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"DISHONESTY OR BREACH OF TRUST" IN 18 U.S.C. 1033: ARE YOU CRIMINALLY LIABLE ON THE BASIS OF AN ASSOCIATE'S RECORD?,

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In a previous article in this *Journal*,¹ S. David Childers and Christy A. Chism issued a cogent warning to insurance professionals about the implications of the insurance provisions of the 1994 Crime Bill.² After nearly a year, nothing has occurred to allay their concerns about the statute and its regulatory impact. The article concentrates on subsection (e) of the newly-enacted 18 U.S.C. 1033 and continues to sound the insurance regulatory bar's alarm to insurance professionals.

Subsection (e) of section 1033 makes it a federal crime for a person to engage in the business of insurance—or to "willfully permit[]" *another* person to engage in the business of insurance—if the person has been convicted of "any criminal felony involving dishonesty or a breach of trust" or of "an offense under this section," *unless* the person has received the written consent of "any insurance regulatory official authorized to regulate the insurer, which consent specifically refers to this subsection." This statute provides for a prison sentence of up to and including five (5) years for anyone who works in the insurance industry, or "willfully permits" another to work in it, in violation of this subsection.

Overview

Subsection (e) of section 1033 creates the potential for a lifetime of exposure to criminal liability in the business of insurance, if not actual exclusion from it. It applies to anyone who has a felony conviction "involving dishonesty or breach of trust." Although subsection (e) provides for one means of lifting this disability, it exposes the person with the disability to serious criminal liability whenever his or her company merges or expands.

Legislative History

A. Pre-existing Legislation. Sections 1033 and 1034 are new enactments rather than amendments to pre-existing sections of Title 18. Congress added it to the end of the chapter of Title 18 on "Fraud and False Statements."

B. Impetus for this Legislation. Section 1033's proscription of former felons was a relatively minor part of a larger bill, H.R. 665. The bill was aimed at fraud by insurance executives.

1. Representative John Dingle was the principal sponsor within Congress. In his capacity as Chairman of the Oversight and Investigations Subcommittee of the House Energy and Commerce Committee, Congressman Dingle conducted hearings over five to six years that H.R. 665 reflected. As he observed on the floor of the House:

(a) In February 1990, the subcommittee focused public attention on the need for Federal criminal legislation with its report, "Failed Promises." In this report, the subcommittee examined four major insurance company failures and concluded that existing State remedies were

company failures and concluded that existing State remedies were ineffective against the fraudulent behaviors that drove these companies into insolvency:

[M]ost people involved with obvious wrongdoing at insolvent insurance companies simply walk away with no real investigation of their activities. Many of them continue to be active in the insurance business.

(b) The subcommittee also found that:

Federal enforcement efforts are greatly restricted because looting an insurance company is not itself a Federal crime, and the 5-year statute of limitations on mail and wire fraud has often run out before a case can be successfully developed.

Congressman Dingle enlisted the Chairman of the House Judiciary Committee, Jack Brooks, as a co-sponsor for H.R. 665.

2. The National Association of Insurance Commissioners (NAIC) was a principal advocate for the statute outside Congress. In the "NAIC Guidelines,"³ the Antifraud Special Issues Committee of the NAIC indicated that "[t]he NAIC had been proposing legislation like this to members of Congress since April 1991."⁴ It explained that "[t]he NAIC originally proposed this type of Federal insurance fraud statute because of the power of the Federal government to bring additional jurisdictional, investigatory and law enforcement resources to bear in combating insurance fraud."⁵ Although the criminal jurisdiction the subsection invokes is federal, the subsection authorizes state regulators—such as the members of NAIC—to grant dispensations.

3. The statute had additional industry support. The House Judiciary Committee Report lists "the National Conference of State Legislators, the National Association of Casualty and Surety Agents, the National Association of Professional Agents, and the National Association of Mutual Insurance Companies" as joining the NAIC in "call[ing] on Congress for a Federal criminal statute to help insurance regulators deal with interstate insurance fraud schemes."

Summary and Discussion of the Text of 18 U.S.C. 1033

A. Substantive provisions of sections 1033 and 1034. Subsections (a)-(d) of section 1033 of Title 18 of the United States Code create four (4) substantive crimes involving the business of insurance:

- Making false statements or reports to insurance regulators—including overvaluing assets—for the purpose of affecting the regulators' decisions.
- Making false entries in books, reports, or statements with the intent to deceive anyone about an insurance company's financial condition or solvency.
- Embezzling from anyone else who is engaged in the business of insurance.
- Using threats or force or "any threatening letter or communication to corruptly influence, obstruct, or impede" insurance regulatory proceedings.

For any of these substantive offenses, section 1033 provides for imprisonment up to and including ten (10) years. If the conduct in question "jeopardized the safety and soundness of an insurer and was a significant cause of such insurer being placed in conservation, rehabilitation or liquidation," the imprisonment can extend to fifteen (15) years. In either event, the punishment may include a fine.

Section 1034 allows the Attorney General of the United States to seek civil penalties for the conduct that section 1033 denounces, on a showing by a preponderance of the evidence rather than the criminal-law standard of proof beyond a reasonable doubt. Under section 1034, the Attorney General may seek an "order" directing any person to desist from engaging in conduct that amounts to a violation of any provision of section 1034.

B. Key language in the criminal section, 1033.

1. "[F]elony conviction involving dishonesty or breach of trust." As the NAIC Guidelines point out, Congress took this language from "several Federal statutes, including provisions relating to Federally insured banks, savings and loans, credit unions, the farm credit system, small business investment companies, and the rural business investment fund."⁶ The principal statutes that include this language are 12 U.S.C. 1818(g) & 1829. The Guidelines point out, as well, that in one case construing the same language in another statute, *Feinberg v. FDIC*,⁷ a federal court held that the federal agency could determine whether a conviction fell within the statutory language.⁸

From this, the NAIC Guidelines draw the inference that each state Insurance Commissioner has the discretion to decide whether a conviction was for a felony "involving dishonesty or breach of trust." On the theory that the NAIC Guidelines advance, a state Insurance Commissioner's decision that a given offense "involve[d] dishonesty or breach of trust" would be reviewable in the judicial courts only for "arbitrary or capricious" determinations.⁹

Another way of viewing the trigger language is, of course, as federal law to be construed by the federal courts. In order to give an objective, principled, predictable meaning to the phrase "involving dishonesty or breach of trust," one could look to the facts of the cases decided under the pre-existing statutes with identical language. A difficulty with this approach is that there are few such cases. In one, *FDIC v. Mallen*,¹⁰ a federal district court considered an application for preliminary injunction; it appeared to take it for granted that "dishonesty or breach of trust" in 12 U.S.C. 1818(g) includes making a false statement in a financial statement for the purpose of influencing the actions of the FDIC¹¹ and making a false statement to a federal agency.¹² Of course, violations of the relevant bank fraud statutes would be parallel to violations of the substantive insurance-fraud offenses in subsections (a)-(d) of section 1033.

Both banks and insurance companies hold and manage money for the public. Like the banking reform statutes of the "New Deal," section 1033 exists as a response to the need for public confidence in the persons these institutions appoint to handle their assets.

The NAIC Guidelines continue to cite the subsequent district-court decision in *Mallen* without noting that the Supreme Court had reversed it.¹³ This reversal did not affect the previous district court decision defining "dishonesty or breach of trust" by reference to the remainder of the federal banking regulatory statutes rather than inviting subjective constructions of these terms as predicates for regulatory power.

In giving content to this critical phrase, one may therefore look to the substantive subsections of section 1033 itself. Is the past offense of an applicant *like* the specific offenses Congress addressed in enacting this statute?

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In their article in this *Journal*,¹⁴ Childers and Chism argue for a complementary narrowing construction of the statute. They point out that the legislative history suggests a substantive scope limited to insurance fraud:

The legislative history of the Fraud Act suggests that the intent of the statute was to protect against white collar insurance fraud and to abate the rising number of insurance insolvencies. When drafted, the provisions of subsection (e) of the statute were apparently specifically aimed at those individuals who had been previously involved in an insurance fraud scheme and were migrating to other insurance companies and repeating their actions. In fact, the Judiciary Committee Report on the law stated:

Under present laws, all too often the perpetrators of fraud and deceptive practices in the insurance field not only are able to carry out their schemes with impunity, but—equally troubling—they move on to another insurance company to inflict still more harm to the good name of the industry. Insurance fraud frequently involves complex "paper trails." . . .¹⁵

Childers and Chism criticize the breadth with which the NAIC Guidelines would apply the statute.¹⁶

2. "[A]ny insurance regulatory official authorized to regulate the insurer." Read by itself—as Congress passed it—this language authorizing an insurance regulator to give a convicted felon permission to work in the insurance industry says that "any" insurance regulator who has the authority to regulate "the insurer" may do so. Paragraph (2) of subsection (f) defines the "insurer" to include *both* an entity employing the person with the conviction *and* the person himself or herself.

Going only from the text, therefore, one would be drawn to the conclusion that if a person with a felony conviction were an officer or employee of an insurance company doing business in all fifty states, the Insurance Commissioner of any state could give him or her written permission to engage in the business of insurance in all fifty states. Under the common-law and constitutional rule that penal statutes must be strictly construed against the sovereign and in favor of the accused citizen, insurance professionals with old criminal convictions are entitled to this reading of the word "any" in subsection (e).

Not so, say the NAIC Guidelines. A majority of the "working group" which prepared the NAIC Guidelines "felt that it could not have been the intent of Congress to allow one state to extend its statutory power into other jurisdictions or to bind Federal prosecutors from initiating actions against prohibited persons who are conducting insurance business in various jurisdictions."¹⁷ Although the NAIC Guidelines do not insist that an insurance professional with a felony conviction obtain "written consent" from the regulators in *all* jurisdictions in which his or her company does business, they assert that NAIC members should adopt "Standards of Review" under which the *regulators* will decide where an insurance professional with a felony conviction must apply for "written consent," and that if the Commissioner in the jurisdiction the regulators deem most appropriate turns down the application, the person would not be able to engage in the business of insurance in any jurisdiction.¹⁸

Childers and Chism criticize the NAIC Guidelines in detail, and suggest yet another reading of the statute: that it may require an insurance professional to obtain written consent in every jurisdiction in which his or her company does business.¹⁹ They observe that at the time of their article (December 1997), no jurisdiction had adopted rules and regulations to counsel the insurance professional with a felony conviction as to how he or she may obtain definitive relief from the statute even in a state where he or she is definitely subject to insurance regulation.²⁰

Available Remedies for Affected Individuals

A. Exemption Process in Statute. Paragraph (2) of subsection (e) provides that a person whom paragraph (1) bars from the business of insurance may engage in it "if such person has the written consent of any insurance regulatory official authorized to regulate the insurer, which consent specifically refers to this subsection."

As the discussion of the text indicates, there is a broad range of opinion about *who* may give "written consent" under this provision. If the NAIC members adopt the NAIC Guidelines, an insurance professional with a criminal conviction in his or her past will be forced into a forum not of his or her choosing, with the state regulator's determination reviewable only under a highly deferential standard. Such a remedy could result in numerous qualified applicants being denied the right to practice their profession without the need for contentious and expensive litigation just to obtain a federal forum to raise their claims arising under Federal law.

B. Pardon. The NAIC Guidelines appear to understate the effect that a pardon has of removing an insurance professional from subsection (e)'s prohibition:

While not discussed in more detail in these Guidelines, the granting of a State and/or Presidential pardon may affect whether an individual is a prohibited person under these statutes. When confronted with an applicant who has received a pardon, Commissioners should consult applicable State or Federal law to determine its impact.²¹

But the general rule is that *a pardon removes the need for even asking the question.*

Under subsection (e), the disqualification depends on the existence of the conviction. It would be a different case if, instead of making a conviction a disqualifying fact and requiring the convicted person to seek regulatory override if a conviction exists, the statute had made "a good reputation for honesty, integrity and fair dealing" an affirmative requirement for engaging in a given profession or occupation and had committed to a regulator the decision whether an individual possessed such a reputation. In *Stone v. Oklahoma Real Estate Commission*,²² an applicant for a realtor's license had experienced numerous state and federal arrests and convictions and had received a pardon for two (2) of his State offenses. The real estate commission and the trial court found that the two pardons did not give the applicant the good reputation the statute required. On these facts, the Oklahoma Supreme Court affirmed, holding that a pardon "does not substitute a good reputation for one that is bad." It also relied on the fact that the Oklahoma Governor's pardon left an Oklahoma robbery conviction and a federal felony conviction intact.²³

The case would also be different if the law left to a public officer "broad discretion" to appoint or refuse to appoint staff based, in part, on the officer's evaluation of their moral character. In *Commissioner of the Metropolitan District Commission v. Director of Civil Service*,²⁴ for example, the court held that a pardon was neither here nor there with respect to the hiring officer's discretion, unless it specifies that the President or the Governor granted the pardon because the applicant was innocent of the offense.

The effect of a state pardon for a state offense may, in principle, vary from state to state. In fact, cases on the construction of pardons are few and far between and are an active area in which the states develop common law by citing each other's decisions. Pardons are no exception to the Full Faith and Credit Clause, U.S. Const. art. IV, 1, in that a regulator of one state must give effect to another state's executive's pardon

U.S. Const. art. IV, 1, in that a regulator of one state must give effect to another state's executive's pardon of an offense against the laws of the pardoning state. Once the insurance professional established that he or she had been pardoned by the state whose laws he or she had been convicted of violating, the regulator would have no cause to inquire into the application of subsection (e).

A pardon is not only a definitive means of overcoming the proscription of subsection (e), but also has several independent advantages over regulatory action under paragraph (3) of that subsection. Insurance executives are frequently called as witnesses in regulatory proceedings and in litigation. A pardon on grounds that the executive has been rehabilitated or that he or she was innocent of the offense in the first place makes the conviction inadmissible under Fed. R. Evid. 609. In addition, a pardon removes the conviction as a disqualification under any state statute analogous to subsection (e) that makes the existence of a conviction a bar to engaging in the business of insurance.

In light of the well-weathered law of pardons—and the *general* benefits of a pardon to the insurance professional with an old criminal conviction—the pardon process is to be preferred to the paragraph (3) process that subsection (e) provides and that the NAIC Guidelines seek to control.

Conclusion

This article has covered only a few of the issues that subsection (e) raises for the insurance industry. Although the most immediate problem may appear to arise for the individual insurance professional with a felony conviction, the provision attributing criminal liability to one who employs such a person creates company-wide problems. At what point can the leadership and the legal counsel of an insurance company rest assured that they cannot be prosecuted for employing someone with a felony record? What may they do to avoid such trouble consistently with the rights of agents, brokers, and other line officers and employees of their companies?

At the December 1998 FORC meeting in Orlando, two (2) of the authors of this article will join with a NAIC Working Group member to elucidate a wider range of issues surrounding the enactment of section 1033, including subsection (e).

Endnotes

1. S. David Childers & Christy A. Chism, "The Extraordinary Scope and Potential Regulatory Pitfalls of the Insurance Fraud Protection Act," FORC Quarterly Journal of Insurance Law & Regulation, Vol. IX, Ed. IV, Dec. 7, 1997, pp. 1, 3-7. ("Extraordinary Scope").
2. P.L. 103-322, ____ Stat. ____ (approved Sept. 13, 1994).
3. "Guidelines for State Insurance Regulators to the Violent Crime Control and Law Enforcement Act of 1994: 18 United States Code Sections 1033 and 1034—December 1997," (draft of Dec. 8, 1997).
4. *Id.* at 4.
5. *Id.* at 5.
6. *Id.* at 24.
7. 420 F.Supp. 109, 116 (D.D.C. 1976).
8. NAIC Guidelines at 24.
9. *Id.* at 24-25.

10. 661 F.Supp. 1003, 1006 (N.D. Iowa 1987)(Hansen, J.).
11. 18 U.S.C. 1014.
12. 18 U.S.C. 1001.
13. *FDIC v. Mallen*, 486 U.S. 230 (1988), *rev'g*, *Mallen v. FDIC*, 667 F.Supp. 652 (N.D. Iowa)(O'Brien, C.J.).
14. "Extraordinary Scope" at 1 & 3-6.
15. *Id.* at 4, citing House Energy and Commerce Subcommittee on Oversight and Investigations, 101st Cong., "Failed Promises: Insurance Company Insolvencies 5," (Comm. Print 1990); and House Judiciary Comm., 103d Cong., "Report on Insurance Fraud Protection Act of 1994," (1994).
16. *Id.* at 4.
17. NAIC Guidelines at 13.
18. *Id.* at 14.
19. "Extraordinary Scope" at 4.
20. *Id.* at 5.
21. NAIC Guidelines at 10.
22. 369 P.2d 642, 644 (Okla. 1962)(*per curiam*).
23. *Id.* at 645.
24. 348 Mass. 184, 203 N.E.2d 95 (1964).
25. 348 Mass. at 195, 197; 203 N.E.2d at 102, 103.