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Banking and Insurance: Before and After the Gramm-Leach-Bliley Act

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I. INTRODUCTION

The Gramm-Leach-Bliley Act of 1999 (GLB) is landmark financial services legislation. GLB is the culmination of over thirty years of effort to reform the regulation of financial services. During this period, Congress considered numerous bills without reaching consensus. GLB was enacted on November 12, 1999, and many of its most significant provisions became effective on March 1, 2000. For many observers, GLB is notable for its repeal of the Glass-Steagall Act restrictions on commercial bank affiliates' investment banking activities. Of equal interest, however, are provisions that widen the entrance for banks into the insurance industry. Both sets of changes are expected to encourage further the consolidation of financial services and provide additional competition in the offer, sale, and underwriting of insurance products and securities.

At the same time, GLB subjects insurance affiliates of banks to “functional” regulation by state insurance and securities regulators. Largely for historical reasons that have little relevance in today's economy, regulation of traditional insurance products has been relegated to the states. Nontraditional insurance products, such as so-called variable insurance products that have a market return feature, are also subject to regulation by securities regulators. Predictably, this welter of regulations and regulators will continue to impede bank insurance activities even as GLB opens the door for their expansion.

This Article traces the growth of insurance in America and describes how its regulatory structure developed separately from the regulatory structure of other financial services. The authors show how banks became involved in insurance activities as a way to expand their traditional banking services. Regulatory restrictions at first impeded that effort, but GLB has now opened the door to allow greater expansion. Nevertheless, as the Article describes, banks continue to face regulatory hurdles and restrictions under GLB that will impair their ability to compete in the insurance business. Finally, the authors

6. See infra Part II.C.-F.
question whether the "functional" regulation on which GLB is premised is an efficient and effective method to regulate financial products.

II. INSURANCE HISTORY AND BACKGROUND

Insurance is an important part of our modern financial structure, and banks play an increasingly important role in that industry. To understand the regulatory tension created when banks provide and market insurance products, it is important to appreciate the background and historical antecedents of the insurance industry. For reasons that will be explained in this part, insurance is regulated at the state level. Banking regulation is a curious mix of state and federal regulation. The regulatory complications created when banking and insurance are offered by the same entity or in affiliated entities are self-evident and are discussed further later in this Article.

A. Early History

Like other aspects of our financial system, insurance had its beginnings in ancient societies. The annuity concept dates back to ancient Egyptian, Hindu, and Chinese societies. Life insurance appeared in Europe between the twelfth and sixteenth centuries. One such policy was issued in March of 1411, insuring the life of a pregnant slave belonging to Barnaba Boneto in Genoa. Fire insurance appeared in Flanders in the early thirteenth century. A legal action on a contract of marine insurance was filed in the City of Bruges in 1377.

The concept of insurance was introduced in England by the Lombards in the thirteenth century. Queen Elizabeth granted rights to register assurances at the Royal Exchange in 1574. Lloyd’s of London began at Edward Lloyd’s Coffee House in 1688,
where merchants gathered to discuss shipping and its attending risks.\textsuperscript{16} Life insurance policies were offered in England as early as 1583.\textsuperscript{17} Life insurance was initially viewed as gambling and was prohibited in several European countries during the sixteenth and seventeenth centuries.\textsuperscript{18} To stop such gambling, insurance contracts in which there was no "insurable interest" were considered wagers and were unenforceable at law.\textsuperscript{19} The requirement of an insurable interest lessened and eventually eliminated resistance to life insurance.

Annuities were bestowed by the Crown in England or even sold by lottery to raise funds.\textsuperscript{20} In 1694, the British government granted annuities that became the subject of speculation.\textsuperscript{21} By 1698, insurance brokers issued annuities to private purchasers, and annuities were being used to raise capital for businesses.\textsuperscript{22} In 1720, the "South Sea Bubble" involved a scheme in which the South Sea Company assumed the obligations of annuities issued by the Crown.\textsuperscript{23} This resulted in massive speculation in the stock of the South Sea Company and an accompanying "bubble" in other security prices.\textsuperscript{24} The eventual collapse of that bubble had a devastating effect on investors.\textsuperscript{25}

Insurance in America began in the shipping industry. One means for insuring marine cargoes during the colonial period in America was to divide the ownership of vessels among several merchants. This spread the risk of loss among many, should the ship founder. Later, individuals or groups of underwriters sold marine insurance.\textsuperscript{26} The first example of reinsurance in America appears to have occurred when Thomas Ritchie became concerned that an overdue vessel he had insured was lost at sea. He convinced another underwriter to assume half of his risk for a premium of twenty percent.\textsuperscript{27}

The Philadelphia Contributionship for the Insuring of Houses from Loss by Fire was created in 1752.\textsuperscript{28} Benjamin Franklin was among its organizers.\textsuperscript{29} The first stock insurance company incorporated in America was the Baltimore Fire Insurance Company.\textsuperscript{30} It was chartered in Maryland in 1787.\textsuperscript{31} Rhode Island became a center for

\begin{thebibliography}{99}
\bibitem{1} Kailin Tuan, Modern Insurance Theory and Education: A Social History of Insurance Evolution in the United States During the Twentieth Century 17 (1972).
\bibitem{19} Angell, supra note 14, at 15.
\bibitem{20} Crobaugh, supra note 9, at 17, 19.
\bibitem{21} Relton, supra note 15, at 118.
\bibitem{22} Crobaugh, supra note 9, at 18.
\bibitem{23} Relton, supra note 15, at 118-119.
\bibitem{24} Id.
\bibitem{25} Id.
\bibitem{27} Perkins, supra note 26, at 288, 290.
\bibitem{28} 2 Joseph Stancliffe Davis, Essays in the Earlier History of American Corporations 234 (1965); S. S. Huebner et al., Property and Liability Insurance 18-19 (Prentice-Hall Inc. 1982) (1911); 1 Tuan, supra note 16, at 41-42.
\bibitem{29} 2 Davis, supra note 28, at 234-35.
\end{thebibliography}
the chartering of insurance companies just before the beginning of the nineteenth century. The joint stock companies were organized for shareholder profit. The companies raised capital through stock subscriptions, and their shareholders retained the profits.

Mutual companies were another form of organization that became popular for insurance companies. They did not rely on capital stock subscriptions. Instead, their capital was obtained from premiums paid by policyholders. Mutual companies operated on the principle that each insured person was a member of the company. The first policies of mutual societies provided for any excess capital or dividends to be paid to annuitants. Later, the policyholders in a mutual company divided profits from premium investments among themselves. A popular form of life insurance was the Tontine plan, named after Lorenzo Tonti, the seventeenth-century Neapolitan financier who brought his scheme to the Court of Versailles. These plans generally provided an annual life income to subscribers who lived beyond a specified date. This was accomplished at the expense of the subscribers who died earlier. At some specified future year, the remaining principal of the contributing investors was divided among the survivors. Such a scheme was used to build New York’s Tontine Coffee House—the center of commerce and stock trading for several years after the American Revolution.

B. Insurance Company Growth in America

Twenty-three life insurance companies were “founded in America between 1812 and 1842.” The great New York fire in 1835 bankrupted many of the privately owned fire insurance companies in that city. Most of the remaining insurance companies in New York City were rendered insolvent by the financial panic that occurred in 1837.
Nevertheless, between 1840 and the outbreak of the Civil War, life insurance business in America grew rapidly.\textsuperscript{45} Outstanding life insurance totaled $10 million in 1840.\textsuperscript{46} By 1860, $180 million of life insurance was in effect, as well as some $3 billion of fire and marine insurance.\textsuperscript{47} Almost thirty new insurance companies were created nationwide between 1867 and 1869, bringing the total number of American insurance companies to over one hundred.\textsuperscript{48} The amount of life insurance in force in the United States in 1865 nearly tripled its pre-war amount.\textsuperscript{49} 

The insurance industry's success was also accompanied by some abuses. The practice of loaning money to insurance company directors from premium reserves held to pay beneficiary claims was one common problem.\textsuperscript{50} In 1837, Massachusetts required each insurance company to maintain a fund to assure that it could carry out its contracts.\textsuperscript{51} This was a reserve requirement or "unearned premium fund."\textsuperscript{52} Massachusetts also strengthened its board of insurance commissioners and provided for more expansive state supervision of life insurance.\textsuperscript{53}

In 1851, New York adopted a general insurance law. It restricted the investment activities of mutual companies.\textsuperscript{54} In 1853, the New York legislature added an unearned premium reserve requirement.\textsuperscript{55} The New York law required a specific percentage of unexpired premiums to be set aside to meet claims.\textsuperscript{56} The New York Insurance Department was created in 1859.\textsuperscript{57}

Insurance companies sold their products across state lines through networks of "agents," a practice The Insurance Company of North America began as early as 1812, which appointed agents outside of its Philadelphia headquarters to sell policies.\textsuperscript{58} The company set rates and accepted policies based on reports from agents.\textsuperscript{59} Such agents soon became a common feature of U.S. insurance companies.\textsuperscript{60}

Henry Hyde's Equitable Life Assurance Society of the United States surpassed Mutual Life Insurance Company of New York as the largest insurance company in

46. Id.
47. Id.
48. O'DONNELL, supra note 26, at 471.
49. ZELIZER, supra note 18, at 6.
50. See MACKIE, supra note 37, at 145.
51. 1 TUAN, supra note 16, at 48.
52. Id.
53. GOODHEART, supra note 38, at 147-48. A leading reformist, Elizur Wright, published policy valuation tables in 1853 for insurance that could be used to set reserve requirements. He spent nine years preparing the tables. AM. COUNCIL OF LIFE INS., 1996 LIFE INSURANCE FACT BOOK 130 (1996) [hereinafter LIFE INSURANCE FACT BOOK].
54. 1 TUAN, supra note 16, at 48.
55. Id.
56. 1 id. at 48-49.
57. 1996 LIFE INSURANCE FACT BOOK, supra note 53, at 131. New Hampshire was the first state to create a regulatory body to oversee insurance companies. Id. at 130.
58. BRYANT & DETHLOFF, supra note 38, at 201.
59. Id.
America in 1889.\textsuperscript{61} Hyde took the name of "Equitable" from an English company founded in 1762, the Society for Equitable Assurances on Lives and Survivorships.\textsuperscript{62} Hyde is credited with introducing aggressive sales practices in the insurance industry through his "army" of insurance agents.\textsuperscript{63}

Efforts to regulate insurance at the federal level in the late 1860s were unsuccessful.\textsuperscript{64} In \textit{Paul v. Virginia},\textsuperscript{65} the United States Supreme Court held that insurance was not interstate commerce and could be regulated by the states as if it were an entirely local business.\textsuperscript{66} In 1886, the Supreme Court again held that the issuance of a policy of insurance was not a transaction in interstate commerce that was excluded from local regulation and presumably subject to federal regulation.\textsuperscript{67} This holding meant that insurance was not subject to federal regulation and that states could regulate such business within their own borders. The states gradually expanded their regulation, and the insurance companies then tried to obtain federal legislation that would preempt state jurisdiction.\textsuperscript{68} Those efforts failed.

Congress passed the National Bank Act (NBA)\textsuperscript{69} during the Civil War. Because the Supreme Court held that insurance was not interstate commerce, the NBA created a national charter option for banks which were previously all chartered by the states.\textsuperscript{70} It was believed that a tax on state bank notes that was introduced as part of the NBA would drive state banks to convert to national bank charters.\textsuperscript{71} State banks, however, responded by replacing their state bank notes with a relatively new product, checking accounts, which were not subject to the onerous state bank note tax.\textsuperscript{72} Thus, the creation of the dual chartering system was largely a historical accident.

\textbf{C. The Armstrong Investigation}

Between 1870 and 1905, the amount of life insurance issued in the United States increased by almost six-hundred percent.\textsuperscript{73} Insurance companies were a growing force in finance. They poured vast amounts of funds into the securities markets. Those funds were generated by large cash flows from premiums and held in reserve to pay policy claims.

\begin{itemize}
  \item \textsuperscript{61} ROUSMANIERE, supra note 42, at 3.
  \item \textsuperscript{62} PRITCHETT, supra note 60, at 24-26; ROUSMANIERE, supra note 42, at 19. Another growing giant was the Prudential Insurance Company, a descendant of the Widows and Orphans' Friendly Society. BRYANT & DETHLOFF, supra note 38, at 207.
  \item \textsuperscript{64} See MORTON KELLER, THE LIFE INSURANCE ENTERPRISE, 1885-1910, at 8 (1963).
  \item \textsuperscript{65} 75 U.S. 168 (1868).
  \item \textsuperscript{66} Id. at 183-85.
  \item \textsuperscript{67} Fire Ass'n of Phila. v. New York, 119 U.S. 110, 119-20 (1886); see also 1 SWAINE, supra note 44, at 225.
  \item \textsuperscript{68} 1 R. CARLYLE BULEY, THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, 1859-1964, at 597-98 (1967).
  \item \textsuperscript{70} 12 U.S.C. § 21 (1994).
  \item \textsuperscript{71} JONATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW AND REGULATION 11 (2d ed. 1997).
  \item \textsuperscript{72} Id.
  \item \textsuperscript{73} North, supra note 63, at 238.
\end{itemize}
Life insurance companies had traditionally invested their assets in a conservative manner. Common stocks accounted for about two percent of the assets held by insurance companies between 1860 and 1880. After 1890, life insurance companies began to participate more broadly in the securities markets.

The growing reserves of insurance companies provided them with a great deal of economic power which engendered criticism. Louis D. Brandeis, a future United States Supreme Court Justice, stated in 1905 that insurance companies were "the greatest economic menace of today" and that as "creditors of [the] great industries," they used their power "selfishly, dishonestly [and] inefficiently." Brandeis's criticism would be given credence by events unfolding at the Equitable Life Assurance Company where twenty-three year old James Hyde had succeeded his father. James Hyde was given to ostentatious displays of his wealth that marked him as a less-than-serious businessman. Hyde's excesses and other industry problems sparked so much criticism that the New York Superintendent of Insurance initiated an investigation of the insurance industry. That investigation led the New York legislature to appoint an investigating committee headed by Senator William W. Armstrong. The Committee was charged with undertaking a broad review of the activities of New York insurance companies. Charles Evan Hughes, a future Chief Justice of the United States Supreme Court, acted as the Armstrong Committee's counsel.

Ultimately, the Armstrong Committee concluded that insurance companies were a part of the trend toward the accumulation of great capital by a few individuals and enterprises. The Committee stated, "No tendency in modern financial conditions has created more widespread apprehension than the tendency to vast combinations of capital

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76. Keller, supra note 64, at 32. Brandeis was the advocate of a proposal to sell life insurance through mutual savings banks in Massachusetts. Michael D. White, What Will It Take for Bank Insurance to Succeed in the United States?, 2 N.C. Banking Inst. 123, 124 (1998). That proposal followed revelations of the Armstrong investigation, which indicated that insurance companies were maintaining "scandalously high premiums and commissions and low policy values and retention rates." Id. Massachusetts enacted legislation in 1907 that allowed mutual savings banks to provide life insurance and annuity policies. S.S. Huebner & Kenneth Black, Jr., Life Insurance 558 (10th ed. 1982). New York and Connecticut adopted similar legislation in later years. Id. Those laws limited the insurance that could be written by the savings banks to small amounts. Id. at 560.
77. John A. Garraty, Right-Hand Man: The Life of George W. Perkins 161-62 (1960); see also Rousmaniere, supra note 42, at 92-93 (finding that Hyde became the subject of criticism after supposedly hosting a $20,000 dinner).
78. Garraty, supra note 77, at 162.
79. Id. at 163.
80. See id.; see also H. Peers Brewer, The Emergence of the Trust Company in New York City, 1870-1900, at 282 (1986) (stating that the Armstrong Committee is an example of an early twentieth century "trust buster").
and assets."\textsuperscript{82} Another matter of concern for the Armstrong Committee was that the large reserves held by the insurance companies were increasingly being invested in the stock market. The Armstrong Committee recommended the prohibition of insurance companies' investment in stocks because such investment endangered the companies' reserves.\textsuperscript{83} The New York legislature, thereafter, restricted the ability of insurance companies to invest in common stocks.\textsuperscript{84} Another reform required insurance companies to divest themselves of bank stocks. Insurance companies were prohibited from acting as underwriters for securities or engaging in securities syndications.\textsuperscript{85} The restrictions imposed by New York and other states on insurance company investments shut off a large source of funds for Wall Street.\textsuperscript{86}

After the Armstrong investigation, insurance companies initially engaged in some "agitation" for federal regulation in order to avoid multiple state regulation.\textsuperscript{87} The industry soon took the view, however, that state regulation was preferable to federal regulation. The industry then contended that its business was not a part of interstate commerce. Hence, it could not be regulated by Congress and was not subject to the antitrust laws. This argument proved persuasive, and the insurance industry avoided federal legislation and resumed its growth.\textsuperscript{88}

Federal legislation in the banking arena increased during this period. Congress enacted the Federal Reserve Act in 1913, creating the Federal Reserve System.\textsuperscript{89} The regional Federal Reserve Banks were to serve as lenders of last resort and help to avoid financial panics such as the Panic of 1907, which was softened only by the intervention of the financier J.P. Morgan.\textsuperscript{90}

\textbf{D. The Depression}

Many insurance companies experienced difficulties during the Great Depression. Over 130 insurance companies were forced to borrow a total of over $90 million from the Reconstruction Finance Corporation (RFC).\textsuperscript{91} The Depression had other effects on the industry. Insurance companies suffered large losses on many of their investments.\textsuperscript{92} Returns dropped as insurance companies concentrated their investments in low interest

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\item \textsuperscript{82} Temporary National Economic Committee, 76th Cong., 3d Sess., Investigation of Concentration of Economic Power, Monograph No. 28, at 7 (GPO 1940) [hereinafter Monograph No. 28] (quoting 10 Armstrong Report 389 (1906)).
\item \textsuperscript{83} See Goldsmith, supra note 74, at 56; Temporary National Economic Committee, 76th Cong. 3d Sess., Investigation of Concentration of Economic Power, Monograph No. 28-A, at 4 (GPO 1941) [hereinafter Monograph No. 28-A].
\item \textsuperscript{84} Monograph No. 28-A, supra note 83, at 4.
\item \textsuperscript{85} See Life Insurance Association of America, Life Insurance Companies as Financial Institutions 76 (1963).
\item \textsuperscript{86} Moody, supra note 75, at 132; Roussinier, supra note 42, at 112.
\item \textsuperscript{87} See Keller, supra note 64, at 263.
\item \textsuperscript{88} I Swaine, supra note 44, at 754-55.
\item \textsuperscript{89} Federal Reserve Act of 1913, ch. 6, 38 Stat. 251 (1913) (codified as amended in scattered sections of 12 U.S.C.).
\item \textsuperscript{90} Jean Strouse, Morgan American Financier 574-93 (1999).
\item \textsuperscript{91} Jesse H. Jones with Edward Angly, Fifty Billion Dollars: My Thirteen Years With the RFC (1932-1945) 206 (1951).
\item \textsuperscript{92} Clough, supra note 18, at 240-41.
\end{enumerate}
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purchasing government securities.\textsuperscript{93} Insurance companies also experienced runs on their assets because hard-pressed policyholders sought to obtain the surrender value of their policies. Several states adopted legislation that froze surrender claims.\textsuperscript{94}

Despite these difficulties, Congress did not seek to regulate the insurance industry as it did the securities, banking, and futures industries.\textsuperscript{95} The legislation resulting from the Armstrong investigation removed insurance companies from speculation in stock markets. This sheltered the insurance companies from many of the speculative excesses of the 1920s and kept them out of the line of fire of congressional investigations that focused on financiers in other areas of the economy.

The insurance industry, however, did not entirely escape scrutiny. Just before World War II, Franklin Roosevelt created the Temporary National Economic Committee (TNEC) to study the concentration of economic power in the United States. The Federal Trade Commission, the Securities and Exchange Commission (SEC), and the Department of Justice conducted this study.\textsuperscript{96} Joseph O'Mahoney, a senator from Wyoming, was the Chairman of the committee.\textsuperscript{97} One area of concern was the insurance industry, which had steadily accumulated enormous reserves. TNEC considered a proposal from the SEC that would establish a new federal regulatory body to oversee insurance companies.\textsuperscript{98} Insurance companies vigorously opposed such a course, pointing out that both Democratic and Republican Party platforms had pledged that supervision of insurance companies would be left to the states.\textsuperscript{99} As a result, TNEC rejected the SEC proposal, and the insurance industry again escaped federal regulation.

TNEC found that the assets of life insurance companies had increased by over eight hundred percent between 1906 and 1938.\textsuperscript{100} Reserves of insurance companies had grown so much that they had national implications for investment and capital flow. TNEC noted, "The investment policies and practices of the legal reserve life insurance companies admittedly influence practically every phase of this country's economic life."\textsuperscript{101} The largest insurance companies in the United States had around $28 billion to

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\bibitem{93} Id. at 245.
\bibitem{94} 2 BULEY, supra note 68, at 996-97 & n.26.; CLOUGH, supra note 18, at 240-41.
\bibitem{95} For bankers, the Banking Act of 1933 created the FDIC and a system of deposit insurance that was mandatory for national banks and state banks that were members of the Federal Reserve System. 12 U.S.C. § 1811 (1994). The second significant aspect of the Banking Act was the so called Glass-Steagall Act, composed of four sections of the Banking Act, that attempted to separate banking and securities activities. See Banking Act of 1933 § 16, 12 U.S.C. § 24(seventh) (1994) (revised 1999); Id. § 20, 12 U.S.C. § 377 (1994) (repealed 1999); Id. § 21, 12 U.S.C. § 378 (1994); Id. § 32, 12 U.S.C. § 78 (1994) (repealed 1999).
\bibitem{97} ID. supra note 81, at 335.
\bibitem{98} MONOGRAPH No. 28-A, supra note 83, at 20-21.
\bibitem{99} Id.
\bibitem{100} Id. at 342.
\end{thebibliography}
invest between 1929 and 1938. In 1930, life insurance companies held about two percent of their assets in industrial and other bonds, and they held twenty-four percent in railroad and public utility bonds. In addition, government securities accounted for substantial portions of life insurance company investments. In 1937, the twenty-six largest insurance companies owned over eleven percent of the long-term debt of the United States government, as well as large percentages of long-term private debt and well over $1.5 billion of real estate. Large life insurance companies had over $10 million to invest each day. Yet, life insurance companies only invested small amounts in equity securities. The great bulk of insurance companies’ investments in securities were in bonds rather than stocks.

TNEC concluded that the increasing amount of reserves being accumulated by life insurance companies was “in effect sterilizing the savings funds received and preventing them from flowing into new enterprises or undertakings where the element of venture or risk is present. Thus the small businessman or average industrialist is denied access to this more important capital reservoir.” Insurance companies were trying to make their investments “riskless.” In fact, their demand for bonds made corporate investments even more risky because the demand placed increased pressure on companies to issue more debt, thereby unbalancing debt-to-equity ratios. Furthermore, bidding by insurance companies for the supply of bonds drove interest rates down and reduced the rate of return for their holders.

TNEC also noted that the emphasis on bond investment by insurance companies would create difficulties “[u]nless the life insurance companies can find methods by which the funds flowing from their control will become available as equity for the stimulation of new enterprises and accessible to small- and medium-sized businessmen.” The Committee thought that insurance companies should increase their investments in common stocks “in order that industrial enterprise may not become overburdened with debt.” The insurance companies, however, were handicapped in their ability to buy common stocks. State insurance laws adopted in the wake of the Armstrong investigation restricted the ability of insurance companies to invest in such securities.

Moreover, insurance companies had come to accept these restrictions and were willing to accept a lower return on their investments because their assets were at less risk. Insurance companies claimed that their safety record was “without parallel, notwithstanding the worst depression in modern history.” They noted that their

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102. Id.
104. MONOGRAPH NO. 28, supra note 82, at 343.
105. Id. at 5.
106. Id. at 7.
107. Id. at 6-7.
108. Id. at 343.
109. MONOGRAPH NO. 28, supra note 82, at 378.
110. Id. at 377-78.
111. Id. at 378.
112. Id.
113. MONOGRAPH NO. 28-A, supra note 83, at 3-5.
114. Id. at 5.
avoidance of equity investments had prevented the insurance industry from being devastated by the stock market crash of 1929. "Happily, the disaster which might otherwise have occurred was avoided."115

Although the insurance industry suffered during the Great Depression, the 70 million life insurance policies in effect in 1933116 grew to over 124 million in 1940, with an outstanding face amount of over $110 billion.117 Those policies were issued by over three hundred life insurance companies, with assets exceeding $28 billion.118 "Legal reserve life insurance companies"119 dominated the insurance business by 1940, writing about ninety-five percent of life insurance policies.120 Fraternal orders and assessment societies wrote the remaining five percent.121 State laws required legal reserve life insurance companies to maintain a reserve for their policies "based on the type of contract, age of issue, and mortality and interest assumptions involved."122 Numerous variations in life insurance were available by the outbreak of World War II, including whole life,123 endowment,124 and term.125 One insurance company offered some 130 varieties of policies, however, whole life policies predominated in 1940.126

Annuities became popular during the Depression.127 The number of annuities being sold increased heavily in 1933.128 Total annuity premiums in 1935 exceeded all premiums from 1866 to 1927.129 In fact, during the period from 1933 to 1937, the total premium income from annuity contracts was $1.7 billion.130 Reserves for annuity contracts rose from some $400 million in 1929 to $2.6 billion in 1938.131

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115. Id. at 4.
116. CROBAUGH, supra note 9, at preface.
117. MONOGRAPH NO. 28, supra note 82, at 5.
118. Id.
119. A "legal reserve life insurance company" is one that sells insurance to the general public. By law such companies are required to set aside a portion of their premium receipts as a reserve to meet policyholders' claims.
120. MONOGRAPH NO. 28, supra note 82, at 5 n.1.
121. Id.
122. Id.
123. A "whole life policy" is one that has a level premium payment over the life of the policy. The insured is covered throughout her life as long as the premiums are paid. It provides a guaranteed death benefit. Cash value accumulates in the policy over time. See generally, Ed Townsend, Life Insurance—How Much, What Kind Do You Need?, CHRISTIAN SCIENCE MONITOR, Nov. 22, 1982, at B13.
124. An "endowment policy" is one written for the benefit of a particular entity. Id. However, the insured may receive the face value of the policy if he survives the endowment period. Ho Sheo Be, Different Policies Available, STRAIGHTS TIMES, Oct. 15, 1993, Life, at 2.
125. Term insurance covers only a particular period of time. Premium costs will increase as the insured grows older. Townsend, supra note 123, at B13.
126. MONOGRAPH NO. 28, supra note 82, at 178.
127. See id. at 154 (finding that "companies first started writing annuities on a large scale in 1927"). Annuities seek to assure that the insured does not outlive his estate by guaranteeing payments for life. In contrast, life insurance seeks to create an estate at death that will provide benefits to the insured's survivors. See generally, Ho Sheo Be, supra note 124, Life, at 2.
128. MONOGRAPH NO. 28, supra note 82, at 154.
129. Id. at 329.
130. Id. at 154.
131. MONOGRAPH NO. 28, supra note 82, at 154, 328.
E. A Regulatory Threat Arises

From March 1933 to October 1938, the principal United States and Canadian insurance companies held conferences at the offices of Dr. Arthur Hunter, Chief Actuary and Vice President of the New York Life Insurance Company. The insurance companies established a uniform program for annuity rates and policy terms at those meetings, essentially fixing prices. In 1944, the Supreme Court in *United States v. South-Eastern Underwriters Ass'n*, held that insurance companies were subject to the federal antitrust laws. In *South-Eastern Underwriters*, two hundred insurance companies were charged with violating the Sherman Antitrust Act by joining the South-Eastern Underwriters Association. The purpose of this association was to control the fire insurance business and to discriminate and retaliate against insurance companies that were not members of the association. After the Supreme Court's decision, insurance companies became concerned that they would not be able to pool their loss statistics or be able to jointly compute actuarially sound premiums. States were concerned that federal antitrust laws would preempt state regulation. Some insurance companies refused to comply with state insurance laws on that ground. Congress responded to those concerns by passing the McCarran-Ferguson Act in 1945. This Act granted insurance companies immunity from federal antitrust laws to the extent they were regulated by state law. The Act largely exempted the insurance industry, as it was then constituted, from federal regulation, a regulatory approach diametrically opposite to the regulatory structure for the securities industry. Regulation of securities was subject to shared control by the federal government and states, but the federal government had overriding authority for regulation. Only in future years, when insurance companies started selling securities-like products, would there be an effort to reassert federal control over the securities-like activities of insurance companies. State dominated regulation was also at odds with the federal regulation already imposed on all banks—even those with a state charter.

F. Post-War Growth

In June of 1952, some $265 billion in face value of life insurance was outstanding in the United States. Insurance companies doubled their assets between 1945 and 1955

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132. *Id.* at 155.
133. *Id.* at 154-57.
134. 322 U.S. 533 (1944).
135. *Id.* at 560-61.
136. *Id.* at 535-36.
137. *Id.*
139. *Id.*
144. MYERS, *supra* note 81, at 390.
and invested large amounts of their reserves in industrial and commercial buildings.\textsuperscript{145} Other insurance company investments in the 1950s included farm loans, city property loans, and government securities issued in the United States and by foreign governments. Insurance companies were involved in the home mortgage market and made term loans to corporations in competition with banks.\textsuperscript{146} Life insurance companies remained the largest single lender in the corporate bond market.\textsuperscript{147} In the early 1950s, insurance companies held about fifteen percent of their assets in industrial bonds and about five percent in railroad bonds.\textsuperscript{148} Public utility bonds comprised another significant portion of life insurance company assets.\textsuperscript{149} Insurance companies increased their investments in common stock as state law restrictions on such investments were eased.\textsuperscript{150}

A new product, the variable annuity, was introduced in 1952 to teachers by the College Retirement Equities Fund (CREF), which was affiliated with the Teachers Insurance and Annuity Association (TIAA).\textsuperscript{151} Under the traditional "fixed" annuity, purchasers received a fixed amount of income based on their premium payments, life expectancy, and an assumed rate of return on the premium payments. The insurance company had to bear the risk that purchasers would live longer than expected and that returns on the investment of premiums might be less than projected. In contrast, the variable annuity operated much like a mutual fund. Annuity premiums were invested in securities, and the performance of those investments determined the amount of the income from the variable annuity rather than the assumed interest rate used for the fixed annuity. The purchaser of a variable annuity incurred the risk that investment returns might be less than expected. Returns could also be higher than those of a fixed annuity if the investment of variable annuity premiums exceeded the rates assumed for the return on the fixed annuity.

During the 1950s, creation of the variable annuity represented an effort by the insurance industry to take advantage of investor interest in the rising stock market. The insurance industry wanted a product to compete with mutual funds. The variable annuity filled that role. Indeed, the variable annuity was itself held to be a security by the Supreme Court in 1959.\textsuperscript{152} This meant that variable annuities were subject to regulation by the SEC under federal securities laws. This ruling signaled the start of a functional regulatory approach, as well as the beginning of a struggle that continues today over the integration of the insurance and securities industries.

In \textit{SEC v. United Benefit Life Insurance Co.},\textsuperscript{153} the Supreme Court again held that an annuity contract, which provided a market-based return, was subject to federal

\begin{itemize}
\item \textsuperscript{147} \textit{VATTER, supra note 103, at 195.}
\item \textsuperscript{148} \textit{Id.}
\item \textsuperscript{149} \textit{Id.}
\item \textsuperscript{150} G. KEITH FUNSTON, \textit{WANTED: MORE OWNERS OF AMERICAN BUSINESS} 11 (1954).
\item \textsuperscript{151} CEDRIC V. FRICKE, \textit{THE VARIABLE ANNUITY, ITS IMPACT ON THE SAVINGS-INVESTMENT MARKET} 2 (1959).
\item \textsuperscript{152} \textit{SEC v. Variable Annuity Life Ins. Co. of Am.}, 359 U.S. 65, 71-72 (1959).
\item \textsuperscript{153} 387 U.S. 202 (1967).
\end{itemize}
Banking and Insurance: Before and After GLB

In United Benefit, the insurer had tried to avoid that regulation by assuming some of the investment risks in the contract through a guarantee of a minimum return after the accumulation phase of the contract. Returns to the investor, however, were also subject to market performance. The Supreme Court held this was sufficient to make the contract a security. As a result, insurance companies were subject to state insurance regulations as well as state and federal securities regulations. Insurance companies were required to separate their variable products from their traditional insurance products. Reserves to support traditional products were kept in the insurance company's general account. So-called "separate" accounts had to be established for variable securities products.

G. More Growth

"Between 1945 and 1960 assets of life insurance companies tripped." By 1965, assets of life insurance companies totaled almost $160 billion. Those holdings were invested largely in mortgages, corporate bonds, and government securities. New York still limited the common stock holdings of life insurance companies to five percent of their total assets.

The states created their own insurance guaranty fund system to cut off a proposed federal program of insurance designed to protect policyholders in the event of an insurance company's insolvency. Between 1969 and 1980, state guaranty funds made assessments for property and casualty insurance of about $200 million. Sixty-seven insurance companies failed during that period. The state guaranty funds were small, however, and could not handle a major default.

In the 1960s, the insurance industry began a series of mergers and acquisitions that sometimes involved noninsurance businesses. In response to this trend, the National Association of Insurance Commissioners (NAIC) approved a model insurance holding

154. Id. at 211-12.
155. Id. at 208.
156. Id. at 210-11.
157. Id.
158. For a discussion of litigation attempting to characterize insurance products as securities, see generally Jeffery S. Puretz, Federal Securities Regulation of Insurance Products, 799 PLI/COMM. 459 (Order No. A00-003V) (2000). The insurance industry engaged in an extended quarrel with the SEC over the regulation of variable insurance products. The SEC, under Chairman William Casey, granted an exemption from registration in 1973 for those variable insurance products, but subsequently revoked it. ROUSMANIERE, supra note 42, at 251. Later, the SEC and the insurance industry reached an accommodation that allowed these products to be sold without undue interference. Id. For a discussion of SEC treatment of separate accounts, see generally Puretz, supra, at 479 (finding that the SEC focuses on mortality risk as distinguishing insurance from securities).
160. MYERS, supra note 81, at 390.
163. 2 id. at 372.
164. 2 id.
165. 2 id. at 359.
166. 2 id. at 72.
company statute that was adopted by most states. This legislation imposed restrictions on companies seeking to acquire insurance companies. Under the model act, insurance holding companies were allowed to manage mutual funds, to sell variable annuities and life insurance, and to act as broker-dealers for their own accounts, but not for the public. Insurance companies and their affiliates were allowed to manage pension funds. The restrictions on insurance holding company activities were similar to the restrictions on bank holding company activities under the Bank Holding Company Act (BHCA) of 1956. The BHCA empowered the FRB to oversee the activities of a holding company and its nonbanking subsidiaries. The BHCA provided federal regulation for bank holding companies; the model insurance holding company statute provided for regulation of insurance holding companies at the state level.

By the 1970s, insurance companies managed about half of all pension funds. Bonds were still the largest type of investment by life insurance companies in the 1970s, and many corporations placed debt through private placements with insurance companies. Indeed, insurance companies accounted for about seventy-five percent of all direct placements, and direct placements accounted for as much as one-half of total long-term corporate financing.

Insurance companies continued to lose market share in the 1970s to mutual funds, even with the creation of variable annuities. Sales of whole life insurance policies had long been popular as a savings program. In the 1970s, however, sales began declining because of reduced investment returns and the high interest rates available elsewhere. Increased interest rates made it more difficult to sell whole life policies that provided low rates of return to policyholders. Instead, policyholders chose term insurance which was relatively cheap in the early years of the insured’s life. This change reduced the premium income of life insurance companies. In addition, whole life holders borrowed on their existing policies at below-market interest rates which further undercut the insurance companies’ returns. Notwithstanding these difficulties, however, life insurance was far from dead. By 1983, eighty-six percent of Americans owned life insurance. Some two thousand life insurance companies were operating in the middle of that decade.

Life insurance companies offered guaranteed interest contracts (GICs). These contracts, similar to annuity contracts, were used to fund pension plans or to terminate

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167. 2 D’ARISTA, supra note 162, at 72. The NAIC is a private trade association of state insurance commissioners.
168. 2 id.
169. 2 id.
170. See 2 id.
171. 2 id. at 68.
172. 2 D’ARISTA, supra note 162, at 72; 12 U.S.C. §§ 1841-1848a (1994)
173. 2 D’ARISTA, supra note 162, at 72.
174. HUEBNER & BLACK, supra note 76, at 606-07.
175. ROUSMANIERE, supra note 42, at 243-44.
176. See ROGER LOWENSTEIN, BUFFETT: THE MAKING OF AN AMERICAN CAPITALIST 237 (1995). Rising interest rates devalued insurance companies’ bond portfolios. Insurance firms thus were reluctant to sell those bonds because they would have to realize a loss. Id.
178. 2 D’ARISTA, supra note 162, at 387 n.16.
179. 2 id.
180. See Rousmaniere, supra note 42, at 263.
coverage of benefit plans.\textsuperscript{181} By 1990, those contracts resulted in huge losses to insurance companies.\textsuperscript{182} Banks responded by offering bank investment contracts (BICs).\textsuperscript{183}

The U.S. insurance industry, unlike other financial service sectors, continued to be regulated only at the state level, except for discrete products that were considered securities and regulated as securities. In 1988, Congress began hearings to determine whether federal regulation was needed, but no legislation resulted. After forty multi-state insurance companies failed in 1992, the Federal Insurance Solvency Act (FISA) was introduced. It sought to create a Federal Insurance Solvency Commission (FISC) that would establish national standards for financial soundness and solvency of insurance companies. The legislation was beaten back by the industry and state insurance administrators.\textsuperscript{184}

In lieu of a federal regulator, the NAIC serves as a coordinator of state insurance regulation and registration examinations.\textsuperscript{185} NAIC drafted model laws, but, as a voluntary organization, it could not compel state legislatures to adopt model acts or regulations.\textsuperscript{186} Most states, for example, did not require independent audits or reviews of actuaries in setting reserves. International reinsurance issues were also outside the jurisdiction of this organization.\textsuperscript{187} NAIC did, however, create a joint reporting and surveillance system for large interstate insurance companies.\textsuperscript{188}

NAIC had only minor enforcement power, which on occasion it did exercise. For example in 1993, it suspended New York’s accreditation in the association because New York had failed to enact NAIC model legislation.\textsuperscript{189} NAIC also established an “Insurance Regulatory Information System” that created risk profiles to determine whether an insurance company’s financial condition was deteriorating.\textsuperscript{190} The system proved to be unsuccessful. Finally, NAIC sought to further its testing of the adequacy of insurance company reserves by creating risk-based capital tests.\textsuperscript{191}

\textsuperscript{181} 2 D’ARISTA, supra note 162, at 317.
\textsuperscript{182} See ROUSMANIERE, supra note 42, at 269, 302 (implying that the contracts resulted in huge losses).
\textsuperscript{185} 2 D’ARISTA, supra note 162, at 304.
\textsuperscript{186} 2 id. at 304-05.
\textsuperscript{187} SUBCOMM. ON OVERSIGHT AND INVESTIGATION, HOUSE COMM. ON ENERGY AND COMMERCE, 101ST CONG., FAILED PROMISES: INSURANCE COMPANY INSOLVENCIES 63 (1990) [hereinafter FAILED PROMISES].
\textsuperscript{188} 2 D’ARISTA, supra note 162, at 304.
\textsuperscript{189} 2 id. at 305.
\textsuperscript{190} 2 id.
Before 1992, most states had capital requirements based on static minimum amounts of capital and surplus. Risk-based capital standards changed this to require capital levels premised on the risk of the investments in an insurance company's portfolio. Between 1969 and 1990, more than 150 property-casualty companies failed. Seventy-five of those failures were between 1985 and 1990. State insurance funds proved to be inadequate in the crisis. By 1985, twenty-one large insurance companies had been liquidated. In 1988, state regulators assumed control of thirteen life insurance companies, thirty-two in 1990, and thirty-four in the first nine months of 1991. Insurance company failures in the 1980s resulted in losses estimated at $10 billion.

Sales practices became another burgeoning problem. The Phoenix Home Life Mutual Insurance Company in New York settled a class action for $100 million. Connecticut General Life Insurance Company entered into a settlement expected to cost $35 million and cover 130,000 policyholders. MetLife, the second largest insurance company in the United States, was required to pay $100 million in Florida for sales abuses. Later, MetLife agreed to settle other lawsuits in connection with deceptive practices in its insurance sales. These settlements reportedly could cost the company as much as $1.7 billion. John Hancock Life Insurance Company conceded it was negotiating a class-action settlement for as much as $100 million and paid Florida regulators $6 million to settle abusive sales practices charges.

Even the venerable Prudential Insurance Company of America came under attack for its sales practices. Class actions were brought charging that thousands of Prudential policyholders were defrauded by agents who churned the sale of whole life policies to generate commissions and who misled customers about "vanishing premium" policies. By 1999, Prudential had paid out more than $1 billion to 250,000 policyholders in the...
class action.\textsuperscript{207} This amount covered only forty percent of the claimants.\textsuperscript{208} Prudential set aside a total of $2.6 billion to settle these claims.\textsuperscript{209} Prudential agreed to settle its life insurance regulatory problems through a multi-state settlement under which it paid a $35 million fine, the largest penalty ever imposed on an insurance company. Prudential had also agreed to settle its limited partnership claims at a cost of about $1.5 billion.\textsuperscript{210} These and other problems resulted in a reduction in Prudential’s credit rating by Standard & Poor’s.\textsuperscript{211}

Despite all of these troubles, the assets of U.S. life insurance companies reached astronomical levels. By 1982, insurance companies had assets of $700 billion, which was more than the value of the assets of the nation’s top fifty corporations combined.\textsuperscript{212} The insurance industry had assets of $1.75 trillion in 1988.\textsuperscript{213} That figure hit $2.1 trillion in 1995.\textsuperscript{214} At the same time, the mix of investments held by insurance companies was changing. For example, mortgage holdings were 9.9% of industry assets in 1995, the lowest percentage since record keeping began in 1890.\textsuperscript{215} In 1998, Kentucky and Minnesota allowed life insurers to invest up to twenty percent of their assets in common stock.\textsuperscript{216} The limit was ten percent in Arkansas, Ohio, and Indiana.\textsuperscript{217}

In 1992, two of every three adults and nine out of ten households had some form of life insurance.\textsuperscript{218} The total life insurance in force in 1995 was at a record level.\textsuperscript{219} The average amount of life insurance per household was $124,100.\textsuperscript{220} The product base for life insurance companies began to change during this period as insurance companies began to sell “universal” insurance products. These products provided more flexibility than traditional whole life policies. Universal life insurance sought to unbundle life insurance mortality costs from the interest credited on policy values and expense charges.\textsuperscript{221} This allowed the policyholder to change death benefits and “to vary the

\begin{thebibliography}{99}
\item 208. \textit{Id.}
\item 209. \textit{See id.}
\item 212. \textit{Big on Profits, Low on Returns – Insurance Says Andrew Tobias, Is America’s Protection Racket}, \textit{PEOPLE MAG.}, Apr. 12, 1982, at 77.
\item 213. \textit{FAILED PROMISES}, \textit{supra note 187}, at 7.
\item 214. \textit{Id.}
\item 215. 1996 \textit{LIFE INSURANCE FACT BOOK}, \textit{supra note 53}, at 7.
\item 217. \textit{Id.}
\item 218. By 1996, 67% of adult Americans owned life insurance, and 154 million Americans were covered by some form of life insurance. 1996 \textit{LIFE INSURANCE FACT BOOK}, \textit{supra} note 53, at 6.
\item 219. \textit{Id.}
\item 220. \textit{Id.}
\end{thebibliography}
amount or timing of premium payments."\textsuperscript{222} Universal life insurance accounted for thirty-eight percent of the industry's premiums by 1985.\textsuperscript{223}

Another new product, variable life insurance, provided life insurance, but death benefits and cash value of the policy were based on the market performance of investments maintained in a separate account by the insurance company. The policy owner had a variety of investment choices in the separate account, including mutual funds with a broad range of investment objectives. This scheme provided an opportunity for a greater return than that available on traditional whole life policies. Coverage from such products increased from about $6.8 billion in 1985 to $83.6 billion in 1995.\textsuperscript{224} Some 110 insurance companies offered over 260 different variable annuity products in 1998.\textsuperscript{225} By 1995, about 12.8 million individuals had variable annuity plans.\textsuperscript{226}

The advantage of variable annuities was hurt by changes in the tax laws that reduced capital gains taxes for competing investments. Even so, the increased emphasis on variable insurance sales meant that insurance companies increasingly grew to resemble mutual fund managers or stockbrokers. This trend accelerated in the 1990s when multiline insurers faced large losses and sold off unprofitable operations such as their property and casualty businesses.\textsuperscript{227} Among those divesting various lines of insurance business were Prudential Insurance Company of America, Metropolitan Life Insurance Company, and Travelers Insurance.\textsuperscript{228}

The assets held in the "separate" accounts required for variable annuity contracts were in excess of $400 billion by 1995.\textsuperscript{229} This was an increase of over thirty percent from 1994.\textsuperscript{230} Common stock constituted over sixty percent of the separate account assets.\textsuperscript{231} In \textit{Prudential Insurance Co. of America v. SEC},\textsuperscript{232} the Third Circuit Court of Appeals held that the separate accounts for a variable annuity contract constituted a separate legal entity from the insurance company, which meant those accounts would be regulated as investment companies.\textsuperscript{233} The SEC granted relief to allow insurance companies to avoid most of the effects of this regulation.\textsuperscript{234} It did, however, set forth requirements that insurance companies had to meet in order to sell securities to retail customers.\textsuperscript{235}

\textsuperscript{222} 1996 LIFE INSURANCE FACT BOOK, \textit{supra} note 53, at 27.
\textsuperscript{224} 1996 LIFE INSURANCE FACT BOOK, \textit{supra} note 53, at 10.
\textsuperscript{226} 1996 LIFE INSURANCE FACT BOOK, \textit{supra} note 53, at 38.
\textsuperscript{227} \textit{Finance and Economics: Breaking Up is Hard to Do}, \textit{ECONOMIST}, Apr. 4, 1998, at 77.
\textsuperscript{229} 1996 LIFE INSURANCE FACT BOOK, \textit{supra} note 53, at 7.
\textsuperscript{230} \textit{Id.}
\textsuperscript{231} \textit{Id.}
\textsuperscript{233} \textit{Id.} at 387-88.
Life Insurance remained in the mainstream of American finance. The life insurance industry provided jobs to 2,238,000 individuals in 1995. Of those individuals, 1,541,200 were employed in home offices and another 696,800 were insurance agents, brokers, and service personnel.\textsuperscript{236} Concern was expressed that the independent insurance agent “may be headed the way of the milkman.”\textsuperscript{237} Insurance agencies’ profits were down and their numbers were sharply reduced. There were some 80,000 independent insurance agencies in the United States in the middle of the 1950s. That number fell to 70,000 in 1983 and then plunged to 41,000 in 1992.\textsuperscript{238} The owners of those agencies were getting older,\textsuperscript{239} and they faced stiff competition from broker-dealers and banks.

\textit{H. Insurance Company Forays Into Banking}

In an effort to meet bank competition, some insurance companies found ways around the BHCA prohibition of the mixing of banking and nonbanking activities such as insurance. Insurance companies mined loopholes in existing statutes and regulations just as their bank competitors did in gaining entry into the insurance business.\textsuperscript{240} The most popular strategies to undertake banking activities involved unitary thrift holding companies, nonbank banks, and limited purpose trust companies. Prior to GLB in 1999, the Savings and Loan Holding Company Act (SLHCA)\textsuperscript{241} provided that a company owning only a single thrift institution was not subject to any restrictions on other activities undertaken by the company so long as the thrift subsidiary was a “qualified thrift lender” (QTL).\textsuperscript{242} A QTL is a thrift that has sixty-five percent or more of its assets devoted to housing or consumer-related lending.\textsuperscript{243} Thus, an insurance company or its holding company could purchase a single thrift, and if the thrift met the QTL test, continue to conduct insurance or any other nonfinancial activities consistent with state law.\textsuperscript{244} Pursuant to this authority, the Principal Financial Group, Travelers, State Farm, American International Group, Inc., and The Equitable Companies, among others, applied for permission to buy or establish their own thrift institutions.\textsuperscript{245}

\textsuperscript{236} 1996 LIFE INSURANCE FACT BOOK, supra note 53, at 111.
\textsuperscript{239} The average agency owner was fifty-six. Wilke & Scism, supra note 237, at A1.
\textsuperscript{240} See infra Part III.
\textsuperscript{242} 12 U.S.C. § 1467a(c)(3)(A) (1994). In addition, since a thrift institution is not considered a bank under the BHCA, 12 U.S.C. § 1841(c)(2)(B), (j) (1994), a company that controls a thrift, but not a bank, is not a bank holding company. 12 U.S.C. § 1841(a)(1) (1994) (stating that “bank holding company” means any company which has control over any bank”).
\textsuperscript{244} Unitary thrift holding companies have included an automobile company, a department store, a homebuilder, and a hotel and entertainment company among others. See OFFICE OF THRIFT SUPERVISION, HOLDING COMPANIES IN THE THRIFT INDUSTRY 4, 11 (1997), available at http://www.ots.treas.gov/docs/48031.html.
\textsuperscript{245} Wolcott B. Dunham et al., \textit{Convergence of Banking and Insurance}, 1146 PLI/CORP. 425, 428 (1999).
A second strategy for entering banking arose prior to 1987 when the BHCA defined a bank as an institution that both accepted demand deposits and made commercial loans. Insurance companies and others desiring to enter the bank business exploited this loophole by establishing or operating what became known as a “nonbank bank.” A nonbank bank was a “bank” because it had a bank charter and accepted deposits. It was a “nonbank” because it failed to meet one of the two prongs of the BHCA’s definition of bank, either by accepting only savings deposits but not demand deposits, or by making consumer loans but not commercial loans. In 1987, Congress closed this loophole in the Competitive Equality Banking Act (CEBA) by redefining “bank” to include any institution with FDIC deposit insurance. Congress, however, grandfathered nonbank banks existing as of March 5, 1987.

These grandfathered institutions were subject to strict limitations. The grandfathered nonbank banks (sometimes referred to as CEBA banks) were not permitted to expand their activities beyond those conducted as of the grandfather date. The parent holding company was prohibited from cross-marketing products to CEBA bank customers if such products could not be offered by a bank holding company. The CEBA bank was prohibited from increasing its assets more than seven percent in any annual period. Finally, CEBA prevented grandfathered CEBA banks from being sold. If the insurance company parent was acquired, the CEBA bank lost its grandfather rights, and if the insurance company parent elected to purchase an additional bank or a thrift institution, it also forfeited the grandfather rights of the CEBA bank.

A third means by which insurance companies entered banking was by operating a limited purpose trust company. A trust company is not considered a “bank” under the

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246. Savings deposits could be accessed by a negotiable order of withdrawal (NOW account), the functional equivalent of a check. See generally Bd. of Governors of the Fed. Res. Sys. v. Dimension Fin. Corp., 474 U.S. 361 (1986) (holding that the FRB’s regulatory attempt to define a demand deposit as an account like a NOW account, that “as a matter of practice” is payable on demand, was in excess of the FRB’s statutory authority) (quoting the 12 C.F.R. § 225.2(a)(1)(A) (1985) rules on NOW accounts).

247. A second type of nonbank bank is one formed after 1987 that has a bank charter, but does not have FDIC deposit insurance. This option is quite unattractive and may not even be a practical alternative since nationally chartered banks are required to have FDIC insurance and many states require banks chartered within their state also to have FDIC insurance. See Dunham, supra note 245, at 433.


251. Id. § 1843(f)(3)(B).

252. Id. § 1843(f)(3)(B)(i).


255. Insurance companies found other ways to expand into financial services. In October 1998, Prudential, the English life assurer, began a direct banking operation. Summaries: Business This Week/Politics This Week, ECONOMIST, Oct. 1, 1998, at 5. One effort in the 1980s by an insurance company to take over a bank failed. Saul Steinberg’s Reliance Group Holdings was unable to complete a hostile takeover of Chemical Bank. David Leonhardt, Chief Executive Quits at Reliance Group, N.Y. TIMES, March 1, 2000, at C11. The Equitable Life Assurance Society of the United States established a fee-based financial planning program, wrap programs, a wholesale distribution network for financial products, and a multi-manager mutual fund for variable insurance products. Press Release, Dechert Price & Rhoads, Announcement Concerning Naomi Friedland-Wechsler
BHCA if the institution functions "solely in a trust or fiduciary capacity," accepts only trust funds (not demand deposits) as deposits, and does not offer FDIC insurance on these deposits.256

I. Demutualization

Many insurance companies offering new financial products in new markets were forced to consider transforming their capital structures and operations to meet competition from banks and broker-dealers.257 Additional capital also provided currency for acquisitions and executive compensation structures. Although mutual life insurance companies accounted for over thirty-five percent of total life insurance in the United States in 1995,258 the mutual capital structure limits the ability of insurance companies to raise capital. In response, New York adopted legislation permitting mutual life insurance companies to convert to stock companies in order to allow mutuals to obtain additional capital from stock issuance.259 The Equitable Life Assurance Society was among those in need of capital, and it demutualized in 1992.260 In 1997, the Mutual Life Insurance Company of New York announced that after 150 years in mutual form, it was converting from a mutual life insurance company into a publicly owned company.261 In 1998, Prudential, the nation's largest insurance company, announced that it was also demutualizing.262 Metropolitan Life Insurance Company planned to demutualize itself through a public offering that would raise $5 billion. This was the largest financial services offering in history.263 In addition to the 130-year-old Metropolitan Life

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258. 1996 LIFE INSURANCE FACT BOOK, supra note 53, at 19.
263. Business This Week, ECONOMIST, Nov. 27, 1999, at A2.
The insurance industry has always been regulated at the state level. Attempts to impose federal regulation were repeatedly made, but nearly always successfully rebuffed by the industry and state regulators. The NAIC attempted to respond to the complications of conducting insurance in multiple states subject to regulation by multiple insurance commissioners and encouraged states to adopt model insurance regulation acts. Notwithstanding these efforts, insurance regulation still varies considerably from state to state.

The state dominated model of insurance regulation stands in contrast to the regulatory regime that has evolved for banks and securities firms. Both of these industries are subject to a host of federal statutes and regulations. Banking retains a substantial dose of state regulation for state banks, but all insured banking institutions must answer to at least one federal regulator. As insurance companies developed variable annuity contracts, they became subject to some functional regulation at the federal level by the SEC. The conflict between state and federal regulators overseeing activities in the same entity presaged many of the difficulties to be encountered by insurance firms endeavoring to expand further into securities and into banking.

III. BANK INSURANCE ACTIVITIES

While insurance companies made forays into banking, banks worked to offer insurance products to their customers. Bank entry into insurance was complicated by numerous statutory and regulatory obstacles. Banks are institutions of limited powers set forth by statute. Generally, state chartered banks may conduct business pursuant to the mandates of state law. Nationally chartered banks are empowered to engage in a specific set of activities under the NBA. In addition to regulation of the bank itself, many banks are owned by a holding company. The activities of the holding company and its nonbanking subsidiaries, before the passage of GLB, were regulated pursuant to the BHCA by the FRB and were limited to banking and activities closely related to banking. With a few exceptions, selling and underwriting insurance were viewed as financial activities separate and distinct from the business of banking. Thus, the entry of banks and bank holding companies into insurance since the early 1990’s is an example of creative


266. The state’s banking commissioner is the primary regulator of a state chartered bank. At the federal level, state chartered banks that are members of the Federal Reserve System are subject to regulation by the FRB. The FDIC regulates state banks that have not joined the Federal Reserve System. See supra note 3.

lawyering and the acquiescence of regulators frustrated with the inability of Congress to statutorily expand the permissible activities of banking organizations.

A. Insurance as a Bank Product

Banks have attempted to act as agents in selling insurance policies provided by independent insurance companies and have in some instances elected to underwrite particular types of insurance products as well as to sell them. Such revenues are particularly needed by banks that are increasingly being squeezed on interest rate margins and are experiencing competition for deposit and loan customers from numerous nonbank competitors. Offering insurance products to bank customers helps banks to offer a full array of financial planning services and perhaps keeps customers who might otherwise be attracted to insurance companies and mutual fund companies offering a wide range of bank-like products.

Banks are well positioned to offer many insurance products to consumers. For example, annuity products, typically offered by insurance companies, are financial investment products with which banks have substantial familiarity. Perhaps most significantly, banks have a perceived competitive advantage in marketing insurance over independent insurance agencies or insurance companies selling products through their own agents. Bank customers frequently visit their local bank branches; insurance customers rarely visit their insurance agent’s office. Bank customers receive monthly communications from their bank in the form of bank statements in which inserts of advertising ancillary products may easily be placed; insurance agents rarely communicate with their insureds. Banks are knowledgeable about the financial circumstances of their customers and thus are also able to anticipate their potential insurance needs; insurance agents are less familiar with their customers and their financial circumstances. Finally, many consumers place a great deal of trust and confidence in their banks and bankers; insurance agents are often viewed as only being concerned with their own financial interests. Additionally, banks’ association with the FDIC’s federal deposit insurance fund lends an aura of stability to bank-sold insurance.

Notwithstanding these significant advantages for banks, they face some additional risks by engaging in insurance agency activities. Chief among them is customer confusion regarding deposit insurance. Banks may trade on their reputations for trust and security, and customers may be misled into thinking that their insurance policies are federally guaranteed against loss. In addition, there is obvious potential for conflicts of

268. Underwriting insurance and selling insurance are two very different activities with different sets of risks and rewards. The selling of insurance by an agent for an underwriter results in commissions for the agent for each policy sold. The agent continues to receive a commission for each premium paid by the policyholder. Underwriting requires the insurance company to set aside and manage premium reserves to meet claims of the insured. Depending on the nature of the product and the structure of the insurer, fees and profits can be made by the underwriter where the premiums paid exceed expenses and claims.


270. Id. at 55 (stating that banks wish to “create value and broaden customer relationships”) (quoting a bank strategic consultant).

interest for a bank acting as a disinterested investment counselor and also acting as an insurance salesperson. Finally, there is a risk that because of their banking relationship (particularly as loan applicants), customers might feel implicitly coerced to buy an insurance product from their bank rather than a nonbank agent.\footnote{272}{CARL FELSENFELD, BANKING REGULATION IN THE UNITED STATES 182-83 (1998).}

Underwriting insurance is an intermediation function that banks may have sufficient expertise to handle. However, an insurance underwriter assumes numerous risks that may make this activity less attractive than serving as an insurance agent for banks. The profits of underwriters are subject to interest rate fluctuations and mortality and actuarial risks.\footnote{273}{S. REP. No. 84-1095, at 14 (1955), reprinted in 1956 U.S.C.C.A.N. 2482, 2495 (reporting on the Bank Holding Company Act of 1956).} Capital of a holding company devoted to insurance underwriting is devoted for the long term and may not be easily transferred back into other parts of the banking enterprise to fund other projects. If a particular insurance product does not perform well, there is a risk to the reputation of the bank and a potential loss of confidence by bank depositors in the individual bank or in the broader banking community. Presumably, federal deposit insurance funds should not be put at risk for failed or failing insurance products. A frequently voiced concern regarding the combination of banking and nonbanking activities, including insurance, is that there might be “misuse or abuse [of] the resources of a bank... in order to gain an advantage [over non-bank competitors] in the operation of the nonbanking activities.”\footnote{274}{See generally Tamar Frankel, The Dual State-Federal Regulation of Financial Institutions—A Policy Proposal, 53 BROOK. L. REV. 1133 (1990).}

\section{B. State Bank Insurance Activities}


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\footnote{272}{CARL FELSENFELD, BANKING REGULATION IN THE UNITED STATES 182-83 (1998).}

\footnote{273}{Banks may find some insurance products easier to underwrite than others. For instance, term life insurance is easier to manage than automobile insurance. The latter requires a massive infrastructure for claim adjustment. For auto insurance, pricing premiums and handling claims involve a great deal of special expertise. See Sweeney, supra note 269, at 56.}


Corporation Improvement Act (FDICIA)\(^ {276}\) limited the activities that might be engaged in by state-chartered banks acting as a principal to those activities permissible for national banks.\(^ {277}\) Nevertheless, state-chartered banks could still engage in agency activities authorized by their state chartering authorities. Other insurance activities, even as a principal, could be authorized under FDICIA if permitted under state law, and if the FDIC found the bank to be well-capitalized and concluded that the proposed activity posed no risk to the safety and soundness of the federal deposit insurance fund.\(^ {278}\)

However, FDICIA specifically prohibited insurance underwriting by state banks, except to the extent permitted for national banks.\(^ {279}\)

Between 1995 and 1998, the number of states that allowed state banks to operate insurance agencies increased from twenty-two to forty, although in some instances state banks were entitled to expanded powers by virtue of so-called “wild card” statutes that permitted state banks to engage in all activities permissible for national banks.\(^ {280}\) Other states permitted banks to sell annuities or insurance.\(^ {281}\) Forty states granted their state banks broad insurance sales powers throughout each of those states.\(^ {282}\) Seven states permitted insurance sales, but only in designated locations (such as places of less than 5,000 in population).\(^ {283}\) Two states permitted insurance sales only in designated places, but permitted insurance products to be marketed throughout the state.\(^ {284}\) One state—Massachusetts—did not permit state-chartered banks to engage in any insurance activities.\(^ {285}\)


\(^ {279}\) Id. § 1831a(b)(1). There was a limited grandfather provision for subsidiaries of state chartered banks to continue but not expand these previously permissible underwriting activities. Id. § 1831a(d)(2)(B).


\(^ {281}\) See White, supra note 76, at 125-27.

\(^ {282}\) See id. at 126.

\(^ {283}\) See id.

\(^ {284}\) See id.

\(^ {285}\) See id.
C. National Bank Insurance Activities

There are two sources of authority for national banks to engage in insurance activities: the “place of 5,000” exception in section 92 of the National Banking Act (NBA) (which is discussed below) and section 24(seventh) of the NBA providing that national banks may engage in the business of banking and “all such incidental powers as shall be necessary to carry on the business of banking.” Section 24(seventh) does not permit national banks to act generally as insurance agents or underwriters. The Office of the Comptroller of the Currency (OCC), however, recognized numerous exceptions to this general rule. It approved underwriting of title insurance and credit life insurance, as well as acting as an agent in the sale of title insurance, municipal bond insurance, and mortgage reinsurance.

286. 12 U.S.C. § 24(seventh) (1994). With regard to activities incidental to the business of banking, the United States Supreme Court held in NationsBank v. Variable Annuity Life Ins. Co., 513 U.S. 251, 258 n.2 (1995), that the Comptroller may authorize additional activities if they are within a reasonable interpretation of § 24(seventh). See also Arnold Tours, Inc. v. Camp, 472 F.2d 427, 432 (1st Cir. 1972) (finding that incidental powers are those that are “convenient or useful in connection with the performance of one of the bank’s established activities pursuant to its express powers”). See generally Julie L. Williams & Mark P. Jacobsen, The Business of Banking: Looking to the Future, 50 BUS. LAW. 783, 786 (1995); Julie L. Williams & James F.E. Gillespie, Jr., The Business of Banking: Looking to the Future—Part II, 52 BUS. LAW. 1279, 1283 (1997); Edward L. Symons, Jr., The ‘Business of Banking’ in Historical Perspective, 51 GEO. WASH. L. REV. 676 (1983).

287. Saxon v. Georgia Ass’n of Ind. Ins. Agents, 399 F.2d 1010, 1013 (5th Cir. 1968) (citing § 92 powers).


290. See OCC Interpretive Letter No. 368, Banks May Act as Agent in the Sale of Title Insurance Incidental to Its Express Authority to Make Loans Secured by Real Property, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,538, at 77,836 (July 11, 1986). The OCC found the sale of title insurance to be incidental to a national bank’s express authority to make loans secured by real estate. Id. The Second Circuit held, however, that pursuant to section 92, banks in towns of more than 5,000 could not act as an agent in selling title insurance. See Am. Land Title Ass’n v. Clarke, 968 F.2d 150, 151 (2d Cir. 1992), cert. denied, 508 U.S. 971 (1993); see also KIRSCH, supra note 234, at 72; Leigh Rademacher, Powers of National Banks to Sell Insurance, Annuities and Securities from Bank Premises, 30 CREIGHTON L. REV. 753, 754 (1997).

291. See 12 C.F.R. § 2.4 (1999). Credit life insurance was found permissible for sale by national banks in part because this form of insurance was not generally available from insurance agencies not affiliated with banks. See Indep. Bankers Ass’n v. Heimann, 613 F.2d 1164, 1171 (D.C. Cir. 1979), cert. denied, 449 U.S. 823 (1980); see also Julie L. Williams et al., After Barnett: The Intersection of National Bank Insurance Powers and State Regulation, 1 N.C. BANKING INST. 13, 17 (1997). The OCC’s approval for a bank to act as agent for the sale of crop insurance was recently struck down by the D.C. Circuit, even though the OCC urged that crop insurance was similar to credit-related insurance. Indep. Ins. Agents of Am. v. Hawke, 211 F.3d 638, 642, 645 (D.C. Cir. 2000).

292. See OCC Interpretive Letter No. 338, Issuance of Standby Letters of Credit by Subsidiary to Support Municipal Bond Issues, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,508, at 77,790 (May 2, 1985); see also Am. Ins. Ass’n v. Clarke, 865 F.2d 278, 282-83 (D.C. Cir. 1989) (holding that municipal bond insurance was functionally equivalent to a standby letter of credit, the issuance of which was traditionally viewed as an activity incidental to banking activities).
National banks made further inroads into the insurance business in 1995 when the Supreme Court held in *NationsBank of North Carolina v. Variable Annuity Life Insurance Co. (VALIC II)*, 294 that a national bank could sell fixed and variable rate annuities. 295 The Court found that annuities were financial investment products (rather than insurance) for purposes of federal banking law and that banks may act as agents or brokers with respect to them. 296 Although annuities may not be insurance products under the NBA, the Seventh Circuit Court of Appeals held that annuities remain insurance products for purposes of the McCarran-Ferguson Act so that their sale is subject to state insurance regulation. 297 The Eleventh Circuit recently held that underwriting an annuity involves a type of risk-shifting that is not the business of banking, but rather the business of insurance. 298

Additionally, national banks successfully exploited a previously overlooked provision of the NBA to expand their insurance agency activities. Section 92 of the NBA, which was added in 1916, permitted a national bank located in a place of less than five thousand to act as an insurance agent. 299 The policies sold had to be written by unaffiliated insurance companies. 300 This statute, some believed, was repealed in 1918, 301 and beginning in 1952, the section was even omitted from the United States


296. *See* *NationsBank*, 513 U.S. at 260; *see also* Rademacher, *supra* note 290, at 761.

297. *See* Am. Deposit Corp. v. Schacht, 84 F.3d 834, 842-43 (7th Cir. 1996), cert. denied, 519 U.S. 870 (1996) (holding that a so-called “retirement certificate of deposit,” which was a fixed annuity investment product, was subject to Illinois insurance regulations). This holding has been criticized as inconsistent with *VALIC II* and the Supreme Court’s 1959 holding in *SEC v. Variable Life Ins. Co.*, 359 U.S. 65, 71 (1959), that annuities are not insurance products for purposes of the McCarran-Ferguson Act. *See* Williams et al., *supra* note 291, at 13, 33; John Jaye, Note, *The Retirement CD and Recent OCC Action Regarding Banks-in-Insurance*, 1 N.C. BANKING INST. 194, 205-14 (1997). Subsequently issued IRS regulations provided that interest on these certificates of deposit could not accumulate tax free, effectively eliminating the justification for the product. 26 C.F.R. § 1.1275-1(d) (1999).


301. David W. Roderer, *Nonexistent Banking Law Warrants Closer Scrutiny*, LEGAL TIMES, Jan. 9, 1984, at 12 (“While compiling the many provisions [of] the omnibus banking legislation passed in 1982... federal lawyers learned—and quietly acknowledged that in 1918 another important provision of law [section 92] was repealed inadvertently.”).
The repeal controversy was put to rest in 1993 when the United States Supreme Court held that the statute was still on the books.\(^{303}\)

When the Comptroller ruled that insurance customers need not be located in a place of five thousand, this statute became a powerful tool for national banks seeking to sell insurance.\(^{304}\) While it is true that the statute only restricted the bank's location to the place of less than five thousand, many believed that the original intention of the section was to give small town banks an additional source of income, rather than to permit those banks or branches to sell insurance nationwide.\(^{305}\) An interpretive letter issued by the Comptroller of the Currency to First Union National Bank detailed the connections that the OCC suggested must exist between the bank's facility located in the place of less than five thousand and the conduct of the insurance agency business.\(^{306}\) The letter required that all agents be licensed from the office in the place of less than five thousand, but permitted marketing and sales activities to be conducted outside of the place of five thousand.\(^{307}\)

Because the McCarran-Ferguson Act had long been thought to provide exclusively for state regulation of the business of insurance, the operation of insurance agencies by national banks inevitably conflicted with state insurance statutes and regulations. In *Barnett Bank of Marion County, N.A. v. Nelson*,\(^{308}\) the Supreme Court held that state legislation could not restrict national banks from selling insurance.\(^{309}\) The legislation in question was a Florida anti-affiliation statute that prevented banks from being affiliated with entities selling insurance within the state.\(^{310}\) While the McCarran-Ferguson Act provided that regulation of insurance was relegated to the states and that federal law was not to preempt it, the Act excepts federal statutes specifically regulating insurance from

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\(^{304}\) See Indep. Ins. Agents of Am. v. Ludwig, 997 F.2d 958, 960 (D.C. Cir. 1993) (finding that customers may be solicited outside of the place of 5,000).

\(^{305}\) 2 CRANMORE ET AL., supra note 302, § 26.08[1]; see Ala. Ass'n of Ind. Ins. Agents v. Bd. of Governors of Fed. Res. Sys., 533 F.2d 224, 243 (5th Cir. 1976) (noting that the legislative history indicated that the primary purpose of the statute was to give small town banks a source of income).


\(^{307}\) See OCC Interpretive Letter No. 753, supra note 306, at 90,220. In OCC Interpretive Letter No. 823, A “Place” for Purposes of Bank’s Insurance Sales Was a Place as Defined by Census, [1997-1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-272, at 90,277 (Feb. 27, 1998) [hereinafter OCC Interpretive Letter No. 823], the Comptroller stated that it interprets the word “place” in accordance with the Census Bureau’s definition. Thus, a “place” can be an incorporated area or a “census designated place” (CDP), defined as a densely settled concentration of population, identifiable by name, but not legally incorporated. Id. at 90,278. A CDP must have 1,000 or more persons if it is located outside an urbanized area (which is defined as a settled area of at least 50,000 persons) or 2,500 or more persons if it is inside the boundaries of an urbanized area. Id. at 90,278.


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this reverse-preemption rule. The Supreme Court held in 

Barnett Bank that section 92 of the NBA did specifically regulate insurance because it provided that national banks could sell insurance in a place of less than five thousand. Therefore, section 92 did preempt inconsistent state statutes purporting to regulate insurance.

In 1996, the OCC issued an advisory letter stating that it would find state insurance regulation problematic where it treats or affects national banks offering insurance differently than other insurance agents. State statutes subsequently challenged by national banks included a Rhode Island statute that limited the ability of national banks to use customer information to solicit and sell insurance; a New York statute that barred national banks in small towns from selling insurance to their loan customers; and an Ohio statute that limited the ability of national banks to sell insurance to their customers.

D. Nonbanking Subsidiary of a Bank Holding Company

Bank holding companies could undertake expanded activities through their nonbanking subsidiaries. Prior to 1982, many bank holding companies had subsidiaries that performed insurance agency functions, and some even underwrote credit life, credit accident, and health insurance. The possibility for expansion of insurance activities through the holding company largely evaporated, however, with the passage of the Garn-St Germain Act of 1982. That Act provided that "it is not closely related to banking... for a bank holding company to provide insurance as a principal, agent, or broker," with certain exceptions. Among the exceptions were two grandfather provisions, including one for activities authorized before 1982. These grandfathered insurance sales provisions have been interpreted to be transferable upon acquisition.

313. See OCC Advisory Letter 96-8, Guidance to National Banks on Insurance and Annuity Sales Activities, 4 Fed. Banking L. Rep. (CCH) ¶ 35-163, at 37,755 (Oct. 8, 1996) (stating that state statutes should not significantly interfere with the national bank’s ability to undertake activities authorized by federal law).
315. See N.Y. Bankers Ass’n v. Levin, 999 F. Supp. 716, 718 (W.D.N.Y. 1998). In Levin, the New York insurance commissioner gave Canandaigua National Bank a license to sell insurance pursuant to § 2501 of the New York Insurance Law, but banned it from writing policies for property pledged as collateral from its borrowers (the Canandaigua branch was located in Bloomfield, a town of 1331 residents). Id. Applying the Barnett Bank holding, the federal district court ruled that the NBA preempted the New York law, which interfered with the bank’s right to sell insurance products to its loan customers. Id. at 719.
317. See FELSENFELD, supra note 272, at 187.
320. Id. § 1843(c)(8)(D), (G). The second grandfather provision related to bank holding companies that became subject to the Bank Holding Company Act in 1970.
Moreover, an exception parallel to section 92 of the NBA exists for activities of the nonbanking subsidiary in a place of less than five thousand people.\textsuperscript{322} The FRB has not read this exception as expansively for nonbanking subsidiaries as the OCC has read section 92 for national banks.\textsuperscript{323} Exceptions also existed for small bank holding companies with total assets of less than $50 million\textsuperscript{324} and for providing credit-related insurance as a principal or agent.\textsuperscript{325} Notwithstanding the many exceptions contained in the BHCA, the clear general rule forbidding bank holding companies from participating in insurance precluded the FRB from authorizing bank holding companies to engage in or affiliate with companies underwriting insurance.\textsuperscript{326}

\section*{E. Other Avenues for Bank Insurance Activities}

There were, of course, other ways that banks proceeded through the restrictive regulatory landscape dealing with insurance activities. Bank holding companies established offshore subsidiaries to engage in reinsuring insurance policies sold abroad—a practice similar to underwriting, although not as risky.\textsuperscript{327} Nonbank financial institutions also sometimes engaged in insurance activities. State chartered savings banks in some New England states were permitted to underwrite life insurance.\textsuperscript{328} A thrift institution, owned by a unitary thrift holding company, found that it could engage in insurance through other subsidiaries of the thrift holding company. Indeed, as previously discussed, a number of insurance companies took advantage of this provision and bought or formed thrift institution subsidiaries prior to the enactment of GLB.\textsuperscript{329}

\section*{F. Bank Involvement in Insurance Pre-Gramm-Leach-Bliley}

Even prior to the enactment of GLB, banks had significant involvement in insurance activities. The bulk of bank insurance activities pre-GLB were agency activities conducted either by state banks pursuant to state authority or by national banks pursuant to section 92 of the NBA. National banks could claim special advantage in the insurance agency area—the ability to preempt state insurance regulations pursuant to the interpretation of the McCarran-Ferguson Act and the NBA in the \textit{Barnett Bank} case.\textsuperscript{330}

\begin{itemize}
\item \textsuperscript{322} 12 U.S.C. § 1843(c)(8)(C). This exception is also available if the bank holding company demonstrated that the place had inadequate insurance facilities. Id. § 1834(c)(8)(C); see Independent Ins. Agents of Am. v. Bd. of Governors of the Fed. Res. Sys., 835 F.2d 1452, 1458 (D.C. Cir. 1987) (relaxing the interpretation of this exception to require only that there be a lending office in the place of less than 5,000 and not the principal place of business).
\item \textsuperscript{323} See PAULINE B. HELLER, FEDERAL BANK HOLDING COMPANY LAW § 5.01 (1998).
\item \textsuperscript{324} 12 U.S.C. § 1843(c)(8)(F) (1994).
\item \textsuperscript{325} Id. § 1843(c)(8)(A).
\item \textsuperscript{326} See Mattingly & Fallon, supra note 300, at 29-30.
\item \textsuperscript{327} See Regulation K, 12 C.F.R. § 211.5(d)(16) (2000). Regulation K, though it does not expressly authorize reinsurance by an offshore subsidiary, has been interpreted to allow for such activity. See Federal Reserve Board, No-Action Letter (May 20, 1997), available at http://www.federalreserve.gov/boarddocs/legalint/Foreign/1997/19970520. See also Niamh Ring, Hold the Underwriters: Bankers Mull Insurance Merger Opportunities, AM. BANKER, Apr. 25, 2000, at 1 (describing a bank underwriting fixed annuities through an offshore reinsurance process pursuant to Regulation K).
\item \textsuperscript{328} 3 JOHN C. DEAL ET AL., BANKING LAW, § 55.04 (1991).
\item \textsuperscript{329} See supra Part II.H.
\item \textsuperscript{330} See supra Part III.C.
\end{itemize}
In addition to agency activities, some banks underwrote credit-related insurance. Seventy percent of all banks offered some insurance products ranging from annuities and credit-related insurance to property, life, and medical insurance. Although annuities and credit-related insurance were the most commonly offered bank insurance products, many banks offered insurance products other than these traditional ones. In the annuity market, banks were significant participants, accounting for twenty-five to thirty percent of all annuity sales. Fully one-third of all fixed annuities and twelve percent of all variable annuity products were sold at banks.

BB&T Corporation, parent company of state-chartered Branch Banking and Trust Company, headquartered in Winston-Salem, North Carolina, operated insurance agencies since 1922 and exemplifies a successful marriage of banking and insurance agency activities. Beginning in the mid-1980's, it expanded its insurance agency operations through an aggressive acquisition strategy of independent agencies. The strategy assumed that there were opportunities for profit by putting agencies with duplicative back office operations under one roof and reducing overall costs. As a result of this strategy, BB&T has one of the thirty largest insurance agency systems in the country—bank or nonbank. BB&T sells life, health, title, and property insurance.

IV. GRAMM-LEACH-BLILEY ARRIVES

The statutory authority for companies that own banks to also directly engage in selling and underwriting insurance came with the enactment of the Gramm-Leach-Bliley Act on November 12, 1999. This significant legislation opened the door to permit holding companies to engage in financial services including insurance, securities, and merchant banking. The statutory and regulatory structure under which these new activities may be undertaken is quite complex as will be discussed in more detail in this part. Moreover, there remain significant opportunities for regulatory conflict that are not solved by GLB's seemingly wholesale adoption of a scheme of functional regulation. Two significant events preceded and paved the way for GLB's enactment—the conversion of important segments of the insurance industry to bank participation in

331. Annuity sales by banks were some $4 billion in 1987. White, supra note 76, at 128. That figure increased to $16.4 billion by 1994. Id.


333. In 1991, banks sold $300 million in ordinary life and health insurance. White, supra note 76, at 130. In 1995, that figure increased to $3.6 billion. Id. By 1996, most banks sold some form of life insurance product. Id. at 129.


335. Sweeney, supra note 269, at 57.

336. Id. See also Larry Larocco, Banks' Role In Insurance To Grow After Gramm-Leach-Bliley Act, NAT'L UNDERWRITER LIFE & HEALTH — FIN. SERVS. ED., Nov. 15, 1999, at 7 (stating that Wells Fargo, a bank, runs the seventh largest insurance agency in the United States).

337. See Sweeney, supra note 269, at 55.

insurance, and the creation of Citigroup, a holding company formed by the merger of Citibank, a bank holding company, and Travelers, an insurance company.

A. The Insurance Industry Capitulates

Initially, the trade association for independent insurance agents ferociously opposed bank intrusion into the insurance industry.\(^{339}\) Clearly, banks were a threat to their existence.\(^{340}\) Independent agencies already faced competition from direct line purchasers that allowed consumers to buy insurance from the insurance underwriting company without having to pay an intervening agency. As one writer noted, "[W]e are witnessing the virtual disappearance, nominally, of the 'life insurance agent' as this person is now being named 'financial planner.'"\(^{341}\) This transformation occurred because many insurance agents and securities brokers were cross-licensed, and many securities brokers selling insurance were working for a bank affiliate. The insurance lobby effectively capitulated to bank competition in 1997 when the Independent Insurance Agents of America announced that it would support legislation allowing the affiliation of banks and insurance firms if functional regulation of insurance activities by the traditional state regulator was retained, and if appropriate consumer protection measures were enacted.\(^{342}\) Perhaps the insurance underwriters decided that banks functioned as good retail delivery vehicles for insurance products and that empowering more bank affiliated insurance agents could improve insurance company sales.\(^{343}\)

B. Creation of Citigroup

The biggest bombshell in the world of banks and insurance arrived in April of 1998 when Citicorp announced that it was merging with Travelers Group, which also owned Salomon Brothers and Smith Barney.\(^{344}\) The value of this merger was set at $83 billion.\(^{345}\) The combined firm's holding company became Citigroup, Inc. Citigroup had more than 100 million customers worldwide and offered a wide range of products ranging from corporate finance to consumer banking and securities. The FRB approval of the Citibank/Travelers merger was subject to a requirement that the new Citigroup divest itself of the Travelers insurance underwriting unit because of the restrictions on bank

\(^{339}\) Much of the litigation that opposed bank involvement in insurance was initiated by an industry trade group—the Independent Insurance Agents of America. See, e.g., Indep. Ins. Agents of Am. v. Bd. of Governors of the Fed. Res. Sys., 890 F.2d 1275, 1284 (2d Cir. 1989), cert. denied, 498 U.S. 810 (1990) (upholding FRB's determination that the nonbanking prohibitions of the BHCA do not apply to subsidiaries of state-chartered banks engaged in insurance activities pursuant to state law).

\(^{340}\) JOHN SPIEGEL ET AL., BANKING REDEFINED: HOW SUPERREGIONAL POWERHOUSES ARE RESHAPING FINANCIAL SERVICES 17 (1996).


\(^{342}\) See FELSENFELD, supra note 272, at 192; Bill McConnell, Agents Endorse Measure that Would Let Banks Own Insurers, AM. BANKER, Jan. 17, 1997, at 2.

\(^{343}\) Trevor Thomas, Distribution Continues as CEOs' Top Issue, NAT'L UNDERWRITER LIFE & HEALTH—FIN. SERVS. ED., Apr. 3, 2000, at 3. Product distribution is a growing concern for insurance companies who have expanded the use of "broker dealers, financial planners and banks." Id.


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holding companies engaging in insurance underwriting activities. The divestiture period, however, was by statute a minimum of two years, which could potentially be extended to a maximum of five years upon application to the FRB. This merger placed increased pressure on Congress to repeal bank restrictions on insurance activities, especially underwriting. Therefore, a portion of GLB was addressed to that concern.

C. Gramm-Leach-Bliley

GLB significantly expanded the ability of banks to engage in insurance activities. The Act created a new type of bank holding company called a “financial holding company” (FHC). Effective March 11, 2000, an FHC may engage in activities that are financial in nature, including banking, securities, insurance (underwriting as well as sale as an agent), and merchant banking. To qualify as an FHC, each subsidiary of a bank holding company must be well-capitalized and well-managed, and have received a Community Reinvestment Act (CRA) rating of at least satisfactory at the depository subsidiary’s most recent CRA examination.

GLB also created a new category of direct subsidiary of a bank called a “financial subsidiary,” which enables banks to expand their financial activities without the necessity of creating an FHC or qualifying as an FHC. As a general matter, a financial subsidiary may engage in many of the same activities as a subsidiary of an FHC. A significant exception, however, is that insurance underwriting may not be conducted in a financial subsidiary, necessitating qualification as an FHC for any bank holding company interested in engaging in insurance underwriting activities. To qualify as a financial subsidiary, GLB requires that the bank and each depository institution affiliate be well-capitalized and well-managed.

Although GLB significantly expanded the activities that may be conducted by banks and their affiliates, the structure and placement of those activities were subject to various qualifications and limitations. For example, GLB also placed restrictions on the activities of financial subsidiaries during the five-year period following adoption of the Act, at which time the FRB and the Secretary of the Treasury may adopt rules permitting such activity.

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350. See note 4 supra.
351. Id. § 103(a), 12 U.S.C.A. § 1843(k)(4).
352. Id. § 103(a), 12 U.S.C.A. § 1843(l).
354. Compare Gramm-Leach-Bliley Act § 121(a), 12 U.S.C.A. § 24a(a)(2)(A)(i) (West Supp. 2000) (a national bank may control a financial subsidiary that engages in “activities that are financial in nature or incidental to a financial activity”), with id. § 103(a), 12 U.S.C.A. § 1843(k)(1)(A) (an FHC may engage in any activity that the FRB determines “to be financial in nature or incidental to such financial activity”).
355. Id. § 121, 12 U.S.C.A. § 24a(a)(2)(B)(i). A financial subsidiary is also precluded from merchant banking activities for the five year period following adoption of GLB, at which time the FRB and the Secretary of the Treasury may adopt rules permitting such activity. Id. § 122, 12 U.S.C.A. § 1834 note.
356. Id. § 121, 12 U.S.C.A. § 24a(a)(2)(C). Further, the aggregate consolidated total assets of all financial subsidiaries of the national bank must not exceed the lesser of 45% of the consolidated total assets of the parent bank or $50 billion. Gramm-Leach-Bliley Act § 121, 12 U.S.C.A. § 24a(a)(2)(D) (West Supp. 2000). If the bank is one of the 50 largest insured banks, it must have at least one issue of outstanding eligible debt currently rated within the three highest investment grade rating categories. See id. § 121, 12 U.S.C.A. § 24a(a)(3)(A)(i). If the bank is one of the second 50 largest, it must meet all the above criteria or any other criteria set forth by FRB and the Treasury Department. Id. § 121, 12 U.S.C.A. § 24a(a)(3)(A)(ii).
activities continue to play an important role in planning permissible new ventures as will be discussed further below with respect to insurance activities.

GLB continues the McCarran-Ferguson Act's requirement that insurance be regulated at the state level.\textsuperscript{357} GLB specifically addresses the interaction between state insurance regulators and federal banking regulators, anticipating the likely regulatory struggle.\textsuperscript{358} The Act's adoption of a functional regulatory structure is likely to be put to the test in regulating the insurance activities of banking organizations.

1. Nonbanking Subsidiary of a Holding Company

Prior to GLB, section 4(c)(8) of the BHCA mandated that bank holding company subsidiaries engage only in those activities "so closely related to banking ... as to be a proper incident thereto."\textsuperscript{359} This section declared that "it is not closely related to banking or managing or controlling banks for a bank holding company to provide insurance as a principal, agent, or broker" except in certain circumstances provided for in the section.\textsuperscript{360} GLB replaced this section with a provision that a bank holding company could continue to engage in those activities permitted by the FRB as of the day before the enactment of GLB.\textsuperscript{361} Thus, the insurance activities of nonbanking subsidiaries of a bank holding company were not expanded by GLB but may continue in accordance with section 4(c)(8) of the BHCA.

GLB also authorized the creation of a financial holding company as a new type of bank holding company. An FHC may conduct all activities permitted under the BHCA and, in addition, may engage in activities that are (A) "financial in nature or incidental to such financial activity," or (B) "complementary to a financial activity" and do not present a substantial risk to the safety or soundness of the depository institution subsidiaries or the financial system.\textsuperscript{362} Specifically listed as activities that are financial in nature are "[i]nsuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any State."\textsuperscript{363} Moreover, it is permissible for an FHC subsidiary to own shares, assets, or ownership interests in a company or other entity if such ownership represents an investment made in the normal course of business by an insurance company in accordance with state law regulating such investments, and the FHC does not routinely manage or operate the company in which it holds the investment, except as necessary to ensure a reasonable return on the investment.\textsuperscript{364}

Thus, GLB legitimates Citigroup's ownership of both Citibank and Travelers Insurance Company. Bank holding companies that wish to expand into insurance

\textsuperscript{357} Id. § 104, 15 U.S.C.A. § 6701(a). The FRB is granted authority over all the FHC's activities including insurance in its role as the "umbrella" supervisor. See discussion infra note 387 and accompanying text.

\textsuperscript{358} See infra Part IV.C.5.


\textsuperscript{360} Id. § 1843(c)(8).


\textsuperscript{362} Id. § 103(a), 12 U.S.C.A. § 1843(k)(1).

\textsuperscript{363} Id. § 103(a), 12 U.S.C.A. § 1843(k)(4)(B).

\textsuperscript{364} Id. § 103(a), 12 U.S.C.A. § 1843(k)(4)(I). Once the holding company has qualified as an FHC, prior approval is not required for it to engage in an activity pursuant to section 1843(k)(4) or pursuant to any FRB regulation issued under section 1843(k)(5). Id. § 103(a), 12 U.S.C.A. § 1843(k)(6)(B).
underwriting need to qualify as an FHC and conduct underwriting activities in a subsidiary of an FHC. Numerous institutions have already filed as FHCs, enabling them to expand their financial activities when they desire.365

2. National Banks and National Bank Subsidiaries

Under GLB, neither a national bank nor its subsidiary may underwrite insurance unless underwriting was permitted by enforceable OCC rulings as of January 1, 1999.366 These authorities permit underwriting of credit-related insurance products.367 The Act, however, specifically prohibits the underwriting of title insurance or an annuity contract even if it has already been approved by the OCC.368

Although the financial subsidiaries of national banks—like the subsidiaries of an FHC—are authorized to engage generally in activities that are “financial in nature or incidental to a financial activity” under GLB, insurance underwriting and annuity issuance are specifically excluded for a financial subsidiary even though both are permitted for an FHC subsidiary.369 This curious distinction is apparently the result of a compromise of the turf war between the FRB (regulator of FHCs, bank holding companies, and their respective nonbank subsidiaries) and the OCC (primary regulator of national banks and national bank subsidiaries).370 The compromise position was apparently premised on an assumption that certain financial activities were too risky to be placed in a financial subsidiary of a bank. Included on the list of impermissible activities for a bank’s financial subsidiary are underwriting insurance, issuing annuities, real estate investment and development, and merchant banking.371

Section 92 of the NBA, permitting national banks to act as an insurance agent in a place of less than five thousand, was not repealed by GLB, so presumably national banks may still conduct insurance agency activities in offices of the national bank located in a place of less than five thousand people.372 A financial subsidiary of a national bank is not

365. Eileen Canning, Financial Services: Fed Chief Says Financial Holding Companies Should Take on New Ventures with Caution, BNA BANKING DAILY, May 26, 2000, at D2. As of mid-May, 2000, 270 domestic banking organizations and 17 foreign banking organizations had qualified as FHCs. Id.


367. See supra note 289 and accompanying text; see also OCC Interpretive Letter No. 886, (Mar. 27, 2000), 2000 WL 529016 (concluding that national banks and their subsidiaries may continue to underwrite credit-related insurance products relating to their own loans and to those of nonaffiliated financial institution lenders and credit-related insurance was an “authorized product” for national banks as of January 1, 1999).


370. The FRB wished to retain its traditional control over the nonbanking activities of bank holding companies and prevent a national bank from engaging in the whole panoply of nonbanking activities in its subsidiaries outside the FRB’s reach. See Patricia A. McKoy, Banking Law Manual § 4.02, at 4-15 (2d ed. 2000) (describing the compromise between the FRB and OCC by which Congress carved out the four financial activities that it deemed to be of highest risk and confined them to FHCs and therefore to the jurisdiction of the FRB).


subject to the place of five thousand limitation, however, and for this reason it is likely that many national banks will transfer their insurance agency activities to a financial subsidiary.

In another curious restriction, GLB forbids the sale of title insurance by a national bank unless authorized under state law for a state-chartered bank. In such a state, a national bank may also sell title insurance subject to the same restrictions applicable to the state-chartered bank. The title insurance sale restriction applies only to the national bank, so presumably, a financial subsidiary should be able to sell title insurance, which would provide an additional incentive to transfer insurance agency activities to a financial subsidiary of a national bank. A grandfather provision permits a national bank or its subsidiary to continue any title insurance activities (underwriting or sale) "actively and lawfully" conducted before the enactment of GLB. However, a national bank with no affiliate other than a subsidiary that underwrites insurance may not directly engage in underwriting title insurance. In addition, if a national bank has an affiliate that underwrites insurance but is not a subsidiary of the bank, neither the bank nor its subsidiary may underwrite title insurance pursuant to the grandfather provision. Although a national bank's title insurance activities may continue pursuant to this grandfather provision, the grandfather proviso in effect pushes out the title insurance activities from the bank to an existing separate subsidiary or affiliate engaged in insurance.

3. State Banks and State Bank Subsidiaries

State banks and their subsidiaries, as a general matter, are prohibited by the FDICIA from engaging in insurance underwriting even if permitted under state law, except to the extent that activity is permissible for national banks. The new insurance underwriting act is subject to the place of five thousand limitation, however, and for this reason it is likely that many national banks will transfer their insurance agency activities to a financial subsidiary.


374. In a December 7, 1999 letter, the OCC authorized Bank of America to convert its insurance subsidiary, Bank of America Insurance Services, Inc., from an operating subsidiary into a financial subsidiary. Rob Garver, Bank of America Is First to Seek Approval to Move Insurance Unit to HQ City, AM. BANKER, Dec. 29, 1999, at 2. The move will free Bank of America from the place of 5,000 restriction.


377. Id. § 303(a), 15 U.S.C.A. § 6713(a); see also Larocco, supra note 336, at 7.


381. See 12 U.S.C. § 1831a(b) (1994) (governing state banks); id. § 1831a(d)(2) (governing subsidiaries of state banks). State banks or their subsidiaries providing crop insurance on or before September 30, 1991 may continue to provide such insurance if the Federal Crop Insurance Corporation reinsured them. Id. § 1831a(b)(2). A grandfather provision also permitted well-capitalized state banks and their subsidiaries to continue to provide insurance lawfully provided as of November 12, 1991 to residents of the state, those employed in the state, or other customers who formerly resided or were employed in the state. Id. § 1831a(d)(2)(B). An additional exception permitted a subsidiary of an insured state bank to provide title insurance if before June 1, 1991 the bank was required to provide such insurance as a condition to obtaining a charter under state law. Id. § 1831a(d)(2)(C).
restrictions for national banks in GLB also restrict the underwriting ability of state banks. Thus, state banks cannot underwrite title insurance unless they fall within one of the limited exceptions provided in the FDICIA. 382

GLB does not answer definitively whether state banks may issue annuities if so authorized under state law. GLB clearly prevents national banks from issuing annuities. But if annuities are not insurance, then they are not subject to the underwriting prohibitions. Moreover, a state bank or its subsidiary could apply for the FDIC’s permission to issue annuities as a principal. 383

Insurance agency activities, if permitted under state law, are not linked to national bank powers since the FDICIA only limits a state bank’s activities as principal. 384 In a state that authorizes title insurance sales for its state banks, those sales may continue under GLB. Although national banks under GLB generally may not engage in the underwriting or sale of title insurance, a national bank may sell title insurance in a particular state to the same extent as a state bank. 385

A state bank, to the extent permitted by state law, may own a subsidiary that engages in activities comparable to those permitted by GLB for a national bank’s financial subsidiary. 386 The conditions for establishing a financial subsidiary of a state bank mirror those that must be met to establish a financial subsidiary of a national bank. 387 In addition, a state bank may retain existing subsidiaries (that may not qualify as financial subsidiaries) and continue to engage in activities lawfully conducted by such subsidiaries as of the date of GLB’s enactment. 388 Moreover, a state bank subsidiary may still apply to engage in new activities pursuant to section 24 of the Federal Deposit Insurance Act, bypassing the requirements necessary for establishing a financial subsidiary. 389

4. Functional Regulation of Insurance Activities

The interplay of federal law and state law will likely continue to be troublesome in spite of the detailed provisions of GLB addressing this issue. For an FHC that operates a subsidiary engaged in insurance, GLB provides for functional regulation. That is, the insurance company subsidiary is to be regulated by its functional regulator, the state

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382. See supra note 278 and accompanying text.
383. To approve this activity, the FDIC would have to find that (a) the state bank is in compliance with all relevant capital standards, and (b) the activity poses no significant risk to the deposit insurance fund. 12 U.S.C. § 1831a(a)(1), (2) (1994). A list of the activities approved by the FDIC is maintained at http://www.fdic.gov/regulations/resources/approved/index.html. FDIC, Equity Investments, Real Estate Activities and Other FDIC-Approved Investments and Activities (Oct. 17, 2000). See also supra notes 297-298 and accompanying text (describing controversy about bank issuance of retirement CDs, a type of annuity).
384. 12 U.S.C. § 1831a(a) (1994). State banks selling insurance are also subject to regulations regarding retail sales practices, solicitations, and advertising. See infra note 403.
386. See id. § 121 (d)(1), 12 U.S.C.A. § 1831w (adding § 46 to the Federal Deposit Insurance Act).
389. Id. § 121(d)(1), 12 U.S.C.A. § 1831w(d)(1).
insurance regulatory authority.\textsuperscript{390} GLB has special provisions for the “functionally regulated subsidiaries” of an FHC, such as an insurance company or a securities firm, and seemingly preserves the primacy of the functional regulator.\textsuperscript{391} Moreover, GLB reaffirms the McCarran-Ferguson Act’s requirement that state law, rather than federal law, regulate insurance.\textsuperscript{392}

The FRB, however, is the primary federal regulator of an FHC, just as it is of a bank holding company pursuant to the BHCA. It is referred to as the “umbrella” regulator, and it retains “oversight” jurisdiction over the insurance company subsidiary of an FHC.\textsuperscript{393} Although GLB attempts to delineate the scope of the FRB’s authority with respect to a so-called “functionally regulated subsidiary,” such as an insurance company, there remains opportunity for regulatory conflict.\textsuperscript{394}

To the extent that a depository institution or its financial subsidiary engages in insurance activities, there is further opportunity for conflict between the primacy of state regulation of insurance and the regulatory authority otherwise asserted over the depository institution and its financial subsidiary.\textsuperscript{395} The opportunity for federal preemption presents itself when the depository institution is federally chartered by the OCC (a national bank) or the Office of Thrift Supervision (OTS) (a federal thrift). This issue, of course, was at the heart of the \textit{Barnett Bank} case where, prior to the enactment of GLB, the Supreme Court declared that a national bank could conduct insurance agency activities in Florida pursuant to section 92 of the NBA, in spite of Florida’s limitation on such activities.\textsuperscript{396} The McCarran-Ferguson Act did not apply to ensure the primacy of the state statutory provision because section 92 of the NBA specifically related to insurance and therefore, pursuant to the McCarran-Ferguson Act, preempted state law.

GLB prohibits states from preventing or significantly interfering with the ability of insurance companies to become an FHC, acquire stock in a depository institution, or reorganize from mutual to stock form.\textsuperscript{397} GLB attempts to resolve any potential conflict by reaffirming the primacy of state regulation of insurance\textsuperscript{398} and providing that states

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\item \textsuperscript{390} Id. § 301, 15 U.S.C.A. § 6711.
\item \textsuperscript{391} Id. See McKay, \textit{supra} note 370, at §12.02[2] (discussing the functional regulation provisions of GLB).
\item \textsuperscript{392} See id. § 104(a), (b), 15 U.S.C.A. § 6701(a), (b).
\item \textsuperscript{393} Id. § 111, 12 U.S.C.A. § 1844(c); see H.R. Conf. Rep. No. 106-434, at 157 (1999), reprinted in 1999 U.S.C.C.A.N. 245, 252 (describing “the Board’s role as an umbrella supervisor”).
\item \textsuperscript{394} Larocco, \textit{supra} note 336, at 7 (the author, the managing director of the American Bankers Association Insurance Association, predicts there will be litigation over the unclear line between the powers of state insurance regulators and federal banking regulators).
\item \textsuperscript{395} Stephen Piontek, \textit{Top Ten Stories of 2000}, \textit{NAT’L UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED.}, Jan. 3, 2000, at 27 (“We’re going to see suits about whether certain activities are permissible or non-permissible; whether the courts owe deference or not; and whether state insurance departments can really tell a bank anything it doesn’t want to hear and make it stick.”); see also Steven Brostoff, \textit{GLB’s Insurance Provisions Called ‘A Morass’}, \textit{NAT’L UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED.}, Feb. 14, 2000, at 13 (reporting that a state insurance regulator and a top official at the OCC agreed that the GLB insurance provisions are an “interpretive morass” likely to spur litigation between state insurance regulators and federal banking regulators).
\item \textsuperscript{396} Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 37 (1996); see \textit{supra} Part III.C (discussing the effects of the case)
\item \textsuperscript{398} Id. § 104(a), (b), 15 U.S.C.A. § 6701(a), (b). According to Julie Williams, Chief Counsel of the OCC, the section 104 standard to determine the applicability of state insurance laws to banks is quite complicated.
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cannot discriminate against FHCs or depository institutions by preventing or restricting their insurance activities.\textsuperscript{399} Nor are states permitted to regulate insurance in a manner that discriminates adversely against depository institutions or their affiliates.\textsuperscript{400} The statute designates thirteen specific "safe harbors" in which states may regulate the insurance activities of depository institutions without fear of preemption.\textsuperscript{401} These safe harbors deal with consumer protection areas and are modeled after provisions in the insurance laws of Illinois and New York. They include the following: (1) tying of insurance to other products such as loans; (2) misrepresenting the insured or guaranteed status of an insurance product in advertisements; (3) providing a written disclosure that an insurance product is not a bank deposit, not FDIC-insured, and not guaranteed by the bank; (4) limiting commission payments to licensed insurance agents; (5) prohibiting referral fees to nonlicensed individuals based on whether the referral results in a transaction; (6) prohibiting the release of insurance information to nonaffiliated third parties to be used for soliciting or selling insurance; (7) prohibiting the use of health information obtained from insurance records without the express written consent of the customer; (8) prohibiting the use of force-placed insurance in transactions; and (9) requiring maintenance of separate insurance books and records that must be made available to state insurance regulators for inspection.\textsuperscript{402}

GLB invites states to regulate the insurance sales practices of banks and sets forth areas of regulation that will be immune from attack by federal regulators. The Act

\textsuperscript{399} Gramm-Leach-Bliley Act § 104(c), (d), 15 U.S.C.A. § 6701(c), (d) (West Supp. 2000); see Notice of Request for Preemption Determination, 65 Fed. Reg. 35420-02 (June 2, 2000); Michele Heller, \textit{OCC May Override W. Va. Law}, AM. BANKER, June 1, 2000, at 4 [hereinafter Heller, \textit{OCC May Override}]. The 1997 West Virginia Insurance Sales Consumer Protection Act contains several restrictive provisions. First, it prohibits financial services employees with lending responsibilities from soliciting the sale of insurance. Lee Ann Gjertsen, \textit{Insurers See Fight Looming on OCC Preemption of States}, AM. BANKER, July 13, 2000, at 1. Second, the law prohibits banks from requiring or implying that the purchase of an insurance product is a condition to the approval of a loan and makes a bank wait until after a loan has been approved before making an insurance-related referral or solicitation. \textit{See id.} at 1. Additionally, the law provides for enhanced privacy protection of information obtained during an insurance transaction and, most importantly, the law requires that the sale of an insurance product take place in an office physically separate from the bank's lending department. \textit{See id.} at 1. The West Virginia Bankers Association asked the OCC to preempt the West Virginia statute under GLB § 104(d)(2)(A), 15 U.S.C.A. § 6701(d)(2)(A) (West Supp. 2000), while the Professional Independent Insurance Agents of West Virginia argued that GLB § 104(d)(2)(B), 15 U.S.C.A. § 6701(d)(2)(B) (West Supp. 2000), specifically allows states to enact stronger consumer protection laws. \textit{See Heller, OCC May Override, supra}, at 1; Gjertsen, \textit{supra}, at 1.

The Massachusetts Bankers Association has requested that the OCC preempt some provisions of the Massachusetts insurance statute relating to bank sales of insurance. Michele Heller, \textit{In Brief: Insurance Group Asks Override of R.I. Law}, AM. BANKER, July 27, 2000, at 20 [hereinafter Heller, \textit{Insurance Group Asks}]. The Financial Institutions Insurance Association renewed its 1996 preemption request of Rhode Island insurance statutes that prohibit bank loan officers from selling insurance, forbid the sale of insurance and other bank products in the same transaction, require insurance sales to take place in an office physically separate from banking offices, and prohibit banks from using private customer information to sell insurance. \textit{Id.} at 20. It is estimated that at least thirty states have consumer protection similar to the type at issue in the West Virginia and Rhode Island provisions relating to bank sales of insurance products. Gjertsen, \textit{supra}, at 1.

\textsuperscript{400} Gramm-Leach-Bliley Act § 104(c), 15 U.S.C.A. § 6701(c) (West Supp. 2000).


\textsuperscript{402} Id. § 104(d), 15 U.S.C.A. § 6701(d)(2)(A).
maintains federal bank regulators' authority over insurance sales by banks by requiring
the federal banking agencies to adopt, by November 11, 2000, regulations on consumer
protection relating to the sale of insurance. Such regulations are to relate to sales
practices, disclosures, and advertising; separation of banking and nonbanking activities
within the bank office; and prohibition against domestic violence discrimination.
Moreover, the federal banking agencies must jointly develop a consumer grievance
process for insurance sales by banks. If there is a conflict between state consumer
protection provisions and these federal regulations, the stricter provisions control.

Inevitably, there will be issues regarding federal preemption of state laws regulating
insurance. In such an event, GLB provides for expedited judicial review in an appropriate
United States Court of Appeals within sixty days of the date the petition is filed. Most
significantly, GLB requires that the reviewing court consider "all questions presented
under State and Federal law... without unequal deference." This new standard also
abrogates the standard of review for federal agency interpretations of federal statutes
provided that a federal agency's interpretation of an ambiguous statute be given
"controlling weight." Deference will continue to be afforded to the OCC in its
interpretation of the NBA vis-a-vis state insurance statutes adopted before September 3,
1998. One effect of GLB may be to prod state legislatures to carefully review their
statutes and adopt provisions consistent with the safe harbors, rather than relying on
existing state statutes.

The FRB (along with other federal banking regulators) is prohibited from
prescribing regulations for; seeking or issuing orders against; imposing restraints,
restrictions, guidelines, requirements, safeguards or standards on; or taking enforcement
action against a functionally regulated subsidiary of an FHC, including an insurance
company. There are significant exceptions to this general prohibition against FRB

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403. Id. § 305(a), 12 U.S.C.A. § 1831x(a). The federal banking agencies are to issue such regulations "after
consultation with the State insurance regulators, as appropriate." Id. § 305(a), 12 U.S.C.A. § 1831x(a)(3).
Comments on the proposed regulations, jointly issued by the OCC, FRB, FDIC, and OTS, are due October 5,

404. Gramm-Leach-Bliley Act § 305, 12 U.S.C.A. § 1831x(g)(2) (West Supp. 2000); see Alex Maurice,
NAIC Seeks Transformation To Stay Viable, NAT'L UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED., Mar. 27,
2000, at 6 (expressing concern that consumer protection will lose out); see also Trevor Thomas,
Bank Insurance Sales Rising Despite Growing Pains, NAT'L UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED., Jan. 3, 2000, at
3 (speculating that adding federal regulations relating to banks selling insurance on top of state laws relating to
insurance might be troublesome).

appeals is the circuit in which the state regulating insurance is located or the District of Columbia Circuit. Id. §
304(a), 15 U.S.C.A. § 6714(a). The 60-day period for review may be extended upon agreement by all parties.
Id. § 304(b), 15 U.S.C.A. § 6714(b).

406. Id. § 304(e), 15 U.S.C.A. § 6714(e); see also Brostoff, supra note 398, at 3 (reporting that Julie
Williams, Chief Counsel for the OCC, has wondered what this means and how this standard applies to
interpretations of fact).

408. Id. at 844.
involvement in the activities of the insurance company as a functionally regulated subsidiary of the FHC. For instance, the FRB may intervene and take any action necessary to prevent or redress an unsafe or unsound practice or breach of a fiduciary duty if there is a “material risk” posed to a depository institution affiliate and if action to address that risk, limited to just the depository institution, will not effectively protect against the risk. In addition, the FRB retains the authority to examine the functionally regulated subsidiary in order to understand its operations and financial condition. Thus, the FRB can gauge the operational risks the subsidiary presents to the affiliated banks and monitor compliance with any specific law the FRB has jurisdiction to enforce. The FRB is required to obtain information about the functionally regulated subsidiary from other regulators, publicly available information, or from audited financial statements. The functionally regulated subsidiary is required to furnish any such report to the FRB at its request. In the event the FRB needs additional information, it is required to request that the functional regulator obtain such report on behalf of the FRB. If the requested report is not made available to the FRB by the functional regulator, the FRB may request the functionally regulated subsidiary to submit the report directly to the FRB. The functionally regulated subsidiary must comply with the FRB’s request if the report is needed to assess a “material risk” to the holding company or any of the depository institution subsidiaries, or if the report is necessary to assess compliance with GLB or any other federal law the FRB has specific jurisdiction to enforce.

The banking regulators—the OCC, the FDIC, and the FRB—may, pursuant to GLB, impose restrictions on transactions between their regulated banks and nonbank affiliates for the purpose of avoiding any significant risk to the safety and soundness of such institutions, including an “undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.” This complicated regulatory regime will likely be tested sooner rather than later. Regarding banks’ engagement in insurance, GLB has shifted the focus from Congress to the states—as regulators of insurance—and the courts—who will be left to interpret the exact content of the overlapping regulatory structure created by GLB.

5. GLB’s Impact on the Regulation of Insurance, Including Privacy Concerns

GLB mandates that by November 12, 2002, a majority of the states establish either uniform insurance licensing requirements for agents or enact reciprocity laws.

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411. Id. § 112(b), § 12 U.S.C.A. § 1831v(a); id. § 113, 12 U.S.C.A. § 1848a.
412. Id. § 111, 12 U.S.C.A. § 1844(c).
414. Id.
418. GLB defines “state law” for this purpose to include the following 57 jurisdictions: the fifty states plus the District of Columbia, “Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, the Virgin Islands, and the Northern Mariana Islands.” Gramm-Leach-Bliley Act § 315(13), 15 U.S.C.A. 6735(13) (West Supp. 2000). Thus, 29 jurisdictions are required to constitute a majority of the states.
419. Id. § 321(a), 15 U.S.C.A. 6751(a). Uniformity must be met in areas relating to “integrity, personal qualifications, education, training, and experience of licensed insurance producers;” continuing education
permitting the licensure of nonresidents to sell insurance within the state.\textsuperscript{420} Presumably, uniformity or reciprocity will ease the burdens on interstate banking organizations attempting to market insurance to customers in multiple states.\textsuperscript{421} Of course, prior to GLB, this burden on multistate insurance operations existed for any insurance company marketing insurance in more than one state.\textsuperscript{422} The uniform approach to insurance licensing of agents will facilitate bank sales of insurance by those banks operating in more than one state and will likely be welcomed by insurance companies as well. The NAIC has drafted a Producer Licensing Model Act that it believes satisfies GLB’s requirements. The NAIC recommends that states adopt this Model Act prior to GLB’s November 2002 deadline.\textsuperscript{423} So far, Kentucky is the only state to enact insurance licensing laws that meet the minimum requirements of GLB.\textsuperscript{424}

The consequence of a sufficient number of states failing to meet the uniformity or reciprocity requirements by GLB’s November 12, 2002 deadline could be severe. If the requisite number of states fail to act, the NAIC must establish by November 12, 2004, the National Association of Registered Agents and Brokers (NARAB).\textsuperscript{425} This private, nonprofit entity would be managed and supervised by the NAIC.\textsuperscript{426} To become a member of the NARAB, a state-licensed insurance producer must meet certain criteria to be established by the NARAB.\textsuperscript{427} NARAB membership entitles the member to licensure in each state for which the member pays any required fees and meets the bonding requirements.\textsuperscript{428}

Other proposed reforms to the insurance regulatory regime have been spawned in the wake of GLB. For instance, the American Bankers Association’s Insurance

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\item \textsuperscript{420} See Maurice, supra note 404, at 6 (expressing concern that states will “give away the store” to the insurance industry so that the industry will not support federal regulation of insurance).
\item \textsuperscript{421} Id. § 321(a)(2), 15 U.S.C.A. § 6751(a)(2).
\item \textsuperscript{422} See Jim Connolly, \textit{NAIC Expediting ‘One-Stop’ Filing Plan, NAT’L UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED., Mar. 20, 2000}, at 1 (detailing burdens of getting new products approved); Kenneth Kehrer, Comment, \textit{State Insurance Regulation Fails Industry and Consumer}, AM. BANKER, July 24, 2000, at 8 (describing how state regulation of insurance interferes with interstate commerce).
\item \textsuperscript{423} See Eileen Canning, Insurance: Insurance Industry on Schedule to Craft Uniform Standards, Senators Told, BNA BANKING DAILY, Apr. 13, 2000, at d5; \textit{Can NAIC Confound The Skeptics On The Sidelines? NAT’L UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED., Mar. 27, 2000}, at 34 (commenting that the NAIC is slow-moving and bureaucratic and must recreate itself fast or face extinction).
\item \textsuperscript{424} Canning, supra note 423, at d5. The NAIC reports that four states—Kentucky, Missouri, New Hampshire, and North Carolina—have adopted legislation regarding reciprocity. NAIC, \textit{State Status Regarding Legislation, at http://www.naic.org/NARAB/state_status_legislation.htm} (last visited Nov. 8, 2000).
\item \textsuperscript{426} Id. § 324, 15 U.S.C.A. § 6754.
\item \textsuperscript{427} Id. § 325(d), 15 U.S.C.A. § 6755. GLB mandates that these criteria are to “include standards for integrity, personal qualifications, education, training, and experience.” Id. § 325(d)(1), 15 U.S.C.A. § 6755(d)(1).
\item \textsuperscript{428} Id. § 325(e), 15 U.S.C.A. § 6755(e); see also Gramm-Leach-Bliley Act §§ 333, 334, 15 U.S.C.A. §§ 6763, 6764 (West Supp. 2000).
\end{itemize}
Association (ABAIA) has approached the issue of insurance regulation much differently than GLB and has proposed that a national charter option be created for insurance companies. In the ABAIA's view, uniform licensing requirements could be imposed by federal regulation more efficiently and effectively than by each state's legislature or insurance commissioner.  The American Council of Life Insurers also recently announced that it supports an optional federal charter for insurance companies.

Insurance companies are also affected by GLB's new provisions relating to privacy of customer information. Although discussions regarding financial modernization legislation had been ongoing for many years, the introduction of privacy into the legislative debate was one of the new features of GLB. These new provisions have already proved to be quite controversial. GLB requires that the various federal regulatory agencies adopt regulations to implement GLB's privacy provisions by November 13, 2000. Privacy regulations have been issued and will take effect on that date, but will not be enforced by the agencies until July 1, 2001, in response to vigorous lobbying by financial institutions asking for additional time to come into compliance with the new regulations.


The efficiency of state insurance regulation was questioned in a recent report issued by the Government Accounting Office that examines the alleged embezzlement of more than $200 million in insurance company assets by Martin Frankel. UNITED STATES GENERAL ACCOUNTING OFFICE, INSURANCE REGULATION: SCANDAL HIGHLIGHTS NEED FOR STRENGTHENED REGULATORY OVERSIGHT (2000), available at http://www.gao.gov/.


432. See Julie L. Williams, Ignore Privacy Concerns at Your Own Risk, AM. BANKER, June 25, 1999, at 9 ("In the last Congress, discussions of privacy were at the periphery of the debate over modernizing the financial services industry."). See generally David W. Roderer, Tentative Steps Toward Financial Privacy, 4 N.C. BANKING INST. 209, 210-11 (2000) (describing the reaction to alleged use of customer account information by U.S. Bancorp as leading to the last-minute inclusions of privacy provisions in GLB).

433. Gramm-Leach-Bliley Act § 510, 15 U.S.C.A. § 1681s note (West Supp. 2000) provides that except for section 504 (privacy rulemaking) and section 506 (protection of Fair Credit Reporting Act), Title V provisions relating to privacy shall take effect six months after the date on which rules are to be prescribed under section 504(a)(3). This works out to one year following enactment, or November 13, 2000. Section 510(a)(1) specifically provides that a later effective date may be specified in the rules. Id. The federal agencies have specified November 13, 2000, as the effective date, but have extended the time for compliance to July 1, 2001. Privacy of Consumer Financial Information, 65 Fed. Reg. 35,162 (June 1, 2000).

434. See id.
The basic outline of the privacy provisions is not complex. The component institutions of an FHC may share certain customer information.\(^435\) This provision is of vital importance to FHCs because it enables cross-marketing, including the marketing of insurance products to bank customers. Customers may, however, "opt out" to prevent their FHC from sharing private information about them with nonaffiliates.\(^436\) The statute provides some significant exceptions to the general prohibition against providing customer information to those outside the FHC. Nonpublic personal information may be provided to a nonaffiliate if necessary to perform services for the FHC (e.g., marketing an institution's own products) or pursuant to a joint marketing agreement between several institutions.\(^437\)

An important, and potentially costly, requirement in GLB is that a financial institution disclose its privacy policy to a consumer at the time of establishing a customer relationship and on an annual basis during the continuation of the relationship.\(^438\) The final prong of the privacy provisions is that states may adopt more stringent privacy provisions, and more stringent state privacy provisions shall prevail over the federal privacy regime.\(^439\)

A fundamental question for insurance companies is whether GLB's basic privacy provisions apply to insurance companies or whether states are required to adopt provisions at least as stringent as those set forth in GLB to regulate their own insurance companies.\(^440\) Insurance companies that provide variable insurance products are subject

\(^{435}\) Gramm-Leach-Bliley Act § 502(e)(1), 15 U.S.C.A. § 6802(e)(1) (West Supp. 2000). Other laws limit the sharing of specific types of information, such as medical information.


\(^{437}\) Id. § 502(b)(2), 15 U.S.C.A. § 6802(b)(2). Other exceptions permit information sharing with nonaffiliates and include information necessary to service or process a financial product or service requested by the customer. Id. § 502(e)(1)(A), 15 U.S.C.A. § 6802(e)(1)(A).

\(^{438}\) Id. § 503(a), 15 U.S.C.A. § 6803(a). Ken Reynolds, executive director of the Association of Banks-in-Insurance, estimates that 2.6 billion privacy notices will need to be sent to financial institution consumers. Steven Brostoff, Privacy Legislation Draws Industry Fire, NAT'L UNDERWRITER LIFE & HEALTH - FIN. SERVS. ED., May 8, 2000, at 1; see also Michele Heller, $1 Per Privacy Notice Is Bank One Target, AM. BANKER, May 25, 2000, at 4 (projecting industry-wide compliance costs at $1.25 billion to send 2.5 billion disclosure statements). Although enforcement of this provision will not begin until July 1, 2001, regulators will start to monitor financial institutions' progress towards compliance this fall. See Michele Heller, Regulators Push Early Privacy Compliance, AM. BANKER, May 30, 2000, at 5.

\(^{439}\) Gramm-Leach-Bliley Act § 507, 15 U.S.C.A. § 6807 (West Supp. 2000). It is uncertain whether or how state legislation can affect the basic structure of GLB's privacy provisions. For instance, may states prevent sharing of inter-affiliate information, or may they require that customers "opt in" and affirmatively elect to permit information sharing among affiliates? See Jim Connolly, Insurers, Regulators Differ On Privacy Guidelines, NAT'L UNDERWRITER LIFE & HEALTH - FIN. SERVS. ED., Mar. 13, 2000, at 3 (stating that many state insurance commissioners favor the opt in approach). Legislators in California have drafted bills that would require a financial institution to get a customer's permission before sharing any information with an affiliate or a third party. Michele Heller, Conflicting Federal Laws Fuel Showdown Over States' Rights to Legislate Privacy, AM. BANKER, Apr. 17, 2000, at 1. Though the Fair Credit Reporting Act bars states from restricting how a bank shares customer information with its affiliates until January 1, 2004, privacy advocates argue that the Sarbanes amendment to GLB trumps the FCRA and gives state legislatures the right to pass stricter privacy provisions. Id.

\(^{440}\) Compare Steve Tuckey, Small Life Firms Get National Voice, INS. ACCT., May 29, 2000, at 1 (affirming that though confusion exists as to whether insurance companies are subject to the GLB rules, the general consensus is that they will be followed until states say otherwise), with Steven Brostoff, Delay of Privacy Regs Draws Sharp Reactions, NAT'L UNDERWRITER LIFE & HEALTH - FIN. SERVS. ED., May 15, 2000,
to the privacy regulations promulgated by the SEC in addition to regulation by state insurance commissioners.\textsuperscript{441} A number of states have begun to consider privacy legislation more stringent than GLB.\textsuperscript{442} This state legislation would apply to insurance companies operating within the state and, if more stringent than GLB, to all financial institutions doing business within the state.\textsuperscript{443} The state-by-state approach to privacy regulation will be cumbersome for insurance companies and other financial institutions who may find themselves subject to different privacy requirements in each state in which they do business.\textsuperscript{444} Furthermore, if states impose more stringent privacy provisions only on insurance companies, those companies will be at a disadvantage with other financial services institutions.\textsuperscript{445} In response, the NAIC has proposed a Model Privacy Bill for adoption by the states.\textsuperscript{446} Insurers are concerned that these proposals go far beyond GLB's requirements.\textsuperscript{447}


\textsuperscript{442} Legislation has been introduced in twenty two states. See Connolly, supra note 439, at 3. However, not much has happened beyond the initial flurry of legislative introductions. See Michele Heller, \textit{Backers Hope Privacy Laws Get a Second Wind}, AM. BANKER, May 15, 2000, at 1. Even California, New York, and Minnesota, which are among the most activist states on privacy, lack the support necessary to pass stricter legislation. See id. See also Gerald B. Silverman, \textit{Privacy: New York Legislature Adjourns, Leaving Financial Privacy Bills Stalled}, BNA BANKING DAILY, June 27, 2000, at d5 (reporting that New York's legislature adjourned "without reaching agreement on a number of key privacy bills"). Three states—Vermont, Connecticut, and Alaska—reportedly already have state statutory standards that exceed the privacy protections mandated by GLB. See Sarah McDonald, \textit{Vermont's Tough Opt-In Privacy Law Could Be Model for Other States}, AM. BANKER, July 6, 2000, at 1.

\textsuperscript{443} There remains a significant issue as to whether a state could adopt a statute requiring customers to opt in before financial information could be shared among affiliates. The Fair Credit Reporting Act (FCRA), Pub. L. No. 91-508, 84 Stat. 1114 (1970), bars states from restricting a bank from sharing information with affiliates until January 1, 2004. See Michele Heller, \textit{Conflicting Federal Laws Fuel Showdown Over States' Rights to Legislate Privacy}, AM. BANKER, Apr. 17, 2000, at 11 (describing the debate over whether the so-called Sarbanes provision in GLB trumps the FCRA).

\textsuperscript{444} See Connolly, supra note 439, at 3 (finding that the patchwork approach to privacy will confuse customers and make compliance with the privacy rules quite complex).

\textsuperscript{445} Id.; Adam Wasch, \textit{Privacy: New Financial Services Law May Cause Loss of Existing State Protections}, BNA BANKING DAILY, June 1, 2000, at d2.


\textsuperscript{447} Gjertsen, supra note 446, at 1; R. Christian Bruce, \textit{Privacy: Insurance Group Urges July 1, 2001, As Compliance Deadline for Privacy Rules}, BNA BANKING DAILY, June 13, 2000, at d5 (urging state insurance regulators to also set July 1, 2001, as the compliance date for state privacy rules); see also States Advised To Create Financial-Privacy Legislation That Parallels U.S. Law, BESTWIRE, May 12, 2000.
Even while the debate over proper privacy protections is being conducted in the federal regulatory arena and in the state legislatures, Congress may have not yet had its last word on the subject. Protecting the privacy of consumer financial information is a cause that plays well in election year politics. Legislation proposed by President Clinton was recently introduced that would undo one of the major tenets of Title V of GLB and provide an opt-in mechanism for sharing information between affiliates of an FHC.\textsuperscript{448}

Chairman Jim Leach of the House Banking Committee has proposed legislation that would prohibit financial institutions from sharing medical financial records and preclude a financial institution from using a customer's medical information in providing credit absent the customer's consent.\textsuperscript{449}

6. GLB's Impact on Insurance Companies' Entry into Banking

An insurance company or its holding company may take advantage of GLB and acquire a bank.\textsuperscript{450} Indeed, for an entity interested in combining financial services and nonfinancial activities, there are potential advantages to be gained by structuring the bank-insurance combination as an insurance company acquisition of a bank. If an insurance company becomes an FHC for the purpose of acquiring a bank, it may continue to engage in all prior lawful nonbanking activities it was engaged in as of September 30, 1999. This grandfather provision lasts a minimum of ten years, and the FHC may apply for an additional five-year extension for a total of fifteen years of continued commingling of banking and nonfinancial activities.\textsuperscript{451} To take advantage of this grandfather opportunity, the FHC must be "predominantly engaged" in financial activities, and only those activities it was engaged in on September 30, 1999, or in those other activities permitted under GLB.\textsuperscript{452} It is possible, of course, that during the fifteen-year grandfather period, the ability of FHCs to engage in activities beyond financial activities will be

\begin{footnotesize}
\footnotesize{448. The Clinton bill has been introduced as S.187 by Senators Leahy (D-Vt.) and Sarbanes (D-Md.) and as H.R. 4380 by Representative LaFalce (D-Ny.). Implementation of Privacy Legislation Delayed, CREDIT RISK MGMT. REP., May 15, 2000, 2000 WL 11846418 (setting forth the main differences between GLB and the Clinton bill). Contrary to GLB, this bill would establish an "opt-in" system for all information sharing, allow consumers to correct their personal information, and greatly restrict the use of medical information. See id.; see also Steven Brostoff, Congress Revisits GLB Privacy Provisions, NAT'L UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED., Mar. 27, 2000, at 38 (predicting that the proposed federal legislation is a template for potential state privacy legislation); Steven Brostoff, Privacy Legislation Draws Industry Fire, NAT'L UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED., May 8, 2000, at 1.

449. See Medical Financial Privacy Protection Act, H.R. 4585, 106th Cong. (2000); Eileen Canning, Some Bankers, Insurers See Positives in Changes in Medical Financial Privacy Bill, BNA BANKING DAILY, June 29, 2000, at d4; Canning, supra note 446, at 5.

450. MetLife recently announced that it intended to take advantage of GLB and enter the banking market, although it is as yet undecided as to whether it will acquire a bank or begin a de novo bank. Liz Moyer, New MetLife Division Will Offer Bank Services, AM. BANKER, May 19, 2000, at 1; David Reich-Hale, Decision for MetLife: Buy Bank or Build One?, AM. BANKER, May 22, 2000, at 1; Joseph Treaster, Metropolitan Life Says it Aims to Start a Full-Service Bank, N.Y. TIMES, May 19, 2000, at C5.


452. Id. § 103(a), 12 U.S.C.A. § 1843(n)(1). "Predominantly engaged" is defined as when annual gross revenues of the holding company (excluding the depository subsidiaries) from financial activities or those that are incidental to a financial activity are 85% or more of annual gross revenues of the holding company. Id. § 103(a), 12 U.S.C.A. § 1843(n)(2). This revenue requirement must be met on a continuing basis. Id. § 103(a), 12 U.S.C.A. § 1843(n)(4).}
\end{footnotesize}
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significantly expanded by further congressional action or regulatory expansion. Chairman Gramm of the Senate Banking Committee lists as his chief regret regarding the historic legislation that bears his name that it did not permit combinations between banking and nonfinancial activities. He predicts that such combinations will be the next stage in the evolution of the regulation of FHCs.

While granting this significant grandfather right for nonfinancial activities, Congress did limit the grandfathered activities in several significant ways. First, grandfathered commercial activities may not be expanded through merger or consolidation with another company. Second, cross-marketing of nonfinancial activities to customers of depository subsidiaries is prohibited, although the statute does permit statement inserts and Internet web sites advertising the commercial products if the FRB approves them as consistent with certain statutory criteria. Finally, revenues from impermissible activities cannot exceed fifteen percent of an FHC's consolidated gross revenues (after deducting all revenues from the depository institution subsidiaries). The obvious drawback for an insurance firm seeking to enter banking by becoming an FHC and acquiring or beginning a bank is subjecting the FHC to the umbrella supervision of the FRB.

GLB also closed the unitary thrift holding company loophole that permitted nonbanking companies (including insurance companies) to establish a single thrift subsidiary. However, an insurance company that acquired or applied for a thrift charter by May 4, 1999 is grandfathered as a unitary thrift holding company and may continue to conduct all of its prior authorized activities. The grandfathered unitary

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453. See Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. 47,696 (proposed Aug. 3, 2000) (to be codified in 12 C.F.R. pt. 225) (FRB’s request for public comments on proposed rule to permit an FHC to act as a “finder” in bringing buyers and sellers together pursuant to the GLB authority for an FHC to engage in activities that are financial in nature or incidental to a financial activity); see also Pssst! Reform Really Did Let Commerce In, AM. BANKER, June 2, 2000, at 1 (prediction of Peter J. Wallison that restrictions on commercial activities will fall as the line between financial and commercial activities is continually redrawn).

454. Dean Anason, Senate Passes Reform Bill; Gramm Calls For a Sequel, AM. BANKER, Nov. 5, 1999, at 1 (predicting that GLB’s separation of business and financial services will prove as anachronistic as Glass-Steagall’s separation of commercial banking and investment banking).

455. Id.

456. Gramm-Leach-Bliley Act § 103(a), 12 U.S.C.A. § 1843(n)(3) (West Supp. 2000). This prohibition does not apply to a company that controls a broadcast station that has been under the control of an insurance company since January 1, 1998. Id § 103(a), 12 U.S.C.A. § 1843(n)(3). The prohibition against acquisition will continue to apply, however, if the acquirer is one of the five largest domestic bank holding companies based on consolidated total assets. Id. § 103(a), 12 U.S.C.A. § 1843(n)(3). This exception appears to apply only to Jefferson-Pilot Financial, an insurance company which owns JP Communications, which in turn owns several broadcast stations.

457. Id. § 103(a), 12 U.S.C.A. § 1843(n)(5). To approve statement inserts or website marketing, the FRB must find that “the arrangement is in the public interest, does not undermine the separation of banking and commerce, and is consistent with the safety and soundness of depository institutions.” Id. § 103(a), 12 U.S.C.A. § 1843(n)(5).

458. See supra Part II.H.

A thrift holding company may not sell its grandfathered rights or have them acquired by another company. GLB does not, however, prevent the grandfathered unitary thrift holding company from expanding by conducting its own acquisitions. GLB unburdens nonbank banks grandfathered by the CEBA in 1987 from a number of limits imposed upon them by the CEBA, including cross-marketing restrictions, the inability to engage in new activities, and the prohibition on asset acquisitions. Finally, trust companies remain a possible point of entry for insurance companies into a limited range of banking services.

A final aspect of GLB that facilitates insurance companies' entry into banking via an FHC is the provision permitting mutual insurance companies to redomesticate to another state for the purpose of converting to stock status. An insurance company organized in the mutual form and owned by policyholders may wish to convert to stock status to raise the capital necessary to expand its financial services activities and to put it in a form that permits it to be owned by an FHC. Some states have laws that are not favorable to mutual-to-stock insurance company conversions. This GLB provision eases the process of converting to stock status by permitting a mutual insurance company to easily redomesticate to a state whose laws are favorable to the stock conversion.

D. Potential Effects of Restructuring

Initially, the possibility of banks combining with insurance companies was heralded as the greatest contribution of GLB to reshaping the financial services landscape. At the time of GLB's passage, the opportunity to combine with securities firms had already been significantly exploited through section 20 subsidiaries of bank holding companies. Although many banks were engaged in insurance agency activities at the time of GLB's enactment, underwriting of insurance was essentially forbidden. These early predictions of a flurry of bank and insurance company mergers have, at least so far, not come true. In the first months following the enactment of GLB, it appears that
banks are treading cautiously when it comes to insurance underwriting, and are instead taking advantage of additional opportunities to expand their agency activities. For instance, in some states where statutes or regulations previously prevented affiliations between banks and insurance agents, those rules are changing pursuant to GLB’s mandate, presenting the opportunity for state banks in most states to begin insurance-agency activities.

The continuing bank focus on agency activities suggests that many bankers feel “they do not need to own the factory in order to sell the product.” A bank interested in insurance products may indeed find the best of both worlds by partnering with an insurance underwriter to devise new insurance products that the bank may then sell to its customers. There are a number of reasons banking companies currently disfavor acquisition of an insurance underwriter. The additional regulatory burdens of owning an insurance underwriter and the risks posed by underwriting have given some bankers pause to reflect on whether insurance underwriting is in the long-term, best interests of their shareholders. Insurance companies in general have a lower return on equity than most banking institutions, suggesting to some that bank-insurance combinations would not be viewed favorably by the market. Some observers have suggested that market forces might account for the current disinterest by banks in insurance companies. Bank stocks are at a low point which makes them poor currency for acquisitions.

Notwithstanding banks’ general disinterest in insurance company acquisition, some banking organizations are quite interested. Citigroup, of course, already owns Travelers Insurance Company and recently announced its intention to buy the fifteen

467. Winokur, supra note 464, at 1.
468. See id.; Craig Woker, Texas Banks, Thrifts Given Insurance Sales Guidelines, AM. BANKER, Jan. 27, 2000, at 9; David Reich-Hale, Broker Scoring Big with Bank-Insurer Deals, AM. BANKER, June 14, 2000, at 1 (reporting that “[b]anks are buying insurance agencies in record numbers”).
469. See Woker, supra note 468, at 9 (discussing recent changes in insurance sales guidelines in Texas and likely changes in Ohio); see also Deborah Lohse, Approval Path For Insurers May Shorten, WALL ST. J., Mar. 14, 2000, at A3.
470. See Winokur, supra note 464, at 1.
471. See Thomas, supra note 404, at 3 (Banks will likely continue to enter insurance through arrangements with third-party agencies to sell insurance in bank offices.); Lee Ann Gjertson, MassMutual Tailors Products for Bank Sales, AM. BANKER, June 16, 2000, at 7 (describing MassMutual’s development of products geared to bank customers); James R. Kraus, Consolidation Ahead, U.S. BANKER, June 2000, at 30, 31 (predicting that “large financial conglomerates will strike marketing alliances with insurance companies and eventually merge with them”).
472. See Sweeney, supra note 269, at 55 (stating that the Bank industry’s return on equity (ROE) is 15-20%, while the insurance industry’s ROE is 10-12%; Bob Stein, Viewpoints: Look at the Numbers, and Don’t Be So Ready to Write Off Bank-Insurer Deals, AM. BANKER, June 30, 2000, at 9 (reporting that bank ROEs are at 18-20%, while life insurance ROEs are at 14-15%); see also Lee Ann Gjertsen, Firmer Insurance Market May Attract Banks, AM. BANKER, July 6, 2000, at 6 (suggesting that slow premium growth made insurance companies unattractive to banks and speculating that recent increase in insurance premiums might make insurance companies more attractive to banks).
473. See Winokur, supra note 464, at 1.
474. See id. Standard & Poor’s predicts that upon a bank-insurance combination, the rating of the insurance company would be adjusted downward to reflect the generally lower ratings for banks. Thomas, supra note 404, at 3.
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percent of Travelers Property Casualty that it does not already own.\textsuperscript{475} The low price-to-earnings ratios at which insurance companies are currently trading make them attractive targets for companies like Citigroup that are trading at more favorable ratios.\textsuperscript{476} Although the low return on equity of insurance companies has been cited as a reason to shy away from an insurance company purchase, some banks believe that an insurance-bank combination presents opportunities to increase the insurance company’s profitability by reducing overly high capital levels,\textsuperscript{477} utilizing bank technology to achieve cost savings, taking advantage of cross-selling opportunities, and reducing costs by decreasing reliance on independent insurance agents and increasing reliance on the bank product delivery system. For those banking companies concerned about the expertise necessary to operate an insurance underwriter, ING Group, the Netherlands’s third largest bank,\textsuperscript{478} announced that it has had discussions with several of the “top-20” U.S. banks about providing the back office operations for the insurance organization on a fee basis.\textsuperscript{479}

Most observers believe that banking companies, which generally have a larger market capitalization than insurance companies, are more likely to acquire insurance companies than vice versa. Insurance company stocks are also currently in decline with price-to-earnings ratios that generally are even less than those of banking companies.\textsuperscript{480} An insurance company wishing to buy a bank would need to become a bank holding company and simultaneously an FHC, subjecting itself to the umbrella regulation of the FRB.\textsuperscript{481} Insurance companies regulated exclusively at the state level may well be reluctant to volunteer for federal regulation. Although MetLife has announced that it will buy a bank\textsuperscript{482} the remainder of the insurance companies interested in achieving “cradle-to-grave” financial services have utilized the thrift charter. In part, this is because many insurance companies established or applied for a thrift charter prior to the May 4, 1999 grandfather date for unitary thrift holding company treatment set forth in GLB.\textsuperscript{483} Continued use of the thrift charter is also attractive as a way to avoid application of GLB and FRB oversight of the FHC. Northwestern Mutual Life Insurance recently received a

\begin{itemize}
  \item \textit{Id.} (finding that Citigroup is trading at 18 times earnings, while Travelers is trading at about 11 times earnings).
  \item \textit{Id.}
  \item Cheryl Winokur, \textit{ING Positioned to Run Insurers that Banks Buy}, \textit{AM. BANKER}, Mar. 10, 2000, at 1.
  \item See McGough & Lohse, \textit{supra} note 475.
  \item Gramm-Leach-Bliley Act § 103(a), 12 U.S.C.A. § 1843(k)(4)(B) (West Supp. 2000); see \textit{supra} notes 337-340 and accompanying text.
  \item Lee Ann Gjertsen, \textit{MetLife Has Big Plans for One-Branch Bank}, \textit{AM. BANKER}, Aug. 17, 2000, at 1 (describing MetLife’s purchase of a small national bank in New Jersey). MetLife must qualify as an FHC and submit itself to oversight regulation by the FRB. One industry analyst commented that because MetLife was subject to state regulation in fifty different states, “being regulated by the Fed might be a welcome relief.” \textit{Id.}
  \item See \textit{supra} notes 242-245 and accompanying text; see also David Reich-Hale, \textit{Insurer Heading for Bank Turf with 16,000 Branches}, \textit{AM. BANKER}, June 21, 2000, at 1 (describing State Farm Insurance Company’s banking activities conducted through its federal savings and loan created with OTS approval in November 1998).
\end{itemize}
limited thrift charter from OTS enabling it to offer trust products and services through a federal savings bank, Northwestern Mutual Trust Co.\textsuperscript{484}

Many industry observers predict that European financial firms will be the first to exploit the new insurance company affiliation opportunities presented by GLB and that these firms will move to purchase U.S insurance companies.\textsuperscript{485} Two principal reasons are given to support this prediction: expertise and size.\textsuperscript{486} European financial firms have for many years been operating insurance and banking operations side-by-side and thus feel comfortable with the challenges posed by operating an insurance company.\textsuperscript{487} In part, because these combinations have been allowed for a number of years, many European financial firms are significantly larger than U.S. insurance companies and have the size to acquire a major U.S. firm. For instance, ING Group recently announced its agreement to acquire ReliaStar Financial Corp., the eighth-largest publicly held life insurance company in the United States.\textsuperscript{488} Many foreign financial firms will also view GLB as an opportunity for them to acquire banks in the United States. Prior to GLB, foreign firms


\textsuperscript{485} Winokur, \textit{supra} note 464, at 1. Indeed, a number of foreign firms have been granted permission by the FRB to become financial holding companies. Stephen Piontek, \textit{Top Ten Stories of 2000}, \textit{NATIONAL UNDERWRITER LIFE & HEALTH – FIN. SERVS. ED.}, Jan. 3, 2000, at 27 (predicting that U.S. insurers will be acquired by foreign financial services conglomerates). Some commentators have expressed concern that the FRB is not as favorable to foreign firms desiring to become FHCs in its proposed regulations as it should be. For example, when the FRB released a list of the first 117 banks to qualify as FHCs on March 12, 2000, only nine foreign banks were on the list, which did not include any German, French, or Italian banks. Rob Garver, \textit{Foreign Banks Say U.S. Reforms Leave Them at a Disadvantage}, \textit{AM. BANKER}, Mar. 16, 2000, at 1. Gerard De Graaf, of the European Commission, claimed that many European banks were effectively deterred from applying because of several contentious points. \textit{Id.} For example, the FRB rule contains a "leverage requirement" that would force foreign banks to hold more capital than their home country regulators require (the FRB rule requires Tier I capital equivalent to 3% of balance sheet assets). \textit{Id.} Effectively, a European bank conducting business in the United States would have to submit to FRB regulation of both its United States and home country operations, creating a fear among many Europeans that the FRB is trying to establish itself as the world banking regulator. See \textit{id.}


\textsuperscript{487} "Banc-assurance" refers to the vertical integration of banks and insurance companies, whereby retail insurance products become core banking products distributed through bank branches. The practice is prevalent in Europe, especially France where over 50% of insurance is distributed through banking channels. Dave Kaytes, \textit{Banks Should Not Replicate the Insurance Agency Model}, \textit{AM. BANKER}, Jan. 30, 1996, at 10. Prior to GLB, banc-assurance appeared in limited form in the United States as many banks began selling credit-related insurance.

engaged in insurance activities were not permitted to acquire U.S. banks under the BHCA. GLB removes this obstacle to foreign ownership of U.S. banking organizations. So, whether a foreign financial firm wishes to purchase a U.S. bank or a U.S. insurance company, the acquisition may be accomplished pursuant to GLB with minimal impact on the foreign firm's existing operations.

GLB enables the creation of full-service financial companies combining banking, insurance, and securities. GLB’s most dramatic change from prior law is the authorization of bank-insurance combinations. It remains too early to tell how many firms will follow Citigroup in combining these two financial activities. Banks and insurance firms considering this route should, however, carefully anticipate the operating burdens imposed by functional regulation at the state level by the state insurance authorities coupled with oversight regulation at the federal level by the FRB.

V. FUNCTIONAL OR DYSFUNCTIONAL REGULATION?

GLB endorses a regulatory structure based on functional regulation. The premise of functional regulation is that financial products can be classified into discrete categories and that each product category should be regulated in the same manner and by the same regulator. Theoretically, functional regulation should ensure fair competition among different entities offering similar products and promote regulatory efficiency and specialization by a regulator concentrating in regulating discrete functions. GLB created a specially defined category for a “functionally regulated subsidiary” of an FHC. The Act requires that many of the activities to be conducted by an FHC be pushed out into the appropriate functionally regulated subsidiary of the FHC. For instance, Title II of GLB requires that many bank securities activities be “pushed out” to securities affiliates and be subject to SEC regulation.

Although the basic regulatory model is relatively easy to describe and initially appears to make good sense, a more detailed examination reveals a number of flaws. First, financial services products often do not fall clearly within one particular function, even when the financial services functions are divided broadly into the categories of banking, securities, and insurance. Second, prior to GLB’s endorsement of functional regulation, financial services were no longer being sold by discrete providers of financial products so that forcing products into a “functionally regulated subsidiary” is counter to


now established business practices permitting one entity to provide numerous products subject to functional regulation by more than one regulator. Finally, the concept of functional regulation clashes with modern technology.493

Innovative financial services products do not necessarily conform to GLB’s broad functional financial categories of banking, securities, and insurance. Thus, an important issue under this new system of functional regulation is which functional regulator should regulate which product. The development and functional categorization of variable annuities demonstrates the problem of a financial product not falling easily into just one functional regulatory category.494 As recounted earlier in this Article, insurance companies first developed variable annuities in an effort to meet increasing competition provided by mutual funds.495 As insurance company products, variable annuities are subject to regulation by the applicable state insurance regulator. The Supreme Court ruled in 1959, and reaffirmed in 1967, that variable annuities, although offered by insurance companies, are securities and therefore subject to regulation by the SEC.496 That holding might seem to affirm the utility of functional regulation, but later events demonstrated the futility of placing variable annuities in only one functional category. In 1964, the Supreme Court declined to review the Third Circuit’s ruling that the separate accounts maintained by insurance companies for variable annuities should be regulated as investment companies subject to the Investment Company Act.497 Finally, in the 1995 VALIC II case, the Supreme Court characterized variable annuities as “financial investment instruments” rather than insurance.498 As such, their sale was permitted by national banks as part of the business of banking. When products such as variable annuities can be placed in more than one functional category, a single, discrete product remains subject to regulation by multiple governmental agencies.499 Thus, functional regulation still struggles with the basic definitional problem of in which functional category or categories a particular financial service product should be placed.500

493. An additional criticism leveled at functional regulation is that “no single regulatory authority may have overall responsibility for one entity’s solvency and risk management.” Jackson, supra note 490, at 388. The FRB’s role as the umbrella supervisor is GLB’s attempt to meet that criticism.


495. See supra Part II.F.


497. Prudential Ins. Co. v. SEC, 326 F.2d 383, 388 (3d Cir.), cert. denied, 377 U.S. 953 (1964). The SEC subsequently granted relief so that insurance companies were able to avoid most investment company regulation. See supra Part II.G.


500. Former Comptroller of the Currency, Eugene A. Ludwig, criticizes functional regulation because evolving financial products do not fit in old functional categories. Garver, supra note 499, at 1; see also Schooner, supra note 490, at 476 (“The functional regulatory model assumes incorrectly that financial products may be divided and conquered,” but the “blending of financial products will continue.”).
A second problem with functional regulation is that it fails to consider the development of multiproduct financial services providers. Prior to GLB's enactment, it was quite common for a single entity to engage in banking and insurance or some other combination of financial functions. Many banks became financial supermarkets offering a broad range of financial services, including banking, securities, insurance, and derivatives. Of equal importance, broker-dealers competed with banks and insurance companies. Merrill Lynch even formed its own life insurance company in 1986. At the same time, insurance companies developed securities businesses. Hannover Re, the German reinsurer, announced that it was planning to issue bonds that would be backed by life insurance policies. "Their effect will be increasingly to blur the distinction between insurance and investment banking.”

GLB, of course, endorses and facilitates the creation of financial services supermarkets under the common ownership of an FHC. Each subsidiary of the FHC engages in certain functions and is functionally regulated. This model for providing and regulating financial services might have worked if GLB had been adopted when each financial services provider offered distinct products and before new products were created that crossed traditional product boundaries. But, as financial services and their regulation developed over time, each separate entity, through creative lawyering and loophole mining, found its way into new product areas. The result was that prior to GLB, one entity—as just previously discussed—sold multiple products including hybrid products that did not fit the traditional product classifications.

GLB recognizes this reality and attempts in various provisions to “push out” products into the “appropriate” functionally regulated subsidiary. However, GLB itself contains numerous exceptions from this grand scheme that indicates effective functional regulation is not likely to occur. For instance, insurance companies may still engage in banking through a grandfathered unitary thrift holding company, a grandfathered nonbank bank, or a limited purpose trust company, as described above. Functional regulation under GLB is premised, however, on the notion that banking activities and insurance activities will be conducted in separate functionally regulated subsidiaries of an

501. See Cohen, supra note 465 at 114; Death By a Thousand Cuts: Can the Independent Agents Who Sell Insurance to Consumers Survive the Change that is Sweeping Their Industry?: Are Insurance Agents Obsolete, ECONOMIST, April 19, 1997, available at 1997 WL 8136660; Randall Smith & Charles Gasparino, Salomon’s Gains are Registering as Part of Citi’s ‘Supermarket,’ WALL ST. J., March 2, 2000, at Cl; see also supra Part III (discussing bank involvement in insurance).


503. Saks, supra note 341, at 326.


505. Id.

506. Karen Shaw Petrou, Holding Company Structure Made Reform Law Old-Hat from the Start, AM. BANKER, June 30, 2000, at 8 (arguing that functional regulation may have been possible when first proposed in 1986, but that today it amounts to unscrambling financial products that fall into more than one regulatory category).

507. The “balkanization of an institution’s operations and services based on function, rather than the institution’s individually tailored operational plan,” has also been criticized for undermining attempts to offer “one-stop shopping” and impairing the application of consolidated risk management. Fein, supra note 490, at 112.

508. See supra Parts II.H, III.E.
FHC. Similarly, banks may still engage in insurance in the following ways: national banks as agents under section 92 of the NBA, state banks as agents pursuant to state law and the FDICIA, all banks as underwriters of credit-related insurance, and state banks as underwriters of title insurance when authorized by state law.\textsuperscript{509} This continuing mixture of functions within a single entity is a byproduct of the ability of financial services firms to exploit statutory and regulatory loopholes to expand into other financial services areas. GLB also continues the use of grandfather provisions, such as that for unitary thrift holding companies, perpetuating the opportunity for some entities to sell multiple products subject to regulation by different functional regulators.\textsuperscript{510} Thus, a single entity may be subject to multiple regulators. This system, resulting in duplication of effort and conflict among regulatory standards and authorities, is needlessly costly and inefficient.\textsuperscript{511} The complexity of this morass is further exacerbated by the large number of potential regulators of banking—viewed under GLB as a single functional product—and the fifty-seven different potential regulators of insurance—also viewed as a distinct functional product.\textsuperscript{512}

Numerous complications will undoubtedly result. Under GLB, a large financial services provider such as Bank of America or Citigroup will be monitored by a host of regulators that will include all of the state insurance commissions, state bank regulators, state securities regulators, the SEC, the CFTC, the SROs (i.e., the stock and commodity exchanges, the NASD and the NFA), the Comptroller of the Currency, the FDIC, the FRB, the Department of Justice, and even the Federal Trade Commission (FTC).\textsuperscript{513} This system of regulation will not be efficient or coordinated. Past experience with functional regulation provides numerous examples of conflicts. The SEC has for years engaged in various jurisdictional battles with the CFTC and bank regulators.\textsuperscript{514} The states have

\textsuperscript{509} See supra Parts IV.C.2-3. Financial subsidiaries of banks may also engage in insurance agency activities. Id.

\textsuperscript{510} Even prior to GLB, there were several notable examples of regulators reaching across traditional borders to provide functional regulation. For example, a subsidiary of Prudential Insurance Company of America was censured and fined $20 million by the NASD for deceptive sales practices in selling variable life insurance. Bridget O’Brian, Prudential Fined $20 Million by NASD Over Its Sales of Variable Life Insurance, WALL ST. J., July 9, 1999, at Cl. NationsBank and its affiliate, NationSecurities, were disciplined by the SEC for blurring the distinctions between their banking and securities operations and creating customer confusion about banking and securities products. See In re NationSecurities and NationsBank, N.A., Exchange Act Release No. 39,947, 1998 SEC LEXIS 833, at *20-26 (May 4, 1998).

\textsuperscript{511} Under the functional model, regulated institutions answer to multiple regulators resulting in increased costs. See Schooner, supra note 490, at 460; see also Fein, supra note 490, at 109 (finding that functional regulation “will likely increase, rather than decrease, the regulatory burden on banking organizations. The multiple regulators required under a functional regulation system will result in fragmented regulation and duplicative, inconsistent, and excessive regulatory requirements.”).

\textsuperscript{512} Depository institutions come in a variety of forms: banks, savings associations, and credit unions. MACEY & MILLER, supra note 71, at 66-69. Each institution type may be chartered at the state or federal level. Id. Thus, a depository financial institution and its activities, depending on charter choice could be regulated by the OCC, a state banking regulator, the FDIC, the FRB, the OTS, a state savings institution regulator, the National Credit Union Share Insurance Fund, a state credit union regulator, or some combination of the above. Id.


\textsuperscript{514} These included fights for regulatory control over transfer and clearing agencies, margin requirements for derivative instruments, and regulation of derivative dealers. See, e.g., 23 & 23A JERRY W. MARKHAM &
variously proved to be inadequate regulators of financial services in the securities area (requiring federal intervention) or too intrusive (requiring federal preemption). A recent example of regulatory conflict is the controversy relating to banks’ accounting for loan loss reserves. The American Institute of Certified Public Accountants, the SEC, and federal bank and thrift regulators view this issue from different perspectives and have yet to reach agreement as to the proper methodology to account for these reserves.

Similar conflicts among different functional regulators are likely to arise under GLB. For instance, to preserve the historical primacy of state regulation of insurance, GLB establishes a concept of “not unequal deference” when conflicts arise between state insurance regulators and federal banking regulators. This concept is a curious blend of normal principles of federal preemption of inconsistent state laws and substantial deference to federal agency interpretations of federal statutes, and the McCarran-Ferguson Act’s anti-preemption rule which attempts to assure the primacy of state regulation of insurance over federal intrusions. Thrown into this mix is the threat of uniform regulation of insurance to be imposed through GLB’s uniformity or reciprocity requirements or eventually the creation of NARAB (to be supervised by a private entity) to grant entry into insurance on a nationwide basis.

Moreover, federal agencies and state regulators are required under GLB to share certain information and engage in coordinated rulemaking. Whether cooperation among these various entities can be achieved and sustained remains to be seen. How functional regulators and the FRB, as an FHC’s oversight regulator, will interact is also

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THOMAS LEE HAZEN, BROKER DEALER OPERATIONS UNDER SECURITIES AND COMMODITIES LAW §§ 2.09[9], 8.02 (1999); Jerry W. Markham, Derivative Instruments: Obstacles to Their Regulation in US, in SWAPS AND OFF-EXCHANGE DERIVATIVES TRADING: LAW AND REGULATION 276, 276-86 (Eric C. Bethelheim et al. eds., 1996); Jerry W. Markham, Federal Regulation of Margin in the Commodity Futures Industry – History and Theory, 64 TEMP. L. REV. 59, 60, 117-21 (1991) [hereinafter Markham, Regulation of Margin].

515. Between 1910 and 1933, blue sky laws were adopted in all of the states except Nevada. LOUIS LOSS & EDWARD M. COWETT, BLUE SKY LAW 17 (1958). Nevertheless, those laws proved to be ineffective because they could not overcome the traditional legal rule of caveat emptor (i.e., let the buyer beware). See WILLIAM J. SCHULTZ & M. R. CAINE, FINANCIAL DEVELOPMENT OF THE UNITED STATES 602 (1937). The federal securities laws are also a reflection of the fact that the state blue sky laws were inadequate to regulate securities trading, which is conducted largely on an interstate basis. Nevertheless, Congress did not preempt the state blue sky laws until recent years when it was concluded that they were imposing redundant and unnecessary burdens. The National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C. section 29), exempted exchange and NASDAQ traded securities from state registration requirements and prohibited the states from imposing regulations different from those of the SEC on many broker-dealer activities.

516. The federal bank and thrift regulators released proposed guidelines as part of a July, 1999 agreement with the SEC. Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions, 65 Fed. Reg. 54268 (proposed Sept. 7, 2000). The guidelines refer, however, to reserves recorded under generally accepted accounting practices (GAAP), and the AICPA currently has under consideration a proposal to change GAAP accounting for loan loss reserves. See Rob Garver, Regulators vs. Accountants On Reserving for Losses, AM. BANKER, Sept. 8, 2000, at 4; see also Gramm-Leach-Bliley Act § 241, 12 U.S.C.A. § 78m note (West Supp. 2000) (requiring consultation and coordination between the SEC and the appropriate federal banking agency prior to any SEC action against a depository institution based on the institution’s loan loss reserve reporting).

517. Jackson, supra note 490, at 390-91 (noting that an interesting feature is the “reluctance to pick regulatory sides” to resolve the inevitable regulatory conflicts).

an open issue. The FRB and the OCC, for instance, have taken very different views about their respective regulatory roles under GLB. For instance, FRB Governor Laurence Meyer has stated that the FRB "needs to know more about the activities within large insured depository institutions [such as national banks] than can be derived from access to public information or from the reports of the primary bank supervisors." Jerry Hawke, the Comptroller of the Currency and functional regulator of national banks, contends that GLB requires the FRB to rely on the OCC and other functional regulators "to the fullest extent possible" and that the FRB’s role is confined to "helping to protect banks from risks that might arise elsewhere in the corporate family, outside the bank."

The combination of these three financial services—banking, insurance, and securities—in one FHC while trying to maintain the historical regulatory framework governing each financial service will be a Herculean task. The regulatory structure that continues to govern each separate financial service is very different, largely the result of historical happenstance. Meshing these very different regulatory systems, either within an FHC or in a single entity subject to multiple functional regulators, is fraught with difficulty.

As this Article describes, the regulation of insurance has always been state dominated. Federal regulation was successfully resisted on several different occasions, and the federal McCarran-Ferguson Act underscores the primacy of state regulation by reversing the normal rule that federal laws preempt inconsistent state laws. Banks began with state charters, and when national banks were created during the Civil War they were supposed to replace state banks. However, regulatory competition and innovation by state banks preserved them as viable entities and led to our current dual system of banking regulation at the federal and state level. Within the banking industry itself, regulatory arbitrage is evident as banks shift from state to national charters and vice versa, as depository institutions change charter types among credit unions, thrifts, and banks, and as the multitude of federal regulatory authorities fight turf wars among themselves. Combining insurance (state-dominated regulation), securities (federal-dominated regulation), and banking (dual state and federal regulation) in one holding company is obviously a recipe for regulatory conflict.

The confusion, complexity, and costly inefficiencies associated with functional regulation are likely to put U.S. financial institutions at a severe competitive disadvantage with European financial firms operating under a universal banking model with a single

519. See Eileen Canning, Financial Services: Fed’s Ferguson Offers More Details on Fed’s Role as Umbrella Supervisor, BNA BANKING DAILY, May 31, 2000, at d7 (describing the increased coordination and cooperation that GLB requires between the FRB and functional regulators).
521. Id.
522. The financial services regulatory structure “is a product of history, not logic.” Garver, supra note 499, at 1 (quoting Eugene A. Ludwig, former Comptroller of the Currency).
regulator. GLB’s repeal of restrictions on affiliations between banks, insurance companies, and securities firms was designed in part to make U.S. firms more competitive with their foreign counterparts. It would, therefore, be ironic if the regulatory structure adopted by GLB impedes effective competition with foreign financial services firms.

A final reason that GLB’s system of functional regulation is not likely to sustain itself over time is that it clashes with modern day technology. Technology is reducing the importance of the intermediation function traditionally performed by financial services firms. The Internet is turning financial services into a commodity that can be bought online, just like a book or a new computer. Utilizing technology to sell existing customers new financial products may also be less expensive than acquiring a bricks-and-mortar entity. Depositors may now bypass banks as places to deposit their savings in favor of direct access to the capital markets to obtain higher returns not subject to transaction costs imposed by an intermediary. Borrowers may similarly bypass banks and go directly to the capital markets to borrow money at a lower cost. Information, expertise, and reduction of transaction costs by pooling funds from various sources are some of the reasons intermediaries have traditionally been successful.

Technology facilitates bypassing the intermediary in several ways. Technology makes information readily available and reduces transaction costs a great deal. Expertise may still give some intermediaries an advantage, but increased information reduces this advantage. This same phenomenon may be seen in the insurance industry. Insurance agents and their role as intermediaries are increasingly bypassed by technologically savvy customers. An insured who buys directly from the insurance company need not pay a commission to an insurance agent. Allstate Insurance Company announced in November 1999 that it would sell car and home insurance directly to consumers through the Internet and over the telephone. Online companies stand ready to help consumers buy

524. The European Union’s Second Banking Directive attempts, through its adoption of mutual recognition, the single banking license, and the agreed-upon activities list to move all European Union countries towards Germany’s universal banking model. See id. at 1734; see also Garver, supra note 499, at 1 (stating that former Comptroller of the Currency, Eugene A. Ludwig, predicts that capital will flow to less regulated foreign financial firms from more regulated U.S. firms). Some states have recognized that this Byzantine regulatory structure impedes progress and have adopted universal regulation of banking, insurance, and securities at the state level. See, e.g., Craig Woker, Mich. Reform Law May Spur Creation of a Banker’s Bank, AM. BANKER, Jan. 24, 2000, at 7 (describing the governor of Michigan’s governor’s announcement of intention to combine the regulatory departments for banks, brokerages, and insurance).

525. “[T]he European Union views the adoption of the universal banking model as a means of improving its competitive position in the global marketplace.” Jeannot, supra note 523, at 1738. Moreover, GLB does not coordinate or enhance the supervisory structure to ensure safety and soundness, while the European Union “placed great emphasis on coordinating its supervisory structure” when it reformed its banking laws. Id. at 1757.

526. See Ely, supra note 494, at 4 (“Technology increasingly empowers the principals in financial transactions (buyers and sellers, payers and payees, borrowers and funders) to deal directly with each other.”).

527. “[M]ore consumers are looking to the Web for financial services. . . .” Lee Ann Gjertsen, First Union Buys Online Agency, AM. BANKER, July 26, 2000, at 8.

528. David Reich-Hale, Web Firms Helping Banks Sell Insurance on Internet, AM. BANKER, June 29, 2000, at 7. Partnerships between banking and insurance web sites are also growing. David Reich-Hale, Quicken Tops Web Insurer Study, AM. BANKER, July 17, 2000, at 10.

insurance on the Internet. One service allows consumers to review the offerings of fifty major insurance companies so that they may find the best product and compare prices.\footnote{UNCAIum Leads Revolution in Online Insurance Shopping, CHAPEL HILL NEWS, Dec. 5, 1999, at A8.}

To the extent a financial services firm no longer performs intermediation as its primary function, the goals of regulation may be changing in a fundamental way. Misconduct by the intermediary need not be a major goal of the financial institution's regulation. Reform legislation, such as GLB, that essentially ignores this fundamental change in the delivery of financial services is doomed to a short life, or at least a troubled one.

Clearly, the functional regulatory structure envisioned by GLB does not comport with this emerging environment of unified financial service providers. Nor has entity-based regulation proven satisfactory.\footnote{Entity- or institutional-based regulation relies on the faulty premise that "different entities present different regulatory issues." Schooner, supra note 490, at 477.} Regulators of different entities often adopt separate regulatory approaches to address essentially the same issues.\footnote{See Caldarelli, supra note 490, at 45 (calling for functional regulation to eliminate the "regulatory arbitrage" that exists in an entity-based regulatory scheme).} For instance, the SEC has used the suitability concept as the center of its regulatory program for protecting unsophisticated investors.\footnote{23A MARKHAM & HAZEN, supra note 514, at ch. 9.} The CFTC rejected such a concept in favor of risk disclosures.\footnote{Jerry W. Markham, Protecting the Institutional Investor-Jungle Predator or Shorn Lamb? 12 YALE J. ON REG. 345, 369 (1995).} Strangely, the bank regulators adopted disclosure for sophisticated investors, but not for the ordinary retail customer.\footnote{Id. at 478-79. Professor Schooner proposes a reassignment of regulatory responsibility as follows: insurance fund risk by the FDIC, systemic risk regulated by the FRB, and unfairness risk by the SEC. Id. at 485-86. Melanie Fein, a Washington D.C. lawyer and banking author, has also criticized functional regulation for many of the same reasons as Professor Schooner. See Fein, supra note 490, at 109-13 (criticizing functional regulation); Jackson, supra note 490, at 387-97 (1999) (commenting on some likely failures of a system based on functional regulation).} Such an uneven regulatory playing field is unfair and invites artificial shuttling of activities into the most favored entity with respect to each regulatory issue. Financial service firms should not be placed in the middle of such conflicting regulatory approaches.

An alternative regulatory approach would cut across entity form and broad functional categorization of financial products to regulate based on underlying risks. Professor Heidi Mandanis Schooner advocates "[r]egulating risk, not function."\footnote{Markham, Regulation of Margin, supra note 514, at 117-21.} She identifies the following three risks associated with banking and securities: insurance fund risk, systemic risk (protection of the financial system), and unfairness risk (control of the risk of fraud and abuse in financial markets).\footnote{Schooner, supra note 490, at 487.} Bert Ely, a bank consultant, has argued for a similar regulatory breakdown which he terms "goals-oriented regulation."\footnote{Id. at 4. The first goal of this regulatory structure would be to protect solvency and systemic stability through regulation of deposit insurance, the payment system, and liquidity. Id. The second goal would be to protect consumers through fair dealing regulations (disclosure and protection from fraud), fair
Authors also advocate consideration of a risk-based regulatory regime that cuts across various financial products.

Borrowing Professor Schooner's risk categories and Mr. Ely's examples of necessary risk regulation, insurance fund risk should involve protection of customer funds that are on deposit with a retail financial services firm. This would include such things as the segregation of customer funds and administration of account insurance, which could be conducted by a single regulator. Systemic risk regulation could include uniform capital requirements, payment system regulation, and financial system liquidity. Unfairness risk regulation would encompass fair dealing with consumers by protecting only "retail" versus sophisticated customers. The securities industry has long recognized that institutional and other sophisticated market participants do not need the same regulatory protections as unsophisticated investors. Sophisticated customers can protect themselves in negotiations and redress any wrongs through their own lawyers. For these reasons, institutional and other "accredited" investors are exempted from much of the regulation that is applied to those dealing with "retail" customers. The CFTC has taken a similar approach in regulating swaps and in other aspects of its regulations. The same approach should be adopted for regulating other financial services. Banking, insurance, and securities activities that do not directly involve an unsophisticated retail consumer should be exempted from regulation.

By the same token, financial services for retail customers should be subject to regulation, and the protections afforded such investors should cut across product lines. This should include the prevention of fraudulent sales practices, prosecution of "churning" of securities and "twisting" of insurance policies, fraudulent profit claims or guarantees, and unauthorized trading or falsification of policy signatures ("windowing" policies). Multiple regulators are not needed to police those very similar problems. Financial services should be viewed as single product regulated by a limited number of regulators based on a defined set of regulatory objectives.

VI. CONCLUSION

The passage of GLB has opened the door a bit wider to competition for the offer and sale of financial services across traditional, institutional lines. That is commendable and is a recognition of the fact that broad ranges of financial services are being offered by single institutions. This provides consumers with choice as well as price competition. Technological innovation, including the Internet, is further improving access to financial services. Yet, while the market has changed, Congress has frozen its regulation along traditional lines that it calls functional. There is nothing functional about the existing regulatory structure, particularly in the case of insurance. State regulation is still in place largely because James Hyde's excesses led to the Armstrong Committee's restrictions on common stock investments. Insurance companies, therefore, avoided the ire of the New Deal legislators. This historical happenstance hardly justifies regulation of modern financial service firms by fifty state insurance regulators and a hodgepodge of federal trading regulations (unfair market manipulations), and maintenance of competitive financial markets (antitrust, market entry, and development of new products). Id.

regulators. Nor does this antiquated and duplicative regulatory structure provide adequate regulation. GLB does not adequately address these issues relating to the regulatory structure of financial services firms. This failure will surely haunt us in future years.