EXPECT FOCUS®

LEGAL ISSUES & DEVELOPMENTS FROM JORDEN BURT LLP

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- SUPREME COURT CONSIDERS WHISTLEBLOWERS

Who Wants to Know?

States Move to Protect Online Privacy

JORDEN BURT LLP
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IN THE SPOTLIGHT

California Refines Online Privacy Protection Act to Require New Disclosures

BY JASON MORRIS

On September 27, 2013, Governor Jerry Brown signed into law changes to California's online privacy law (the California Online Privacy Protection Act), making California the first state to impose disclosure obligations on web site operators who track the online behavior of consumers.

Under the amended law, any "operator of a commercial Web site or online service that collects personally identifiable information through the Internet about individual consumers residing in California who use or visit its commercial Web site or online service" must post a privacy policy on its Web site, or in the case of an operator of an online service, make the privacy policy available in a reasonably accessible way. In addition to privacy policy requirements contained in the previous version of the law, the amended law requires that the privacy policy now disclose:

- "How the operator responds to Web browser 'do not track' signals or other mechanisms that provide consumers the ability to exercise choice regarding the collection of personally identifiable information about an individual consumer's online activities over time and across third-party Web sites or online services, if the operator engages in that collection"; and

- "Whether other parties may collect personally identifiable information about an individual consumer's online activities over time and across different Web sites when a consumer uses the operator's Web site or service."

The first of the above-stated requirements may be satisfied by the operator including a hyperlink in the privacy policy "to an online location containing a description, including the effects, of any program or protocol the operator follows that offers the consumer that choice."

> California is the first state to impose disclosure obligations on website operators who track consumers' online behavior.

As with the previous version of the law, operators who "fail[] to post its policy within 30 days after being notified of noncompliance" will be deemed to have violated the law, subjecting the operator to potential litigation and/or enforcement action by the California Attorney General's Office.

Financial service institutions with web sites, mobile apps or other online services that collect personally identifiable information about consumers residing in California should consider reviewing how their current systems respond to "do not track" mechanisms, and their applicable privacy policies in light of the new California requirements.

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LIFE INSURANCE

No Time for Hibernating This Winter: New Charges and Recommendations

BY ANN BLACK

After long growing seasons, several items being reviewed by groups within the NAIC resulted in new charges and recommendations being harvested in time for the NAIC 2013 Winter Meeting. In addition, the Life Actuarial Task Force (LATF) began sowing the seeds for work to be done next year and established two new subgroups.

Since 2009, the Separate Account Risk Working Group (the SARWG) has been examining the use of separate accounts to fund products with general account guarantees. The SARWG issued on October 24, 2013 its "Potential Actions/Recommendations" (SARWG's Recommendations). During a November 1st call, SARWG received comments on the first four of the five items in SARWG's Recommendations. On November 21st, the SARWG exposed the first three proposals for a comment period ending December 13th, with the intent of finalizing them for submission to the Financial Condition (E) Committee. The three proposals are included:

- Adoption of five principles that would apply before assets in a separate account may be insulated for non-variable products.
- Revision of the Modified Guaranteed Annuity Model Regulation (Model #255) and Statement of Statutory Accounting Principles Number 56 – Separate Accounts to clarify that assets transferred from the general account to the separate account would be non-insulated assets and that those assets would be given the same priority as general account assets in the event of an insolvency.
- Review of the Separate Accounts funding Guaranteed Minimum Benefits for Group Contracts Model Regulation (Model #200) to ensure the relevant products are appropriately addressed in the Model, and to consider for book value products whether asset diversification requirements should apply.

In addition, on November 21st, the SARWG exposed the remaining two proposals for a comment period ending January 10, 2014. The separate exposure was intended to allow time to for additional materials to be submitted to the regulators. The two proposals are:

- Consideration of how to incorporate guidance for bank-owned or corporate-owned life insurance products.
- Consideration of individual products within separate accounts and a recommendation that use of an insulated separate account be prohibited unless the separate account is unitized.

Whether individual products should be insulated will likely result in a bountiful array of colorful discussions.

Since late 2010, the LATF, the Life Insurance and Annuities (A) Committee (the A Committee), and the Contingent Deferred Annuity Working Group (the CDA Working Group) have been mulling over contingent deferred annuities (CDAs). While initially the work focused on whether CDAs should be viewed as an annuity, the CDA Working Group has been evaluating the adequacy of existing laws and regulations and whether additional solvency and consumer protection standards are required. Based on the CDA Working Group's report and findings and recommendations, the A Committee developed and adopted on October 21, 2013, a menu of charges to consider whether changes to various NAIC model laws and regulations or adoption of additional guidance to address CDAs are necessary. Nine different groups that have the specific subject matter expertise within the NAIC are being invited to the feast. The list of charges is comprehensive.

Several states have been conducting unclaimed property audits for several years and a group of regulators within the NAIC has been focusing on the unclaimed property issue since at least 2011. No group within the NAIC had been charged with formally reviewing this issue. During its December 4, 2013 call, the A Committee adopted the following charge:

> The Life Insurance and Annuities (A) Committee should undertake a study to determine if recommendations should be made to address unclaimed death benefits.

During its October 30, 2013 call, LATF established two new subgroups. The CDA Subgroup was formed to address the charges sent to LATF on CDAs. In addition, LATF created the Index Linked Subgroup to review index linked products that do not place a floor on the index-related crediting rate and that are funded by a separate account. The Index Linked Subgroup was tasked with providing recommendations to LATF regarding the applicability of the separate account regulatory framework and standard nonforefeiture law to these index linked products.

The various NAIC working groups will be kept busy this winter with the cornucopia of items they need to address.

More Annuity Class Settlements in California

BY ROLLIE GOSS

Federal courts in California have preliminarily approved the class-wide settlement of two lawsuits alleging misconduct in the sale of deferred annuities to seniors. Motions for preliminary approval were granted September 27, 2013 in *In re American Equity Annuity Practices and Sales Litigation*, in the United States District Court for the Central District of California, and on August 30, 2013 in *In re National Western Life Insurance Deferred Annuities Litigation*, in the United States District Court for the Southern District of California. The *American Equity* case encompasses over 149,000 annuities, while the *National Western* case encompasses over 12,000 annuities. The final approval hearings are set in the *American Equity* case for January 27, 2014, and in the *National Western* case for January 10, 2014.

Settlement terms in both cases somewhat similar.

The settlement relief proposed in both cases is similar:

- **Policies in deferral:** a bonus to the annuitization value of up to 10% (*National Western*) or 10.75% (*American Equity*) on a sliding scale, based on the policy year at the time of annuitization, if the policy is annuitized for a period of life with a 10 year or longer payment guarantee.
- **Annuitized policies:** an enhancement in the amount of annuity payments. This benefit is a capped amount in the *National Western* settlement; it is not capped in the *American Equity* settlement.
- **Surrendered policies:** a refund of a portion of the surrender charges incurred available only in a claim review process with two levels of relief available: a higher amount based on a showing of misrepresentation or unsuitability at the time of purchase; a lesser amount based upon a showing of current need for funds. There is a cap on the amount of this settlement benefit in both of these settlements.

Contact partner Rollie Goss in our Washington, DC office if you would like to obtain additional information about these proposed settlements.

Insurance Agent's Criminal Conviction Reversed in California

BY KYLE WHITEHEAD & DAWN WILLIAMS

A California law penalizes theft, embezzlement, forgery or fraud with respect to the property of an elder or a dependent adult by any person not a caretaker who knows or reasonably should know that the victim is an elder or a dependent adult. In February 2012 a California insurance agent was convicted of felony theft and sentenced to 90 days in prison for the sale of an annuity to an elderly woman that prosecutors claim had apparent dementia. Recently reversing that conviction in *People v. Neasham*, the California Court of Appeals assumed that there was evidence sufficient to support findings at trial that the plaintiff was incapable of giving informed consent to the transaction and resolved the matter by examining the alleged substantive offense and associated jury instruction.

Because the prosecution in *Neasham* did not allege, and the trial court did not instruct the jury to determine, that the agent either induced the plaintiff to purchase the annuity by misrepresenting its terms or embezzled the plaintiff's funds, the appellate court focused on theft by larceny.

> With no allegations or jury instructions as to fraud or embezzlement in the trial court, the appellate court focused on theft by larceny.

The appellate court first held that acceptance of the annuity premium could not constitute larceny because the premium was given to the agent, not taken or converted, in exchange for an annuity of equal value. Moreover, no evidence was offered to suggest that the contract's penalty and withdrawal provisions somehow reduced the value of the annuity.

Noting that California approved the annuity for sale to persons through age 85, the appellate court asserted that treating the transaction as a trespassory taking would convert otherwise lawful activity into a crime.

The appellate court then found that the trial court's jury instruction inexplicably omitted larceny's intent requirement. Reversing the conviction, the appellate court reiterated that omission of an essential element of an offense "is an error of constitutional significance."

LIFE INSURANCE

Connecticut District Court Again Certifies Nationwide Class in 401(k) Revenue Sharing Case

BY MICHAEL VALERIO & JOHN PITBLADO

After the Second Circuit vacated his original class certification order last year, the Connecticut federal district court judge overseeing a long-running 401(k) "revenue sharing" case against retirement plan service provider, Nationwide Life Insurance Company, has again certified a class, but this time under Federal Rule of Civil Procedure 23(b)(3) rather than Rule 23(b)(2).

According to the Second Circuit, the district court's original Rule 23(b)(2) certification of a nationwide class of retirement plan trustees in *Haddock v. Nationwide Financial Services, Inc.* failed to survive the Supreme Court's landmark 2011 *Wal-Mart* decision because the case would require thousands of individualized proceedings to determine each class member's entitlement to a monetary award. However, the district court revisited the class certification issue on remand, this time analyzing plaintiffs' renewed motion under Rule 23(b)(3).

The district court first found that the Second Circuit's mandate did not disturb its previous analysis regarding the proposed class's satisfaction of Rule 23(a)'s prerequisites. Thus, the court reaffirmed that aspect of its original holding, as well as its prior determination that plaintiffs' ERISA liability theories are legally viable.

Second, the court held that the proposed class met Rule 23(b)(3)'s "predominance" and "superiority" requirements, finding that the two "core determinations" of fiduciary function and breach with respect to Nationwide's receipt of revenue sharing payments from mutual funds placed on its retirement product menu "both hinge on the ERISA consequences of Nationwide's basic investment process, a process that was relatively uniform across the proposed class." **In making this finding, the court reiterated its earlier conclusion that "the plaintiffs' liability case is particularly well suited for class-wide adjudication" because the plaintiffs' "legal and factual theories are premised on the structural nature of Nationwide's contractual relationship with the Plans, which is identical across the Class."** The court declined to credit Nationwide's concerns about individualized issues associated with adjudicating plaintiffs' disgorgement claims, and it similarly rejected Nationwide's "manageability" arguments.

Choice of Law Can Influence STOLI Outcomes

BY DAWN WILLIAMS

The determination of which state's law governs in STOLI disputes often influences the outcome of the case. One question that divides courts is what type of misrepresentation justifies rescission. In entering judgment for the insurer after trial, the District of Minnesota recently found that misrepresentations about the insured's net worth were material in *PHL Variable Ins. Co. v. 2008 Christa Joseph Irrevocable Trust*. The court found the test for materiality in Minnesota was not whether it increased the risk of loss, but whether it substantially influenced the insurer's decision to provide coverage. The statements about the insured's net worth were "gross misrepresentations that were material to PHL's decision to issue the Policy" and as such entitled the insurer to both rescind the policy and to retain the premiums paid.

Another question as to which state laws can widely differ is whether an incontestability provision will bar a declaratory judgment action brought after the period to seek a policy declared void *ab initio* has expired. The Southern District of Florida recently weighed in on this issue, diverging from the majority view and finding that the public policy underlying the incontestability statute weighed in favor of barring a challenge to the policy. In *Pruco Life Ins. Co. v. U.S. Bank*, the court opined that the purpose of the statute – to provide the insured with certainty while providing the insurer with a limited opportunity to discover fraud – would be furthered by its ruling.

These cases reflect the obvious: that beyond the issue of the statutory and common laws of the various states on STOLI differing so greatly, **there remains a fair amount of uncertainty within jurisdictions regarding STOLI law interpretation and application** that makes predicting the outcome of such cases a continuing challenge.

The Bang from *Zhang*: Shockwaves Already Felt in California

BY DAWN WILLIAMS

The California Supreme Court's significant decision in *Zhang v. Superior Court*, reported in our last issue (see *Expect Focus*, Vol. III, Summer 2013), has already impacted state and federal practice. The key holding, that insurance practices violating California's Unfair Insurance Practices Act (UIPA) can support a cause of action under that state's Unfair Competition Law (UCL), has already been relied upon by numerous courts. The Ninth Circuit cited *Zhang* in reversing a trial court's dismissal of a UCL claim, finding that the fact that the alleged conduct may have also violated the UIPA did not bar the UCL claim. And the California Supreme Court mentioned *Zhang* by analogy in holding that violations of the federal Truth in Savings Act could support a UCL "unlawful" claim.

As importantly, the plaintiffs' bar has been quick to react, and insurers appear more likely to face complaints that allege violations of various insurance laws as predicate UCL claims. In existing cases, plaintiffs may move to amend their complaints or for reconsideration of earlier rulings. For example, in a case involving equity-indexed universal life insurance, *Walker v. Life Ins. Co. of the S.W.*, the plaintiffs recently moved for reconsideration and to amend their complaint to re-allege UCL claims that were dismissed over two years ago. They argued that under *Zhang*, the purported violation of the state laws regarding the content of illustrations could now support a cause of action under the UCL. Whether or not courts allow plaintiffs to succeed remains to be seen, but companies should be aware that even their past victories may be open to re-litigation.

Scribner, Hall & Thompson, LLP

Agent Advances – Loans or Compensation?

BY SAMUEL A. MITCHELL

Whether agent advances are loans, or compensation, is an important question for insurance companies and agents. If an advance is compensation, the insurance company can deduct it for tax purposes and the agent must pay tax on receipt. Conversely, if the advance is a loan, the insurance company cannot deduct it and the agent is not required to pay tax on it. Agents typically repay the loans through future commission offsets and pay tax on the commissions in the year they are earned.

The law in this area has been relatively well-settled since 1999, when the IRS formally acquiesced in the result of a Tax Court case that it lost. In *Gales v. Commissioner*, TC Memo. 1999-27, the Tax Court held that certain agent advances were loans. In AOD 1999-011 (Action on Decision) (Oct. 6, 1999), the IRS stated that it would no longer assert that an agent advance is compensation if (1) the advance is structured as a loan requiring the payment of interest; (2) there is personal liability for repayment at the time of the advance; and (3) the payor in practice or in fact demands repayment of the advance if commissions earned are not sufficient for repayment. Two years later, the IRS released Revenue Procedure 2001-24, 2001-1 C.B. 788, which provides similar rules for the insurance company tax side.

Although the basic rules are well settled, issues of fact still arise for the agent. In most cases there are proper legal documents that structure the advances as loans repayable on a date or dates certain with adequate interest. However, questions regarding personal liability can arise, in spite of what the documents say, if the company does not seek to collect past due balances or if it routinely forgives loan balances. In other words, attention should be paid not only to the documents, but to the company's actual practices, in order to ensure loan treatment.

Washington Makes it Riskier for Insurers to Talk to Lawyers

BY BERT HELFAND

In Washington, a lawyer owes a duty of care to a non-client third party, if the lawyer's work is "intended to benefit" that party. Where a non-client insurer hires a lawyer to represent its insured, some states presume that intent, so long as the interests of the insurer and the insured do not conflict. But in *Stewart Title Guaranty Co. v. Sterling Savings Bank*, a malpractice suit brought by a title insurance company against the attorneys it hired to represent an insured lender, the Washington Supreme Court declined to adopt this presumption.

Consequently, it now takes more than the absence of a conflict to establish that insureds' attorneys owe a duty of care to the insurer. Unfortunately, the court's unanimous, *en banc* opinion gave no indication about what kind of additional evidence might suffice. As a result, plaintiffs who sue insured defendants now have an opening to demand access, through discovery, to communications between defense counsel and their clients' insurers.

As conditions on a loan for the purchase and development of real property, Sterling Savings received a first-position security interest in the land, and Stewart Title issued a policy, guaranteeing the priority of Sterling's interest. When the loan closed, however, the borrower's contractor had already started its development work. In April 2008, as the real estate market fell, the contractor filed a mechanics' lien, which related back to the date on which development began. Thus, the entire lien had priority over Sterling's interest. The contractor then filed suit to establish its lien and foreclose against the property. Sterling hired counsel to defend the action, and Stewart Title subsequently agreed to retain those attorneys on the bank's behalf.

Sterling's lawyers disagreed with Stewart over whether to assert a defense based on equitable subrogation. Counsel argued that the defense was not viable, and also that it would disserve Sterling's interests to delay resolution of the contractor's suit, because the value of the bank's remaining interest in the underlying property was rapidly falling. The attorneys agreed to amend Sterling's answer, but the contractor was awarded summary judgment anyway, and Stewart Title paid to remove the lien and restore Sterling's priority.

Stewart Title then sued Sterling (which had allegedly known about the contractor's work) and its attorneys (for malpractice). Stewart could not assert *Sterling's* rights, under a subrogation theory, because it was also suing Sterling itself. But the trial court permitted the insurer to sue in its own behalf, on the theory that the attorneys' work was "intended to benefit" Stewart. It then granted summary judgment to the attorneys, finding that there had been no malpractice.

According to the trial court, the attorneys owed a duty of care to their client's insurer, because (among other reasons) the interests of insurer and insured were "aligned." In fact, there were good reasons to think otherwise: Stewart did not share Sterling's interest in resolving the case quickly, before the value of the property declined further; Stewart and Sterling's counsel disagreed about the subrogation defense; and Stewart ultimately sued Sterling, claiming it had known about the mechanics' lien all along.

But the Supreme Court left this finding intact; it simply held that "an alignment of interests is insufficient to support a duty of care to a nonclient." On that basis, it held that Stewart had failed to establish that the attorneys owed it a duty of care, and it affirmed summary judgment on that basis alone.

In February, in *Cedell v. Farmers Ins. Co.*, the same court created a presumption that the attorney-client privilege does not protect communications about claims handling from being disclosed in a subsequent, first-party bad faith suit. As a practical matter, insurers must now assume that their communications with Washington coverage counsel will be subject to (at least) *in camera* review. In *Stewart Title*, the Court left insurers without any guidance about how they can securely establish a privileged relationship with lawyers who represent their insureds. Until that issue is resolved, plaintiffs will be pursuing communications between defense counsel and insurers in discovery, and insurers will be well advised to manage such communications carefully.

In a Tennessee Coverage Dispute, All Insured Things Must Come to an End

BY JOHN PITBLADO

In *Hartford Cas. Ins. Co. v. Ewan*, the U.S. Court of Appeals for the Sixth Circuit had to determine if a CGL policy issued to a landscaping service covered damage caused by a Mack truck that had a "tree spade" attached. The matter turned (in part) on the question of whether the tree spade was "permanently mounted," within the meaning of an exception to the policy's auto exclusion. The equipment was originally welded to the truck; after the welding broke, it was attached by steel rods and secured with metal bolts. Finding that it was nevertheless "not an indefinite or unchanging truck component to be considered permanent," the court held that the policy did not apply.

The context mattered a lot. The truck was owned by M & W Tree Service, which obtained, in a single transaction, both the CGL policy and an automobile policy. The policies recognized that M & W purchased multiple coverages. The auto policy defined "auto" in the same way as the CGL policy, and it identified the truck as a covered "auto"—strong evidence that the truck was also an "auto" within the meaning of the CGL policy.

In March 2005, the truck collided with an automobile belonging to Deshon and Patrick Ewan, who sued M & W in a Tennessee court. M & W disclosed its auto policy and settled the suit for the policy limit of $500,000. But then the Ewans learned about the CGL policy, which had a $1,000,000 limit, and they moved to rescind the settlement. The Hartford responded with a declaratory judgment action in federal court, seeking to establish that the CGL policy did not cover the Ewans' claim.

The CGL policy expressly excluded from coverage any damages arising from either (1) the use of an "auto" or (2) the transportation of "mobile equipment" by an "auto." As the court noted, however, those exclusions *did not* include damage caused by "mobile equipment on its own"—which could be either "[v]ehicles … on which are permanently mounted … shovels, loaders, diggers or drills," or "[v]ehicles … maintained primarily for purposes other than the transportation of persons or cargo." The issue, therefore, was whether a Mack truck with an attached tree crane fit either of these definitions of "mobile equipment."

Considering the first definition, the court found that "permanent" means "lasting or meant to last indefinitely," or "not expected to change in status, condition, or place." In this case, M & W bought the tree spade attached to a different truck and transferred it to the insured vehicle. There was also testimony that it had been detached from the truck for repairs at least once. The court acknowledged the welding, steel rods and metal bolts, but it held that these connections did not suffice to make the mount "permanent" within the meaning of the policy: they did not make the spade an "indefinite or unchanging truck component."

The court also found that the truck was not maintained "primarily" for purposes other than the transportation of trees and employees to M & W work sites. Thus, it found that the truck and tree spade were an "auto," not "mobile equipment," and it affirmed judgment for the insurer.

In the Seventh Circuit, Moral Hazard Does Not Create Moral Clarity

BY BERT HELFAND

The defendant in *Carolina Cas. Ins. v. Merge Healthcare Solutions* was insured under a D&O policy that excluded coverage for the "multiplied portion of multiplied damages." In an underlying securities suit, the court awarded attorneys' fees to the insured's shareholders, using a lodestar amount and increasing it with a multiplier. The U.S. Court of Appeals for the Seventh Circuit held that the "multiplied portion" exclusion did not apply to the fee multiplier, and, therefore, that the insurer was liable for the entire fee award. The decision rested on a finding that attorneys' fees do not constitute "damages" under governing law. But the court also used the case as an occasion for further reflection on the concept of moral hazard. Courts in the Seventh Circuit have increasingly relied on that concept to provide a rule of decision, but the impact of the concept remains hard to predict.

As discussed in the Winter 2013 issue of *Expect Focus*, Judge Posner relied on the doctrine last year in *Ryerson Inc. v. Federal Ins. Co.*, in which the insured seller of a business settled a claim for rescission, based on alleged fraudulent inducement. Federal's policy defined a covered "loss" to include "settlements" of "claims" based on "misleading statement[s]," but the court ruled against coverage for the settlement, on the ground that "[y]ou can't … sustain a 'loss' of something you … shouldn't … have."

This year, in *OneBeacon America Ins. Co. v. City of Granite City*, a federal court in Illinois decided a dispute over coverage for a state court suit challenging a local ordinance, under which the owners of impounded vehicles had to pay the City an administrative fee to get them back. The underlying class action contended the fee was an unlawful "taking" under the Illinois Constitution. The City's liability policy applied to suits seeking recovery of "damages," and it expressly covered sums the insured became obligated to pay as "damages" for public officials' errors and omissions and/or law enforcement wrongful acts. The district court, however, found *Ryerson* "clear" in holding "that restitution of monies wrongfully taken does not constitute 'damages' within the meaning of an insurance policy." It absolved OneBeacon not only of responsibility for indemnifying the City, but also of the duty to defend the underlying suit. Thus, it implicitly held that a suit involving "the potential 'restoration of an ill-gotten gain'" does not even *potentially* fall within the coverage of any liability policy.

> The court found that a suit involving "the potential 'restoration of an ill-gotten gain'" does not even potentially fall within the coverage of any liability policy.

What these bright-line rulings fail to do is clearly explain what will count as "restitution" or "ill-gotten gain" in future cases. Judge Posner's elaboration in *Schlueter v. Latek* didn't help matters: "Damages are measured by the plaintiff's loss, restitution by the defendant's gain. Often they're equivalent … [b]ut not always." In *Granite City*, it was arguable that the $400 fee at issue produced something less than a $400 "gain" to the City; yet the court's ruling meant that no part of the plaintiffs' case constituted a claim for "damages."

Judge Easterbrook's opinion in *Merge Healthcare* only muddied these already murky waters. The court said the exclusion provision listed penalties "that insurers regularly exclude to curtail moral hazard—the fact that [the availability of coverage] induces the insured to take extra risks." It then asserted that "attorneys' fees in commercial litigation are not remotely like punitive damages" and other remedies that punish risky or unethical behavior. But the defendants in *Merge Healthcare* allegedly used false statements to win approval of a sale of their company for less than its actual value, and the amount of the attorneys' fees was intended to reflect the additional value that shareholders ultimately realized. It is far from clear why a moral hazard argument against coverage for treble damages would not also apply to fees based on the amount by which management allegedly underpriced its own shares.

Fiduciary "Harmonization": No Quick Task

BY KYLE WHITEHEAD

Progress on harmonizing the standards of conduct applicable to those who provide investment advice is measured (at best):

Securities and Exchange Commission

- Though Chairperson Mary Jo White is not predicting when the SEC might propose regulations concerning the standards of conduct applicable to broker-dealers (BDs) and investment advisers (IAs), she has affirmed that this is a "major focus." Nevertheless, the SEC's published regulatory agenda for 2014 schedules the matter for "long-term," rather than highest priority, action. The SEC is still considering responses to its March 1 request for cost-benefit data and other input (see "Dearth of Data on Uniform Broker-Dealer/Investment Adviser Standard" in Expect Focus, Volume III, Summer 2013).

- The SEC's Investor Advisory Committee has adopted a recommendation that personalized investment advice that either a BD or an IA renders to retail customers be governed by an enforceable, principles-based requirement to act in the customers' best interests. The committee's preferred means of achieving this would be to narrow the Advisers Act BD exclusion, such that a broader range of advisory services would require a BD to register thereunder. Alternatively, the committee recommends that the SEC adopt an enforceable, principles-based fiduciary standard by separate rule that would apply equally to BDs and IAs.

  Under either alternative, BDs would retain the ability to offer transaction-specific recommendations compensated through commissions, so long as adequate disclosures are made regarding sales-related conflicts of interest and those conflicts are appropriately managed.

> BDs would retain the ability to offer transaction-specific recommendations compensated through commissions, so long as adequate disclosures are made.

  The committee also recommends that the SEC mandate a plain English disclosure document for customers that outlines the material contours of the client relationship, including the nature of services offered, fees and compensation, conflicts of interest, and disciplinary record. Both BDs and IAs would be required to provide this document.

  Some aspects of the committee's recommendations are stirring controversy, however, and, in any event, it is not clear what action, if any, the SEC will take with respect to the recommendations.

Department of Labor

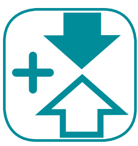
- Since withdrawing its original proposal to redefine "fiduciary" under Section 3(21)(A) of ERISA, the DOL has worked to repropose a more surgically drafted definition that will have fewer unintended consequences for retirement investors and less potential for conflict with intersecting regulations. Some weeks ago, Assistant Secretary of Labor Phyllis Borzi countermanded a previously announced timeframe for issuing a reproposal, and the DOL's 2014 priority list now projects such a reproposal in August. Ms. Borzi has confirmed that issuing a rule is her "number one regulatory priority" and that any proposed regulation will involve IRAs, will amend existing prohibited transaction exemptions, and will preserve commission-based compensation in some form.

- The DOL also has responded to concerns of swap dealers and major swap participants that they would be deemed "fiduciaries" under ERISA as a result of certain business conduct standards that, effective April 2012, the Commodities Exchange Act has imposed on their dealings with counterparties, including ERISA plans. In this connection, the DOL confirmed its intent not "to impose fiduciary obligations on persons who are merely counterparties to plans in arm's length commercial transactions." Ms. Borzi has assured that any redefinition of "fiduciary" will be carefully harmonized with CFTC standards.

Congress

- The House of Representatives has passed a bill (The Retail Investor Protection Act, or RIPA) that would preclude the DOL from redefining the term "fiduciary" under ERISA until 60 days after the SEC issues a final rule relating to a uniform fiduciary standard for BDs and IAs. RIPA would also require that the SEC, prior to promulgating any final rule, conduct new layers of cost/benefit analysis relating to the different standards applicable to BDs and IAs.

- A Senate companion bill to RIPA has not been introduced. However, ten Democratic senators sent a joint letter to the OMB, dated August 2, 2013, urging that the administration delay any DOL proposals until the SEC has completed its work.



SECURITIES

Adviser Disaster Plans Don’t Hold Water

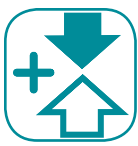
BY TOM LAUERMAN

In the wake of Hurricane Sandy, an SEC National Exam Program Risk Alert has identified gaps in some investment advisers’ disaster recovery and business continuity procedures (BCPs), including:

- inadequate anticipation of truly widespread disasters in which, for example, key personnel are not even able to work from their homes and other planned remote locations, or back-up facilities are not safely located;
- failure by advisers to critically evaluate the BCPs of their IT and other service providers (including SSAE 16 reports);
- failure to arrange for maintenance that will assure that back-up computer servers will function properly;
- insufficient testing of the adviser’s BCPs, including overly narrow test scenario assumptions or failure to apply the assumptions to all critical business operations and systems. In particular, the Risk Alert criticizes advisers who failed to test a critical system because the system’s vendor imposed a charge or other disincentive to testing; and
- inadequate arrangements for communicating with employees and clients in the event of a crisis.

The Risk Alert, which is based on a National Exam Program review of the BCPs of 40 investment advisers, was motivated by Hurricane Sandy and contains numerous other observations and specific suggestions. **According to the Exam Program staff, “Advisers should review their continuity plans in light of the staff’s observations and consider revising their plans if they see ways to make them better.”**

The points covered in the Risk Alert provide advisers a useful checklist for doing just that, and SEC examiners can be expected to refer to the alert, as well.



SECURITIES

SEC Extracts Public Confession

BY JASON BROST

The SEC's new policy of requiring more settling defendants to admit wrongdoing saw its first application in *SEC v. Falcone*, which was approved in the Southern District of New York on September 16, 2013. As part of that settlement, the defendants – hedge fund manager Philip Falcone and his advisory firm – admitted that they engaged in a market manipulation scheme; that, in order to pay his personal income taxes, Falcone improperly borrowed $113.2 million from a client hedge fund; and that they offered preferential redemption terms to large investors to gain support for more restrictive terms for smaller investors without properly disclosing the arrangement to independent trustees or other investors. The defendants agreed not to deny, directly or indirectly, or make any statements to the effect that they have not admitted the SEC's allegations against them, in addition to agreeing to a five year industry bar and disgorgement of more than $18 million.

In announcing the new policy last June, SEC Chairperson Mary Jo White stated that such admissions, which stand in sharp contrast to the decades-old norm of settling defendants neither admitting nor denying wrongdoing, would be required in particularly egregious cases. This followed, among others, Southern District of New York Judge Jed Rakoff's highly publicized decision in 2011 (currently on appeal) refusing to approve a $285 million settlement between the SEC and Citigroup in part because Citigroup was not required to admit wrongdoing.

Proponents argue that the new policy will help deter misconduct by enhancing the reputational harm resulting from wrongdoing, while critics worry that it will needlessly prolong litigation as defendants, unwilling to admit wrongdoing for fear it will enhance their exposure in investor lawsuits, choose to take their chances at trial.

Advertising Under Rule 506: A Two-Edged Sword

BY TOM LAUERMAN

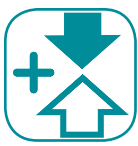
It is not necessarily advisable for issuers to take advantage of a recent SEC rule amendment – required by last year's "JOBs Act" -- that permits general solicitation or advertising (collectively, "general solicitation") in connection with private offerings under Rule 506 of the SEC's Regulation D.

Of course, general solicitation often could enable issuers to reach a larger number of potential investors and to avoid often cumbersome procedures that historically have been necessary to ensure the general solicitation would not be deemed to have been used. However, using general solicitation will require the issuer in a Rule 506 offering to:

- forego the opportunity to sell the offering to any investors who are not "accredited." This may become more important to the extent that, as is likely, the SEC in the future raises the requirements for being "accredited";
- take "reasonable steps" to verify each purchaser's accredited status that in many cases will need to go well beyond the process by which investors historically have simply "self-certified" that they the meet one of the standards for being accredited;
- forego the possibility of falling back on the traditional (non-Regulation D) private offering exemption as a back stop in case the issuer inadvertently fails to satisfy any of the conditions for availability of Rule 506. This can expose issuers to additional risk, particularly because the amendments that the SEC has recently adopted or is currently contemplating are likely to complicate Regulation D in ways that can substantially increase the risk of such an inadvertent failure (*see* ""Bad Actors" Barred from Rule 506 Private Placements" on page 14); and
- check a special box on its Form D filing, which could very well prompt intense scrutiny by various state and federal regulatory bodies, who already have expressed keen interest in general solicitation activities.

At a minimum, issuers will have ample reason to scrupulously avoid any materially inaccurate, incomplete or misleading solicitations.

Moreover, **the SEC has proposed a number of potentially troublesome additional requirements under Regulation D that would apply only to issuers making a general solicitation**; and it is not certain to what extent such requirements, if adopted, might be triggered, for example, by the continuation of offerings that had already commenced using general solicitation. Finally, use of general solicitation may in some cases result in less favorable treatment for certain purposes under state and non-U.S. securities laws and CFTC regulations.



SECURITIES

"Bad Actors" Barred from Rule 506 Private Placements

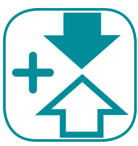
BY SCOTT SHINE

The SEC recently amended Regulation D to make Rule 506 unavailable if the issuer of a security, any persons involved with promotion or sale of the security, or any of numerous categories of persons who have some relationship with any of such persons, have been subject to any "disqualifying event." Amended Rule 506 – which is commonly relied on to exempt private securities offerings from registration -- defines such disqualifying events to include a wide variety of felony and misdemeanor convictions, other court orders and injunctions, and regulatory orders.

If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known of a disqualification, it can still rely on the Rule 506 exemption. **The instructions to the new requirement, however, make clear that, in order to rely on this exception, an issuer must make a reasonable factual inquiry into whether any disqualifying event exists.**

The SEC indicated that, although in some cases an issuer might reasonably rely solely on a person's signed questionnaire or similar documentation to establish the absence of any disqualifying event as to that person, the reasonableness of an issuer's factual inquiry will vary based on the facts and circumstances of the issuer and other offering participants.

The "bad actor" prohibition therefore injects a somewhat vague, "principles-based" element into the requirements of Rule 506. This move away from the rule's previously more "rules-based" approach, together with other potential complexities of identifying and making reasonable factual inquiries as to all necessary persons, will, in many cases, materially increase the costs, burdens and risks of reliance on Rule 506.



SECURITIES

Supreme Court Considers Mutual Fund Whistleblowers

BY GARY COHEN

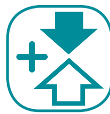
The U.S. Supreme Court heard oral arguments November 12 in the cases of two Fidelity whistleblowers claiming retaliation after they alleged deficiencies in mutual fund prospectus and shareholder report disclosure. The issue is whether certain Sarbanes-Oxley Act anti-retaliation protections apply to employees of *private*, as well as *public*, companies.

An assistant Solicitor General argued the SEC's position that the protections apply to employees of private companies, including fund investment advisers. The rationale is that, otherwise, funds would not benefit from the anti-retaliation protections, because, as Justice Breyer put it, a fund "has virtually no employees and does all its work really through investment advisers" that are often private companies.

Justices Kagan, Ginsburg, Roberts, and Scalia also recognized the SEC's position. For example, when the assistant SG pointed out that "investment advising . . . is the heart of what [private investment adviser] contractors of mutual funds do for mutual funds," Justice Scalia said, "I understand that."

On the other side, Fidelity argued for non-applicability of the anti-retaliation protections, noting that the Act gave rule-making authority to implement the Act to the Department of Labor -- not the SEC. Justice Breyer said that this fact raised the question whether "it's the SEC we should defer to."

Fidelity also emphasized the availability of other potent protections for whistleblowers, pointing to the Act's unrestricted imposition of *criminal* liability on "whoever shall retaliate against anybody who provides information to a law enforcement officer, which includes the SEC," as well as the anti-retaliation protections in the later-adopted Dodd-Frank Act. In fact, under Dodd-Frank, the SEC in October 2013 announced awards to whistleblowers of $150,000 and $14 million, which probably signals a building momentum for that program.



Firms ask FINRA to explain its game plan.

FINRA to Firms: Disclose Signing Bonuses

BY ANN FURMAN

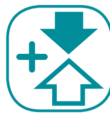
FINRA recently approved a proposed rule requiring disclosure of the details of any "enhanced compensation" paid by a broker-dealer to a registered representative whom it recruits from another firm. FINRA believes that such compensation creates a conflict of interest when registered representatives encourage former customers to follow them to a new firm.

Enhanced compensation could include signing bonuses, up front or back-end bonuses, loans, accelerated payouts, transition assistance, and similar benefits provided to a registered representative in connection with the transfer of securities employment. As proposed in January 2013, the rule would have required specific disclosure only if such incentives to a registered representative exceeded $50,000.

Several commenters challenged FINRA to better explain the nature of any conflict of interest and to require disclosure only when enhanced compensation actually creates such a conflict. Also, SIFMA and other commenters suggested the creation of model enhanced compensation disclosure.

As approved by FINRA's Board of Governors on September 19, 2013, the disclosure threshold has been increased to $100,000, and a reporting component has been added. Specifically, firms would be required to report "significant increases in total compensation paid to a newly recruited registered representative during the first year." FINRA intends to use this information in its risk-based examinations.

FINRA must send the proposed rule to the SEC before it can become effective. As of this writing, FINRA had not yet done so.



CFTC Issues Double No-Action for CFCs

BY JOAN BOROS

The Commodity Futures Trading Commission responded favorably to an Investment Company Institute no-action request regarding the reporting obligations of commodity pool operators (CPOs) of SEC-registered funds (funds) and their wholly-owned and controlled foreign subsidiaries (CFCs) under Regulations 4.27 and 4.22. The relief, granted on September 5, 2013, is motivated by, and its "Compliance Date" is linked to that of, the CFTC's recent rule harmonizing its compliance regime with the SEC's.

Absent this relief, CFTC Regulation 4.27(c) would require CPOs that trade commodities through CFCs to file separate quarterly reports for the CFCs on Form CPO-PQR with the National Futures Association. The relief generally removes the need to file such separate reports, if (a) consolidated reports for the fund are filed that include the relevant data for its CFSs and (b) the CPO either:

- consolidates the financial statements of the fund and its CFCs, or
- is working on converting to such consolidated financial statements (although this latter alternative is available only for an interim period and if certain other significant conditions are met).

The no-action relief also generally permits the omission of separate annual reports that Regulation 4.22(c) otherwise would require to be filed with respect to a CFC, if consolidated annual reports for the fund are filed that (a) contain consolidated audited statements of the fund and (b) separately note the holdings, gains, losses, and other financial statement information for the CFC.

In order to rely on the September 5 letter, a CPO must file a claim via email with the CFTC, and the letter sets forth several requirements for such claims. **Whether a fund will need the relief will depend on whether it uses any CFCs**, notwithstanding the negative attitude of the Internal Revenue Service toward treating such subsidiaries' investment results as contributing to a fund's compliance with Sub-Chapter M of the Internal Revenue Code.

CFPB Orders Restitution and Civil Penalties for Unfair Practices in Billing for Add-On Identity Theft Protection Products

BY ELIZABETH BOHN

In the CFPB's most recent administrative adjudication issued September 18th, Chase Bank USA, N.A. and JP Morgan Chase Bank, N.A (Chase) entered into a Consent Order with the Bureau related to its billing and administration of Identity Theft Protection products (IPP) marketed to Chase card and other retail customers.

Although Chase did not admit liability in the Consent Order (the Order), the Bureau found that Chase and its third-party vendors[1] had engaged in unfair acts and practices in violation of Dodd-Frank by billing and accepting monthly fees for credit monitoring services which were not provided. Specifically, consumers were billed before the credit reporting agencies (CRAs) had processed authorizations given to Chase or its vendors to access their credit information, a prerequisite to provide those services. The CFPB also found that the bank's compliance monitoring service provider failed to identify, prevent, or correct those billings.

Chase took steps to correct the practices by ending the marketing of the IPP before March, 2012 and issuing some consumer refunds in October, 2012. But the Order prohibits Chase from further marketing or solicitation of IPP absent presentation and approval to the CFPB of a Compliance Plan detailing how consumers would be informed that such services would not be activated until authorization was given to access their credit information, and how the bank would ensure that customers would not be billed in the future for such products before the credit reporting agencies had processed the consumers authorizations to access their credit information.

The Order also required Chase to:

1. Develop a vendor management policy designed to insure products sold through vendors would comply with applicable federal consumer financial law, including adding requirements to comply with such laws in vendor contracts and implementation of procedures for ongoing call monitoring of vendors;

2. Complete refunds of approximately $309 million, plus interest, to more than two million consumers who enrolled in the credit monitoring product and were charged for services they did not receive. In addition to the amount paid for the product, Chase was required to refund interest and any over-the-limit fees resulting from the charge for the product.

> The Order prohibits Chase from further marketing or soliciting of IPP abscent CFPB approval of Compliance Plan.

3. Submit to an independent audit.

4. Pay a $20 million penalty to the CFPB's Civil Penalty Fund.

The Office of the Comptroller of the Currency undertook a separate action and separately ordered restitution and civil money penalties of an additional $60 million.

The Order serves as a road map on what the CFPB expects with regard to third party marketing vendor management and compliance auditing, and again demonstrates the Bureau's willingness to assess penalties against covered entities for practices found to be in violation of the law but carried out by third-party vendors.

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[1] In April, 2012, the CFPB issued a bulletin stating that it expected covered entities to monitor their service providers, and would hold them responsible for violations by service providers of Federal consumer financial laws.

CFPB's Major Overhaul of Mortgage Rules to Take Effect January 10, 2014

BY ELIZABETH BOHN

Dodd-Frank required the CFPB to adopt specific mortgage rules, and pursuant to that authority, several mortgage-related rules were enacted by the CFPB. The new rules are targeted at eliminating factors that are believed by the CFPB to have contributed to the 2008 mortgage meltdown, including the making of mortgage loans to persons who could not afford to pay them, inadequate disclosures of loan terms, steering of consumers to higher priced loans by tying loan originator compensation to loan terms, and inadequate record keeping by mortgage servicers, among others. Here are highlights of the key rules taking effect in January:

- **The Ability to Repay/Qualified Mortgage Rule.** This Rule requires financial institutions to make a reasonable good faith determination that a consumer has a reasonable ability to repay the loan, considering factors such as the consumer's income or assets and employment status and the mortgage loan payment and other ongoing expenses related to the mortgage or property. "Qualified Mortgages" (QM) are presumed to comply with the ability to repay requirements. Generally, a mortgage loan with a debt to income ratio which does not exceed 43% is a QM. QMs also must not contain risky features such as allowing interest only payments, negative amortization, or in most cases, balloon payments. Loans eligible for purchase by a GSE such as the FHA or VA are presumed to be QMs.

- **The Home Ownership and Equity Protection Act (HOEPA) Rule.** This Rule requires additional disclosures and pre-loan counseling for consumers for "high-cost" mortgages, home equity lines, and other loans secured by a consumer's dwelling. The APR, points and fees, and pre-payment penalties factor in to determining whether the transaction is subject to the HOEPA high-cost mortgage requirements. For example, a transaction is considered a high cost mortgage if its APR exceeds the average prime offer rate for comparable loans by 6.5 points.

- **The Loan Originator Rule.** This Rule prohibits compensation to a loan originator based on the terms of the loan transaction, or a "proxy" for the terms of the transaction. Thus, any rate or cost of a loan which is a term of transaction cannot be the basis for compensation. Under the proxy analysis, pricing of a transaction may relate not only to the terms of loan, but also on whether the originator has discretion to steer the consumer toward a product with different terms. The Rule also imposes qualifications on loan originators, who must either be licensed and registered under the SAFE Act or other state or federal law.

Old mortgage rules needed some sprucing up.

- **The Mortgage Servicing Final Rules.** These Rules affect mortgage servicing under and amend the Real Estate Settlement Procedures Act (RESPA, as implemented by Reg X), and the Truth in Lending Act (TILA, implemented by Reg Z). Small servicers (servicing 5,000 or fewer mortgages) are exempt from certain provisions of the new servicing rules.

The new RESPA Rule imposes detailed requirements for responding to consumer requests for information and for resolution of errors; placement of force-placed insurance; creation of servicing files and record retention; early intervention and continued contact with delinquent customers including providing them with loss mitigation options; and establishment of loss mitigation procedures which require assisting customers in completing loss mitigation applications and refraining from foreclosure while a customer is being evaluated for loss mitigation options.

The new TILA Rule addresses interest rate adjustment notices for adjustable rate mortgages, crediting of mortgage payments and responses to requests for payoff amounts, and periodic billing statements. Among other things, the Rule requires at least 210 days notice before a first interest rate adjustment, prescribes the content of such notices, as well as the content, delivery and frequency of periodic billing statements. It also requires payments be credited as of the date of receipt, and that accurate payoff balances be provided within 7 days of the consumer's request.

Third Circuit Rules Consumer May Revoke Consent to Call Cell Phone

BY ELIZABETH BOHN

The Telephone Consumer Protection Act, 47 U.S.C. § 227 (TCPA), prohibits calls to cell phones using automatic telephone dialing systems or prerecorded voice messages absent the called party's prior express consent.

In a 2008 declaratory ruling, *In the Matter of Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991*, the Federal Communications Commission (FCC), which interprets the TCPA, found that autodialed and prerecorded message calls to wireless numbers provided by the called party to a creditor in connection with an existing debt were permissible as calls made with the "prior express consent" of the called party. The FCC concluded that providing a cell phone number to a creditor in a credit application reasonably evidenced prior express consent to be contacted at that number regarding the debt. Based on the 2008 FCC ruling, courts have repeatedly rejected TCPA claims when the plaintiff provided the called number in connection with the transaction.

In one of the few reported decisions addressing the revocability of consent, *Gager v. Dell Financial Services, LLC*, the district court held that where a cell number was provided to a creditor in a credit application, the consumer could not revoke consent to call the number, finding that because the TCPA is silent as to revocation of prior express consent, such a right did not exist. The *Gager* decision was relied on by creditors to defend TCPA claims by debtors who had provided cell phone numbers in their credit applications.

On appeal, the Third Circuit reversed, based on a 2012 FCC ruling, *In the Matter of Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991, SoundBite Communications, Inc.*, (*SoundBite*), which held that a consumer could revoke consent to receive text messages. In *SoundBite*, the FCC acknowledged that the TCPA does not expressly deal with revocation of consent, but ruled that a consumer may revoke such consent to receive text messages by sending an opt-out message. The Third Circuit found that even though *Soundbite* dealt with text messages, the ruling indicated that consumers can in fact revoke the prior express consent under the TCPA and therefore reversed the district court's decision in *Gager*.

As a result of the Third Circuit's decision, creditors may no longer argue that provision of the called number in a credit application prevents the consumer from thereafter revoking consent to call that number.

TD Bank Learns the Hard Way: Anti-Money Laundering Law Is About More Than Terrorists

BY MICHAEL KENTOFF & SONIA ESCOBIO O'DONNELL

In agreeing to pay a $37.5 million civil money penalty to the Financial Crimes Enforcement Network (FinCEN) and an additional $15 million penalty to the SEC this past September, TD Bank N.A. unwittingly provided an expensive lesson to the financial services industry: the Bank Secrecy Act, often called the "anti-money laundering (AML) law," is not just about stopping terrorism.

According to statements by the SEC, FinCEN's newly-created Enforcement Division, and the Office of Comptroller of the Currency (which partnered with FinCEN on the $37.5 million penalty), Scott Rothstein, chairman of the Fort Lauderdale, Florida-based law firm, Rothstein Rosenfeldt Adler, operated a Ponzi scheme worth nearly $1 billion from April, 2008 through September, 2009 while banking with TD Bank. The scheme involved convincing individuals to invest in purported confidential structured settlements that were available for purchase; upon doing so Rothstein would forge judges' signatures on fake settlements.

> Under the Bank Secrecy Act, banks are obligated to report transactions that involve or aggregate to at least $5,000, are conducted by, at, or through the bank, and that the bank "knows, suspects, or has reason to suspect" are suspicious.

Under the Bank Secrecy Act, banks are obligated to report transactions that involve or aggregate to at least $5,000, are conducted by, at, or through the bank, and that the bank "knows, suspects, or has reason to suspect" are suspicious. According to FinCEN, the bank "failed to properly identify, monitor, and report suspicious activity" in Rothstein's Interest on Trust Accounts (IOTAs) at the bank; many transactions therein were part of Rothstein's Ponzi scheme. Rothstein used these TD Bank IOTAs to project safety and legitimacy to potential investor victims.

Although the bank's AML surveillance software allegedly issued alerts at that time concerning activity in Rothstein's accounts, the bank did not file any Suspicious Activity Reports (SARs) until 2011, after an internal review uncovered approximately $900 million in aggregate suspicious activity in Rothstein's accounts – and after Rothstein had plead guilty to RICO charges in June, 2010.

While the SEC separately alleged fraudulent facilitating activity by the bank's regional vice president, ***FinCEN, in its Assessment, focused squarely on the bank's delay in filing SARs***, blaming it largely on "[a] lack of adequate training for both the business and Bank Secrecy Act/Anti-Money Laundering staff."

Effective Now: Increased Prohibitions on Unauthorized Possession of Personal Identification Information

BY JASON MORRIS

Under a new Florida law, a person's use or possession of personal identification information (PII) of five or more individuals gives rise to an inference that the action was intentionally performed knowingly and without authorization, unless the person can provide a satisfactory explanation for the conduct. On October 1, 2013, Florida Statute Section 817.5685, made it a crime to intentionally or knowingly possess, without authorization, the PII of another person in any form (including hard copy or electronic). Prior to this statute, Florida already had a law on the books criminalizing the fraudulent use, or possession with intent to fraudulently use PII concerning an individual without authorization or that individual's consent, and that law remains effective.

The statute defines PII to include medical records, financial information (including bank account numbers, credit or debit card numbers), and government identification information (including Social Security numbers, driver license numbers, government-issued identification numbers, alien registration numbers, passport numbers, employer or tax identification numbers, and Medicaid or food assistance account numbers).

The statute exempts the following:

(1) "the parent or legal guardian of a child and who possesses the personal identification information of that child";

(2) a guardian of another person for the possession of PII of that other person, if the guardian is authorized to possess the PII and make decisions regarding that PII;

(3) a government agency employee who possesses the PII of another person in the ordinary course of business;

(4) a person engaged in a lawful business and possesses PII of another person in the ordinary course of business; and

(5) a person who finds government-issued documentation containing PII "of another person and who takes reasonably prompt action to return that" document to "its owner, to the governmental agency that issued the card or document, or to a law enforcement agency."

In the early stages of this statute's effectiveness, it is unclear whether the possession of legally-acquired PII for a temporal period longer than needed by a financial services institution would be considered "the ordinary course of business" or a violation of the new statute.

However, the statute creates two affirmative defenses to alleged violations of the statute for cases where the person possessing the PII of another person (1) "did so under the reasonable belief that such possession was authorized by law or by the consent of the other person," or (2) obtained the PII from a public record, or other "forum or resource that is open or available to the general public."

Violations of the statute are punishable as a first degree misdemeanor, in the case of a person possessing PII of four people or less, and as a third degree felony, in the case of a person possessing the PII of five or more people.

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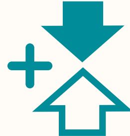

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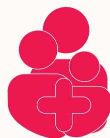
Property & Casualty Insurance

Investment Companies & Advisers



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