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Insurance Regulation After the Gramm-Leach-Bliley Act

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Summary

Congress passed the Gramm-Leach-Bliley Act in 1999, anticipating wholesale integration in financial services. Since then, markets have not really integrated, and regulatory silos — with few exceptions — remain intact. Congress is now exploring federal standards for some aspects of state regulation of insurance. This report was written under the supervision of Barbara Miles, Government and Finance Division, and will be updated as events warrant.

Background

Congress passed the Gramm-Leach-Bliley Act[1] (the GLB Act) in 1999 to enhance competition among financial services providers and to modernize their regulation.[2] Competition among those providers has evolved differently than most observers expected it would, as fewer than expected cross-sectoral mergers and consolidations have occurred.[3] Mergers and consolidation have instead occurred largely within sectors, though companies within each sector are producing and distributing a broader range of financial products.[4]

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[1] P.L. 106-102. See CRS Report RL30375, *Major Financial Services Legislation, The Gramm-Leach-Bliley Act (P.L. 106-102): An Overview*, by F. Jean Wells and (name redacted).

[2] See, e.g., Federal Reserve Bank of San Francisco, "The Gramm-Leach-Bliley Act and Financial Integration," *FRBSF Economic Letter*, vol. 2000-10, March 31, 2000, available at [http://www.frbsf.org/econrsrch/wklyltr/2000/el2000-10.html], visited April 4, 2004.

[3] CRS Report RS21807, *Convergence in Financial Services: The Insurance Market*, by (name r edacted)

[4] Ibid.; Insurance Information Institute and Financial Services Roundtable, *Financial Services Fact Book 2004* (New York: Insurance Information Institute, 2004), pp. 10-11 (showing the financial products available from the top 10 companies in each sector), available at [http://financialservicefacts.org/financial2/today/convergence/], visited April 5, 2004.

The GLB Act preserved the role of the Federal Reserve Board as an umbrella supervisor for holding companies,[5] and it also expressly preserved state regulation of insurance.[6] It allowed national banks to underwrite insurance in a financial holding company affiliate[7] and to sell insurance.[8] These insurance activities were to "be conducted in a manner that is consistent with applicable State regulation."[9] The states were not, however, to frustrate congressional intent by discriminating against banks or their subsidiaries or affiliates.[10] The Act implemented the concept of "functional regulation:"

> The bill generally adheres to the principle of functional regulation, which holds that similar activities should be regulated by the same regulator. Different regulators have expertise at supervising different activities. It is inefficient and impractical to expect a regulator to have or to develop expertise in regulating all aspects of financial services. Accordingly, the bill is intended to ensure that banking activities are regulated by bank regulators, securities activities are regulated by securities regulators, and insurance activities are regulated by insurance regulators.[11]

The concept of functional regulation as implemented in the GLB Act has been praised and criticized. Some praise it for opening communication among sectoral regulators.[12] Others criticize it for not modernizing financial services regulation at all but rather combining functional and institutional regulation,[13] preserving the status quo,[14] or

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[5] P.L. 106-102, sec. 102 and 103, 113 Stat. 1341-51.

[6] Ibid., sec. 104 (a), 113 Stat. 1352 ("The Act entitled 'An Act to express the intent of Congress with reference to the regulation of the business of insurance' and approved March 9, 1945 ... (commonly referred to as the 'McCarran-Ferguson Act') remains the law of the United States.")

[7] Ibid., sec. 103 (a), 113 Stat. 1343.

[8] Ibid., sec. 104 (c), 113 Stat. 1352-53.

[9] U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Financial Services Modernization Act of 1999*, report to accompany S. 900, 106th Cong., 1st sess., S.Rept. 106-44 (Washington: GPO, 1999), p. 11.

[10] P.L. 106-102, sec. 104 (e), 113 Stat. 1357; S.Rept. 106-44, pp. 11-15.

[11] S.Rept. 106-44, p. 9. U.S. Congress, Conference Committee, Gramm-Leach-Bliley Act, conference report to accompany S. 900, H. Rpt., 106-434, 106th Cong. 1st sess. (Washington: GPO, 1999), pp. 166-67.

[12] "Functional Regulation and Financial Modernization," remarks by Mark W. Olson, member of the Federal Reserve Board of Governors, at the annual meeting of the National Conference of Insurance Legislators, Nov. 22, 2003, available at [http://www.federalreserve.gov/boarddocs/speeches/2003/20031122/default.htm], visited April 5, 2004.

[13] Heidi Mandanis Schooner and Michael Taylor, "United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets," *Texas International Law Journal*, vol. 38, spring 2003, pp. 317 et seq.

[14] Lissa L. Broome and Jerry W. Markham, "Banking and Insurance: Before and After the Gramm-Leach-Bliley Act," *Journal of Corporation Law*, vol. 25, summer 2000, pp. 723 et seq.

creating bias.[15] The purpose of this report is not to resolve that question but instead to examine briefly how functional regulation is evolving in practice.

Cooperation

The GLB Act required that state insurance regulators, the Federal Reserve Board, and federal banking regulators coordinate efforts and share information about insurers and affiliated depositary institutions.[16] The National Association of Insurance Commissioners (NAIC)[17] has reported that, as of February 2003, 46 states had signed regulatory cooperation agreements with the Office of Thrift Supervision; 43 states, with the Office of the Comptroller of the Currency; 47 states, with the Federal Deposit Insurance Cooperation, and 38 states, with the Federal Reserve.[18] The NAIC has also consulted with federal banking supervisors "to discuss examination procedures and enhance the development of needed expertise and exchange information with respect to regulatory trends in the financial services marketplace."[19]

The Federal Reserve Board has not itself issued public statements about coordinating with state insurance regulators, though a Governor has reported that the Board has "established very successful partnerships" with the NAIC and individual commissioners "to enhance our mutual understandings of our supervisory frameworks and to facilitate the sharing of supervisory information and consumer complaints."[20] The Board has also established resource centers to monitor developments in the insurance industry and has undertaken cross-training with various state insurance supervisors.[21]

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[15] Peter J. Wallison and Charles W. Calomiris, "The Gramm-Leach-Bliley Act," *Statement of the Shadow Financial Regulatory Committee Meeting: Papers and Studies, Statement No. 174* (Washington: American Enterprise Institute, Dec. 3, 2001), available at [http://www.aei.org/publications/pubID.15942/pub_detail.asp], visited April 5, 2004.

[16] P.L. 106-102, sec. 307, 113 Stat. 1415-17 ("...thereby to improve both the efficiency and quality of supervision ....").

[17] The NAIC is a voluntary association of the chief insurance supervisors of the states and U.S. territories, incorporated in Delaware as a non-profit. It has a 2004 budget of $57.5 million. See [http://www.naic.org/about/2004_budget_highlights.htm], visited April 14, 2004.

[18] National Association of Insurance Commissioners, "Coordinating with Federal Regulators," *Gramm-Leach-Bliley Act: The Statement of Intent — Delivering on a Promise*, available at [http://www.naic.org/GLBA/coordinating_fed.htm], visited April 6, 2004.

[19] Ibid.

[20] Remarks by Mark Olson, supra note 13.

[21] Ibid.

Litigation

On the other hand, state insurance regulators and the Office of the Comptroller of the Currency, which charters and supervises national banks,[22] have not always agreed about who should regulate insurance-related activities of national banks. Their disagreements have involved both the scope of the preemption standard established in the GLB Act and the definition of "insurance." Anticipating such disagreements, the Act provided an expedited judicial review process.[23]

Under that expedited review, the U.S. Supreme Court in October 2003 decided not to review an important decision of the 4th Circuit Court of Appeals.[24] That action left standing the 4th Circuit's decision in *Cline v. Hawke*[25] — in effect, upholding the Comptroller's letter ruling preempting certain provisions of West Virginia's insurance law.[26] Those provisions had imposed some restrictions on bank employees' selling insurance to loan applicants and had required banks to sell insurance in an area separate from its lending and deposit-taking activities.[27] In its letter, the Comptroller had found that those provisions prevented West Virginia banks from cross-marketing effectively and efficiently, therefore significantly interfered with their federally granted power to sell insurance, and were thus preempted.[28] The NAIC had disagreed with that standard of preemption, arguing that the GLB Act had expressly reaffirmed the McCarran-Ferguson Act and codified functional regulation of insurance by the states.[29] Observers generally agree that the effect of this Supreme Court decision and other court cases has been to allow the Comptroller to expand the scope of preemption under the GLB Act.[30]

The Comptroller and state insurance regulators have also disagreed about the definition of "insurance." The longest running dispute has been about whether "debt

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[22] See OCC website at [http://www.occ.treas.gov/].

[23] P.L. 106-102, sec. 304, 113 Stat. 1409-10 ("Expedited and Equalized Dispute Resolution for Federal Regulators").

[24] *Independent Insurance Agents and Brokers of America and National Association of Professional Insurance Agents v. John D. Hawke, Comptroller of the Currency*, U.S. Supreme Court, No. 02-1620, Oct. 6, 2003, available at [http://www.supremecourtus.gov/docket/02-1620.htm], visited March 31, 2004.

[25] 51 Fed. Appx. 391, 2002 WL 31557392 (4th Cir. 2002).

[26] CRS Report RL32197, *Preemption of State Law for National Banks and Their Subsidiaries by the Office of the Comptroller of the Currency*, by (name redacted), pp. 23-24.

[27] U.S. Dept. of the Treasury, Office of the Comptroller of the Currency, "Preemption Opinion," *Federal Register*, vol. 66, no. 195, Oct. 9, 2001, p. 51502.

[28] Ibid., pp. 51508-51512.

[29] Carolyn Johnson-Speck, "Abstracts of Significant Cases," *Journal of Insurance Regulation*, vol. 21, Winter 2002, p. 104.

[30] CRS Report RL32197, *Preemption of State Law for National Banks and Their Subsidiaries by the Office of the Comptroller*, by (name redacted), pp. 24-29.

cancellation contracts" issued by national banks are "insurance."[31] In essence, a debt cancellation contract functions like credit insurance — a borrower pays a fee for a contract (or contractual provision) promising to cancel or pay the loan in the event of some specified event, such as the borrower's death, disability, or unemployment.[32] State insurance regulators have maintained that debt cancellation contracts are insurance and therefore subject to their jurisdiction, even when issued by national banks. The Comptroller has maintained just as steadfastly that debt cancellation contracts are banking products — not insurance — and are therefore not subject to insurance regulation.[33]

The GLB Act attempted to resolve this conflict. Title III of the Act, entitled "Insurance," provided that the "insurance activities of any person ... shall be functionally regulated by the States ...."[34] In the next section, Title III provided an exception for products authorized by the Comptroller as of January 1, 1999.[35] Most — but not all — states have accepted an interpretation of these provisions that excludes their insurance supervisors from regulating debt cancellation contracts.[36] Other states have determined that debt cancellation contracts are insurance, but they have declined to regulate them,[37] particularly after the Comptroller adopted consumer protection rules in 2002 that flatly excluded state regulation.[38]

These disagreements over the scope of "functional regulation" are not academic. They affect the regulatory burdens that attach to particular product designations. In this example, credit insurance is arguably much more regulated than analogous products offered by national banks as debt cancellation contracts.[39] Redefining the coverage as a "banking product" not subject to insurance regulation eases banks' regulatory burdens by

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[31] U.S. Dept. of the Treasury, Office of the Comptroller of the Currency, "Debt Cancellation Contracts and Debt Suspension Agreements," *Federal Register*, vol. 67, no. 182, Sept. 19, 2002, pp. 58902- 58904.

[32] CRS Report RL31454, *Consumer Credit Insurance*, by S. Roy Woodall.

[33] Ibid., pp. 7-10.

[34] P.L. 106-102 sec. 301, 113 Stat. 1407. For the NAIC's interpretation of this provision, see National Association of Insurance Commissioners, *Definition of Insurance: Definition of Insurance Working Group White Paper* (Kansas City, MO: NAIC, 2000).

[35] P.L. 106-102, sec. 302 (b) - (c), 113 Stat. 1407-1408.

[36] CRS Report RL31454, *Consumer Credit Insurance*, by S. Roy Woodall, p. 7.

[37] Audrey Samers, Deputy Superintendent and General Counsel, New York Insurance Dept., "Bank Sales of Debt Suspension Agreements and Debt Cancellation Contracts," Opinion issued April 4, 2003, available at [http://www.ins.state.ny.us/rg030411.htm], visited March 30, 2004; Texas Dept. of Insurance, "Regulatory Position Regarding Debt Cancellation/Suspension Agreements," available at [http://www.tdi.state.tx.us/company/pcckdeb2.html], visited April 16, 2004, and "Review Requirements Checklist: Debt Cancellation Policy," available at [http://www.tdi.state.tx.us/company/pcckdebt.html], visited April 16, 2004.

[38] *Federal Register*, supra note 32, pp. 58902 et seq.

[39] Thomas A. Player, "Regulatory Alchemy: The Conversion of Credit Insurance to Debt Protection," *Insurance, Reinsurance, and Managed Healthcare Review*, Fall 2003, pp. 1, 5 (including a chart comparing the regulatory requirements under both regimes), available at [http://www.mmmlaw.com/industry/insurance/fall_2003.pdf], visited April 16, 2004.

eliminating 50 sets of state insurance requirements.[40] That is a classic example of regulatory arbitrage.[41] At least one federal appellate court has declined to make that decision — *i.e.*, when does regulatory arbitrage exist under the GLB Act's paradigm of "functional regulation."[42]

Conclusion

Representative Oxley, Chairman of the House Committee on Financial Services, has determined to streamline state insurance regulation by imposing federal standards but not federal regulation.[43] Representative Baker, Chairman of the Subcommittee on Capital Markets, Insurance and Government-Sponsored Entities, held a hearing on March 31, 2004, to "craft a middle ground to [insurance regulatory reform] that strives for improvements while retaining the benefits of state-based regulation consumers currently enjoy."[44] Senator Hollings, Ranking Member of the Senate Committee on Commerce, Science, and Transportation has introduced S. 1373, the Insurance Consumer Protection Act, to mandate federal regulation of insurance. It remains to be seen whether such proposed improvements in insurance regulation will improve the operation of the risk transfer marketplace generally in the U.S. or the regulation of insurers as financial intermediaries.[45]

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[40] Beth Climo, James C. Sivon, and James T. McIntyre, letter on behalf of the American Bankers Insurance Association to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, rë Docket No. R01167, Jan. 30, 2004, available at [http://www.federalreserve.gov/SECRS/2004/February/20040205/R-1167/R-1167_114_1.pdf], visited April 16, 2004.

[41] See Peter R. Fisher, Undersecretary for Domestic Finance, U.S. Dept. of Treasury, "The Need to Reduce Regulatory Arbitrage," remarks at the Brooklyn Law School, Sept. 20, 2002, available at [http://www.ustreas.gov/press/releases/po3444.htm], visited April 16, 2004, for a discussion of regulatory arbitrage and the distinction between product regulation and financial supervision.

[42] Bowler v. Hawke, No. 02-1738 (1st Cir., Feb. 13, 2004).

[43] Chairman Michael G. Oxley, "Road Map to State-based Insurance Regulatory Reform," speech to the National Association of Insurance Commissioners, March 14, 2004, (released March 15, 2004), available at [http://financialservices.house.gov/news.asp], visited April 16, 2004.

[44] "Baker Subcommittee To Discuss Insurance Regulatory Reform," Press Release, House Committee on Financial Services, Mar. 30, 2004, available at [http://financialservices.house.gov/news.asp], visited April 16, 2004.

[45] See CRS Report RL32138, *Revising Insurance Regulation: Policy Considerations*, by (name redacted), for a discussion of related issues.