

**WAITING FOR THE SECOND COMING
(OF S.B. 956 IN TEXAS)**

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Introduction

Historically, Texas agent licensing laws (life and property/casualty) have discriminated against three potential competitors of the local independent agent (non-resident agents, corporations and financial institutions) by prohibiting them from obtaining a license altogether¹ or restricting the scope of the license available to them.² A chain of events since the Supreme Court decided *Barnett Bank*³ in April 1996 is moving Texas' once restrictive agent license laws, slowly, but inexorably, to the point where non-resident agents, corporations and banks may obtain life, accident and health ("LAH") and property and casualty ("P&C") agent licenses on an equal footing with resident individuals and their wholly-owned, licensed corporations. A bill enacted by the 76th Legislature in the 1999 Regular Session, S.B. 956, would have addressed all of these differences. The bill, however, was vetoed by Governor George W. Bush at the last minute, throwing Commissioner Jose Montemayor's efforts to comply with the coming reciprocity requirements of financial services reform into chaos.

In recent months however, Commissioner Montemayor has taken bold action to partially address Texas' restrictions with respect to non-resident P&C agents and banks by issuing two significant interpretive bulletins,⁴ discussed more fully below. The impetus for these steps is well-known: the march toward federal enactment of financial services modernization, now known as the Gramm-Leach-Bliley Act (the "Act"), which was enacted by the 106th Congress and signed into law by President Clinton on November 12, 1999.

The Act contains provisions⁵ which effectively mandate reciprocity among the states concerning licensing of the general types of LAH and P&C agents to sell insurance. The underlying assumption is that such reciprocity is required to allow all types of financial institutions covered by the Act to obtain such licenses on an equal footing in each state with all other types of existing insurance agents. Yet, in the face of this impending, sweeping reform, Texas (primarily the independent agents) was slow to accept the inevitable and respond. As late as the 1997 Regular Legislative Session in Texas, the strong restrictions against non-resident agents "soliciting" insurance in Texas (they could purportedly do all other acts of a local agent, such as servicing an account)⁶ were strengthened even further.⁷ Furthermore, even in the face of *Barnett Bank*, although banks and their branches in a "place of 5,000" were allowed to obtain licenses and own insurance agencies located there, they were effectively prohibited from selling insurance in and sharing revenue with branches in places with populations exceeding 5,000 for referral of business to the so-called "small town" branch.⁸

An interim study of Texas' entire agent licensing scheme was mandated by the 75th Texas Legislature in 1997.⁹ It was completed in July 1998 and resulted in the passage of two bills¹⁰ which, together, would have consolidated and reclassified many of the numerous specialty license types and also would have addressed the issues of reciprocity with non-resident agents and equal requirements for corporations and banks. S.B. 957, dealing with certain types of limited "specialty" licenses (i.e., manufactured housing retailers, travel agents, credit, rental car and self-storage facilities), passed and was signed into law by Governor Bush. S.B. 956, which contained a comprehensive re-write of the general lines retail LAH and P&C agent licenses (known in Texas parlance as, respectively, the "Group I Legal Reserve Agent" and the "Local Recording Agent") and which would have permitted general business entities and banks to obtain such licenses on an equal basis with traditional independent agents, also passed. However, it was unexpectedly vetoed by Governor Bush when an obscure but unacceptable provision relating to bail bonds was discovered in S.B. 956 by the Governor's staff after the end of the Session. The veto of S.B. 956 was an enormous shock to all concerned parties, including the Commissioner of Insurance, principally because it would have allowed Texas to join in and sign the NAIC's Declaration of Uniform Treatment ("Declaration")¹¹ as a preemptive strike against the NARAB provisions contained in the version of the Act then pending in Congress calling for a nationally run scheme of agent licensing administered by the NAIC.¹² The final version of the Act still contains these NARAB "default" provisions which take effect in three years if a specified number of states do not adopt the Declaration.

These are the events which led Commissioner Montemayor to issue Bulletin B-0037-99 on July 1, 1999 and Bulletin B-0005-00 on January 18, 2000. These Bulletins, in the normal course of regulatory affairs in Texas, represent quite unusual and bold actions for a Texas Commissioner of Insurance, and, in the author's opinion, should be applauded. They did not, however, address several significant remaining licensing anomalies which would have been cured by S.B. 956, as discussed below.

Bulletin B-0037-99

The intent of Bulletin B-0037-99 is to permit an *individual* non-resident, retail P&C agent with a resident license in a state which (1) has executed the NAIC's Declaration or otherwise waived license requirements which impede compliance with the Declaration and (2) grants reciprocity to Texas resident agents, to obtain the equivalent of an unrestricted Texas resident Local Recording Agent license.¹³

Although this is an admirable step by the Commissioner in Texas, Bulletin B-0037-99 is, quite frankly, based upon an extremely strained interpretation of language in Article 21.11 of the Texas Insurance Code ("Code"). The statutory authority for the Bulletin is Texas Insurance Code Article 21.11, Section 1(b) which provides that a non-resident license applicant "must meet the requirements for issuance of a license under Article 21.14 of this code, except that the department shall *waive any of those license requirements* for an applicant with a valid license from another state or jurisdiction that has license requirements substantially equivalent to those of this state."

The language allowing waiver by the Department of *any* of the license requirements of Article 21.14 of the Code (the resident Local Recording Agent license statute) appears straightforward enough, but completely belies the true legislative intent of the significant amendments to Article 21.11 which were enacted in 1997 to *strengthen* the prohibition against non-resident agents "soliciting" insurance or even having a presence in the State of Texas. This intent can only be gleaned by reading Section 1(b), upon which the Commissioner relies, together with Subsections 2(a) and 2(b) which specifically deny to a non-resident agent the most basic functions of a resident Local Recording Agent, i.e., the rights to: (1) "maintain an office in this state; (2) solicit insurance business in this state by any method, including an oral, written, or *electronic*¹⁴ communication; or (3) employ solicitors or others to directly or indirectly solicit insurance in this state." The changes in the State and national political landscape which permitted the Commissioner to issue Bulletin No. B-0037-00 were obviously powerful and decisive.

It is important to note that Bulletin B-0037-99 does not apply to *non-resident business entities (corporate or partnership)* which are still not allowed to obtain any type of Texas non-resident agent license (LAH or P&C); it applies only to individuals (natural persons). However, the Commissioner will now allow non-resident agents who obtain a "resident" Local Recording Agent license under the Bulletin to own stock in a Texas corporate Local Recording Agency or to be a partner in such a Texas partnership agency. This is an important development for those non-resident agencies which have been forced in the past to *sponsor* the establishment of a Texas corporate Local Recording Agency with a Texas resident agent.¹⁵ (Caveat: the prohibition against the Texas agency sharing commissions directly or indirectly with the sponsoring non-resident agency in connection with any acts defined as those of an insurance agent is still in effect.¹⁶ Thus, the need for a service agreement with the non-resident entity remains.)

Furthermore, Bulletin B-0037-99 does not address in any way the licensing or permissible activities of non-resident LAH agents, either individual or entity. An individual non-resident LAH agent from a state enjoying reciprocity with Texas may obtain a Texas non-resident license¹⁷ which does allow the non-resident to "solicit" insurance in Texas (a big distinction from the pre-Bulletin B-0037-99 non-resident P&C agent). Also, interestingly, and by pure historical interpretation of the Texas Department, non-resident LAH agents may own stock or a partnership interest in a Texas resident Group I corporation or partnership and be an officer and director in such a corporation. However, such a non-resident individual LAH licensee may not "*maintain a place of business*" in Texas.¹⁸ (Query: Does being an officer or partner in a resident Group I agency automatically constitute maintaining a place of business in Texas? Apparently not, according to the Texas Department's interpretation.)

Likewise, Bulletin B-0037-99 does not address the prohibition in Texas law against licensed non-resident LAH entities obtaining any type of license in Texas, non-resident or otherwise. As in the case of non-resident P&C agencies, S.B. 956 would have done away with this prohibition. Therefore, although Bulletin B-0037-99 is a brave effort on

Commissioner Montemayor's part to hasten the advent of agent license reciprocity, Texas is still a long way from implementing complete reciprocity, and establishing a direct insurance agency business in Texas is still very problematic for non-resident business entities.

Bulletin No. B-0005-00

Bulletin B-0005-00 also represents a sea change in Texas' restrictive stance on licensing depository institutions as adopted in the 1997 Regular Session. In the Bulletin, the Commissioner acknowledges that the Act *preempts* the 1997 restrictions which (1) limited the definition of a "bank" to a national bank, a Texas state bank, a Texas state savings bank, and a bank branch or operating subsidiary "located and doing business in this state *in places with a population of 5,000 or less,*" and allowed a bank operating subsidiary located in such a place to own a licensed corporate agency also located and doing business in a place of 5,000 or less;¹⁹ (2) allowed only a licensed bank, bank branch, bank operating subsidiary, on an agency owned by an operating subsidiary, located in the place of 5,000 or less population, to have additional offices in Texas, *but only in other places of 5,000 or less,* and to receive profits from insurance business generated by such licensed bank entities, but only from such business where "conducted only in a place with a population of 5,000 or less."²⁰

The very clear intent of these provisions was to pay lip service to *Barnett Bank* while keeping a tight "place of fewer than 5,000" rein on the functional scope of any actual bank agency activities and profits. The Bulletin, however, sweeps away these prior statutory restrictions, which the Commissioner says, in the opening paragraphs, are preempted by the Act:

On November 12, 1999, the President signed into law an Act which makes significant changes to the delivery of financial services in the U.S. Based on the provisions of the new law, several provisions of the Texas Insurance Code are *preempted* as applied to depository institutions and other affiliated entities who wish to exercise powers granted under federal law to engage in the business of insurance in Texas.

Because I must continue to carry out my responsibility to regulate the sale of insurance in Texas and the Legislature may not have the chance to act on these issues for several months, I believe it is in the public interest to provide interim guidance for the licensing of depository institutions and other affiliated entities as insurance agents in this state.

The Bulletin then goes on to address the specific restrictions which are preempted in each type of general authority agent license in the Code:

1. The definition of a "bank" entitled to licensing (broadened by the Bulletin to include Federal Savings Banks, non-resident state banks, financial holding companies and financial subsidiaries);
2. The provisions which prohibited a bank licensed as an agent from conducting insurance agency business from additional offices in places with a population exceeding 5,000;
3. The provisions which prohibited a bank operating subsidiary from owning a licensed corporate agent located and doing business in a place with a population exceeding 5,000;
4. The required individual licensing of all officers, directors, shareholders, members, managers, and partners;
5. The Texas residency requirement; and
6. The currently required statutory form of organization (corporation, general partnership or limited liability partnership in which all officers, directors, etc., are individually licensed).

The Bulletin stresses that these guidelines are "interim only and do not confer any 'grandfathered' status or 'property' right" in that they may be superseded or terminated (presumably by the Legislature when it convenes again in January 2001).

S.B. 956 All Over Again

With all the pressure applied to the states to conform to Gramm-Leach-Bliley and adopt reciprocity,²¹ and with the memory of the veto of S.B. 956 burning brightly, it is anticipated that no one in the State of Texas will have the temerity (or stupidity) to oppose the coalition bill which the Commissioner has disclosed will be introduced to replace S.B. 956 in the upcoming Regular Legislative Session beginning in January of next year. When (not “if”, as Charlie Brown said of the coming of the Great Pumpkin) that happens, assuming the legislation remains in approximately the same form, full reciprocity will be granted to all lines LAH and P&C licensees, including business entities (both insurance and non-insurance, resident and non-resident). Also, such non-resident businesses, even though themselves unlicensed as an agent, will be able to *own* a Texas-domiciled insurance agency if that is the preferred method of doing business in the state. In addition, the “guidelines” adopted in Bulletin B-0005-00 will be incorporated into the Code carrying forward the same preemption of earlier restrictions on agent licensing of financial institutions. At that point, Texas should be authorized to join fully in the Uniform Treatment Declaration. However, since Texans still hold that we are smarter than most everyone else, do not anticipate that the NAIC’s Producer Licensing Model Act will be adopted anytime soon or that provisions peculiar to this State’s history and culture will not appear (or reappear) in the Texas Insurance Code concerning the licensing of insurance agents in this State. Although the second coming of S.B. 956 next year should be a fairly routine affair, given what happened last time, no one is counting their chickens until the fat lady sings (i.e., Governor Bush, or his successor, has signed the son of S.B. 956 into law).

Endnotes

1. Tex. Ins. Code Ann. Art. 21.14, § 3 (corporations).
2. Tex. Ins. Code Ann. Art. 21.11, § 2 (non-residents).
3. *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996).
4. Commissioner’s Bulletin No. B-0037-99 (Non-resident Individuals). Commissioner’s Bulletin No. B-0005-00 (Depository Institutions).
5. The Gramm-Leach-Bliley Act, §§ 321 to 336 (Establishment of National Association of Registered Agents and Brokers or “NARAB”; preemption of non-conforming state laws).
6. Tex. Attorney General Opinion No. JM-1163.
7. Tex. Ins. Code Ann. Art. 21.11, §§ 1 and 2. When Oklahoma, which had for years been granting full non-resident P&C agent licenses to Texas Local Recording Agents, learned of the non-resident amendments to Article 21.11, it ceased granting reciprocity to such Texas agents. Reciprocity with Oklahoma resumed when Commissioner Montemayor issued Bulletin B-0037-00.
8. Tex. Ins. Code Ann. Art. 21.14, § 3a(5) (Local Recording Agent) and Art. 21.07-a, § 3(b) (Group I Legal Reserve Life, Accident and Health Agent).
9. Tex. Ins. Code Ann. § 21.15-7.
10. S.B. 956 and S.B. 957.
11. See www.irin.org for extensive information on the NAIC’s “uniform treatment project” and a copy of the Declaration itself.
12. *Id.* at Endnote 5.

13. As of April 12, 2000, 39 States had adopted all or parts of the Declaration. The IRIN website reports the status of Texas adoption of the Declaration as follows: "Texas has signed the Uniform Treatment Declaration and is accepting the Uniform Non-Resident Licensing Application for Individual NRs only."
14. Texas is in the process of addressing E-Commerce in insurance, agent licensing and advertising. The Department's current position on those subjects may be found in Commissioner's Bulletin No. B-0012-00. *See also* E-Commerce and Insurance Regulation: A Q & A for Agents and Companies on the Department's website www.tdi.state.tx.us (click on "Agent" or "Company").
15. For non-resident entities (corporations or partnerships), even those holding all-lines LAH and P&C licenses in their state of domicile, Texas law currently bars (1) obtaining *any type* of Texas non-resident license or (2) owning or controlling, directly or indirectly, the stock of or a partnership interest in a licensed Texas agency entity. This prohibition has, over many years, spawned two principal approaches for non-resident agencies desiring to produce insurance business in Texas (LAH or P&C): 1) for P&C only, purchase a Texas "grandfathered" Managing General Agency ("MGA") which at one time cost up to \$300,000, but now runs somewhere in the \$100,000 range and dropping in anticipation of passage of S.B. 956's successor in 2001; such an MGA is a "wholesale" agency which markets P&C business through retail P&C producers and whose shareholders, directors and officers need not be licensed; and 2) through a relationship formed with one or more Texas resident licensed individuals, to assist such resident agent(s) with every aspect of organizing, operating and funding a Texas resident corporate agency (P&C, LAH or both) and installing and selling the desired programs and products which are within the particular expertise of the "sponsoring" non-resident corporate agency in return for certain fees (consulting, administration, license of I.P., etc.) determined as a percentage of premiums produced by the Texas Agency. (*See Solomon v. Greenblatt*, 812 S.W. 2d 7 (Tex. App. - Dallas, no-writ), the only Texas case dealing with the right of a non-licensed person performing "non-insurance" services to receive a percentage of insurance premiums as compensation, which was addressed in an excellent article by FORC members, Tony Schrader and John Hamje in the last issue of the FORC Quarterly Journal of Insurance Law and Regulation.) The "services" provided to the resident agency may not include any services defined by Tex. Ins. Code Ann. Arts. 21.02 or 1.14-1 as the acts of an agent or the business of insurance. Also, unless such services are properly defined and/or "received" outside the State of Texas, Texas' sales tax of 6% on "insurance services" will apply to compensation paid on such service agreements. (Texas Tax Code Section 151.0101(a)(9).) S.B. 956's successor should make these service arrangements and the use of grandfathered MGAs obsolete.
16. Tex. Ins. Code Ann. Art. 21.14, §§ 3a and 4 (Local Recording Agents).
17. Tex. Ins. Code Ann. Art. 21.07-1, § 7.
18. Tex. Ins. Code Ann. Art. 21.07-1, § 7(a)(3).
19. Tex. Ins. Code Ann. Art. 21.07-1, § 1C.
20. Tex. Ins. Code Ann. Arts. 21.07-1, § 3(b) and § 4(f).
21. *See* NAIC's April 13, 2000 News Release, "NAIC Supports Reciprocity and Uniformity in Agent Licensing," at www.naic.org/1news/releases/041200_NAIC_testifies_NARAB.htm.