result in a preemption of the corresponding state law unless the state adopts legislation within three years to override such preemption.

Section 306. As a complement to the preemption provisions found in Section 104 of the bill, Section 306 preempts state action which significantly interferes with the ability of an insurer to become a financial holding company. This preemption, however, is expressly made subject to the standard set forth in Section 104(c)(2) which provides a safe harbor for state action approving or disapproving the acquisition of a domestic insurer. Section 306 also restricts the ability of a state to limit the amount of an insurer's assets which may be invested in the voting securities of a depository institution, and preempts state interference with mutual insurer reorganizations by non-domiciliary states.

By carrying forth the safe harbors set forth in Section 104(c)(2), the state's ability to "significantly interfere" with an acquisition of a bank by a domestic insurer may be largely restored. Because, however, Section 306 does not address the change of control of a domestic insurer, courts and regulators will be required to engage in some interpolation of the standards in Section 104(c)(2) in order to make them fit within the parameters of Section 306.

Sections 311 - 316. These provisions will allow a mutual insurer organized in a state that has not enacted a mutual insurance holding company law to redomesticate to a state which has enacted such a law. Generally, these sections preempt state laws that would prohibit

redomestication or otherwise impede the activity of an insurer redomesticating pursuant to these provisions.

States are, however, entitled to notice of the redomestication and may require approval by boards of directors, continued voting control by policyholders, restrictions on awards of stock options or other equity to officers and directors, preservation of policyholder rights and other fair and equitable treatment of policyholders. Licenses are preserved and outstanding policies must remain in force; however, a state may require such a redomesticating insurer to refile policy forms.

Sections 321 - 336. Of course, prior to enactment of GLB, states were free to adopt whatever requirements were deemed appropriate with respect to the licensing of agents and brokers. In a major change to the present state of affairs, if states fail to achieve a specified level of uniformity and reciprocity within three years following enactment of GLB, a National Association of Registered Agents and Brokers ("NARAB") will be created.

The NARAB would be a quasi-governmental entity designed to provide a mechanism for uniform producer licensing, appointment, continuing education, etc. Membership in the NARAB would entitle a producer to licensure in each state in which he or she pays the requisite licensing fees. The NARAB would have broad authority to establish membership criteria, conduct examinations and take enforcement action against errant members, State laws in conflict with the NARAB membership guidelines would be preempted. Under these provisions, the NAIC would have exercise over the NARAB unless, after two years following its creation, (1) the states fail to achieve a minimal level of uniformity and reciprocity and, (2) the NAIC fails to approve NARAB bylaws or otherwise fails to supervise the NARAB.

While the NAIC has made significant progress in the direction of uniform producer licensing laws, it remains an open question whether enough states will see the need for uniform and reciprocal licensing, and take action thereto, prior to the end of the three year time period provided. The NAIC is, however, charged with making an initial determination as to whether the requisite level of reciprocity and uniformity has been achieved. Presumably, the NAIC will make a determination that such levels have been achieved, thus averting the creation of the NARAB. Such a finding by the NAIC may be challenged in federal court, which is charged with applying an "abuse of discretion" standard in its review of the NAIC's determination. This standard of review will make challenges to the NAIC's determination more difficult to sustain.

Privacy

Sections 501 - 527. Under the law prior to GLB, there existed no federal statute which would directly and comprehensively limit the ability of a financial institution, be it a bank, securities underwriter or insurance company, to share the financial information of its customers with other entities for business purposes. For the first time, these sections impose limitations on a financial institution's disclosure of non-public, personally identifiable, financial information to a non-affiliated third party, and impose criminal penalties upon those who access such information through fraudulent means.

Irrespective of whether a financial institution, including an insurer, is affiliated with a financial holding company, such financial institution must provide notice, to each of its customers, describing the institution's policies and procedures with respect to the disclosure of this information to affiliates and non-affiliated third parties. Each such financial institution must further give its

customers the opportunity, before any disclosure to non-affiliated third parties, to direct that such information not be disclosed.

There are a number of broadly drafted exceptions to this "opt-out." Generally, disclosures to non-affiliated third parties which are providing services for, or functions on behalf of, a financial institution will not be subject to the "opt-out" if full disclosure is made to the consumer. Additionally, typical insurance-specific transactions, such as reinsurance, should fall under a list of "general exceptions" which include secondary market sales, institutional risk control and providing information to rating organizations, guaranteed funds, persons assessing compliance, attorneys, accountants, auditors, etc.

A broad array of federal administrative agencies are charged with rulemaking after appropriate consultation with the NAIC. Enforcement is left up to the relative functional regulator. Importantly, states retain their ability to regulate their privacy policies and practices of financial institutions, so long as such state regulation provides protection at least as great as these provisions. Certain states have already begun to consider privacy requirements more restrictive than that provision in this Act.

RECOMMENDATIONS

It is impossible to make general recommendations regarding the advisability of affiliating with a bank holding company. Every insurer must evaluate its long-term strategy, its products, its marketing methods, its geographic and demographic markets, and its capital resources in order to determine the existence of competitive or business advantages to affiliation. Prospective affiliation partners must be carefully screened. The factors which should be considered are innumerable, but will certainly include the capital strength of the potential partner, the breadth and compatibility of its existing products, the type, number and location of potential outlets for insurance products, the potential for successful co-branding and hybridization of bank products, the long-term strategies of the potential partner and the compatibility of its corporate culture.

Most important aspects of this legislation will be greatly affected by rulemaking at the federal level in the next 18 - 24 months. Federal banking regulators recognize they are under a very tight deadline for adoption of rules implementing GLB. Both the Fed and the OCC note that at least 40 separate "projects" are under way.

The majority of rulemaking fails to the Fed, which is charged with the supervision of financial holding companies. Notwithstanding the preeminent role for the Fed, much rulemaking can also be expected at the level of the OCC. In competition with the Fed, this agency is promising to streamline its regulatory process as much as possible, so as to maximize the amount of financial activity conducted in national bank operating subsidiaries.

All insurers, whether actively considering affiliation or otherwise, *must* monitor this rulemaking process, and participate if necessary. At a minimum, such federal rulemaking can be expected to affect such areas as:

- definition of financial activities and "Regulation Y"[5];
- certification process for financial holding companies (proposed rules already published in the *Federal Register);*
- whether and when conditions in a holding company rise to a level requiring federal enforcement against a functional regulated subsidiary (includes affiliated insurers);
- bank/insurance sales consumer regulations; and
- privacy

Because the privacy provisions are not limited to insurers affiliated with a financial holding company, all insurers must begin developing notice procedures for both new and existing policyholders, which will make sufficient disclosures and preferably explain the opt-out right that each policyholder will have. Insurers must further evaluate all disclosures made to non-affiliated third parties to determine if such disclosures will fall within the exceptions provided. Federal rulemaking will determine the scope of the information considered "financial" and further define the scope of exceptions provided!

Activity at the state level must be monitored as well. The "brave new world" of functional regulation will require a level of cooperation and discourse between and amongst the NAIC and federal regulators never before seen. Most rulemaking at the federal level will not be conducted

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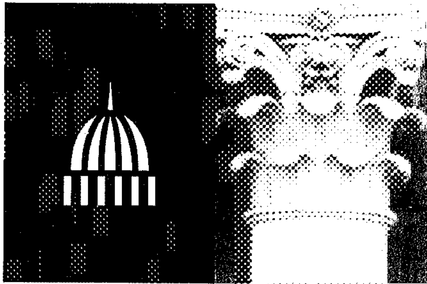
[5] 12 C.F.R. Part 225. This Federal Reserve Board regulation addresses bank holding company powers and sets forth the application requirements for prospective BHCs.

[6] The federal Reserve Board released, for comment, a proposed regulation implementing the privacy provisions on February 3, 2000. Although thisregulation should not directly impact non-affiliated insurers, rulemaking at the state level will likely parallel regulations adopted by the federal regulators.

without considering input from the NAIC. Critically, with new emphasis on privacy concerns, and the failure of the privacy provisions of GLB to preempt state law, states are free, and can be expected to, adopt privacy provisions far more restrictive than those in this bill. Insurers will be wise to stay abreast of this activity at the state level.

APPENDIX G



National Conference of State Legislatures

LEGISBRIEF

BRIEFING PAPERS ON THE IMPORTANT ISSUES OF THE DAY

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NARAB and the Future of Insurance Regulation

By Cheye Calvo

States have two years to enact a national system to license and register insurance agents and brokers or face a federal takeover.

States have two years to enact a national system to license and register insurance agents and brokers or face a federal takeover. Currently, insurance producers must meet different licensing requirements for every jurisdiction in which they do business, including separate applications, education standards and exams. Failure to meet the challenge set by federal legislation passed last year endangers hundreds of millions of dollars a year in state producer licensing revenues and would threaten state regulation of the $824 billion insurance industry.

Federal Action

The Financial Modernization Act of 1999, also called Gramm-Leach-Bliley, tore down Great Depression-era barriers to permit insurance, banks and securities firms to affiliate with one another. A key provision of the law gives states three years to establish uniform laws or a system of reciprocity to govern the licensing of insurance producers (individuals and entities authorized to sell, solicit or negotiate insurance). If 29 states, territories and commonwealths do not enact reciprocity by Nov. 12, 2002, the act establishes the National Association of Registered Agents and Brokers (NARAB). The association would be a quasi-governmental entity that could preempt existing state laws governing producer licensing.

States can better provide the close degree of scrutiny needed in insurance regulation.

Preserving State Insurance Regulation. Congress explicitly endorsed state regulation of insurance with the 1948 McCarran-Ferguson Act. The unique nature of insurance that promises benefits only if certain events come to pass requires the closer degree of scrutiny that states can better provide. States can more ably respond to consumer inquires on highly technical insurance contracts, review rates and underwriting guidelines, and monitor insurance market conduct. The largely local nature of pooled insurance risks also favors a state-based system that is more responsive to the needs of consumers, agents and insurers.

The patchwork of state insurance laws and regulations, however, has created problems for national companies.

The patchwork of state insurance laws and regulations, however, has created problems for national companies. Although directly reaffirming the principle behind state insurance regulation, Gramm-Leach-Bliley calls on states to modernize the regulatory system and adopt uniform processes and standards, where appropriate.

The provision to create NARAB will test the ability of states to respond to an increasingly national —and global—insurance market. Meeting this challenge would show the ability of state lawmakers and regulators to modernize insurance regulation while continuing to protect consumers. Failure would be an invitation for federal intervention of state insurance regulation and would further encourage some financial services interests that are already advocating a duel federal-state regulatory system modeled on banking regulation.

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Reciprocity. The National Association of Insurance Commissioners (NAIC) has responded to Gramm-Leach-Bliley by establishing working groups designed to examine every component of state insurance regulation. NAIC seeks to work with state lawmakers to nationally streamline state regulation while preserving state-based authority and standards.

NAIC has created a producer licensing model act that will satisfy the NARAB provision of Gramm-Leach-Bliley. The federal law requires states to establish either a system of reciprocal producer licensing or uniform standards for licensing. The NAIC model satisfies the reciprocity mandates of the law. Producers holding a resident license in a state could obtain a nonresident license in another state by 1) providing evidence of the license in good standing in the resident state, 2) completing the uniform nonresident application, 3) paying the appropriate state fee and 4) satisfying the continuing education requirements of the resident state.

The new federal law requires that states establish reciprocal arrangements to licensing producers from other states.

The model act also goes beyond the reciprocity mandates of Gramm-Leach-Bliley to offer states uniform definitions, exemptions and safeguards to ensure producer requirements. The model sets standards for who should be licensed as a producer and who should not. It provides uniform definitions of the five major lines of insurance—life, accident and health, property, casualty, and variable life and variable annuity—to ensure that the authority to sell, solicit and negotiate certain types of policies will be understood by other states. The model also establishes consistent standards for states to deny, not renew and revoke producer licenses.

The National Insurance Producer Registry, a nonprofit affiliate of NAIC, created the Producer Information Network and the Producer Database for states to use to check the good standing of producers and report infractions. The database currently makes information on 2.6 million of the nation's 3 million producers available to regulators and insurance companies. Thirty-three states currently connect to the database, and NAIC hopes to have all 50 states linked by the end of this year.

State Action

Kentucky and New Hampshire enacted NAIC's producer licensing model act in 2000. Lawmakers in Missouri and North Carolina passed the key provisions to satisfy the requirements of Gramm-Leach-Bliley, but held the uniform standards for further consideration. Insurance commissioners from 31 states have pledged to seek enactment of the model act from their state legislatures in 2001.

Insurance commissioners from 31 states have pledged to seek enactment of the model act from their state legislatures in 2001.

Gramm-Leach-Bliley has spurred a thorough evaluation of state insurance regulation that promises to be a major issue for state legislatures in the years ahead. NARAB presents the first and most immediate challenge. How states respond to the larger issue of modernizing state oversight of the nearly $1 trillion insurance industry while continuing to protect consumers will ultimately decide the fate of continued state control over insurance regulation.

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APPENDIX H

SUMMARY - PRIVACY REQUIREMENTS

Generally, the privacy provisions applicable to the insurance industry with respect to nonpublic personal financial information should include requirements to the following effect:

(a) **Notice -** Each licensee shall clearly and conspicuously give notice to each consumer of its policies for collecting and sharing the consumer's nonpublic personal financial information. The notice must be given to ongoing customers at least annually.

(b) **Opt-Out Choice -** Each licensee shall provide consumers an "opt-out" choice (i.e. the right to "opt-out" of the licensee disclosing the consumer's personal nonpublic financial information to non-affiliated third parties) subject to certain exceptions. The exception: the "opt-out" choice with respect to disclosures doesn't apply to affiliates under GLBA; however, under the Fair Credit Reporting Act there is currently a requirement for an "opt-out" choice with respect to sharing of application information with affiliates.

(c) **No Disclosure of Account Access Information -** A licensee shall not disclose account access information of consumers to third party marketers.

(d) **Security -** Each financial institution shall have an established privacy policy (that complies with federal and state laws/rules) to ensure security and confidentiality of customer records, to protect against hazards to security of customer records and to protect against unauthorized access to such information

(e) **Access** to **Record -** Consumers shall have access to any personal nonpublic financial records maintained by a licensee and shall have the right to correct any incorrect information in those records.

(f) **Non-Discrimination -** A licensee shall not unfairly discriminate against any customer or consumer who has opted out from the disclosure of his or her nonpublic personal financial information.