

SCHWARTZ & BALLEN
1990 M STREET, N.W. · SUITE 500
Washington, DC 20036-3418
(202) 776-0700

FACSIMILE
(202) 776-0720

DIRECT DIAL

MEMORANDUM

February 28, 2001

**RE: WHAT REGULATIONS DOES TITLE V OF THE GRAMM-LEACH-BLILEY ACT
REQUIRE STATE INSURANCE AUTHORITIES TO ADOPT?**

I. SUMMARY

The question has arisen as to what regulations a State is required to adopt under Title V of the Gramm-Leach-Bliley Act (“the GLB Act”), Pub. L. 106-102, 15 U.S.C. §§ 6801 *et seq.* in order to retain the State’s ability under § 305 of the GLB Act (“305”) to override a Federal determination to pre-empt State provisions relating to the sale of insurance by banking organizations. In order to retain its override authority, the only regulations that a State is required to adopt under Title V of the GLB Act are regulations under § 501 of the GLB Act (§ 501”), which relates to the protection and security of nonpublic personal information. There is no requirement that a State adopt regulations relating to the disclosure of consumer nonpublic personal information under §§ 502 and 503 of the GLB Act (“§§ 502 and 503”). Accordingly, a State would not lose its override authority under § 305 if it did not adopt regulations relating to §§ 502 and 503.

II. STATUTORY FRAMEWORK

Title V of the GLB Act (Subtitle A) provides two distinct requirements. First, § 501 establishes Congressional policy that each financial institution has an obligation to protect the security and confidentiality of its customers’ nonpublic personal information. Second, §§ 502 and 503 impose certain requirements relating to the disclosure by financial institutions of nonpublic personal information of consumers. The GLB Act imposes distinct obligations on financial institutions regarding these two requirements. The GLB Act requires certain Federal agencies to adopt rules to implement the requirements of § 501 as well as §§ 502 and 503. However, the only requirement imposed on State insurance authorities is to adopt rules to implement

SCHWARTZ & BALLEN

§ 501. As presented in greater detail below, there is nothing in the GLB Act that requires the State insurance authorities to adopt rules to implement §§ 502 and 503.

A. SECTION 305 INSURANCE CUSTOMER PROTECTIONS

Section 305 of the GLB Act amended the Federal Deposit Insurance Act (“FDI Act”) by adding § 47 relating to insurance sales practices of depository institutions. 12 U.S.C. § 1831x. The section requires the Federal Banking Agencies¹ to adopt rules relating to customer protections with regard to the insurance sales practices of depository institutions, as well as by any person on the institution’s premises or on behalf of the depository institution. 12 U.S.C. § 1831x(a)(1).

Section 47 provides that the rules adopted by the Federal Banking Agencies are not applicable in a State where the State has in effect laws or rules that are inconsistent or contrary to the rules prescribed by the Federal Banking Agencies. 12 U.S.C. § 1831x(g)(2)(A). Notwithstanding this general rule, if the Federal Reserve Board, OCC and the FDIC determine that the protection provided by the Federal rules are greater than those of the State provisions, they may notify the State insurance authority that they have determined to pre-empt the State provisions. If the Federal agencies pre-empt the State provision, the State may adopt legislation to override the Federal pre-emption. The State must take action within three years after the date the State is notified by the Federal agencies of their determination to pre-empt the State provision. 12 U.S.C. § 1831x(g)(2)(B)(iii). It is this ability of the State to override Federal preemption of State provisions that is at risk if the State insurance authority fails to adopt rules that are required under Title V of the GLB Act. Precisely what rules a State insurance authority is required to adopt under the GLB Act is presented below.

B. SECTION 501 PROTECTION OF NONPUBLIC PERSONAL INFORMATION

Section 501(b) provides that each authority described in § 505(a) of the GLB Act (“§ 505(a)”) shall establish appropriate standards for the financial institutions subject to its jurisdiction relating to administrative, technical, and physical safeguards

- (1) to insure the security and confidentiality of customer records and information;

¹ The “Federal Banking Agencies” are the Federal Reserve Board, the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”) and the Office of Thrift Supervision (“OTS”).

SCHWARTZ & ALLEN

- (2) to protect against any anticipated threats or hazards to the security or integrity of such records; and
- (3) to protect against unauthorized access to or use of such records or information which could result in substantial harm or inconvenience to any customer.

Section 505(a) confers authority to enforce Title V of the GLB Act upon the following agencies:

- the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the National Credit Union Administration Board (“NCUA”), with regard to Federally insured depository institutions;
- the Securities and Exchange Commission (“SEC”), with regard to broker-dealers, investment companies and registered investment advisors;
- the applicable State insurance authority of the State in which the insurer or other person providing insurance is domiciled; and
- the Federal Trade Commission (“FTC”), with regard to all financial institutions not otherwise subject to the jurisdiction of the authorities specified above.

Section 505(b)(1) of the GLB Act (“§ 505(b)(1)”) provides as follows:

Except as provided in paragraph (2), the agencies and authorities described in [§ 505](a) shall implement the standards prescribed under section 501(b) in the same manner, to the extent practicable, as standards prescribed pursuant to section 39(a) of the Federal Deposit Insurance Act are implemented pursuant to such section.

Section 505(b)(2) (“§ 505(b)(2)”) of the GLB Act provides:

The agencies and authorities described in paragraphs (3), (4), (5), (6), and (7) of subsection (a) shall implement the standards prescribed under section 501(b) by rule with respect to the

SCHWARTZ & BALLEN

financial institutions and other persons subject to their respective jurisdictions under subsection (a). (Emphasis added)

The agencies described in paragraphs (3), (4), (5), (6) and (7) of § 505(a) are the SEC, the FTC and the State insurance authorities. Accordingly, the SEC, the FTC and state insurance authorities are required by § 501 (b)(2) to adopt rules implementing the standards provided for under § 501(b). The Federal Banking Agencies, however, are required to implement the standards by issuing guidelines in accordance with § 39 of the Federal Deposit Insurance Act.² The Federal Banking Agencies adopted standards to implement § 501 in February 2001. *See 66 Fed. Reg.* 8616 (February 1, 2001). The SEC adopted final rules implementing the § 501(b) standards at the time it adopted its rules relating to privacy under §§ 502 and 503. *See 17 C.F.R.* § 248.30. The FTC has not as yet adopted a final rule, although it issued a proposed rule for public comment last September. *See 65 Fed. Reg.* 54186 (September 7, 2000).

C. SECTIONS 502 AND 503 PRIVACY REQUIREMENTS

Section 502 and 503 require financial institutions to make certain disclosures to consumers regarding the collection and use of nonpublic personal information. Financial institutions generally are required to provide consumers with an opportunity to instruct the institution not to make certain types of disclosures to nonaffiliated third parties. Financial institutions are also required to provide annual notices to customers concerning their information collection and disclosure practices. § 502(a), (b).

D. SECTION 504 RULEMAKING REQUIREMENTS

Section 504(a)(1) of the GLB Act (“§ 504(a)(1)”) provides as follows:

The Federal banking agencies, the Secretary of the Treasury, the [NCUA, SEC, and the FTC] shall each prescribe, after consultation as appropriate with representatives of State insurance authorities designated by the National Association of Insurance Commissioners, such regulations as may be necessary to carry out the purposes of this subtitle with respect to the financial institutions subject to their jurisdiction under section 505.

² Section 39 of the Federal Deposit Insurance Act (12 U.S.C. § 1831p-1) was adopted in 1991 as part of the Federal Deposit Insurance Corporation Improvement Act, Pub. L. 102-242. The Federal Banking Agencies are required under § 39 to adopt standards for insured depository institutions with regard to a broad spectrum of areas, including operational and managerial standards, lending criteria, asset quality and compensation.

SCHWARTZ & BALLEN

Section 504(a)(3) of the GLB Act (“§ 504(a)(3)”) provides the following:

Such regulations shall be prescribed in accordance with applicable requirements of [5 U.S.C.], and shall be issued in final form not later than 6 months after the date of the enactment of this Act.

The requirement established in § 504(a)(1) that the Federal agencies adopt rules is further confirmed by other sections of Title V of the GLB Act. For example, § 510 of the GLB Act provides that Title V becomes effective “6 months after the date on which the rules are required to be prescribed under section 504(a)(3),” These provisions, therefore, require the Federal Banking Agencies, the SEC, the NCUA and the FTC to adopt rules necessary to carry out all sections of Title V, including §§ 501, 502 and 503. In response to this statutory mandate, the Federal Banking Agencies, the SEC, the NCUA and the FTC adopted final rules to implement §§ 502 and 503 of the GLB Act.³ However, there is nothing in § 504 that imposes any requirement upon State insurance authorities to adopt rules to implement any section of Title V of the GLBA.

E. Section 505 Enforcement Provisions

Section 505(c) of the GLB Act (“§ 505(c)”) provides:

If a State insurance authority fails to adopt regulations to carry out this subtitle, such State shall not be eligible to override, pursuant to section 47(g)(2)(B)(iii) of the Federal Deposit Insurance Act, the insurance customer protection regulations prescribed by a Federal banking agency under section 47(a) of such Act.

This provision is not a statutory requirement because it does not require State insurance authorities to do anything. It establishes a sanction in the event a State insurance authority fails to adopt a rule that is required under Title V. As indicated above, the only provision that imposes a requirement on State insurance authorities to adopt regulations is found in the immediately preceding provision, § 505(b)(2), which requires the State insurance authority (as well as the SEC and FTC) to adopt rules relating to § 501.

³ See 65 *Fed. Reg.* 35162 (June 1, 2000)(OCC, Federal Reserve FDIC and OTS); 65 *Fed. Reg.* 40334 (June 29, 2000) (SEC); 65 *Fed. Reg.* 33646 (May 24, 2000); 65 *Fed. Reg.* 31722 (May 18, 2000) (NCUA).

SCHWARTZ & BALLEN

There is nothing in Title V that imposes a requirement on State insurance authorities to adopt rules relating to any provision of Title V other than § 501. This is unlike the express provision in § 504(a)(1) that requires the Federal Banking Agencies, the SEC, the NCUA and the FTC to adopt regulations relating to all other provisions of Title V (Subtitle A). It is incorrect to read § 505(c) as a backhanded way in which Congress intended to require State insurance authorities to adopt rules to implement §§ 502 and 503. ([A] section of a statute should not be read in isolation from the context of the whole Act. *Richards v. United States*, 369 U.S. 1, 17 (1962).) This is particularly the case when Congress in the very same Title V expressly imposed rulewriting requirements for §§ 502 and 503 on the Federal Banking Agencies, the SEC, the NCUA and the FTC.⁴ Accordingly, it is clear that the GLB Act does not require State insurance authorities to adopt rules relating to §§ 502 and 503, although it does require States to adopt rules under § 501(b).

In enacting § 505(c), Congress determined to impose a sanction on the States for the failure to adopt rules which it directed and required States to adopt under § 501. Congress chose this route because the only sanction the Federal government may impose if States fail to enact rules required under Federal law is to take away a benefit from the States. *See Hodel v. Virginia Surface Mining & Reclamation Association, Inc.*, 452 U.S. 264, 288 (1981); *FERC v. Mississippi*, 456 U.S. 742, 761-762 (1982). Congressional action that takes a benefit away from States that fail to perform actions required by Federal law has been upheld as a constitutional exercise of Federal authority. *New York v. United States*, 505 U.S. 144, 168 (1992).

When requiring State insurance authorities to adopt rules relating to § 501, Congress provided an incentive to the States to carry out the Congressional mandate. A State would retain its authority to override the

⁴ The Conference Report on S. 900, the bill that became the GLB Act, also confirms that unlike § 501, Congress did not require State insurance authorities to adopt regulations relating to §§ 502 and 503. The Conference Report stated the following:

The Federal functional regulators, the Secretary of the Treasury, and the FTC, in consultation with State insurance authorities, are directed to prescribe such regulations as may be necessary to carry out the purposes of the privacy subtitle. The House bill had called for a joint rulemaking. The relevant agencies are required to consult and coordinate with one another in order to assure to the maximum extent possible that the regulations each prescribes are consistent and comparable with those prescribed by the other agencies. It is the hope of the Conferees that State insurance authorities would implement regulations necessary to carry out the purposes of this title and enforce such regulations as provided in this title.

H. Rep. 106-434, 106th Cong., 1st Sess. at 171.

SCHWARTZ & BALLEN

Federal Banking Agencies' pre-emption of State insurance sales protections if it adopted the rules required by Congress under § 501. Because there is no requirement imposed under the GLB Act on a State insurance authority to adopt rules under §§ 502 and 503, there can be no penalty imposed upon the States for their failure to adopt something that is not otherwise required.

If Congress had intended State insurance authorities to adopt rules relating to §§ 502 and 503, it could have expressly required as much somewhere in Title V just as it did with respect to § 501. Congress chose not to do so. Accordingly, a State would not lose its override authority under § 395 if it did not adopt rules to implement §§ 502 and 503 because Congress did not impose such a requirement upon State insurance authorities.

* * *

If you have any questions concerning this memorandum, please contact Gilbert T. Schwartz.