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THE FEDERAL INSURANCE ANTIFRAUD STATUTE

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Are you guilty of a felony under The Violent Crime Control Law Enforcement Act of 1994? Is your client insurance company, agency, accounting firm, actuarial firm, or other service provider to the business of insurance in violation of this statute? The NAIC Antifraud Task Force found the application of this statute to be very broad. Indeed, the extent of its possible interpretation and its lack of clarity are troubling. This federal statute, in essence, provides that anyone engaging or participating in the business of insurance in any capacity who has been convicted at any time of a criminal felony involving dishonesty, or any individual in the business of insurance who willfully permits such participation, shall be fined or imprisoned, or both. The "business of insurance" not only means the writing of insurance, or the reinsuring of risks by an insurer, but includes all acts necessary or incidental to such writing or reinsuring and the activities of persons who are officers, directors, agents, or employees of insurers, or other persons authorized to act on behalf of such persons. Any person with such a felony conviction (a "prohibited person") may seek an exemption from the state insurance regulator.¹

A working group of the Antifraud (E) Task Force of the NAIC has provided a resource guide (the "Guidelines") for all insurance regulators regarding this statute and their responsibility to respond to requests from prohibited persons. The Guidelines which were adopted in March 1998 will be supplemented in early 1999. A training session is scheduled for December 5, 1998, at the NAIC Winter National Meeting to provide a general overview of the concepts, principles and procedures developed by the Antifraud (E) Task Force. The purpose is to provide suggestions to insurers (and others at risk of violating the statute) and to assist Commissioners and regulators regarding their obligations created by the statute and anticipated use of the statute by federal prosecutors.

While the Guidelines attempt to provide some specificity and clarity, they expressly disclaim any authority to define the law or to create administrative or procedural requirements for state regulations. State regulators, who have been delegated the authority under the statute to establish administrative process for the consideration of exemptions, have the implied authority to interpret the provisions of the statute necessarily involved in the delegated authority. Outside of this delegation of authority, however, the interpretation of the statute by a state regulator is entitled to no deference under the law.²

The Violent Crime Control and Law Enforcement Act of 1994 was enacted for the purpose of controlling insurance fraud activities involving interstate commerce. As stated in the Guidelines: "The NAIC originally proposed this type of insurance fraud law because of the power of the federal government to bring additional jurisdictional, investigatory and law enforcement resources to bear in combating insurance fraud." A federal statutory basis was required to allow federal law enforcement agencies to assist the state insurance departments in so doing.³ The provisions of Section 1033(a)-(d) deal with conduct in the business of insurance involving false reporting, embezzlements, misappropriation and the like. The subject of this article, Section 1033(e), leaps beyond such direct antifraud provisions and, as noted in a prior article, beyond the apparent legislative intent found in Congressional subcommittee reports.⁴

Section 1033(e), with key words italicized, is quoted as follows:

(e)(1)(A) Any individual who has been *convicted of any criminal felony involving dishonesty or a breach of trust*, or who has been convicted of an offense under this section, and *who willfully engages in the business of insurance* whose activities affect interstate commerce or *participates in such business*, shall be fined as provided in this

interstate commerce or *participates in such business*, shall be fined as provided in this title or imprisoned not more than 5 years, or both.

(B) Any individual who is engaged in the business of insurance whose activities affect interstate commerce and who *willfully permits the participation* described in subparagraph (A) shall be fined as provided in this title or imprisoned not more than 5 years, or both.

(2) A person described in paragraph (1)(A) may engage in the business of insurance or participate in such business if such person has the *written consent of any insurance regulatory official authorized to regulate the insurer*, which consent specifically refers to this subsection."

The questions arising from these key words are:

- What is "convicted of any criminal felony involving dishonesty or breach of trust"?
- What does "willfully engages in the business of insurance . . . or participates in such business" mean?
- Who is an individual engaged in the business of insurance "who willfully permits the participation" of a prohibited person in the business of insurance?
- What "written consent of any insurance regulatory official authorized to regulate the insurer" will provide the necessary exemption to avoid the crime created by this statute?

What is "convicted of any criminal felony involving dishonesty or breach of trust"?

Criminal felony may be either a state or federal conviction. The Guidelines point out that a "deferred adjudication" is not a conviction, and a conviction on appeal, though not a final judgment, is such a conviction. There is no time limit, statute of limitations or "grandfather provision" with respect to any such criminal conviction. The statute relates back to the earliest time a person may be subject to a criminal felony conviction. There is federal and statute authority dealing with both federal and state convictions involving the definitions of dishonesty, breach of trust, or other similar descriptions. The Guidelines note that some federal courts seem to apply a "you know it when you see it" to the dishonesty test and refer to authorities using words such as "perjury or subordination of perjury, false statement, criminal fraud, embezzlement, or false pretense or any other offense which involves some element of deceit, untruthfulness, or falsification."⁵

What does "willfully engages in the business of insurance . . . or participates in such business" mean?

The Guidelines say: "There appears to be no limitation or restrictions . . . as to which persons are covered so long as those persons are engaged in, or participate in, the "business of insurance" – a term broadly defined by Section 1033 . . ."⁶

The statute defines the "business of insurance" as "the writing of insurance or the reinsuring of risks, by an insurer, including all acts necessary or incidental to such writing or reinsuring and the activities of persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons " This latter group of "other persons," according to the Guidelines, appears to include any subcontractors, third party administrators, consultants, professionals and the like."⁷

What is the significance of the statute's reference to both anyone who "engages in the business of insurance" and who "participates in such business"? Since "participates in such business" is stated separately from the term "engages in the business of insurance," it is assumed by the Guidelines that "participation" is broader than merely engaging in the business of insurance. The Guidelines suggest that the broad sweep of this subsection includes any person who receives compensation or remuneration from such insurance business.⁸

Who is an individual engaged in the business of insurance "who willfully permits the participation" of a prohibited person in the business of insurance?

The Guidelines have expanded the meaning of "individual" beyond a natural person to include an "entity" or "company" by saying: "Thus, the statute makes it illegal for an insurer, reinsurer, its officers, directors, employees, agents and brokers (or

saying: "Thus, the statute makes it illegal for an insurer, reinsurer, its officers, directors, employees, agents and brokers (or others) to willfully employ a person who has been convicted of a felony crime involving dishonesty or breach of trust." As emphasized by the Guidelines, the law makes it a crime for any of these employers or their subcontractors to continue to employ an individual if the employer or subcontractor subsequently learns of a conviction and does not immediately terminate the individual. The Guidelines describe the "universe" of individuals who may not participate with, or work with, such a prohibited person as very broad in its scope.⁹

The Guidelines suggest means of satisfying an insurer's responsibility to discover any such person within the insurer's organization. Is the fact that the conviction is contained within personnel records, or within the knowledge of any management level person within a corporate organization, sufficient knowledge to place the burden on the insurer to take action? If a research of records is unduly burdensome, the Guidelines suggest that a program may be implemented whereby written certifications are required of both current and prospective employees, as well as other affected persons involved with the insurer. An ongoing program should require that employees or other such persons promptly notify the insurer in writing of a subsequent felony conviction.¹⁰

What does "willfully" mean in this context of the above two questions?

The statute refers to the prohibited person "who willfully engages in the business of insurance" and to the individual engaged in the business of insurance "who willfully permits the participation" of the prohibited person. The meaning of "willfully" is uncertain in this context. It has been held in some cases that an act or omission is "willfully done" if done voluntarily and intentionally and with the specific intent to do something the law forbids. In other cases, however, "willfully" has been held to require mere knowledge of the relevant facts and not knowledge that the fact situation is illegal.¹¹ These inconsistent definitions are extremely important to the application of this statute since it can be assumed that there are numerous violations occurring at this time with the affected parties having no knowledge of this federal crime.

The Guidelines present a "two-tier" definition of "willfully." In the case of the "insurer," the Guidelines suggest that the insurer's actual knowledge of the statutory prohibition is required in order for the insurer's employment, or continued employment, of the prohibited person to constitute a crime. Therefore, one not knowing of the effect of the antifraud statute, though knowing of the existence of a felony conviction of an employee, would not be individually acting in violation of the statute.

On the other hand, the Guidelines suggest applying the more stringent definition to the individual convicted of a crime. That person's involvement in the insurance business would be a crime after the statute's enactment in September 1994, even with no knowledge of the statute. This is based upon the general rule that one is presumed to know the law. Based upon that presumption, since a person is deemed to know the existence of his own conviction for felony, any involvement by that person in the business of insurance is a crime.¹² While there may be an instinctive reaction in favor of this distinction, i.e., one who was previously convicted of a crime being subject to a more stringent definition of "willfully" than an insurer who had no knowledge of the statute, different definitions of the same word in adjoining provisions are difficult to justify.

What is "interstate commerce"?

The Guidelines do not attempt to discuss the requirement of "interstate commerce" since it is apparently assumed that all insurance involves interstate commerce.¹³

What written consent of "any insurance regulatory official authorized to regulate the insurer" will provide the necessary exemption to avoid the crime created by this statute?

The statute is silent as to the procedure and standards to be used by a regulatory official in considering and granting any exemption requested by a prohibited person. The nature and form of the consent, so long as it is written and refers to this statute, are apparently within the discretion of the regulator, or the Commissioner, director or superintendent of the regulatory agency, as the Guidelines have identified the "regulator." Depending upon the facts of each case, the regulatory official's consent may be limited or conditional in the discretion of the regulator. For example, the prohibited employee may be limited to a certain employer, and there may be a limitation in the scope of the nature of the employment or the time period for the exemption. Conditions may be attached which could involve the employer's agreement. All of these would seem reasonable and within the implied authority of the regulator.

and within the implied authority of the regulator.

There are questions raised in this area which may not be within the discretion of the regulator. The most serious is the jurisdictional effect of any action by "any state regulatory official authorized to regulate the insurer." Is the effect of an exemption limited to the regulator's state or does it apply to some or all states (plus territories) of the United States? What if multiple insurers are involved? Does the statute intend there to be "extraterritorial" authority of a state regulator? It is argued by some in the industry that the Commissioner of any state where the insurer is authorized to conduct business would have the authority to grant an exemption to the statute.¹⁴ This would not, in that view, be "extraterritorial," but would simply apply a literal interpretation of the statute. The counter argument is that each state affected by the prohibited person's insurance activities has the authority to give or to withhold an exemption. The Guidelines have suggested a procedure for determining the "appropriate regulatory official" whose written consent would apply to all states.¹⁵ Until this issue is resolved by the federal courts or by Congress, the safest route is for a system to be put in place in which the "appropriate regulatory official" is determined and, through reciprocity, all states follow with an automatic form of "written consent."

Also a concern is the suggestion by the Guidelines that if a determination is made that an application does not meet all criteria set by the regulatory agency for consideration (e.g., whether the crime involves dishonesty or whether there is participation in the business of insurance) the application would be returned. That is, a regulatory official may, relying on a staff opinion that an exemption is not necessary, determine that an application is, therefore, not appropriate, as opposed to turning it down on the merits. In that situation, consideration should be given that some form of "tentative" written consent or, at the very least, a "regulatory interpretation" be issued so as to provide the insurer and others with some comfort that they are not violating a federal criminal statute. It should be remembered that a regulator's interpretation of this statute, outside the delegation of authority, is entitled to no deference by the U. S. Attorney General's office.

What is the application process?

The application process itself is wholly within discretion of the regulatory official (absent an arbitrary or capricious ruling) as is with the discretion of the regulatory official to grant or deny an exemption to the prohibited person. In an earlier draft of the Guidelines, there was included a sample form for a person applying for a certificate of exemption to the U.S. Parole Commission. In the Guidelines finally adopted, proposed administrative practices and procedures have been modified to apply to this statute. It is understood that the Guidelines will be supplemented in this area.

An important suggestion of the Guidelines is that there be established an "initial" application form to determine whether an "expedited" written consent should be granted to a prohibited person whose insurance activity on its face does not constitute a risk or a threat to insurance consumers or to the insurer.¹⁶ If the regulator concludes in the expedited process that the applicant's activities could pose a risk or a threat, only then would a standard application form be required. The contents of the standard application include, as expected, a request for personal historical information, or full description of the criminal conviction, and an explanation for the reasons that a risk will not be posed to insurance consumers or the insurer. The submission of character endorsements is also requested.¹⁷

The Guidelines' suggested form contains a requirement that, for purposes of the application, the applicant not contest the validity of the felony condition. No reviewing authority wants to hear the "retrial" of the case. However, if the applicant has mitigating information, this could be contained in the description of the nature of the crime.

According to Michael Bownes, General Counsel, Alabama Insurance Department, a policy has been instituted to require Alabama agents, under certain circumstances, to obtain an exemption under this statute upon renewal of their licenses. Those agents, whose licenses have been granted pursuant to an exemption to the Alabama statute controlling the issuance of licenses to persons convicted of a crime, are now required to obtain an exemption under the specific authority of Section 1033(e) before their agents' licenses are renewed. Although the state is not required to notify anyone of a requirement to file such an application, this is a positive effort to connect state agents' laws to the federal statute.

Conclusion

This statute has ramifications beyond the ability of the Guidelines to anticipate, and of course, to provide an authoritative answer. Its broad look has potential application to almost anyone involved in the insurance business if enforced strictly by the U.S. Attorney General's office. The Guidelines and the scheduled training sessions at the NAIC Winter Meeting are intended to alert the industry and to provide some guidance to the responsibilities raised by this statute, in addition to the

intended to alert the industry and to provide some guidance to the responsibilities raised by this statute, in addition to the assistance directed to state regulators. Michael A. Bownes, who has served as chairman of the working group involved in the preparation of the Guidelines, is a speaker at the education program in December. He has observed that the states are generally receptive to the establishment of procedures.

Conversations with the New York department's general counsel's office indicate that New York has been aware of and processed applications under this statute for several years. Texas is instituting the procedures and has been involved in the preparation of the Guidelines. Some states have less interest and, therefore, little or no awareness of the import of the statute. With the NAIC's activities, there will be a greater understanding of the statute's requirements and, we assume, a greater awareness of the statute's inadequacies. With some urging, Congress may realize that there is a need to correct the inadequacies.

The overly broad and uncertain application of the statute to the individuals (or companies) who are obligated to exclude prohibited persons from the business of insurance should be corrected. The prohibited activities of "prohibited persons" should bear a reasonable relationship to the risk of insurance fraud. The definition of "insurance business" should be reasonably contained and the word "willfully" should be defined for these purposes. With respect to the exemption process, the jurisdictional question should be resolved.

While a federal antifraud statute applicable specifically to the insurance industry was appropriate, there was a leap in the federal government's involvement in insurance regulation from specific and direct antifraud provisions to a statute which applies to all felony convictions involving dishonesty which may or may not be relevant to past or future fraudulent activities in the insurance industry. Does the situation addressed in Section 1033(e) have the same urgency as investigating and prosecuting insurance fraud schemes and conspiracies on an interstate basis? Since states have similar provisions with respect to the licensing of agents, which are administered by the state regulatory authority, couldn't states be relied upon to enact similar statutes for other persons who might be involved in the insurance business? Are the difficulties in applying this statute a preview of the federalization of insurance laws?

Endnotes

1. The Violent Crime Control Act of 1994, 18 U.S.C. 1033 and 1034, effective September 13, 1994. This statute has also been the subject of two previous articles in this *Journal*: Ann Monaco Warren and John William Simon in the Fall edition, dated September 12, 1998, and S. David Childers and Christie A. Chism in the Winter edition, December 7, 1997.

2. *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 108 L.Ed.2d 585, 110 S.Ct. 1384 (1990).

3. Guidelines for State Insurance Regulators to the Violent Crime Control and Law Enforcement Act of 1994 adopted March, 1998 - 2.

4. *Supra*, Childers and Chism article

5. Guidelines - 21.

6. *Id.* - 4.

7. *Id.* - 4.

8. *Id.* - 9.

9. *Id.* - 4.

10. *Id.* - 9, 10.

11. *Id.* - 24, 25.

12. *Id.* - 26.

13. *Id.* - 9.

14. *Id.* - 10.

15. *Id.* - 11.

16. *Id.* - 15.

17. *Id.* - 17, 18, 19.