

# DISPUTE RESOLUTION UNDER THE GRAMM-LEACH-BLILEY ACT

Van R. Mayhall, Jr., Esq.  
Peter A. Kopfinger, Esq.  
Rajini Sharma, Esq.  
(225) 387-4000

## *Introduction*

Enacted into law on November 12, 1999, the Gramm-Leach-Bliley Act (“GLB”) represents a revolution for the financial marketplace. GLB, by repealing the Glass-Steagall Act and amending the Banking Holding Company Act, has eliminated the barriers that previously forced a separation of the banking, securities and the insurance businesses. GLB permits the formation of a single holding company structure, known as a financial holding company (“FHC”), which is authorized to provide a wide range of financial products and services, including insurance, to consumers through affiliated entities.

## *GLB and the Insurance Industry*

GLB is premised upon the concept of “functional regulation.” The Board of Governors of the Federal Reserve System (“Federal Reserve”) is the umbrella regulator of a FHC and its subsidiaries, known as functionally regulated subsidiaries. However, the financial activities conducted by each functionally regulated subsidiary will continue essentially to be regulated by its existing functional regulator. Thus, a functionally regulated subsidiary carrying on the business of insurance will essentially be regulated by its domiciliary state insurance department.<sup>1</sup>

Even though GLB expressly reaffirms the primacy of states to regulate insurance companies pursuant to the mandate of the McCarran-Ferguson Act,<sup>2</sup> there is significant overlap between the scope of the authority of the Federal Reserve and that of state regulators. There are several provisions in GLB which recognize the Federal Reserve’s authority to take certain actions against, or with respect to insurance companies which are functionally regulated subsidiaries. For instance, GLB authorizes the Federal Reserve to impose restrictions or regulate relationships or transactions between a bank and its affiliated insurance company if the Federal Reserve determines that the restrictions or requirements are consistent with the purposes of GLB and other federal banking laws and are appropriate to prevent an evasion of any such law or to avoid significant risk to the safety and soundness of banks or any federal deposit insurance fund or other adverse effects.<sup>3</sup> Further, the Federal Reserve has authority to take action against or with respect to a functionally regulated subsidiary to prevent or redress an unsafe or unsound practice or breach of fiduciary duty by such subsidiary that poses a material risk to the financial safety, soundness, or stability of an affiliated bank or the domestic or international payment system where it is not reasonably possible to effectively protect against the said risk through action directed against the affiliated bank.<sup>4</sup>

There is no doubt that these and other similar provisions in GLB will raise serious conflicts and disagreements between the Federal Reserve (whose objective is to protect the affiliated bank and its deposit holders) and the state insurance regulator (whose primary objective is the protection of policyholders) in the event a FHC (with bank and insurance subsidiaries) becomes financially troubled. Similar disputes may arise with respect to other functional regulators such as the Office of the Comptroller of the Currency (“OCC”), the FDIC and the Securities and Exchange Commission, among others. GLB recognizes the possibility of disputes and disagreements between federal and state insurance regulators and provides for an expedited dispute resolution mechanism under Section 304. This article focuses on this dispute resolution mechanism and the standard of the court’s review.

## *Dispute Resolution and Standard of Review*

Under Section 304, either the state or federal regulator may file for expedited judicial review in the case of a regulatory conflict involving insurance issues. The jurisdiction to hear such petitions vests in the Court of Appeals for the Federal Circuit of the state where the dispute arises or in the United States Court of Appeals for the District of Columbia circuit.<sup>5</sup> Such a petition challenging an order, ruling, determination, or other action of a federal regulator or state insurance regulator must be filed within twelve months of such order, ruling, determination or action becoming final, or within six

months from the effective date thereof, whichever is later.<sup>6</sup> The Court shall make a decision within sixty days of filing of the petition, subject to extension by agreement of all parties.<sup>7</sup> Disputes subject to the expedited dispute resolution process include a determination of whether a state law, rule, regulation, order, or interpretation regarding any insurance sales or solicitation activity is preempted by federal law.<sup>8</sup> A request for certiorari to the United States Supreme Court must be filed as soon as practicable after the Court of Appeals' judgment is issued.<sup>9</sup>

Generally, the standard of review is neutral, meaning the Court must decide the dispute on the merits after considering all relevant federal and state law "without unequal deference" (hereinafter referred to as the "Without Unequal Deference Standard") to either.<sup>10</sup> The Without Unequal Deference Standard suggests that the Court, in deciding a case, must give equal weight to state and federal law. The Without Unequal Deference Standard of review attempts to eliminate the "deference advantage" the OCC and other federal agencies have enjoyed in prior litigation. Examples of the "deference advantage" are found in the following three United States Supreme Court cases where deference was given to a federal agency: *Nations Bank v. Variable Annuity Life Ins. Co.*,<sup>11</sup> (OCC deference), *Chevron U.S.A. Inc. v. Natural Resources Defense Council*,<sup>12</sup> (EPA deference), and *Barnett Bank v. Nelson*.<sup>13</sup> (OCC deference). (The standard applied in the above cases is hereinafter referred to as the "Deference Standard.") The Without Unequal Deference Standard is thought to be designed to put the state insurance regulators on a more level playing field.

Unfortunately, the Without Unequal Deference Standard does not apply in all situations. In many cases GLB requires the imposition of the Deference Standard of review. Importantly, Section 104(d)(2)(C)(i) of GLB provides that the Without Unequal Deference Standard does not apply with respect to any "State statute, regulation, order, interpretation, or other action regarding insurance sales, solicitation, or cross marketing activities described in subparagraph (A) that was issued, adopted, or enacted before September 3, 1998, and that is not described in subparagraph (B)."

Subparagraph (A) of Section 104(d)(2)<sup>14</sup> establishes a general preemption framework with respect to certain insurance activities based on the preemption standards set forth in *Barnett Bank*,<sup>15</sup> (*i.e.*, preemption of state laws that prevent or significantly interfere/restrict powers granted to national banks by Congress). Subparagraph (B) of the said Section carves out certain "safe harbor" exceptions which provide protection to state laws from federal preemption. The "safe harbor" exceptions take the form of thirteen enumerated exceptions,<sup>16</sup> as well as other "restrictions that are substantially the same as but no more burdensome or restrictive" than the thirteen listed exceptions.

What this means is that the Deference Standard will apply to any state laws or regulations regarding insurance sales, solicitation, and cross-marketing activities issued or adopted before September 3, 1998, and which are not covered by the safe harbor exceptions. While not entirely free from doubt, by implication, the Without Unequal Deference Standard will apply to any state laws or regulations regarding insurance sales, solicitation, and cross-marketing activities issued or adopted after September 3, 1998, as well as state laws enacted pursuant to the safe harbor exceptions.

The differing standards reflect a number of compromises between state and federal interests. Distilled, the results are as follows: where applicable,<sup>17</sup> the utilization by the courts of the Without Unequal Deference Standard should be generally favorable to the states and state regulators; and the residual applicability of the Deference Standard to pre-September 3, 1998 statutes, regulations, etc. not covered by the safe harbor exceptions must be viewed as favorable to federal interests and federal regulators.

### ***Conclusion***

Where the Without Unequal Deference Standard leaves us is a little unclear. The new standard has a nice sound, but the real question is whether it will ring true. Both state and federal parties will attempt to persuade the courts that their respective position is the better one. The courts are now left with the struggle of applying the new standard in practice in the face of an actual justiciable controversy, without the appearance of deference. Moreover, the exact roles of the Deference Standard, the Without Unequal Deference Standard, federal preemption, as well as the McCarran-Ferguson Act, overlaid on the September 3, 1998 date, will take time and case law to iron out.

There are other uncertainties surrounding Section 304. The Section is confined to disputes between state and federal regulators regarding "insurance issues." It is unclear from reading Section 304 whether a state Insurance Commissioner acting in his capacity as a receiver is included with the term "regulator."<sup>18</sup> Will the process of determining the answer to that question be subject to the Without Unequal Deference Standard? This is all uncharted territory.

Moreover, the answer to some of these questions could affect the strategy associated with and results of various controversies. If Section 304 is interpreted to include an Insurance Commissioner acting in his capacity as a receiver, both state and federal “regulators,” including the Insurance Commissioner as receiver, will have access to the dispute resolution provisions of Section 304 utilizing the Without Unequal Deference Standard. In effect, even with respect to receivership and liquidation issues where the Commissioner is acting as receiver, Section 304 could be interpreted to apply bringing with it the benefits of leveling the “deference” playing field in certain instances. On the other hand, such an interpretation could have the effect of removing liquidation disputes from the liquidation court which has always been thought to be the main stay of interpretation in such matters. Such a movement away from the liquidation court, generally a state court, could be viewed as unfavorable to state insurance regulators even though the Without Unequal Deference Standard would apply in the federal forum under Section 304. Conversely, if Section 304 is interpreted to be limited to state and federal regulators acting solely in their capacity as regulators and not as receivers, the primacy of the liquidation courts would be preserved. However, in contests between state and federal regulators in such courts on some issues, the Deference Standard might be applied since the Without Unequal Deference Standard is only applicable in disputes resolved under Section 304. There is no clear resolution in the case law as to whether an Insurance Commissioner acting as a receiver is a regulator and vice versa. There are cases that may be interpreted to support each point of view.<sup>18</sup> This is simply another of the many issues in the dispute resolution area that will have to be resolved in the future.

#### *Endnotes*

1. Section 104.
2. *Id.*
3. Section 114(b).
4. Section 113.
5. Section 304(a).
6. Section 304(d).
7. Section 304(b).
8. Section 304(a).
9. Section 304(c).
10. Section 304(e).
11. 513 U.S. 251, 115 S.Ct.810, 130 L.Ed.2d 740 (1995).
12. 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984).
13. 517 U.S. 25, 116 S.Ct. 1103, 134 L.Ed.2d 237 (1996).
14. Section 104(d)(2)(A) states: “In accordance with the legal standards for preemption set forth in the decision of *Barnett Bank of Marion County N.A. v. Nelson*, 517 U.S. 25 (1996), no State may, by statute, regulation, order, interpretation, or other action, prevent or significantly interfere with the ability of a depository institution, or an affiliate thereof, to engage directly or indirectly, either by itself or in conjunction with an affiliate or any other person, in any insurance sales, solicitation, or cross-marketing activity.”
15. *Supra.*
16. The thirteen exceptions that permit States to restrict certain insurance related practices are paraphrased as follows:

(1) restrictions prohibiting the rejection of an insurance policy solely because the policy was issued or underwritten by an unaffiliated entity when insurance is required in connection with a loan or extension of credit; (2) restrictions prohibiting a requirement for a debtor, insurer, insurance agent, or broker to pay a separate charge in connection with the handling of insurance required with a loan or extension of credit, or other banking products unless the charge would be required when the depository institution or affiliate serves as the licensed insurance agent or broker providing the insurance; (3) restrictions prohibiting misleading advertising that would cause a reasonable person to believe that the state or federal government is responsible for the insurance, stands behind the insurance, or guarantees any returns on the insurance products or is a source of payment; (4) restrictions prohibiting the payment or receipt of commissions or broker fees to any person unless such person holds a valid state license as an insurance agent or broker; (5) restrictions prohibiting the payment of compensation to a person who is not licensed to sell insurance for a referral if the referral is based on the purchase of insurance by the customer; (6) restrictions prohibiting the release of insurance information of a customer to any person other than an officer, director, employee, agent or affiliate of the depository institution, for the purpose of soliciting or selling insurance, without the express consent of the customer; (7) restrictions prohibiting the use of health information obtained from insurance records of a customer for any purpose, other than for insurance activities; (8) restrictions prohibiting the extension of credit, lease, or sale of property or furnishing of services or the fixing or varying of consideration for any of the foregoing, on the condition that the customer purchase insurance from the depository institution, affiliate or a particular insurer; (9) restrictions requiring that depository institutions provide written disclosures to customers indicating that a customer's choice of insurance providers will not affect the credit decision or terms of credit of the depository institution; (10) restrictions requiring clear and conspicuous disclosure, in writing, where practicable, to customers prior to the sale of insurance that the insurance is not a deposit, not insured by the FDIC, not guaranteed by the depository institution or its affiliate, and where appropriate, involves investment risk, including loss of principal; (11) restrictions requiring that the insurance and credit transactions be completed through separate documentation; (12) restrictions requiring that the expense of the insurance premiums shall not be included in the primary credit transaction without the express written consent of the customer; and (13) restriction requiring that the depository institution maintain separate and distinct books and records for insurance activities, which must be made available to the state insurance regulator for inspection upon reasonable notice.

17. Generally to post-September 3, 1998 statutes, regulations, etc., and to the thirteen reserved exceptions (see endnote 16).
18. There are opposing views. Some courts, including the Louisiana Supreme Court, have held that the Insurance Commissioner, in his capacity as a liquidator or receiver, acts as an officer of the state in a public capacity. See for e.g. *State v. Preferred Accident Ins. Co. of New York*, 115 So.2d 384 (1959) and *El Paso Elec. Co. v. Texas Dept. of Ins.*, 937 S.W.2d 432 (Tex. 1996). However, other courts have created a distinction between an Insurance Commissioner's role as a regulator and as a receiver, and have held that a state Insurance Commissioner is not acting as a regulator when serving in the capacity of a liquidator. See for e.g. *In re Liquidation of Ideal Mut. Ins. Co.*, 532 N.Y.S. 2d 371 (1988) and *Crawford v. Employers Reins. Co.*, 896 F. Supp. 1101 (W.D. Okla. 1995). A third "hybrid" position was espoused by the Supreme Court of New Jersey in *In re Liquidation of Integrity Ins. Co.*, 754 A.2d 1177 (N.J. Jul 26, 2000). The Court held that the Insurance Commissioner, when overseeing the liquidation of an insolvent insurer, functioned in a hybrid status, part public and part private.