EXPECTFOCUS® Vol. IV Fall 2008

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Graphics and Design
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Subscriptions
Changes in address or requests for subscription information should be submitted to:

Moira Demyan
mfd@jordenusa.com

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INTHESPOTLIGHT

GMWB Features Get Complex

BY CHIP LUNDE

In 2007, over 66% of all variable annuity sales included a Guaranteed Minimum Withdrawal Benefit (GMWB) feature.

GMWBs are a type of living benefit that allows variable insurance contract owners to receive a guaranteed amount of income regardless of the market performance of their account, provided that the owner limits annual withdrawals to a specified percentage. Generally, GMWBs guarantee either a total return of purchase payments, or lifetime withdrawals. GMWBs recently have proven popular with consumers faced with the combined retirement threats of reduced savings rates, longer expected longevity, and lower market performance.

As insurers compete for assets, insurers are offering GMWBs with more attractive features. Some GMWBs offer higher annual withdrawal limits (up to 7%) if the owner waits to a certain age to begin taking withdrawals. Other GMWBs promise a benefit base that will increase 10% per year until withdrawals begin. At the same time, insurers are hedging their risks by establishing investment limitations, required portfolio rebalancing, and penalties for excess withdrawals.

As the benefits and restrictions increase, so does the challenge of explaining these features to customers. Recently some industry commentators have suggested that the risks and benefits of GMWB features are not well understood by consumers, and that the features could be a future source of litigation or regulatory attention. In order to limit risks related to offering GMWBs, insurers should review their prospectus disclosure and sales materials and implement other steps in the sales process to ensure that the nuances of these features are adequately understood by those who buy and sell GMWBs.

CONTENTS

INTHESPOTLIGHT

GMWB Complexity 2

LIFE&HEALTHINDUSTRY

Certification of Bonus Annuity Class Denied 4

Third Senior Summit 5

Synthetic Annuities 5

Indexed Annuity Update 6

Dot Anything gTLDs Expected in Early 2009 6

NAIC Fall Meeting 7

Summary Judgment Affirmed in "Juvenile Smoker" Case 7

PROPERTY&CASUALTYINDUSTRY

Xactimate Update 8

Waiver and Estoppel Can't Rewrite Policy 8

Insured Denied Bigger Umbrella 9

Failure to Notify is Deceptive 9

REINSURANCEINDUSTRY

NAIC to Act on Modernization 10

NY Announces "Contract Certainty" 10

Treaty Tips: Keeping an Eye on Losses 11

Unknown "Fortunes" Preclude Declaratory Relief 11

NOTEWORTHYSPECIAL

Bailout Bill May Impact Insurance Companies 12

Washington Monitor 12

MUTUALFUNDS&INVESTMENT ADVISERSINDUSTRY

Removal of NRSRO Rating Reliance? 14

IDC Issues Report on Board Oversight of Derivatives 14

SEC Clarifies Cash Solicitation Rule 15

Electronic Filing of Applications Mandated 15

Court Finds Duty to Disclose in Market Timing Case 16

FinCEN Withdraws Proposed AML Rules 16

SECURITIESINDUSTRY

Broker-Dealer Responses to Market Turmoil 17

Criminal Probes Target Financial Market Players 18

Market Turmoil Spawns Class Actions 18

Regulatory Mulligan for the 21st Century 19

FINRA Homes in on Certain Customer Complaints 19

CONSUMERFINANCE& BANKINGINDUSTRY

Circuit Courts Refuse to Expand TILA Remedies 20

Seventh Circuit Reject CAFA Loophole Attempt 20

Nonintervening Class Member Appeal Allowed 21

Individualized Damages Defeat Class Certification 21

IFCRA Damages Provision Uconstitutional . 21

Arbitration Roundup 22

FACTA "Red Flag" Compliance Delayed . . . 22

NEWS & NOTES

NEWS & NOTES 23

Class Certification Denied in Bonus Annuity Litigation

BY SHAUNDA PATTERSON-STRACHAN

Formidable road blocks for class certification

Past *Expect Focus* articles have reported on the dismissal of "bonus" fixed annuity suits by several courts (see *Expect Focus*, Vol. IV, Autumn 2007, and Vol. II, Spring 2007). Now, a Pennsylvania federal district court has rejected efforts to certify national and state-only classes of "bonus" annuity purchasers.

The plaintiff in *Smith v. John Hancock* had alleged that purchases of the insurer's fixed annuity contract were predicated on the promise that purchasers would receive a first-year bonus interest rate, which was supposedly illusory because the product allegedly was designed to allow the bonus to be "recaptured" in subsequent years through the setting of lower renewal rates. Prior to issuing the class certification ruling, the *Smith* court dismissed seven of the nine claims in the complaint, concluding, inter alia, that plaintiff's theory of liability did not support a breach of contract claim. While the plaintiff's common law and statutory fraud claims survived dismissal, the court ultimately rejected class certification of those claims on multiple grounds.

The court ruled that plaintiff's purchase of two fixed annuities with a first-year bonus interest rate from another insurer just two months after she purchased the defendant's annuity subjected her to unique defenses, rendering her both an inadequate and atypical class representative. Also, finding that the relief sought by the plaintiff related exclusively or predominately to money damages, the court declined to certify a Rule 23(b)(2) class. Finally, rejecting a Rule 23(b)(3) class, the court found that common questions did not predominate over those affecting only individual class members because the element of reliance, key to both fraud-based claims, could not be presumed.

Smith confirms that despite efforts by the plaintiffs' bar to focus on purportedly uniform product features rather than point-of-sale representations and omissions, the need to establish reliance remains a formidable obstacle to class certification. *Smith* also illustrates the potential benefits of pursuing dispositive motions prior to a court's assessment of class certification so that, at a minimum, the number of claims under consideration for class certification might be narrowed and sharpened. Jorden Burt represented the insurer in this litigation.

Mark your Calendars

Jorden Burt attorneys are speaking at the American Bar Association Tort Trial & Insurance Practice Section's 35th Annual Midwinter Symposium, January 15-18, 2009 in Bonita Springs, FL. **Robin Sanders**, associate in the DC office and Vice Chair of the Life Insurance Law Committee of the ABA TIPS Committee, will be on a panel "Lies, More Lies, And Oops!: Misrepresentations In Life, Health And Disability Applications." **Irma Solares**, partner in the Miami office, is speaking on "Tier-Rating Of Health Insurance–When And Where Is Individual Re-Underwriting For Claim History Permitted?" For more information, visit www.abanet.org/tips.

SEC Holds Third Seniors Summit

BY GARY COHEN

SEC's Third Seniors Summit, held on September 22, 2008 focused on how declining mental faculties of seniors can negatively impact their financial management skills. The Summit had two sessions: one to help educate senior investors and their families and the other to inform financial services professionals as to new practices that firms use when advising senior investors.

Chairman Christopher Cox opened the Summit by announcing that the SEC had brought more than 50 major cases over the past two years that involved securities fraud on senior citizens. He explained that "[o]ur recent cases have ranged from Ponzi schemes and offering frauds, to schemes specifically targeting senior investors through free lunch programs and sales pitches disguised as seminars."

Chairman Cox seems to have a personal stake in the subject. He said that "[b]efore my mother died [of throat cancer] a few years ago, she was pestered by a seemingly endless barrage of unsuitable investment schemes and foolish mortgage offers."

The SEC tries to help seniors sort through their options

Patricia Struck, Administrator, Division of Securities, Wisconsin Department of Financial Institutions, spoke about the "complexity and risks" of index annuities and supported the SEC's proposed Rule 151A that would require SEC registration. Although the program did not so identify Ms. Struck, she seemed to speak for NASAA.

Susan Voss, Iowa Securities and Insurance Commissioner, respectfully disagreed with Ms. Struck. Ms. Voss insisted that index annuities were insurance products and emphasized that index annuities were subject to current and proposed regulation. The program identified Ms. Voss as the Iowa insurance commissioner, but she stressed that she also acts as the state securities commissioner. She argued that she was well aware of the position of other securities commissioners regarding index annuities and "respectively disagreed."

Synthetic Annuities in Today's Market

BY JOAN BOROS

Two realities may be combining to increase the level of public receptivity to annuitization in the form of a guaranteed stream of income over either a stipulated period or life. The first reality is that aging "boomers" are increasingly concerned about outliving their assets. The second is the expectation that the recent dramatic decline and volatility of the markets is going to be prolonged. Guarantees have taken on new meaning, and that is what synthetic annuities are all about.

Market turmoil has boomers seeking cover

Synthetic annuities can be described as a guaranteed deferred annuity contract that has "unbundled" the insurance guarantees from the assets by which the value and the duration of guarantees are measured (the "measuring assets" or "benefit base"). The guarantees are for a specified stream of withdrawals from the measuring assets followed by a stream of payments for life when the measuring assets are depleted by certain permissible causes. To date, the separate measuring assets have been either retail mutual fund shares or the holdings in a private investment advisory account.

Notwithstanding the heightened interest in synthetics, there are several major unresolved tax, regulatory, and pricing issues on the path to launching a successful new product that addresses the two realities. Pending action by the IRS, the companies now offering synthetic annuities are taking the positions: (i) that a synthetic product is an annuity for tax purposes and (ii) that the synthetic product link does not affect the current favorable capital gains and dividend treatment of the income from measuring assets. It remains to be seen whether the IRS will ultimately agree. The regulatory issues include the frequently disabling burdens of the reporting requirements under the Securities Exchange Act of 1934 and its coupling with Sarbanes-Oxley, which may or may not be resolved depending on the fate of proposed and pending Rule 12h-7. Finally, the prime pricing issue for insurers is the same decline and volatility of the markets that is capturing the boomers' attention. The insurers must factor in the costs of their hedging transactions, and the potential strain of their reserving requirements, while trying to price the guarantees at saleable levels.

Index Annuity Regulatory Update: Comment Period Extended

BY RICHARD CHOI & ANN FURMAN

On October 10, 2008 the SEC announced that it was re-opening the comment period on proposed Securities Act Rule 151A and proposed Exchange Act Rule 12h-3 for an additional 30 days. Prior to conclusion of the initial comment period on September 10, 2008, the SEC had received, but did not act on, numerous requests to extend the Rule 151A comment period. The stated reason for the extension was "to provide additional time for the public to thoroughly consider the proposal." The extended comment period ended November 17, 2008, 30 days following the publication of the SEC release in the Federal Register.

Rushing to the new deadline

Intellectual Property & Technology Update

Dot Anything gTLDs Expected in Early 2009

BY DIANE DUHAIME

Most U.S. companies already own domain name registrations that end in .com,.net, .org, .info, .biz, .mobi and/or .us. The current domain name system includes 21 generic top level domains (gTLDs). In late June 2008, the Board of Directors of the Internet Corporation for Assigned Names and Numbers (ICANN) approved a recommendation to expand gTLDs to include just about anything that just about any applicant would like to purchase. For example, the expanded system will accommodate the addition of company names, such as FORD or BANKOFAMERICA; trademarks, such as GATORADE or MATTEL; geographic places, whether or not abbreviated, such as NYC or NEWYORKCITY; and names of target markets or communities, such as FINANCE, INSURANCE, MONEY, RETIREMENT, LAPTOPS, or BOOKS.

The implementation plan for the new gTLD process is expected to be approved in early 2009, with applications for new names becoming available in the second quarter of 2009. ICANN recognizes that some gTLDs could become the subject of disputes, especially because company names, trademarks, and other terms will not be automatically reserved for their owners. Applications will be processed on a first-come, first-served basis. When more than one applicant applies for the same domain name and the applicants are not able to resolve the matter themselves, the domain name may go to auction, with the domain name going to the highest bidder. Also, ICANN reports there will be an independent dispute resolution process whereby third parties with standing may launch objections to applications for new gTLDs, and the Uniform Domain Name Dispute Resolution Procedure (UDRP) will apply to all new gTLDs. The present Internet address system is limited to 37 Roman characters. The expanded system, however, is expected to support local language characters. Therefore, it is important to consider obtaining registration of applied-for strings in not only Roman characters, but in scripts for other languages.

ICANN estimates that the total fee per gTLD applicant will be $185,000. Some speculate that the high application fee will deter cybersquatters, while others insist that one must promptly purchase new gTLDs, or risk losing them to cybersquatters. In other words, trademark owners that do not obtain new gTLDs for their flagship names and marks as a defensive measure may need to pursue cybersquatters at an even greater expense and without the certainty of prevailing. Some trademark owners believe the new system will be extremely burdensome and have publicly criticized ICANN for proposing a plan that essentially forces brand owners to invest in gTLDs so as to prevent their trademarks from being abused and their customers from being confused.

2008 NAIC Fall Meeting Highlights

BY STEVEN KASS & SARAH JARVIS

Held September 21-24 in Washington, D.C., the NAIC 2008 Fall National Meeting produced the following significant developments:

Guidelines call for new producer training

- **Annuity Suitability and Disclosure.** The Wisconsin Insurance Department recently developed "Annuity Supervision, Monitoring and Training Guidelines," which were presented to the Suitability of Annuity Sales Working Group as points for consideration in updating the Suitability in Annuity Transactions Model Regulation. The Working Group primarily focused on three elements of the Guidelines: producer training, liquidity analysis and "red flags" that would trigger heightened scrutiny. The Working Group established a subgroup (CA, FL & WI) to prepare a draft "liquidity needs" questionnaire for use at point-of-sale, which is expected to be presented to the Working Group at the upcoming Winter National Meeting. The Consumer Guides subgroup also expects to present draft Consumer Guides for fixed indexed annuities and variable annuities to the Working Group for discussion at that meeting.

- **New Working Groups & Task Forces.** An Indexed Annuities (EX) Working Group was formed to (i) develop a response on proposed SEC Rule 151A, (ii) conduct a coordinated, nationwide data call with a specific focus on index annuity sales and marketing practices, and (iii) coordinate regulatory responses based on the data call. An AIG Special (EX) Task Force was created to (i) oversee regulatory activities related to AIG insurance subsidiaries and coordinate interaction between regulators and the company, (ii) manage communication of information and coordination of activities related to insurers proposed to be sold by AIG, and (iii) ensure concerns regarding the 17 life insurers in the AIG group are adequately addressed. An Annuity Disclosure (A) Working Group was charged with reviewing and considering changes to the Annuity Disclosure Model Regulation to improve the disclosure of annuity product information, provide insurers uniform guidance and monitor distribution of annuities.

- **Senior Designations Model Regulation.** The NAIC Plenary formally adopted the Model Regulation on the Use of Senior Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities. The regulation seeks to prevent fraud and abusive sales practices aimed at seniors, and is patterned on NASAA's model rule.

Third Circuit Affirms Summary Judgment in "Juvenile Smoker" Case

BY MICHAEL KENTOFF

Previously we reported on a number of federal district court decisions rejecting plaintiffs' theory that in checking the NO box beside the smoking question in a life insurance application, they reasonably expected that the insured would be provided a non-smoker discount premium rating as opposed to the "standard" rating used industry-wide (see *Expect Focus*, Vol. I Winter 2008). These decisions signaled a clear indication that merely answering a tobacco question in the negative on a life insurance application does not obligate an insurer to provide a specific premium rating.

One such decision, *Ross v. Metropolitan Life Insurance, from the Western District of Pennsylvania*, was recently affirmed by the U.S. Court of Appeals for the Third Circuit. In the Third Circuit's October 28, 2008 decision, the court praised the district court's "thorough opinion" and observed that "it appears that MetLife promised to provide life insurance coverage in exchange for disclosed premium payments, and fully honored its part of the bargain."

Xactimate Update: Fifth Circuit Affirms Federal Jurisdiction Under CAFA

BY JOHN PITBLADO

Was there a lack of competition?

Louisiana's Attorney General filed suit against several property insurers, alleging that they conspired and colluded among themselves, and with co-defendants Xactware, Inc., Insurance Services Office, Inc., and McKinsey & Company Inc., to artificially reduce the value of property claims by manipulating a claim database used as an industry reference (see *Expect Focus*, Vol. I, Winter 2008). Following the defendants' removal of the case to federal court, which was based on the jurisdictional provisions of CAFA, the plaintiff sought to have the case remanded to Louisiana state court, arguing that CAFA did not apply to the action because it was a "parens patriae" suit brought by the state on behalf of its citizens, rather than a true class action. The court denied the motion to remand, and the plaintiff appealed (see *Expect Focus*, Vol. II, Spring 2008). On July 18, 2008, the Fifth Circuit Court of Appeals affirmed the court's decision, holding that a "parens patriae" action brought by a state attorney general constitutes a "class action" or "mass action" as those terms were intended to be construed under CAFA, and that the more flexible jurisdictional requirements under CAFA thus precluded a remand to state court.

The defendants have collectively filed a motion to dismiss the claims, asserting that the plaintiff's antitrust claims under the Louisiana Monopolies Act are not legally sufficient because they fail to properly allege a conspiracy between the defendants, and they fail to allege any injury to competition, both of which, they argue, are required elements of such a claim. Plaintiff's brief in opposition argues that the claims are sufficiently pled, that defendants improperly rely on federal pleading standards, and that under appropriate state pleading standards, the claims set forth the necessary facts to demonstrate a violation of the Louisiana Monopolies Act. No oral argument date has been set. *Expect Focus* will continue to monitor the case and report developments.

Waiver and Estoppel Cannot Rewrite Policy

BY JAMES GOODFELLOW

In *Ulico Casualty Company v. Allied Pilots Association* (APA), the Texas Supreme Court rejected an insured's attempt to rewrite an insurance policy by claiming that an insurer had waived or was estopped from denying coverage for an untimely claim under a claims-made policy.

The policy was effective from August 25, 1998 through October 25, 1999. On October 4, 1999, American Airlines commenced suit against APA. APA notified its attorney and broker, but not Ulico. APA did not notify Ulico until November 5, 1999. In December 1999, Ulico informed APA that its claim was being reviewed, and that APA would be notified of Ulico's coverage decision, and advised that no expenses could be incurred without Ulico's prior written consent. In March 2000, Ulico informed APA that it would provide a defense, but reserved its right to deny coverage. In April 2001, Ulico informed APA that it had agreed to cover reasonable and necessary defense expenses. In May 2001, APA's attorney submitted a bill to Ulico for approximately $635,000 in fees, without having had any contact with Ulico regarding the lawsuit.

On Ulico's declaratory judgment claim, the trial court entered judgment in favor of APA, concluding that based on its actions following receipt of notice of the lawsuit, Ulico had waived or was estopped from denying coverage. The Texas Supreme Court reversed the decision concluding that by the time APA had informed Ulico of the lawsuit, the policy had lapsed. Since APA failed to comply with the express terms of the policy, and because Ulico's actions had not prejudiced APA, the court concluded that APA could not use the doctrines of waiver and/or estoppel to effectively re-write the policy to provide coverage where none exists.

Insured Denied Bigger Umbrella

BY JACOB HATHORN

The Tenth Circuit Court of Appeals recently held in *Sewell v. Great Northern Insurance Company* that an insurance broker has no responsibility to advise an insured to procure excess uninsured/underinsured motorist (UM/UIM) coverage in an umbrella policy in addition to the coverage selected in an underlying automobile policy.

In 2001, Marla Sewell used the services of Professional Lines Insurance Brokerage (PLI) to procure automobile and umbrella insurance coverage for her family. Ms. Sewell did not specifically request any information on UM/UIM coverage. PLI sent her quotations for coverage, from which she selected an automobile policy with $300,000 of UM/UIM coverage, and an umbrella policy with no excess UM/UIM coverage. PLI then prepared and sent written materials including the umbrella policy with blank spaces indicating that Ms. Sewell had not elected to procure the optional excess UM/UIM coverage. Ms. Sewell read the materials, signed the policy, and returned it without making any changes.

No umbrella for you!

In 2004, Ms. Sewell's husband was killed when his car was struck by an escaping felon in a high-speed police chase. The Sewells submitted a claim for excess UM/UIM benefits, but it was denied by the excess insurer because they never purchased excess UM/UIM coverage.

The Sewells asserted numerous Colorado common law and statutory claims against PLI based on PLI's alleged failure to procure excess UM/UIM coverage on their behalf. Following removal of the case, the federal district court granted PLI's motion for summary judgment because the Sewells received precisely the coverage they requested, and because PLI, as their agent, neither misrepresented any information regarding the policy nor otherwise breached any duty to affirmatively advise or warn the Sewells regarding their coverage. The appellate court affirmed summary judgment for PLI on all claims, agreeing with the trial court that the standard insurer-insured relationship between PLI and the Sewells required no more of PLI than to obtain the specific coverages requested and to answer any question brought to its attention, which is what PLI did.

Failure to Notify Constitutes Deceptive Practice

BY JOHN PITBLADO

The New York Appellate Court recently revisited one of its previous insurance coverage decisions, holding that an insurer that failed to notify its insureds of their right to select independent counsel of their choosing, paid for by the insurer, in a case involving coverage conflicts, was in violation of New York's deceptive practices statute, warranting attorney's fees.

In its first decision, *Elacqua v. Physicians' Reciprocal Insurers*, the Appellate Court held that, because the coverage dispute involved both covered and non-covered claims, the plaintiff insureds had a right to a defense of all the underlying claims against them by independent counsel of their choosing, at the insurer's expense, and that the insurer had an affirmative obligation to inform the insureds of those rights.

The case was thereafter remanded, and the insureds added a claim for violation of New York's deceptive acts and practices statute, N.Y. Gen. Bus. Law § 349, which allows a prevailing plaintiff to recover attorneys fees. The trial court entered judgment in favor of the insurer on the statutory claim, and the insureds appealed.

In the second decision, *Elacqua v. Physicians' Reciprocal Insurers*, the Appellate Court reversed, finding that the insurer's practice was "consumer-oriented" within the meaning of the statute, and that actual, if not necessarily pecuniary, harm was caused by the insurer's practice of failing to notify insureds of the right to paid independent counsel of their choosing in cases of coverage conflicts. The case was remitted for a trial on damages.

Ensure insured notification

NAIC Adopts Reinsurance Modernization Proposal

BY ANTHONY CICCHETTI

On December 7, 2008, the NAIC adopted a Reinsurance Regulatory Modernization Framework proposal that aims to effect single-state regulation for reinsurers and eliminate the dichotomy between U.S. and non-U.S. reinsurers as the controlling factor in determining collateral requirements.

NAIC moving toward modernization

The framework contemplates the creation of two new classes of reinsurers in the United States: national reinsurers and port of entry (POE) reinsurers, each of which would be regulated by a single U.S. supervising jurisdiction. A Reinsurance Supervision Review Department (RSRD) in the NAIC would, among other functions, determine jurisdictions eligible to be recognized as POE states. A supervisory board of the RSRD would establish uniform standards for the U.S. supervising jurisdictions of national and POE reinsurers, as well as determine collateral reduction eligibility criteria. In conjunction with its adoption of the framework, the NAIC also approved the creation of the RSRD.

With regard to credit for reinsurance, the framework employs a ratings-based approach. The U.S. supervising jurisdiction would assign to each national reinsurer and POE reinsurer one of five ratings based substantially on the reinsurer's financial strength ratings (from S&P, Moody's, Fitch, A.M. Best, or other rating agency approved by the U.S. Securities and Exchange Commission). A reinsurer's failure to maintain at least two financial strength ratings from SEC- approved rating agencies would result in a Vulnerable-5 rating.

Subject to an exception (described below) for certain national reinsurers, the rating assigned by the reinsurer's supervising jurisdiction would determine the amount of reinsurance collateral required on a sliding scale, as follows:

Secure-1:	0% collateral required
Secure-2:	10% collateral required
Secure-3:	20% collateral required
Secure-4:	75% collateral required
Vulnerable-5:	100% collateral required

A national reinsurer rated Secure-3 or above would not be required to post collateral.

A more detailed summary of the NAIC's Reinsurance Regulatory Modernization Framework proposal, and updates on its status, can be found on Jorden Burt's *Reinsurance Focus* blog at http://www.reinsurancefocus.com/uploads/NAICreinsuranceproposalstatusmemo12.9.08.pdf.

New York Announces Position on "Contract Certainty"

BY STEVEN KASS

To promote "contract certainty," the New York Insurance Department recently announced in Circular Letter No. 20 (2008) that parties to reinsurance contracts and P&C insurance policies should reach final and complete agreement on all contract terms by contract inception. The Department noted that lack of contract certainty may give rise to misunderstandings about the nature and scope of coverage and exposes the parties to increased legal risk and complex litigation, such as the litigation that followed the World Trade Center disaster.

The Department expects industry to adhere to a set of reasoned principles and practices to enhance contract certainty, and accordingly: (i) in addition to having terms finalized by contract inception, the contract should be executed at or "promptly" after inception (i.e., within 30 days, with any extension being carefully documented); (ii) licensees should strive for contract certainty in at least 90% of such contracts; and (iii) insurers should, within one year, develop and implement appropriate practices. The Department stated that it will verify industry's progress through various methods, including examinations and inquiries to licensees.

Treaty Tips:
Keeping An Eye On "Losses"

BY ANTHONY CICCHETTI & DAN CRISP

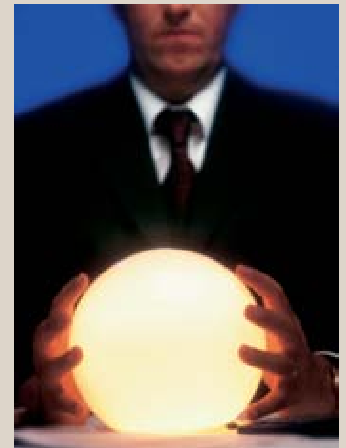
Losing sight of fundamental treaty definitions as a reinsurance arrangement changes over time can result in unexpected consequences. For example, in *Employers Reinsurance Corp. v. American Southwest Insurance Managers, Inc.*, the dispute centered on whether a $1.3 million claims start-up fee paid by Employers Reinsurance Corp. (ERC) pursuant to an administrative services agreement put in place three years into the reinsurance transaction should be included in calculating "losses incurred" by ERC under the treaty between it and American Southwest Insurance Managers (ASI). Greater "losses incurred" by ERC resulted in lower commission rates for its counterparty, ASI, the managing general agent and producer of the reinsured business.

ASI took the position that the fee did not fall under the definition of "losses incurred" because the administrative services agreement characterized the fee as "additional compensation" to the service provider (an affiliate of ASI), not a part of the separately calculated loss adjustment fees. The court rejected ASI's argument, noting that the treaty's definition of "losses incurred" – which apparently was not re-visited when the administrative services agreement was effected – expressly included "loss adjustment expenses." The court went on to reason that, however characterized in the services agreement, the $1.3 million claims start-up fee constituted a part of the expenses incurred by ERC for the loss adjustment services, thereby warranting inclusion in "losses incurred."

Unknown "Fortunes" Preclude Declaratory Relief For Cedent

BY ANTHONY CICCHETTI

The United States District Court for the Northern District of California has refused to grant declaratory relief to a ceding company concerning its reinsurer's obligations under the reinsurance agreement because the ceding company had not yet made a payment to the primary insured. In *Tall Tree Insurance Company v. Munich Reinsurance America, Inc.*, Tall Tree alleged that it owed its insured pursuant to the underlying policies for certain litigation defense costs, but that Munich had denied any obligation to reimburse Tall Tree because Munich claimed the underlying policies were not covered by the reinsurance agreement. Tall Tree sought a declaration by the court that Tall Tree's obligation to reimburse the primary insured gave rise to Munich's obligation under the reinsurance agreement to reimburse Tall Tree for amounts paid in good faith to the primary insured.



Notwithstanding Tall Tree's allegation that Munich had denied any obligation to reimburse Tall Tree, the court dismissed the complaint, reasoning that "until [Tall Tree] has paid a claim that [primary insured] has submitted or may in the future submit, or until a determination is otherwise made that [Tall Tree] is obligated to pay any such claim, [Tall Tree]'s request for declaratory relief is premature, because defendant has not yet been put in a position where it can decide if plaintiff has paid a claim in good faith." In other words, although California recognizes the "follow the fortunes doctrine," the ceding company's "fortunes" were yet to be known inasmuch as Tall Tree had made no act (i.e., payment to the primary insured) for Munich to assess and "follow."

Congratulations

Reinsurance Focus, Jorden Burt's reinsurance and arbitration blog, was recently honored by LexisNexis as one of the Top 50 insurance-related blogs. It is one of only five blogs that purport to address reinsurance issues, and is among the ten blogs listed in the "Top Blogs" box on the home page of LexisNexis' Insurance Law Center. Congratulations to blogmaster Rollie Goss and the entire blog staff.

SPECIAL**FOCUS**

Bailout Bill May Impact Insurance Companies

BY LYNLEE BAKER & SUSAN HOTINE (SCRIBNER, HALL & THOMPSON, LLP)

On October 3, 2008, President George W. Bush signed into law what has been commonly referred to as the "bailout bill," Public Law No. 110-343 (Oct. 3, 2008), which includes provisions for economic stabilization, energy improvements, and the extension of expiring tax provisions and AMT relief. The new law authorizes the Secretary of the Treasury to spend up to $700 billion to purchase, insure, hold, and sell a wide variety of financial instruments, especially mortgage-backed securities, or to invest directly in struggling banks. Whether or not an insurance company participates directly in the bailout bill, some of the provisions, tax and otherwise, may impact its operations.

Deferred compensation from tax-indifferent entities

As partial payment for the extension of tax expiring provisions, new rules now make deferred compensation from certain foreign corporations and partnerships, i.e., tax-indifferent parties, includible in gross income by the service provider when there is no substantial risk of forfeiture of the service provider's rights to the compensation. Generally, the Code postpones the service recipient's deduction for deferred compensation to the year in which it is paid, regardless of the accounting method used by the service recipient. Thus, there is a tension between the service provider and the service recipient that tends to constrain the length of deferral, which is absent when a service recipient is exempt from U.S. tax. Although developed in response to reports of deferred compensation from off-shore hedge fund operations, the new provision applies to any deferred compensation to be paid to U.S. persons by any off-shore entities.

Securities broker basis reporting

In addition, new information reporting rules require securities brokers currently required to report transactions to the IRS and the customer to include the customer's relevant adjusted basis and holding period in the report. Also, transferors of securities are required to report to the brokers the relevant basis and holding period upon transfer to the broker, and issuers of securities are required to report to the IRS and brokers when any organizational action affects the securities' basis.

Recoupment of losses from the bailout bill

The bailout bill is intended to restore liquidity and stability to the financial system of the United States. To this end, the Secretary of the Treasury is authorized to purchase troubled assets from any financial institution. As quid pro quo, those financial institutions that participate in the bailout benefits also will be subject to a new lower limit on executive compensation. Also, at the end of five years, if the plan of acquiring troubled assets has incurred a net loss, the President must submit a legislative proposal that recoups from the "financial industry" an amount equal to any shortfall in order to ensure that the troubled asset acquisition plan does not add to the deficit or national debt. Based on the statutory language, it appears that the obligation to provide for recoupment of a shortfall will fall on the financial industry as a whole, without regard to whether a particular financial institution participates in the bailout.

WASHINGTON MONITOR—An inside look at key regulatory agencies

Parsing the 151A Labyrinth

BY GARY COHEN

What's up with the SEC's twists and turns on proposed Rule 151A? First, we have the substantive twists and turns. The SEC has proposed a standard that, for many insurers, seems to come from out of the blue. These insurers do not believe that the SEC has adequately explained how the standard relates to Supreme Court principles.

Second, we have the procedural twists and turns. Many parties asked the SEC to extend the September 10, 2008 deadline for comments. The SEC remained silent and let the deadline pass. Then, a month later, the SEC announced a 30-day extension of the comment period.

Moreover, the SEC continued to post, on its website, comment letters dated after September 10. This process seems to undercut the September 10 deadline by suggesting that the SEC would consider comments received after the deadline. Some considered the SEC to have granted a de facto extension of the comment deadline.

And the industry has experienced its own twists and turns.

First, a number of insurers favor the proposal, while others, particularly issuers of index annuities, vigorously oppose it. So, some groups like the ACLI, NAVA and CAI may not achieve a sufficient consensus to submit comments during the extension.

Second, even insurers that support the proposal have difficulties with Rule 151A in its proposed form. These insurers believe that the proposal would sweep into its ambit unintended insurance products The fact that the SEC did not honor requests for extension of the comment deadline generated a number of speculations. The principal speculation – for which the author has no factual foundation – is that SEC Chairman Christopher Cox wants to adopt a "do good" rule to protect seniors in order to burnish his legacy as Chairman.

Is Chairman Cox feeling targeted from within?

Chairman Cox, a Republican, has come under withering criticism within his own ranks. The *Wall Street Journal*, for example, ran a highly critical article. Presidential candidate John McCain publicly called for the Chairman's ouster. And the SEC's Inspector General published a report faulting the SEC in connection with the current financial crisis. The SEC has publicly stated that Chairman Cox intends to leave after the end of the current administration. The SEC did not state how long "after" the end of the current administration Chairman Cox intends to leave. The expectation is that Chairman Cox will leave in February 2009.

So, one speculation is that the SEC did not extend the comment deadline in order for Chairman Cox to have sufficient time to get Proposed Rule 151A adopted before he leaves the SEC in February 2009. But the financial crisis has overtaken the Rule 151A proposal. So, the SEC may have granted the extension because it couldn't get to the proposal for another month anyway.

Removal of NRSRO Rating Reliance?

BY SARAH JARVIS

Is now the time for renovations to the system?

In an effort to address concerns regarding the use of credit ratings issued by nationally recognized statistical rating organizations ("NRSROs"), the SEC has proposed to remove all references to NRSRO ratings from the rules under the Investment Company Act and the Investment Advisers Act. The SEC believes that including NRSROs in the rules has effectively placed an "official seal of approval" on the ratings, and that this in turn has caused undue reliance on the ratings resulting in a lack of due diligence and investment analysis by market participants. SEC Division of Investment Management Director "Buddy" Donohue has stated that the SEC hopes that removal of NRSRO ratings will "require a subjective determination of the quality of the instruments at issue" instead of allowing reliance on the NRSRO rating.

Comments from the industry have generally been critical of the proposed changes, especially those to Rule 2a-7. Currently, under Rule 2a-7, money market funds are only allowed to invest in securities that are in one of the two highest short-term rating categories, or comparable unrated securities. Opponents of the changes point out that, by removing references to NRSRO ratings, the SEC will effectively be removing a uniform, objective "floor" and replacing it with a subjective requirement that funds assess the risk of an investment on their own. Commenters, such as the Investment Company Institute, also point out that NRSRO ratings are merely a component of the determination required to be made by money market funds under Rule 2a-7 as to whether a security presents minimal credit risk and that such determinations are not made solely based on the NRSRO ratings.

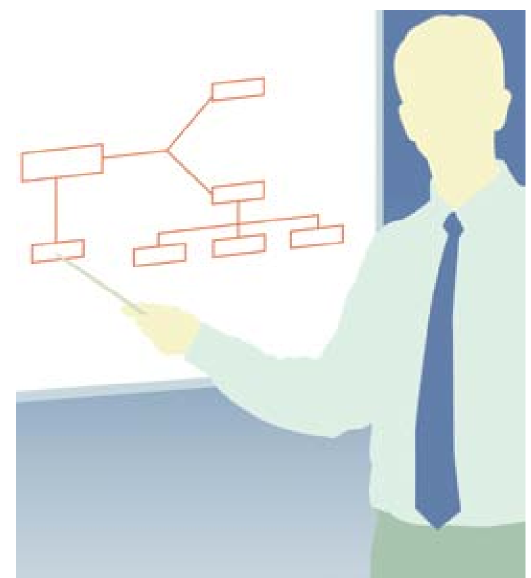
IDC Issues Report on Board Oversight of Derivatives

BY KAREN BENSON

A task force of the Independent Directors Council, comprised of independent fund directors and advisory firm representatives, has issued a report on board oversight of fund investments in derivatives. The July 2008 report, which is designed to provide an overview of derivatives and practical guidance to fund directors, discusses:

- board oversight responsibilities;
- definitions and primary categories of derivatives;
- portfolio management applications, risks, and controls;
- operational and regulatory considerations (such as custody and collateral, senior securities and asset segregation, valuation, taxation, and accounting and financial reporting); and
- board practices and resources.

The report also includes various appendices, which provide a detailed list of potential topics for board-adviser discussions regarding the fund's derivatives investments, a glossary of terms, examples of derivatives applications, and references to additional educational resources.



Envisioning new oversight structure

SEC Staff Clarifies Scope of Cash Solicitation Rule

BY ED ZAHAREWICZ

In a recent interpretive letter, the Division of Investment Management clarified the scope of Rule 206(4)-3 under the Investment Advisers Act, sometimes called the cash solicitation rule. According to the SEC staff, "Rule 206(4)-3 generally does not apply to a registered investment adviser's cash payment to a person solely to compensate that person for soliciting investors or prospective investors for, or referring investors or prospective investors to, an investment pool managed by the adviser." The letter reverses the position taken in certain SEC staff no-action letters, suggesting that Rule 206(4)-3 applies to cash payments by registered advisers to persons who solicit investors to invest in investment pools.

Whether an adviser's cash payment to a person is being made solely to compensate that person for soliciting investors or prospective investors for, or referring investors or prospective investors to, an investment pool managed by the adviser will depend upon all of the facts and circumstances of the particular case. In the staff's view, the most pertinent facts and circumstances generally will be those relating to the following:

- The nature of the arrangement between the soliciting/referring person and the investment adviser.
- The nature of the relationship between the investment adviser and the solicited/referred person.
- The purpose of the adviser's cash payment to the soliciting/referring person.

The SEC staff cautioned, however, that depending upon the facts and circumstances, a soliciting/referring person may be "advising others … as to the advisability of investing in … securities … and thus may be an investment adviser subject to Section 206 of the Advisers Act." The staff was also careful to note that its letter does not address whether a person's receipt of cash compensation from an adviser of an investment pool for soliciting or referring investors or prospective investors to invest in the pool would result in the person being considered a "broker" as defined under the Securities Exchange Act.

Electronic Filing of Applications Mandated

BY ED ZAHAREWICZ

The SEC adopted rule amendments that, effective January 1, 2009, will make mandatory the electronic filing on EDGAR of applications for orders under any section of the Investment Company Act. Previously, only applications for deregistration were required to be filed electronically. Among other things, the rule amendments also eliminate the requirement that certain documents accompanying an application be notarized, as well as the requirement that applicants submit a draft notice as an exhibit to an application. In response to issues raised by commenters concerning applications submitted to the SEC's staff in draft form, the adopting release reaffirms the staff's policy that "the staff will not, except in the most extraordinary of situations, review draft applications."

Court Finds Duty to Disclose in Market Timing Case

BY KAREN BENSON

The U.S. District Court for the Southern District of New York recently ruled in favor of the SEC on a motion to dismiss in the case of *SEC v. O'Meally, et al.*, finding that the agency sufficiently pled securities fraud claims against four securities brokers involving allegedly fraudulent market timing practices. The SEC alleged, among other things, that the defendant brokers used fraudulent and deceptive trading practices to conceal their and their clients' identities in connection with the market timing of purchases and sales of mutual fund shares after being directed by the funds to cease from trading shares in their funds.

One of the defendant brokers sought to dismiss the action on the basis that the complaint failed to sufficiently plead the existence of a duty to disclose their true identities to the mutual funds. The broker argued that mutual funds do not require buyers or sellers to reveal their identities. The Court, however, found that "it is at least plausible that, after the mutual funds explicitly notified [the] [d]efendants that … [they] no longer wanted … [them] to trade shares in their … funds and actively sought to block their trading activities, there was a duty on the part of [the] [d]efendants to disclose their identities should they choose to use different account names or [broker identification] numbers in the future." The Court further found that failing to reveal their true identities would have rendered misleading their subsequent representations as to their identities and affiliations in connection with new trades.

FinCEN Withdraws Proposed AML Program Rules

BY STEPHANIE FICHERA

On October 30, 2008, FinCEN announced that it withdrew its proposed anti-money laundering (AML) program rules for unregistered investment companies, commodity trading advisers, and investment advisers. The rules, which were initially proposed in 2002 and 2003, would have required these entities to establish and implement an AML program. FinCEN cited efficiency and the "passage of time" since the rules were first proposed as among the reasons for the withdrawal.

While noting it would continue to consider whether and to what extent it should impose AML requirements on these entities, FinCEN stated that it would not implement any AML program requirements without first publishing a new proposal and allowing interested parties an opportunity to comment on its contents.

In announcing the withdrawal of the proposed rules, FinCEN also noted that the activity of these entities is not entirely outside the current AML regulatory regime as their transactions are conducted through other financial institutions that are subject to AML regulations, such as banks, broker-dealers, and futures commission merchants. In addition, these entities continue to be subject to U.S. criminal money laundering statutes as well as the economic and trade sanctions programs administered by OFAC.

Broker-Dealer Responses to Market Turmoil

BY MARILYN SPONZO

Broker-Dealer firms have been reviewing their supervisory and operational procedures, training programs and annual compliance reviews, in light of the financial markets' recent myriad difficulties. Such reviews are advisable to ensure that issues such as the following are addressed:

Suitability. Appropriate recommendations and adequate suitability review present special challenges in an environment of heightened investor concern, regulatory scrutiny and rapid market changes. Rather than considering a recommendation in isolation, firms should try to evaluate whether the recommendation is consistent with an overall asset allocation that is appropriate for the investor.

Switching. Firms should head off any possible tendency of registered representatives to make unsupportable recommendations to liquidate securities of financially viable issuers merely because an affiliate of the issuer has solvency problems, particularly when a recommended substitute investment benefits the firm or the representative.

Disclosure. Many issuers are revising prospectuses and collateral material to reflect altered market conditions and investment strategies. Firms and their representatives should be aware of these changes and provide accurate, updated disclosure to customers. Firms should also remember that FINRA requires specific disclosures regarding the federal money market fund guarantee program. (See FINRA Notice to Members 08-58.)

Regulatory reporting. The potential increase in customer complaints and regulatory inquiries, as well as adjustments in a firm's financial situation, may require more frequent updated filings on Form U4, Form BD, FOCUS reports, and/or event and quarterly filings under FINRA Rule 3070

Customer communications. Registered representatives will frequently want to communicate with their customers about the current market conditions. Firms should ensure that these communications comply with content, approval, filing and retention requirements, particularly with respect to email.

Reviewing procedures at broker-dealer firms

SIPC disclosure. Concerned customers may inquire about protections against a broker-dealer's insolvency. Registered representatives should be able to provide complete information about the Securities Investor Protection Corporation. (See www.sipc.org.)

Data security and privacy. Clients may change broker-dealers and/or retain independent consultants to evaluate their financial situations. Firms should have adequate data security and privacy programs, and pay particular attention to the new FTC "red flag" requirements and proposed amendments to Regulation S-P.

Mark your Calendars

Joan Boros will discuss "Indexed and Synthetic Products: Case Studies in Securities Analysis" during the keynote speech at PLI's Understanding the Securities Products of Insurance Companies 2009, January 5-6, 2009 in New York, NY. More information can be found at www.pli.edu.

Criminal Probes Target Financial Market Players

BY PAULA CRUZ CEDILLO

As turmoil in the financial markets has intensified, both companies and individuals are increasingly being investigated for criminal securities fraud and other unlawful activity associated with recent market volatility. The staggering scale of government intervention—particularly the $700 billion rescue package—has prompted calls for increased regulation, investigation, and accountability. Regulators and enforcement officials have in fact undertaken numerous investigations aimed at addressing any fraud or other legal violations and assuaging public demand for accountability.

Trading cufflinks for handcuffs?

At the epicenter of the crisis, Fannie Mae and Freddie Mac recently indicated that they received subpoenas from the U.S. Attorney's Office for the Southern District of New York. The mortgage giants were subpoenaed as part of a federal grand jury investigation into their accounting, which arose in the wake of their recent government takeover. The SEC is also investigating both companies and has directed them to preserve all relevant records. In addition to its investigations of Fannie and Freddie, the SEC has initiated as many as 50 other investigations related to recent financial market events.

Likewise, the FBI is not only investigating Fannie Mae, Freddie Mac, Lehman Brothers, and AIG in connection with their recent failures and/or takeovers, but is also probing 26 cases of potential corporate fraud related to the collapse of the U.S. mortgage lending industry.

Some companies are also facing congressional investigations. For instance, congressional leaders recently called for the establishment of a task force to investigate Fannie Mae and Freddie Mac. Other companies being investigated by one or more enforcement agencies for activities related to the market turmoil include Credit Suisse, Countrywide Financial, UBS, New Century Financial, Lehman Brothers, and Bear Stearns.

Market Turmoil Spawns Class Action Lawsuits

BY LIAM BURKE

The recent upheavals in the global financial markets have set the table for new waves of class action litigation. Originally sparked by the sub-prime mortgage meltdown, the market turmoil has led, among other things, to abrupt recapitalizations, mergers, and failures of major companies. This has provided a rich stew of potential litigation, and class action plaintiffs' lawyers are beginning to feed.

For example a class action was filed on behalf of shareholders against Constellation Energy alleging that the company improperly covered up the extent of its potential losses on amounts owed to it by Lehman Brothers. In another recent action, shareholders of Merrill Lynch filed a complaint claiming that its planned acquisition by Bank of America was based on a flawed process and an unconscionable agreement, and further alleging that the defendants breached their fiduciary duties in the deal. In yet another class action, shareholders of AIG have asserted claims arising from AIG's purported over-exposure to allegedly grossly imprudent risk taking in the sub-prime lending market.

Class action gears are turning

One question of particular interest that arises with respect to the AIG case and other similar litigation is what role, if any, the unprecedented scale of the government's intervention in AIG, and the financial crisis generally, will have on the litigation. Whether the government's involvement serves to limit the scope of private actions in any way remains unclear. For instance, AIG was facing a number of share-holder suits prior to the government's acquisition of an 80% stake in the insurer. How these suits will be affected by the government's stake remains to be seen. Some commentators have even suggested that the government itself may become the biggest litigant of all as a result of the magnitude of its intervention.

A Regulatory Mulligan for the 21st Century

BY TOM LAUERMAN

By now, almost everyone can agree that current regulatory regimes (or the implementation thereof) have not adequately addressed new financial products and practices that have developed in the past few years. How much loss might have been avoided if effective new approaches to regulation had been implemented at the turn of the century? Having "whiffed" on the first try, Congress and regulators are winding up for another swing.

These are some of the ideas that seem most likely to be implemented in the foreseeable future:

- Improved settlement system for credit default swaps, and perhaps other new regulation of these instruments. A "central counter party" system for these instruments is currently under development. New York currently plans to regulate some credit default swaps as financial guarantee insurance. The SEC and others have argued that credit default swaps are related to regulated instruments in ways that can frustrate regulatory objectives if the swaps are not also regulated.
- Regulation intended to reduce the likelihood that home mortgages will be issued on terms not appropriate for the homebuyer.
- Mechanisms to enhance the reliability of NRSRO ratings.
- Increased regulation of, or at least transparency for, hedge funds.
- Merger, or at least better coordination, between the SEC and CFTC (except to the extent that certain functions of those entities are assigned to other governmental bodies, as has been proposed in a Treasury Department "Blueprint").
- Federal regulation of life insurance, to which insurers can "opt in," as an alternative to regulation by individual states.
- A revised modus operandi and regulatory scheme for Fannie Mae and Freddie Mac (if those entities are not wholly privatized).
- A new conceptual framework for how money-market funds should function and be regulated (and whether and how they should be insured), in relation to other depository institutions.

Some of these ideas will not make it across the finish line. Also, it is inevitable that many other ideas will arise in the coming weeks and months.

FINRA Homes in on Certain Types of Customer Complaints

BY MARILYN SPONZO

FINRA has added new problem and product codes for broker-dealers to use in their quarterly reporting to FINRA of statistics on customer complaints. Certain complaints that previously had been reported under more general codes must now be broken out separately, as follows:

- Problems in establishing new accounts
- Non-transaction-related problems with existing accounts
- Other problems with existing accounts
- Problems with access and functionality of a firm's online system
- Poor recommendations to purchase or sell securities
- Problems with "structured products"

FINRA has been receiving reports of significant numbers of complaints in these areas, and the new reporting system is intended to help FINRA to better identify potential operational or sales practice issues at member firms. The revisions were effective October 1, 2008, and must be reflected in the fourth quarter filing due January 15, 2009.

Circuit Courts Refuse To Expand TILA Remedies

BY MICHAEL SHUE

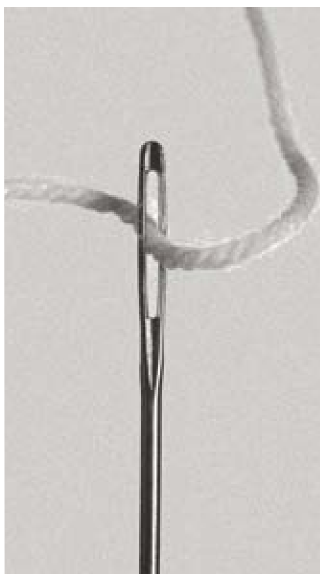
In two rare pieces of good news for the mortgage lending industry lately, two recent Circuit Court of Appeals decisions refused to expand the remedies available under the Truth in Lending Act (TILA). First, the Seventh Circuit in *Andrews v. Chevy Chase Bank* became the latest Federal Court of Appeals to hold that TILA does not allow for the rescission of mortgages on a class basis. Given the recent economic volatility, this decision is a victory for the entire mortgage lending industry, where allowing thousands of class members to rescind their mortgages at one time would deliver a fatal blow to lenders. Reversing the district court, the Seventh Circuit held that "the personal character of [rescission] makes it procedurally and substantively unsuited to deployment in a class action." The court acknowledged that TILA does not explicitly prohibit rescission on a class-wide basis but reasoned that, because class actions are specifically mentioned in TILA's statutory damages provision and not its rescission provision, this absence supports the conclusion that rescission is "a purely individual remedy that may not be pursued on behalf of a class." Although lower courts in other jurisdictions have held otherwise, the Seventh Circuit joined the First and Fifth Circuits to establish unanimity among the Circuit Courts of Appeal that have addressed the issue.

Courts prevent fatal blow to lenders

One month after the *Andrews* decision, the Eleventh Circuit in *Christ v. Beneficial Corporation* held that private injunctive relief is not an available remedy under TILA. In *Christ*, Plaintiffs waived statutory damages, conceded that they could not establish actual damages, and sought injunctive relief only. After the district court awarded injunctive relief and 22 million in restitution and disgorgement, the Eleventh Circuit vacated, holding that injunctive relief is not an available remedy under TILA. Noting that TILA neither provides for nor prohibits injunctive relief, the Court held that "where Congress has provided a comprehensive statutory scheme of remedies, as it did here … . we do not read TILA to confer upon private litigants an implied right to an injunction or other equitable relief such as restitution or disgorgement."

Seventh Circuit Rejects Attempt To Create CAFA Loophole

BY FARROKH JHABVALA



Seventh Circuit sewing up CAFA loopholes

The Seventh Circuit recently addressed a novel CAFA issue and slammed the door on a plaintiffs' effort to create a loophole in that statute. In *Bullard v. Burlington Northern Santa Fe Railway Co.*, 144 plaintiffs filed suit in Illinois state court seeking damages from four entities. The defendants removed the case under CAFA's provision which creates federal jurisdiction over "mass actions" in which plaintiffs propose a trial involving the claims of 100 or more litigants and minimal diversity and amount-in-controversy requirements are met. The plaintiffs moved to remand the case to state court, arguing that their complaint never proposed a trial, they would be happy to win by summary judgment or settlement, and the case could only be removed on the eve of trial after a final pretrial order set the number of parties for trial. The district court denied the motion. The Seventh Circuit affirmed, finding the lower court's conclusion was "the only sensible reading" of the relevant CAFA provision. In a characteristically direct opinion, Judge Easterbrook decried plaintiffs' attempt to create a loophole in CAFA whereby cases satisfying federal jurisdictional requirements would not be removable simply because the complaint had not "proposed" a trial of 100 or more litigants. "Courts," he explained, "do not read statutes to make entire subsections vanish into the night." He agreed with the district court that the complaint proposed "one proceeding and thus one trial," regardless of whether a trial covering 100 or more plaintiffs actually ensued, and that the joinder of multiple plaintiffs because their claims arose out of the same transaction or series of transactions and had common questions of law or fact was "exactly when a single trial is appropriate."

Sixth Circuit Allows Appeal By Nonintervening Class Member

BY ARI GERSTIN

In *Fidel v. Farley*, the Sixth Circuit joined the Ninth Circuit in holding that an unnamed, nonintervening member of a Rule 23(b)(3) class may appeal the approval of a class settlement. The appellant in *Fidel* sought to set aside the district court's approval of the settlement and award of attorney's fees because certain class members received notice of the settlement after the deadline for objecting to the settlement. Class counsel argued that the appellate court should decline to hear the appeal because the unnamed class member was not a "party" for purposes of appealing the settlement. Generally, a non-party to a lawsuit is not permitted to appeal a district court's order unless it has first sought leave to intervene. However, in *Devlin v. Scardelletti*, the Supreme Court determined that in the context of a mandatory Rule 23(b)(1) class, nonnamed class members are parties to the proceedings in the sense of being bound by the settlement. This feature of class action litigation, the Court explained, requires that class members be allowed to appeal the approval of a settlement when they have objected at the fairness hearing. Although *Fidel*, unlike *Devlin*, involved a Rule 23(b)(3) class from which the appellant could have technically opted out, the Sixth Circuit was nonetheless persuaded by the Ninth Circuit's rationale for applying *Devlin* to Rule 23(b)(3) classes

Individualized Damages Issues Defeat Class Certification

BY RICHARD SAHUC

Class certification was recently denied in *In re Genetically Modified Rice* (E.D. Mo. Apr. 14, 2008), because individual issues predominated over common issues with respect to damages. In August 2006, the U.S. Department of Agriculture announced it had found traces of an unapproved genetically-modified rice strain developed by Bayer Crop-Science in the U.S. rice supply. Rice producers in five different states sued Bayer, alleging they suffered losses due to Bayer's contamination of the U.S. rice supply. The multi-district litigation was consolidated in the Eastern District of Missouri.

The court acknowledged that ordinarily, variation in individual damage amounts is not a bar to class certification, but noted that class certification may not be suitable where the calculation of damages is not susceptible to a mathematical or formulaic calculation, or where the formula by which the parties propose to calculate damages is inadequate. In the case at hand, the class members sold rice under several different types of sales contracts and at different times. Moreover, while the plaintiffs proposed to use the Chicago Board of Trade prices to determine damages, not all class members sold their rice based upon the Board's prices. The court concluded that an accurate and true assessment of any plaintiff's damages would require an extensive inquiry involving the circumstances of that plaintiff's damages, and that individual damages issues predominated over common elements and defeated class certification.

Court Finds FCRA Damages Provision Unconstitutional

BY ELIZABETH BOHN

In *Grimes v. Rave Motion Pictures*, a U.S. District Court in Alabama has held that the Fair Credit Reporting Act (FCRA) provision imposing strict liability for willful violations of credit card truncation requirements is unconstitutional. Under the Fair and Accurate Credit Transactions Act, which amended the FCRA, vendors are required to truncate credit card numbers and delete the card's expiration date from receipts provided to customers to reduce identity theft. Section 1681n(a) of FCRA holds willful violators liable for actual damages or "damages of not less than $100 and not more than $1,000," and "such punitive damages as the courts may allow." The *Grimes* court found that the damages section as worded perfectly illustrated "void for vagueness," noting that under the section's language "the same customer could go to the same establishment many times in a single day to generate multiple non-complying receipts in order to assert multiple violations," while having suffered no actual damages, creating a possibility for "misuse of the cards by customers of astronomical proportions more than the possibility of misuse of credit card information by thieves." The court also found that the imposition of punitive damages on defendants where no actual harm was suffered would impose so severe a penalty in such disproportion to actual damages sustained as to deny due process of law.

FCRA provision vague

Arbitration Roundup

BY LANDON CLAYMAN

In March 2008 the U.S. Supreme Court ruled in *Hall Street Associates, L.L.P. v. Mattel Corp.* that if judicial review of an arbitration award is sought under the Federal Arbitration Act, the parties could not supplement by contract the limited grounds for review provided by the FAA. In the wake of this ruling, lower courts have differed as to whether and how "manifest disregard of the law" remains a viable standard of review.

Headaches over "manifest disregard of the law" causing disagreements

Some decisions, such as *Prime Therapeutics LLC v. Omni-Care, Inc.* (D. Minn.), have held that after *Hall Street* courts may no longer vacate an award due to an arbitrator's "manifest disregard of the law" in a proceeding governed by the FAA. Other decisions, such as *Joseph Stevens & Co. v. Cikanek* (N.D. Ill.), have held that the "manifest disregard" standard is "cabined entirely" within the review standards provided by the FAA. The Second Circuit Court of Appeals, in *Stolt-Nielsen SA v. Animal Feeds International Corp.*, held that the "manifest disregard" standard survives *Hall Street*, while the Sixth Circuit in *Coffee Beanery, Ltd. v. WW, L.L.C.*, deemed it imprudent to cease using such a universally recognized principle. Some courts, such as the Supreme Court of California in *Cable Connection, Inc. v. DirectTV, Inc.*, have seized on *Hall Street's* disavowal of any decision concerning "other possible avenues" for judicial review of arbitration awards, and held that "manifest disregard of the law" is a standard of review available under state law.

Given the inconsistent interpretations of *Hall Street*, a party contemplating an arbitration proceeding should consider – at the outset – the judicial forum that will review the outcome of the arbitration, and how best to ensure the breadth of review the party desires

FTC Delays Compliance With FACTA "Red Flag" Identity Theft Rules

BY ELIZABETH BOHN

On October 22, 2008, the FTC announced a six-month extension of the deadline for compliance with the FACTA Identity Theft "Red Flag" Rules in order to give financial institutions additional time to develop and implement identity theft procedures. The compliance date was extended to May 1, 2009. The rules were issued jointly by the Federal Reserve Board of Governors, OCC, FDIC, FTC, and NCUA last year to implement sections of the *Fair and Accurate Credit Transactions Act* (FACTA) targeted at reducing identity theft. The rules require "financial institutions" and "creditors" with consumer accounts and other accounts "for which there is a reasonably foreseeable risk of identity theft" to develop and implement written identity theft prevention programs incorporating policies and procedures to guard against identity theft.

Although the federal agencies identified 31 patterns and activities as possible indicators of risk of identity theft, the final rules permit covered entities to limit red flags in their businesses based on experience, supervisory guidance and amendment as dictated by circumstances. The rules require financial institutions and creditors to implement procedures which enable them to:

- *identify* specific forms of activity which are red flags of possible identity theft in their business;
- *incorporate* the red flags in their programs; and
- *detect* and *respond* appropriately to red flags detected to prevent and mitigate identify theft.

The rules also require debit and credit card issuers to establish procedures to assess the validity of notices of address changes when followed by requests for additional or replacement cards, and to take steps to verify the request for the replacement card or the request for address change.

NEWS & NOTES

Speeches and Publications

Richard Choi was the planning chair and Joan Boros and Gary Cohen were on the faculty for the ALI-ABA Life Insurance Company Products conference, November 13-14, 2008 in Washington, DC.

Thomas Finn was one of thirteen attorneys nationwide invited to contribute to "Inside the Minds–Managing White Collar Legal Issues: Leading Lawyers on Key Defense Strategies, Responses for Civil and Criminal Investigations, and Recent Enforcement Trends," which was published by Aspatore Press, a Thompson Publisher.

Rollie Goss authored "International Treaties Providing for Arbitration of Reinsurance Disputes Are Not Subject to Reverse preemption by State Law Pursuant to the McCarran-Ferguson Act" in the *Insurance Litigation Reporter*, vol. 30, no. 18.

Announcing

Jorden Burt LLP announced in October 2008 that it has formed a strategic alliance with Scribner, Hall & Thompson, LLP, focused on the provision of services related to federal income tax matters.

For more than 25 years, Jorden Burt has enjoyed a national reputation for excelling in litigation and counseling services to the financial services and insurance industry. For over 40 years, Scribner Hall has represented members of the insurance industry and their affiliates in the area of federal income tax matters.

Particularly in light of current financial market events, entering into this alliance with Scribner Hall highlights Jorden Burt's tradition of proactively anticipating client needs, along with enhancing service capabilities in areas of vital interest to its clients.

Scribner Hall will provide its services as Special Tax Counsel for Jorden Burt clients for whom such expertise is necessary. Under the agreement, with the prior consent of a client, the two firms will act as co-counsel in the client's matter.

Although each firm will maintain its separate existence and will continue to operate with complete independence, they will collaborate on professional development and educational initiatives to ensure that each firm maintains its expertise in cutting edge and developing areas of the law and regulation impacting the financial services and insurance industry. Please see Scribner Hall's article on page 12.

JORDEN BURT LLP

JORDEN BURT LLP is the premier national legal boutique providing litigation services and counseling to the financial services sector. The firm serves clients in six key industries:

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SOUTHEAST
Suite 500
777 Brickell Avenue
Miami, FL 33131–2803
305.371.2600
Fax: 305.372.9928

WASHINGTON, D.C.
Suite 400 East
1025 Thomas Jefferson St., N.W.
Washington, D.C. 20007–5208
202.965.8100
Fax: 202.965.8104

NORTHEAST
Suite 301
175 Powder Forest Drive
Simsbury, CT 06089–9658
860.392.5000
Fax: 860.392.5058

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Navigating Rough Seas

Industry news in today's choppy waters

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