EXPECT FOCUS®

LEGAL ISSUES & DEVELOPMENTS FROM JORDEN BURT LLP

VOLUME III SUMMER 2012

In This Issue:

No Fancy Tricks

Keeping an eye on the ball pays

JORDEN BURT®

EXPECT**FOCUS**® VOL. III SUMMER 2012

EXPECT**FOCUS**® is a quarterly review of developments in the insurance and financial services industry, provided on a complimentary basis to clients and friends of Jorden Burt LLP.

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Changes in address or requests for subscription information should be submitted to:

Lauriell Webb
lwe@jordenusa.com

IN THE SPOTLIGHT

CFTC Rule Changes: A Silver Lining?

BY JOAN E. BOROS & TOM LAUERMAN

Investment advisers to mutual funds, ETFs, and private funds are chafing under recent CFTC rule changes that may require them to register as commodity pool operators or commodity trading advisers (see "Commodity Pool Operator Rule Under Fire" on page 18). Such advisers, however, may be well positioned to explore a number of new product initiatives, some of which have been enhanced by recent legislation.

Once an investment adviser goes to the trouble and expense of registering and preparing to discharge all the functions of a commodity pool operator, it can offer a wide variety of CFTC-regulated funds. Moreover, to the extent that a fund does not invest primarily in "securities," it could avoid registration under the Investment Company Act of 1940 (1940 Act). The Dodd-Frank Act has facilitated this by clarifying that most swaps and other derivatives, including derivatives based on broad-based securities indexes, will be regulated by the CFTC, rather than being regulated as securities by the SEC. **This enables advisers that qualify as commodity pool operators to potentially offer a broader range of funds that do not bring the 1940 Act into play.** For example, an ETF or other fund could, through the use of derivatives, provide investors with returns that are very similar to those of certain registered investment companies investing directly in securities.

Such an alternative fund would have the advantage of not being subject to the "moratorium" that the SEC currently is imposing on certain new registered investment companies that use derivatives and would not be subject to numerous other requirements that would apply to a registered investment company, including:

- limitations on performance fees, leverage, investment concentration, investing in securities-related issuers, and transactions with affiliates; and

- requirements for portfolio diversification, shareholder voting on various matters, and governance by a board of directors/trustees.

Offering an alternative fund would still require registration with the SEC under the Securities Act of 1933, unless the private offering exemption under Regulation D (or another exemption) were available. However, by directing the SEC to rescind Regulation D's prohibition on any general solicitation or advertising, the recently-passed JOBS Act has made it potentially more attractive to rely on Regulation D.

Even a fund relying on Regulation D would be subject to reporting under the Securities Exchange Act of 1934 (1934 Act), if any class of its equity securities has at least 2000 holders of record. Here again, however, the JOBS Act has potentially been very helpful, by increasing this threshold for 1934 Act reporting from its prior level of 500 holders of record. (For more discussion of the relevant provisions of the JOBS Act, see "*JOBS Act Lifts PPVIP Limits*" in Spring 2012 Expect Focus.)

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Contingent Deferred Annuities Update

BY KRISTIN SHEPARD

The NAIC Contingent Deferred Annuities (CDA) Working Group met on June 27th in Washington, D.C. to hear presentations from industry groups and regulators. The American Academy of Actuaries, the Insured Retirement Institute, and the American Council of Life Insurers emphasized that CDAs operate like stand-alone guaranteed lifetime withdrawal benefit (GLWB) riders, but with the assets held outside the insurance company (similar to synthetic guaranteed investment contracts). Because CDAs are similar to these products, the insurance industry has demonstrated the ability to manage CDA-type risks. Industry representatives emphasized that CDAs are subject to state and federal regulation; regulators would monitor CDAs and provide consumer protection safeguards.

CDAs can be individual or group products. CDAs sold to certain qualified pension plans are exempt from registration with the Securities Exchange Commission (SEC) (as well as from certain state insurance requirements), but remain subject to the securities laws' antifraud and enforcement protections, and are also subject to regulation by the Department of Labor. An SEC staff member stated that its disclosure requirements for CDAs are similar to those for variable annuities, and that CDA prospectuses are subject to the SEC's plain English rules. **Unlike variable annuities, however, CDAs are not subject to the provisions of the 1940 Act because the underlying assets are not held by a separate account of the insurance company.** FINRA also regulates CDA distribution by registered broker-dealers.

The US Government Accountability Office (GAO) is examining CDAs pursuant to a charge to explore lifetime income products from the Senate Committee on Aging and looking at the operation, risk profile, fees, and suitability issues associated with CDAs, as well as the regulation of these products at the federal and state level. The GAO plans to complete its work by February 2013.

The CDA Working Group will meet again at the NAIC Summer Meeting to discuss its progress to date. The Working Group plans to present its final recommendations on its charges to "evaluate the adequacy of existing laws and regulations applicable to the solvency and consumer protections of annuities as such laws are applied to CDAs" at the NAIC Fall Meeting.

Insurers have shown they can manage the potential perils

STOLI and Contestability Provisions: Is Time on your Side?

BY DAWN WILLIAMS

The outcomes of STOLI cases often turn on the jurisdiction in which the suit is brought, as state laws on insurable interest, misrepresentation, and myriad other factors vary widely. One recent illustration of this principle can be found in **two seemingly contradictory decisions** by different state courts concerning whether a challenge to insurable interest must be brought within the policy's contestability period.

In *Halberstam v. U.S. Life Insurance,* a New York court recently required the challenge to be made before the contestability period expires. Due to the particular New York contestability statute, which prevents *any* contest after two years, and judicial precedent that a contract lacking insurable interest is voidable but not void *ab initio*, the court granted summary judgment against the insurer because its insurable interest claims were brought after the two-year contestability period.

The Superior Court of Connecticut found otherwise, denying a motion for summary judgment brought on the same basis. The court in *PHL v. Charter Oak Trust* opined that because a contract lacking insurable interest is void *ab initio*, the contestability clause would never have come into effect, and so would never operate as a bar to insurable interest claims.

Noteworthy Developments in COI Cases

BY DAWN WILLIAMS

Many insurers have been threatened with or embroiled in litigation over cost of insurance (COI) rates in the last few years. The lawsuits, often brought as putative class actions, typically focus on the factors the insurer considered either when setting rates, or in increasing its current COI rate schedules. Insurers recently achieved important victories in both areas.

In Illinois federal court, an insurer secured summary judgment in a putative class action alleging that it was in breach of contract when it considered factors other than those specifically enumerated in the policy. The court in *Norem v. Lincoln Benefit Life* found that the contract, which provided that the COI rates would be "based on" certain listed items, did not exclude consideration of other factors, and "so long as the rates remained below the guaranteed rates, defendant had discretion in setting those rates." The court then denied class certification without prejudice, though noting that the summary judgment ruling would "appear to apply equally to any other member of the class." In *Thao v. Midland National Life Insurance,* a Wisconsin federal court addressed similar contract language in denying a motion for class certification, holding that, although **whether the insurer breached its contracts by considering other factors might be a common question, the disparity in policyholders' payment preferences – some policyholders would be better off with the current calculations – rendered class treatment inappropriate**.

With regard to rate increase litigation, an insurer recently prevailed on motions to dismiss all non-contract based claims in two COI rate increase actions pending in New York and California, respectively. Jorden Burt represents the insurer in those two actions. A separate putative class action involving a COI rate increase by a different insurer recently settled; the proposed relief includes a reduction in the COI rate with a guarantee that the rates will not increase for a period of five years.

International Financial Regulatory Reform

BY ROLLIE GOSS

While the US's Financial Stability Oversight Council (FSOC) has been working on a methodology to identify potential systemically significant non-bank financial institutions (which may include large insurance companies) for potentially enhanced regulation, a similar effort has been underway on the international front. The International Association of Insurance Supervisors (IAIS) has released a document containing its proposed methodology for identifying such companies, titled *Global Systemically Important Insurers: Proposed Assessment Methodology,* which is open for comment through July 31, 2012. Since the IAIS does not have direct regulatory authority, its work will result in recommendations for consideration by the national regulatory authorities.

The IAIS has recognized that "traditional insurance" generally neither generates nor amplifies systemic risk within the financial system, but that there is a potential for systemic risk in insurance companies when they "significantly deviate from the traditional insurance business model and particularly where they engage in non-traditional insurance or non-insurance activities or as a result of interconnectedness."

IAIS: Systemic risk for insurers who "significantly deviate" from traditional model

The IAIS's proposed methodology for identifying significant insurers is similar to, but not the same as, the methodology published by the FSOC, and consists of **five "indicator" categories of potential systemic risk: size; global activity; interconnectedness; non-traditional and non-insurance activities; and substitutability**. In the non-traditional and non-insurance activities category, the issuance of variable annuities with guaranteed benefits can introduce systemic risk.

It is anticipated that insurers identified as being "significant" risks will be required to have a "Recovery and Resolution Plan" in place by mid-2014, with additional regulatory measures to follow starting in mid-2017 at the earliest.

MARKYOURCALENDAR

The 17th Annual Advanced ALI-CLE Conference on Life Insurance Industry Class Actions and Complex Litigation will take place September 20-21, 2012 in Cambridge, MA. Managing Partner **Jim Jorden** serves as planning Co-Chair, and both he and DC Partner **Wally Pflepsen** are on the faculty. The Conference will focus on major litigation arising from challenges to the marketing, sale, and administration of financial and insurance products; recent developments in complex and class action litigation, including the trial of cases; FINRA arbitration and ERISA developments. For more information and to register, visit www.ali-aba.org.

The 30th Annual Conference on Life Insurance Company Products will be held October 31-November 2, 2012 at the Washington Plaza Hotel in Washington, DC. Co-chaired by **Richard Choi**, partner in the Washington office, the conference will feature an executive forum and compliance workshop, and will address topics such as index product developments, the JOBS Act, the Federal Insurance office, as well as other recent legislative, regulatory, and compliance developments relevant to organizations and individuals involved with these products. **Chip Lunde** and **Gary Cohen**, also partners in the Washington office, serve on the faculty. For more information and to register, visit *www.ali-aba.org*.

Captiv(e)ating Developments at the NAIC

BY ANTHONY CICCHETTI

The NAIC's Financial Condition (E) Committee has created the Captive and Special Purpose Vehicle Use (E) Subgroup. **The Subgroup's charge is to study insurers' use of captive reinsurers and special purpose vehicles to transfer insurance risk,** other than self-insured risk, in relation to existing state laws and regulations, and to establish appropriate regulatory requirements to address concerns identified in the study. Such regulatory requirements may involve modifications to existing NAIC model laws and/or the generation of a new NAIC model law.

In January 2012 the Subgroup issued a Request for Comment to the 50 states and the District of Columbia covering a number of questions relating to the regulation and use of captives and special purpose vehicles. The results from the 31 responding regulators are available on the NAIC website. The Subgroup has prepared a corresponding Request for Comment aimed at individual insurance companies addressing their use of captives and special purpose vehicles. The Subgroup's work plan also includes the drafting of a White Paper on captives and special purpose vehicles, with exposure targeted for late July 2012.

NAIC trying to come to grips with insurers' transfer of risk

SCRIBNER, HALL & THOMPSON, LLP

FATCA – Evolving Guidance Unlikely to Exempt Insurance

BY BRION GRABER

The Foreign Account Tax Compliance Act (FATCA) was enacted in March 2010 in response to concerns over U.S. taxpayers evading their tax obligations through the use of foreign accounts and foreign entities. FATCA's objective is to increase information reporting by foreign financial institutions (FFIs). To encourage FFIs to provide the requisite information, FATCA requires 30 percent withholding on certain payments to FFIs that do not participate.

The initial question for the insurance industry was whether a foreign insurance company is an FFI and what insurance products are covered. In February 2012, the government published extensive proposed regulations that attempt to answer numerous questions about FATCA's scope and the manner in which it will be implemented. Under those regulations, whether an insurance company is an FFI depends on the types of insurance that it issues. In general, products offering pure insurance protection, such as term life and property and casualty contracts, do not present the tax evasion concerns that FATCA is intended to address and are thus outside its scope. Indemnity reinsurance is also viewed as unproblematic. However, any cash value insurance contract or annuity contract will constitute a financial account, causing the issuing insurance company to be an FFI.

The government has received more than 200 sets of comments on the proposed regulations, including a substantial number from the insurance industry. The proposed regulations will be revised, but time is short because FATCA takes effect January 1, 2013 (with implementation of certain aspects delayed to later dates).

As FATCA is an evolving and complex area, many developments are certain to come throughout this year. Nevertheless, insurance companies should already be considering how FATCA might affect them and the actions necessary to comply with its requirements. Ultimately, it is unlikely that insurance companies and their products will receive a complete exemption from FATCA.

Eleventh Circuit Affirms Denial of ALF Coverage Under Home Care Only Policy

BY JASON KAIRALLA & CLIFTON GRUHN

Rejecting an invitation by appellant-plaintiff to disregard express policy language, the Eleventh Circuit Court of Appeals denied an appeal by an insured seeking home health care benefits for services received in an assisted living facility (ALF). Both the district court and the Eleventh Circuit rejected the plaintiff's argument that state law and public policy required that the court "rewrite the policy" to provide coverage.

In 1997, the plaintiff in *Sherman v. Transamerica Life Insurance Company* purchased a "Home Care Only" policy. At that time, she had the option of purchasing a "facility-only" policy or an "integrated" policy, both of which would have provided ALF coverage, but she chose the less expensive home care-only policy. Years later, she moved into an ALF and applied for benefits for services received there. According to plaintiff, she was entitled to coverage because the ALF had become her "home." The district court dismissed the complaint, holding that the policy plainly did not provide the coverage sought.

On appeal, the Eleventh Circuit affirmed finding that the plaintiff, having "knowingly purchased an insurance policy that covers only health care services provided in her home," was not entitled to benefits for services rendered in an ALF. **Florida's insurance laws, said the court, do not "prohibit an insurance contract from covering health care services provided only at an insured's home, as opposed to a facility" and public policy does not disfavor limited benefit policies that exclude ALF coverage.** Additionally, the court noted that an "ALF is a highly-regulated environment with access to round-the-clock care services as necessary," whereas "[i]n her home plaintiff's living arrangements are not regulated by the Department of Elder Affairs, and she had only part-time access to a home health aide on a pre-arranged schedule."

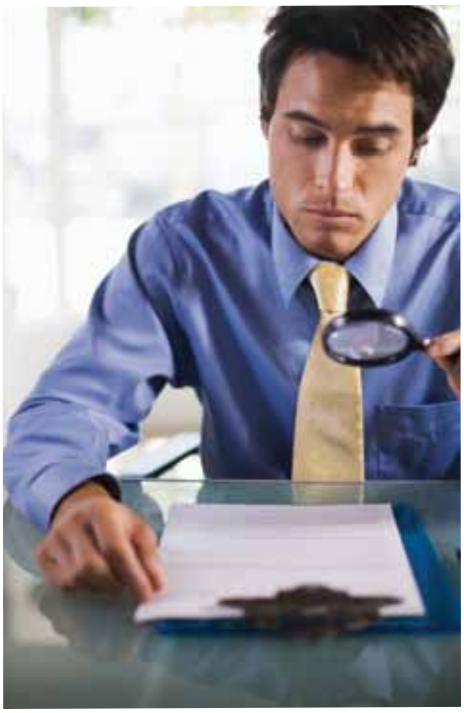
Fifth Circuit Limits Insurer's Discretion in Interpreting Summary Plan Description

BY GLENN MERTEN

When Nancy Koehler discovered there was no participating provider who could supply a medically necessary dental device, she obtained a referral to an out-of-network specialist, as permitted by her plan. Aetna later denied coverage on the grounds that the referring physician failed to obtain pre-authorization for the referral. Koehler filed suit for benefits pursuant to ERISA § 502(a)(1)(B), and the District Court granted summary judgment to Aetna.

In *Koehler v. Aetna Health Inc.*, the Fifth Circuit Court of Appeals reversed and remanded, holding that the certificate of coverage does not unambiguously require pre-authorization by the insurer, especially compared to other clearer provisions. The court also noted the certificate's assurance that Aetna would "not use any decision making process that operates to deny Medically Necessary care that is a Covered Benefit," and held that it "seems to disavow relying on a harmless procedural lapse as a basis for refusing" otherwise covered services.

The court also noted that while the plan gives Aetna discretion to resolve ambiguities in its favor, ambiguities in the summary plan description must be resolved in favor of the beneficiary. **Since Aetna had conceded earlier in the litigation that the text in the certificate of coverage constitutes the summary plan description, the identical language was subject to two different interpretive standards.** And although the Supreme Court's decision in *CIGNA Corp. v. Amara* requires that the terms of a plan control over those of the summary, ambiguous plan language should be "given a meaning as close as possible to what is said in the plan summary."



Identical language may be resolved differently depending on the document

DUI Not Necessarily Bar to Life Insurance Benefits

BY GLENN MERTEN

The Eighth Circuit Court of Appeals recently affirmed an award of life insurance benefits the ERISA plan administrator/insurer previously denied because the insured was heavily intoxicated at the time of his motorcycle crash. In *McClelland v. Life Insurance Company of North America,* a plan participant passed away after "weaving in and out of traffic for approximately six miles" and crashing his motorcycle. Toxicology reports revealed that his blood alcohol content was over two-and-a-half times the legal limit in Minnesota. The administrator denied policy benefits to his widow, asserting that the crash was not a covered accident within the meaning of the policy terms because it was "foreseeable due to [the insured's] intoxicated state at the time of the crash." On remand after the beneficiary filed suit, the administrator again denied benefits, relying heavily on its expert witness report. The beneficiary again filed suit, and the district court awarded benefits, finding that the administrator abused its discretion by unreasonably interpreting the term "accident."

The Eighth Circuit affirmed, holding that the controlling definition of an "accident," set forth in *Wickman v. Northwestern National Insurance Co.*, **requires the administrator to take into account the deceased's subjective, individual "characteristics on the day of the accident,"** rather than merely the characteristics of a person the same age as the deceased "who consumes alcohol and drives at a high rate of speed." The administrator should have considered reports that the insured was in a good mood, joked with friends, had no problems with balance or orientation, and had been deftly driving his motorcycle before the accident, and those reports amounted to "overwhelming evidence" that the insured did not consider his death likely. Accordingly, his death was an accident, and policy benefits should have been paid.

Florida Supreme Court: No Cause of Action for Common Law Bad Faith

BY JOHN PITBLADO

Florida's highest court clarified in May that the state's bad faith statute is the exclusive means by which an insured may pursue damages for the alleged mishandling of a claim.

QBE Ins. Co. v. Chalfonte Condominium Apartment Assoc. involved a coverage dispute under a property insurance policy. The insured contended that QBE's investigation and processing of the claim had been so dilatory as to constitute a breach of the covenant of good faith and fair dealing that is implied into every contract by Florida's common law. The insured also asserted that the policy's hurricane deductible was invalid, because its type size and terminology allegedly violated a Florida notice statute. On an appeal from a judgment that awarded damages to the insured for bad faith, but which applied the hurricane deductible to reduce the amount of the award, the Eleventh Circuit Court of Appeals certified questions to Florida's Supreme Court.

Bad faith in Florida: go to the statutes

The Supreme Court observed that Florida's statute governing insurer bad faith expressly creates a private right of action, and it held that such an action is the exclusive remedy for alleged misconduct in handling an insurance claim. Consequently, **there is now no additional, common law cause of action for bad faith** in Florida.

On the other hand, the Court held that the Florida statute containing technical requirements for a hurricane deductible does not create a private right of action and does not create penalties for non-compliance. Because "courts cannot provide a remedy when the Legislature has failed to do so," the hurricane deductible was enforceable, despite QBE's technical violations of the notice statute.

Ripples From Spitzer's Big Splash Have Not Yet Subsided

BY BERT HELFAND

In October 2004, then-New York Attorney General Eliot Spitzer dramatically announced charges against insurance broker Marsh & McLennan, claiming that Marsh's receipt of contingent commissions from commercial insurers suppressed competition and led to bid-rigging and other abuses. While the resulting class actions against Marsh and various insurers were finally settled in March 2012, a recent decision shows that basic questions about brokers' incentive payments remain unresolved.

New York law permits insurers to pay fees that take account of the volume a broker generates. Moreover, New York's highest court held, in *Cuomo v. Wells Fargo Insurance Services*, that a broker owes no common law duty to its clients to disclose such incentive payments. (A new regulation that requires disclosure of factors that may affect a broker's compensation was upheld by a lower court in March 2012.) On the other hand, in *State v. Acordia, Inc.*, a lower court in Connecticut reached the opposite conclusion in 2010: It held that a broker's failure to disclose contingent commissions constituted a breach of fiduciary duty.

These decisions turned on **whether a broker is an agent of the insured, as *Acordia* held, or if it has "dual agency status," because its fees are typically paid by insurers.** The latter view prevailed in *Cuomo*, and it was recently adopted by Missouri's Supreme Court, in *Emerson Electric Co. v. Marsh & McLennan Companies*. *Emerson* observed that commissions in general need not be disclosed, and it rejected an argument that contingent commissions should be treated differently, because they allegedly create a heightened danger of conflict of interest.

Nevertheless, the court also held that the question of whether Marsh had breached a duty to its customer could not be resolved from the face of the pleadings: If the customer could show that Marsh failed to advise it of lower-cost insurance available from companies that did not pay such commissions—in other words, if Marsh actually harmed its customer because of the incentives that contingent commissions create—then Marsh would be liable. Contingent commissions are lawful per se, but they can still contribute to significant exposure.

Fundamental Insurance Defenses May Be Asserted Against Additional Insureds

BY BERT HELFAND

Acts by policyholders that can invalidate coverage—such as misrepresentations, or even nonpayment of premiums—often do not impair the rights of additional insureds. Recent decisions in New York and Florida show that this immunity **does not apply to defenses based on the underlying invalidity of the insured risk**.

Admiral Insurance Co. v. Joy Contractors arose out of the collapse of a tower crane during construction of a high-rise building in Manhattan. The crane operator's excess liability policy with Admiral identified the building's owner as an additional insured. Admiral sought to avoid coverage for the owner, because the operator's underwriting submission had falsely stated that it did not perform exterior work, and that it performed no construction work above two stories. In response, the owner cited cases in which policyholders' misrepresentations did not affect coverage for additional insureds.

In one such case, an auto policy made a dealer an additional insured, but it misidentified the insured lessee. New York's Court of Appeals distinguished this case, on the ground that the misstatement "did not deprive the insurer of . . . [an] opportunity to evaluate the risks for which it was later asked to provide coverage." That is, the insurer was misled about who would drive the car, but it still understood it was insuring the dealer against theft. By contrast, the crane operator's false statements to Admiral prevented the insurer from anticipating that it would insure any party against the collapse of a crane.

In *Interstate Fire & Casualty Co. v. Abernathy,* the holder of a liability policy supplied an inflatable bungee run to the Choctaw Touchdown Club for its Jellyfish Festival, with predictably tragic consequences. Four days after a young girl was injured, the policyholder obtained a Certificate of Insurance, naming the club as additional insured. A Florida Appellate Court held that any agreement to provide the club with coverage for the accident would be void under the known loss doctrine; the claimant's status as additional insured did not mitigate the force of that fundamental defense.

Agent's Error Imputed to Insurer, Trumping Insured's Duty to Read

BY JOHN PITBLADO

As we discuss in this issue, an insurance agent's ambiguous role permits it, in some states, to accept undisclosed compensation from insurers. In Tennessee, that ambiguity can also enable insureds to avoid basic contractual responsibilities.

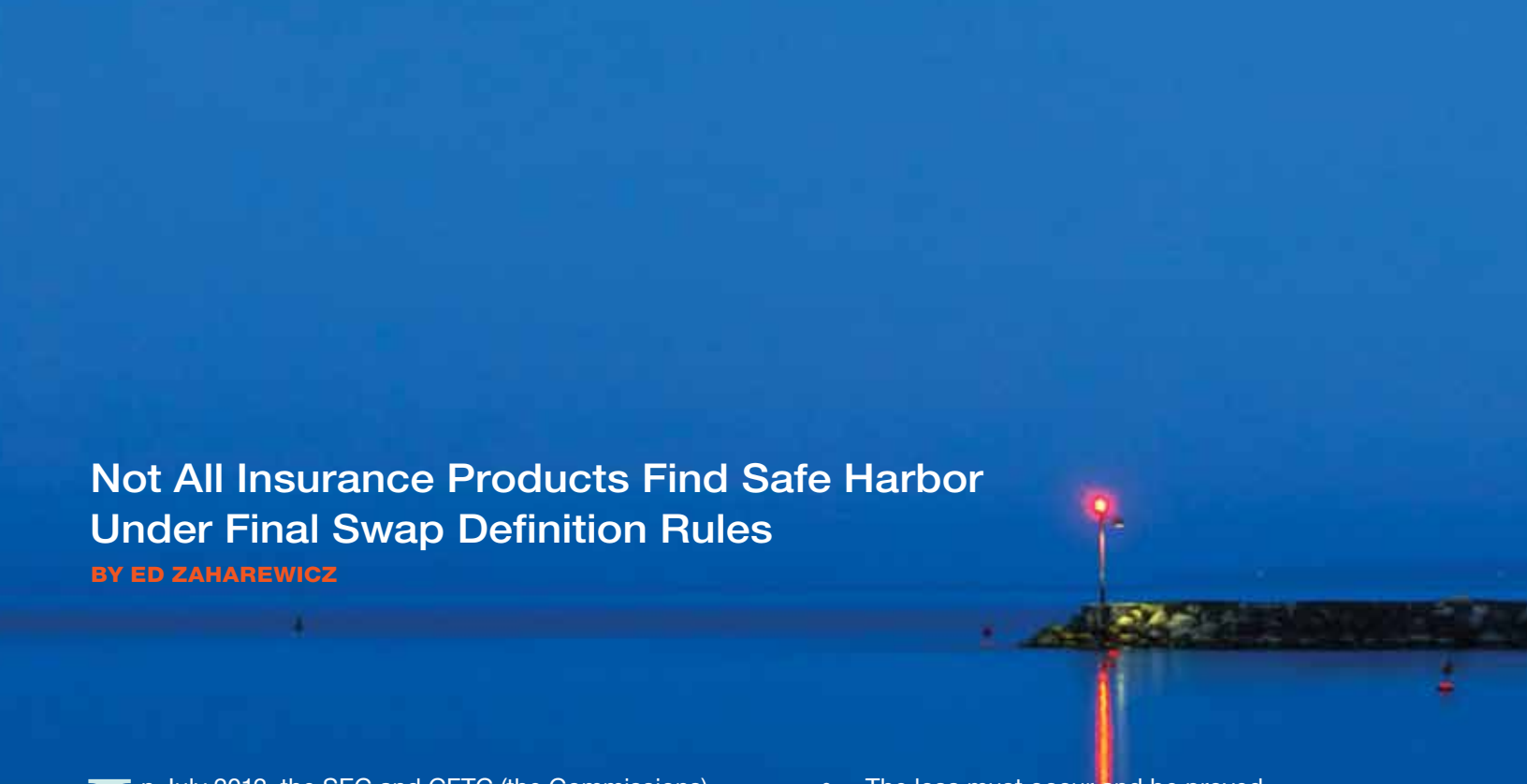
In *Allstate Insurance v. Tarant*, the insured's van was covered under a business insurance policy. On renewal, the van was transferred to a personal policy with lower limits. Allstate sent the insured a letter about the change and followed it with bills that described the coverage and charged correspondingly reduced premiums. After an accident, the insured sought the higher level of liability coverage, claiming his agent had transferred the van in error. In a declaratory judgment action, Allstate contended the insured had ***ratified*** the agent's mistake when he paid the reduced premiums.

In March 2012, the Tennessee Supreme Court found in favor of the insured, relying on a Tennessee statute which states that "[a]n insurance producer who solicits or negotiates an application for insurance shall be regarded, in any controversy arising from the application for insurance. . . as the agent of the insurer and not the insured." The Court found that the agent had, in fact, transferred the van in error, and that, under the statute, the agent's mistake was imputable to the insurer. The Court held that Allstate was therefore estopped from denying coverage under the commercial policy.

The Court also rejected Allstate's ratification argument, on the ground that **one can ratify only the acts of one's own agent**, and, under the statute, the agent here had committed the error in the capacity of agent for the *insurer*. Because the insured's receipt of Allstate's letter and payment of reduced premiums did not constitute ***ratification***, the court held that these acts did not prevent the insured from receiving coverage at the higher level.

Not All Insurance Products Find Safe Harbor Under Final Swap Definition Rules

BY ED ZAHAREWICZ



In July 2012, the SEC and CFTC (the Commissions) approved long-awaited joint rules and interpretations concerning certain key definitions, including "swap" and "security-based swap" (collectively Swaps). The new rules and interpretations will take effect 60 days after the date of their publication in the Federal Register.

The Swap definition is central to the comprehensive new regulatory scheme that Dodd-Frank establishes for instruments that fall within the definition. Following effectiveness of the definition, affected persons must comply with applicable new regulatory requirements in accordance timetables that the respective Commissions have developed and will likely continue to refine.

Under the final rules an insurance agreement, contract or transaction (insurance product) will not be considered a Swap if, as set out in the related SEC "fact sheet," it meets any of the following three provisions:

Grandfather Provision: The product is an existing agreement, contract or transaction entered into before the effective date of the final rules and was provided by a person or entity that satisfied the "provider test."

Product Safe Harbor: The product is provided in accordance with the provider test and satisfies the following conditions:

- The beneficiary of the insurance product must have an insurable interest and thereby bear the risk of loss with respect to that interest continuously throughout the duration of the agreement, contract, or transaction.
- The loss must occur and be proved.
- Any payment or indemnification for loss must be limited to the value of the insurable interest.
- The agreement, contract or transaction must not be traded, separately from the insured interest, on an organized market or over-the-counter.
- With respect to financial guaranty insurance only, in the event of a payment default or insolvency of the obligor, any acceleration of payments under the policy must be at the sole discretion of the insurer.

Enumerated Product Safe Harbor: The product is provided in accordance with the provider test and falls within the following categories:

- surety bond
- fidelity bond
- life insurance
- health insurance
- long term care insurance
- title insurance
- property and casualty insurance
- annuity

- disability insurance
- insurance against default on individual residential mortgages
- reinsurance (including retrocession) of any other enumerated product.

In order for a state-regulated insurance company to satisfy the "provider test," the product must be regulated as insurance under applicable state or federal law. Notably, the safe harbor for enumerated products is included as part of the final rules, rather than as an interpretation, as proposed. The final rules also were adopted without the proposed requirement that annuities comply with Section 72 of the Internal Revenue Code in order to qualify as an enumerated product.

Products not specifically enumerated in the safe harbor provisions should be considered in a facts and circumstances analysis.

The final rules clarify that the safe harbor provisions are non-exclusive. Accordingly, any insurance product that does not fall within with safe harbor will require further analysis of the applicable facts and circumstances to determine whether it is insurance or a Swap.

While many traditional insurance products will fall within the safe harbor provisions, others clearly will not. For example, the Commissions specifically declined to expand the list of enumerated products to include guaranteed investment contracts (GICs), synthetic GICs, funding agreements, structured settlements, deposit administration contracts, immediate participation guaranty contracts, industry loss warrants, and catastrophe bonds. According to the adopting release, these products should be considered in a facts and circumstances analysis.

GICs and synthetic GICs are common forms of "stable value contracts" (SVCs) as defined in Section 719(d) of the Dodd-Frank Act. The Commissions' pending study of SVCs will likely largely resolve the issue of whether these products are swaps. In connection with the study, the Commissions are required to determine whether SVCs fall within the definition of a swap. If they so determine, the Commissions must then determine whether an exemption for SVCs from the definition is appropriate and issue implementing regulations.

Dodd-Frank also provides that SVCs in effect prior to the effective date of the regulations shall not be considered swaps. Unfortunately, for other insurance products that do not fall within the safe harbor provisions, there may be far less legal certainty as to whether those products should be treated as insurance or Swaps.

Mutual Funds and Insurance Companies Eye "Major Swap Participant" Definition

It remains to be seen how the Commissions' definition will impact insurance companies

BY TOM LAUERMAN

In April, the CFTC and SEC (the Commissions) finalized rules defining what swap or security-based swap activities will cause a person or company to be a major swap participant or a swap dealer under Dodd-Frank. Mutual funds and insurance companies have been concerned primarily with the major swap participant definition, as the swap dealer definition would apply to such companies' activities only in exceptional circumstances.

In general, the final rules define a major swap participant by reference to the same complex quantitative tests that the Commissions proposed in late 2010. **Each mutual fund and insurance company will need to consider its use of derivatives in light of these final rules, as the Commissions declined to provide any blanket exemption from major swap participant (or a swap dealer) status for such companies' activities.**

However, a number of changes do reduce the possibility of major swap participant status—particularly for mutual funds and their advisers. For example, the adopting release for the final rules provides that swap positions of a client account generally will not be attributed to the adviser or manager of that account. Also, a swap will be attributed to a parent company, other affiliate or guarantor only if the counterparty would have recourse to such parent, affiliate or guarantor.

On the other hand, the Commissions rejected comments by insurance industry representatives and regulators that would have tailored the rules' tests to the unique circumstances of insurance companies in certain important respects. Although this may make it more difficult for some insurance companies, the adopting release still estimates that the total number of major swap participants under the CFTC's jurisdiction will be "six or fewer" and those under the SEC's jurisdiction will be "fewer than five and, in actuality, [perhaps] zero."

Fund Manager Fined For Favoring One Client Over Another

BY BEN SEESSEL

Scottish fund manager Martin Currie was fined $8.3 million by the SEC and $5.6 million by the U.K's Financial Services Authority for causing a U.S. publicly-traded advisory client, The China Fund, Inc. (China Fund), to make an unfavorable investment in bonds in order to prop-up another advisory client, the Martin Currie China Hedge Fund, a U.S. closed-end fund (Hedge Fund).

The Hedge Fund had purchased $10 million of illiquid bonds issued by Hong Kong-based Jackin International. The Hedge Fund got into trouble during the financial crisis when it faced an increase in redemption requests from investors, while, simultaneously, Jackin became unable to service the bonds. To alleviate the Hedge Fund's problem, Martin Currie steered the China Fund to invest $22.8 million in bonds issued by a Jackin subsidiary, $10 million of which was, in effect, used to redeem at par the bonds held by the Hedge Fund. The China Fund sold the bonds it had purchased from the Jackin subsidiary two years later for about an $11.5 million loss.

Helping one client at the expense of another, a no-no

According to the SEC, Martin Currie was aware of the conflict of interest and purported to cure it by seeking approval from the China Fund's board of directors. Martin Currie, however, neglected to disclose that the proceeds of the China Fund's investment would be used to redeem bonds held by another investment advisory client and other relevant facts. The SEC's Director of the Division of Enforcement stated that the sanctioned conduct "strikes at the heart of the fiduciary relationship between an investment adviser and its client" and issued the following warning:

> **"Advisers must treat each client with undivided and disinterested loyalty, and must make full and fair disclosure of all material conflicts of interest."**

Applying Janus One Year Later

BY GARY COHEN

Two principal questions have emerged as courts have endeavored to apply the U.S. Supreme Court's decision a year ago in *Janus Capital Group, Inc. v. First Derivative Traders,* which held that primary liability based on Rule 10b-5 under the Securities Exchange Act is limited to those with ultimate authority over alleged misstatements.

First, courts have struggled over the Court's holding that liability, in a *private* suit based on Rule 10b-5(b), falls on the "maker" of a defective statement – whom the Supreme Court identified as the person with ultimate authority over the statement. For example, can an individual officer or director, as distinguished from that person's company, be a "maker" of a statement and can there be more than one maker of the same statement? Courts have answered *Yes* to both questions. In one instance, a court found ultimate authority based on share ownership and in another fact situation a court did not.

Another significant question has been how the *Janus* holding applies to enforcement actions brought by the SEC. Although there is consensus that the holding applies to SEC actions brought under Rule 10b-5(b) based on "statements," **it is less certain that the SEC has latitude to bring suits based on so-called "scheme" or "course of conduct" liability under Rule 10b-5(a) and (c), respectively**.

An administrative law judge, quoting a 2011 decision in the Southern District of New York, has ruled that the SEC does *not* have that latitude "[w]here the primary purpose and effect of a purported scheme is to make a public misrepresentation or omission." But the SEC has refused to affirm that ruling without further consideration, explaining that "this is a case of first impression" that "raises important legal and policy issues."

Who Is a "Supervisor" After the Urban Case?

BY ANN FURMAN

A recent SEC case involving Theodore W. Urban underscores how difficult it can be to determine whether legal and compliance officers are also "supervisors" of business line-level employees.

The SEC issued an order instituting administrative proceedings against Urban in 2009, alleging that he ignored red flags and failed to supervise Stephen Glantz, a registered representative at Ferris, Baker Watts, Inc. (FBW). At the time of the alleged events, Urban was general counsel of FBW, where he headed the compliance, human resources, and internal audit departments. While Urban did not consider himself to be Glantz's supervisor, and this belief was supported by direct evidence, the SEC's chief ALJ found in 2010 that (i) Glantz engaged in securities law violations, (ii) Urban was Glantz's supervisor, and (iii) Urban "performed his responsibilities in a cautious, objective, thorough and reasonable manner." In reviewing the ALJ's decision earlier this year, however, three SEC Commissioners recused themselves without explanation and the remaining two could not agree. Under an SEC Rule of Practice that applies in these odd circumstances, the ALJ opinion has no effect.

Thus, although the SEC alleged, and the ALJ found, Urban to be a supervisor, the question remains completely unresolved. The case illustrates, however, what SEC Commissioner Gallagher, speaking at a recent conference, dubbed a "dangerous dilemma" where the Commission's position on supervisory responsibility for legal and compliance personnel may have the "perverse effect of increasing the risk of supervisory liability in direct proportion to the intensity of their engagement in legal and compliance activities."

Until the Commission provides further guidance, legal and compliance officers of broker-dealers and investment advisers may find themselves well served by reviewing current procedures. Taking steps to strengthen the firm's compliance and supervisory infrastructure, and its system to implement the firm's policies and procedures, should go a long way toward reducing future risk of failure-to-supervise liability for legal and compliance personnel.

This article draws upon the author's outline ("Clear as Mud: The Status of Legal and Compliance Officers as Supervisors After the Urban Case") presented at the ACLI Compliance and Legal Sections Annual Meeting on July 17, 2012, in Las Vegas.

FSOC Sheds Little Light on Systemic Risk Determinations

BY TOM LAUERMAN

The Financial Services Oversight Council (FSOC) has now spilled considerable ink describing the manner in which it will discharge its responsibility under Dodd-Frank to determine which non-bank financial companies present sufficient risk to the U.S. financial system that they should be subject to special Federal Reserve Board (Fed) regulation pursuant to Dodd-Frank. This could include some insurance companies, mutual funds, hedge funds, and investment managers.

Among other things, the FSOC in April of this year issued a rule and interpretive guidance outlining a multi-stage process in which the FSOC would generally give a company notice and opportunity to submit information bearing on whether it should be designated as being a systemically important financial institution (SIFI) and thus subject to Fed regulation. If the process goes far enough, the company also would have the right to a hearing (though not necessarily an in-person or oral hearing). In May the FSOC published additional procedures that will apply to the conduct of such hearings.

To be sure, the FSOC's guidance specifies certain quantitative standards and general considerations that will guide its decisions as to what companies to evaluate for SIFI status, as well as its ultimate determinations. However, it is not possible to know how the FSOC will apply these standards and considerations in particular cases. **Indeed, the FSOC has discretion to deviate even from the specific quantitative standards, if it considers that appropriate in light of Dodd-Frank's purposes.**

Accordingly, it seems that the actual parameters of SIFI regulation will emerge only slowly over time, through an arduous back-and-forth process between the FSOC and potential SIFIs that it identifies.

Variable Product Communications Rule QUIETLY Withdrawn

BY ANN FURMAN

Inquiring minds want to know: what was the problem with proposed FINRA Rule 2211 governing communications with the public about variable insurance products? Without warning or explanation, FINRA withdrew the proposed rule on April 27, 2012. Gone without a trace.

The disappearance of proposed rule 2211 is a mystery

FINRA introduced the proposed rule in Regulatory Notice 08-39 on July 28, 2008, in order to "modernize" the variable product guidelines set out in NASD Interpretive Material 2210-2. Following FINRA's submission to the SEC in October 2009, the SEC released the proposed rule for comment, but while it received comments, it never acted further. Now, mysteriously, FINRA has withdrawn the proposed rule and removed its administrative history from the FINRA website.

In its withdrawal filing with the SEC, FINRA provided no rationale for its action and gave no indication of its intent to re-propose FINRA Rule 2211. Instead, buried away in a footnote to FINRA Regulatory Notice 12-29 (addressing SEC-approved rules governing communications with the public), FINRA simply states that proposed FINRA Rule 2211 "will be the subject of a separate proposal."

Enter the Dodd-Frank Act of 2010. In particular, **Section 916 of Dodd-Frank, together with certain implementing rules that the SEC has adopted, establishes strict new time deadlines applicable to the SEC's publication, review, and approval/disapproval of proposed FINRA rule changes**. Any forthcoming proposal along the lines of FINRA Rule 2211 would be subject to these new time deadlines, which are intended to prevent proposals from being hung up without final action as in this case.

A Risk-Based Approach to Suitability Documentation

BY MARILYN SPONZO

Unlike its treatment of other suitability components, FINRA Rule 2111's general approach to suitability documentation does not include specific requirements. Rather, broker-dealers have been governed by their general obligation to evidence compliance with FINRA rules.

In its recent Regulatory Notice 12-25, however, FINRA articulates a risk-based approach to appropriately documenting suitability determinations. Under that approach, the basis for some recommendations does not require documentation, but the need for such documentation increases with the risk and complexity of the recommended security or investment strategy and an assessment of the customer's investment profile. Previous FINRA pronouncements have provided considerable guidance on complex and potentially risky securities products, many of which are identified in an extensive footnote to the Notice.

Supplementary information to the Rule also makes clear that, despite the absence of a purchase or sale, an explicit recommendation to hold securities is an investment strategy subject to a suitability determination. The Notice states that, **in evaluating the appropriateness of documentation of a hold recommendation, broker-dealers "may want to focus on," among other things, factors that make the security in question risky to hold for more than a short period of time**—such as particular susceptibility to changes in market conditions or periodic reset or similar mechanisms that could alter the investment's character over time.

The Notice acknowledges that many methods may be used to document hold recommendations. It refers, for example, to the possibility of creating "hold" tickets (or adding a hold field to existing order ticket forms), narrative explanations, or additional data fields in automated supervisory systems.

Commodity Pool Operator Rule Under Fire

BY JOAN E. BOROS

The Investment Company Institute and the U.S. Chamber of Commerce have joined together as plaintiffs to challenge recent changes the CFTC made to its Rule 4.5, which specifies limits in commodity interest holdings by mutual or exchange traded funds. If a mutual fund or an ETF maintains holdings in excess of those limits, the fund's adviser must register as a commodity pool operator.

In briefing on summary judgment pleadings filed this spring and summer in District of Columbia federal court, plaintiffs assert that the CFTC:

- acted arbitrarily and capriciously under the Administrative Procedure Act (APA) and the Commodity Exchange Act (CEA);
- failed to make the kind of cost-benefit analysis required by the CEA; and
- failed to adequately explain the CFTC's change of position reflected in the rule amendment.

Plaintiffs rely largely on a District of Columbia Circuit Court of Appeals opinion that, in 2010, vacated the SEC's former Rule 151A (concerning index annuities). Although plaintiffs believe that the CEA requires a cost-benefit analysis comparable to what the DC Circuit required of the SEC, the CFTC is arguing for somewhat different considerations and analysis. In addition, the CFTC contends that its initiative to "harmonize" the duplicative and conflicting securities law and commodities law compliance obligations applicable to SEC/CFTC dually-regulated funds is addressing cost-benefit issues and that any challenge to that initiative is not yet ripe.

According to the CFTC, Congress, through Dodd-Frank, charged the CFTC "with the task of illuminating previously dark markets in the complex derivative instruments at the heart of the crisis known as 'swaps'." It cites Dodd-Frank's more general objective of controlling "systemic" risks as justification for its amendment of Rule 4.5. Plaintiffs counter that nothing in Dodd-Frank abrogates the CFTC's obligations under the APA and CEA and that investment companies are not the source of the core systemic risks.

An ultimate victory by the CFTC concerning its Rule 4.5 amendment could assuage any dismay that, as recently reported, former MF Global Holdings Ltd. Chairman and Chief Executive Jon S. Corzine was the only senior official registered with the CFTC, which makes any CFTC action against other executives more difficult. The ICI included its objection to the CFTC changes to Rule 4.5 in recent testimony on Dodd-Frank to the Capital Markets Subcommittee of the House Financial Services Committee.

Tippee Liability for Confidential Government Information

BY SCOTT SHINE

The Stop Trading on Congressional Knowledge Act of 2012 (STOCK Act), which was signed into law on April 4, 2012, makes clear that members and employees of Congress, as well as other officials and employees of the executive and judicial branches of the federal government, are subject to insider trading prohibitions arising under Rule 10b-5.

Among other things, the STOCK Act imposes a duty of trust and confidence on all of these governmental persons with respect to material, nonpublic information derived from their positions or gained from the performance of their official responsibilities. Accordingly, these governmental persons may be liable if they trade on the basis of any such information.

It is important to note an additional risk: any person in the private sector who trades on information learned from persons in the federal government will be exposed to "tippee liability" under Rule 10b-5. Tippee liability can be imposed on recipients of material non-public information who engage in securities trading based on that information despite their knowledge that it was improperly disclosed by the tipper.

Therefore, companies, trade associations, lobbyists, and others who interact with persons in the federal government should exercise care, and consider adopting procedures to control the risk of tippee liability. Although both the application of the STOCK Act to the private sector and the scope of tippee liability are still unsettled, **the STOCK Act has the potential to significantly increase the risk of serious legal consequences for trading on information learned from persons in the federal government**.

New at The Consumer Financial Protection Bureau

BY ELIZABETH BOHN

CFPB publishes Consumer Complaint Data

The CFPB accepts consumer complaints about credit cards, mortgages, and other financial products, forwards them to the companies involved for response, makes the responses available to the consumer through a secure web portal, and where it deems it appropriate to do so, may refer complaints to the applicable regulatory agency.

On June 19, 2012, the Bureau published a snap shot of consumer complaints received between July 21, 2011 and June 1, 2012. According to the snapshot, the most common consumer complaints were:

- **Mortgages:** Problems when consumers were unable to pay mortgages, including issues related to loan modifications, collection, or foreclosure.
- **Credit Cards:** Billing disputes, with customers reporting confusion with the process and limitations on challenging inaccuracies on monthly statements, and complaints about APR and interest rates.
- **Other bank products and services:** Related to opening, closing, or managing the account, including confusing marketing, denial, fees, and statements. Other common complaints related to deposit and withdrawal issues such as transaction holds, unauthorized transactions, bounced checks, and overdraft and late fees.

A detailed data base of all credit card complaints collected by the CFPB, including the type of complaint, the name of the card issuer, whether the issuer responded, and how the complaint was resolved is also now publicly accessible on its website.

New Mortgage Rules Proposed

On July 9, 2012, the CFPB proposed and requested comment on a new rule providing for revised Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (Reg X) and the Truth In Lending Act (Reg Z).

The proposed rule would amend Reg X and Reg Z by establishing new requirements and disclosures and combining them with existing requirements for most consumer credit transactions secured by real property. The proposed rule also provides for two new forms, the "Loan Estimate Form" and "Closing Disclosure Form."

The new "Loan Estimate Form" would replace the existing RESPA "Good Faith Estimate" form, as well as the "early" TILA disclosure designed by the Federal Reserve Board, and incorporates new disclosures required by The Dodd-Frank Act. The "Closing Disclosure Form" would replace the current HUD-1, and also contains additional disclosures required by Dodd-Frank.

Final Rule Issued on Protecting Privilege

On July 5, 2012, the CFPB issued its final rule relating to the confidential treatment of information. The Bureau has authority to supervise and examine insured depository institutions and credit unions with assets of more than $10 billion as well as their affiliates and service providers, to assess their compliance with Federal consumer financial law, obtain information about their activities subject to such laws and their associated compliance systems or procedures, and to detect and assess risks to consumers and to markets for consumer financial products and services.

The rule is intended to ensure that disclosure of confidential privileged information to the Bureau in the course of its supervisory or regulatory processes, or by the Bureau's exchange of privileged information with another Federal or State agency will not waive or otherwise affect any privilege that may be claimed by the person submitting the information with respect to such information under Federal or State law as to any other person or entity. It also provides that the Bureau's provision of privileged information to another Federal or State agency will not waive any applicable privilege, whether the privilege belongs to the Bureau or any other person.

MARKYOURCALENDAR

The ABA TIPS Midwinter Symposium on Life, Health, Disability and ERISA will be held January 17-19, 2013 in Fort Lauderdale, Florida. Washington Associate, **Robin Sanders** is the Program Chair. For more information and to register, visit *www.americanbar.org/tips*.

Pennsylvania Court Says Consumer May Not Revoke Consent to Call Cell Phone After Formation Of Contract

BY ELIZABETH BOHN

The Telephone Consumer Protection Act (TCPA) restricts the use of automated telephone dialing systems (ATDS) and prerecorded messages (PM) when calling consumers, prohibiting the use, without the consumer's prior express written consent, of an ATDS or PM when calling consumer cell phones. The FCC has exclusive rule-making authority for the TCPA.

Imposing strict liability for violations and permitting recovery of statutory penalties from $500 (non-willful) to $1,500 (willful) per violation/call along with attorneys' fees in individual and class actions, the TCPA drives numerous claims against businesses which use ATDS or PM technology to call consumers.

If the consumer provides the cell phone number to the creditor, in a credit application, for example, the FCC has ruled that this constitutes express consent to be contacted at the cell number with respect to the debt. As stated in one of its key rulings on the issue, "persons who knowingly release their phone numbers have in effect given their invitation or permission to be called at the number which they have given, *absent instructions to the contrary*."

The TCPA does not state, nor has the FCC ruled on whether express consent may be revoked, and if so, how. Thus, courts have interpreted the "absent instructions to the contrary" to mean that the consumer may revoke express consent after the fact, in writing (in Texas, New York, and Florida), or orally (in California).

However, in *Gager v Dell Computer*, a decision issued in May, a Pennsylvania court held that a consumer's letter requesting a lender to cease and desist calling did not suffice to revoke the consumer's prior express consent to call the cell phone, because the revocation was not made at the time the debtor initially released his phone number in connection with the credit contract.

In granting a motion to dismiss the TCPA claim alleging calls to a cell phone without consent, the Court interpreted the FCC's rulings referencing consent given during the formation of contract absent "instructions to the contrary," as meaning that such instructions (to the contrary) must be provided at the time a person "knowingly release[s]" her telephone number. **The Court stated that it could find no basis in the FCC Rulings or in the TCPA for permitting post-formation revocation of consent, and, distinguished the existing cases permitting written revocation of prior express consent as not addressing when revocation must take place, but only the manner of revocation (written or oral).**

Although not binding in other courts, the *Gager* decision provides a logical argument that a consumer who provides a lender with his phone number at the outset of a lending relationship should not be able to revoke consent to be contacted at that number as long the loan is unpaid and outstanding.

11th Circuit Ruling Severs Fee Shifting Provision

BY ELIZABETH BOHN

We previously reported the Eleventh Circuit Court of Appeal's ruling in *Buffington v. SunTrust Banks* (*In Re Checking Account Overdraft MDL*), requiring SunTrust Bank account holders to arbitrate claims for excessive overdraft fees under an arbitration provision in a depositor agreement (Expect Focus, Vol. II, Spring 2012). The *Buffington* complaint, typical of such claims in the multidistrict Checking Account Overdraft Litigation, alleged that SunTrust breached its contract, converted funds, and was unjustly enriched in assessing overdraft fees and processing account transactions so as to maximize overdraft charges.

The district court denied SunTrust's motion to compel arbitration based on a finding that the arbitration clause was substantively unconscionable because its provisions granting SunTrust the right to recover its arbitration expenses disproportionately allocated the risks of loss in the dispute to the Plaintiffs. On appeal, the Eleventh Circuit reversed, finding the clause neither procedurally nor substantively unconscionable (under Georgia law); thus **the bank was entitled to arbitration as provided in its agreement under the Federal Arbitration Act (FAA), and the Supreme Court's 2011 decision in *AT&T v. Concepion*.**

In another Checking Account Overdraft MDL decision issued July 6th, the Eleventh Circuit again reversed the district court's denial of arbitration based on a finding that a fee-shifting provision in the agreement was unconscionable. This time, however, the Court agreed that the provision *was* unconscionable, but invalidated and severed it in order to enforce the arbitration agreement.

In reaching its decision in *Barras v. Branch Banking and Trust*, the Court found the one-way fee and cost shifting provision to be unconscionable under South Carolina law and broad enough to apply to costs arising from arbitration. It also found that the Bank had waived the right to have the arbitrator determine unconsionability by litigating the issue for over a year without raising that argument until after the district court's adverse decision.

Because the the cost-and-fee-shifting provision was not contained in or referred to in the arbitration provisions, which incorporated American Arbitration Association (AAA) rules, and because those rules operated independently, the Court found the arbitration agreement would not be impaired by invalidating the cost-and-fee-shifting provision.

ARBITRATION ROUNDUP

BY LANDON CLAYMAN

Two recent decisions with an international flavor: First, *Consorcio Ecuatoriano de Telecomunicaciones, S.A. v. JAS Forwarding (USA), Inc.*: a party to a pending arbitration in Ecuador filed an application in federal district court under 28 U.S.C. § 1782 seeking discovery for use in the foreign arbitration proceeding. The U.S. Court of Appeals for the Eleventh Circuit affirmed the district court's order permitting the discovery, holding that the Ecuadorean arbitration was a "proceeding in a foreign or international tribunal" under § 1782 because it acts as a first-instance adjudicative decisionmaker, it permits the gathering and submission of evidence, it has the authority to determine liability and impose penalties, and its decision is subject to judicial review.

Second, *ESAB Group, Inc. v. Zurich Insurance PLC*: a foreign insurance company issued global liability policies that provided coverage to a South Carolina manufacturer. The policies contained provisions requiring the resolution of disputes in Swedish arbitral proceedings in accordance with Swedish law. South Carolina has a statute that invalidates arbitration agreements in insurance policies. The insurer argued that the arbitration agreements were valid and enforceable under Chapter 2 of the Federal Arbitration Act, which enacts the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The manufacturer argued that pursuant to the McCarran-Ferguson Act, Chapter 2 of the FAA is "reverse-preempted," and the arbitration agreements were invalid under South Carolina law. The U.S. Court of Appeals for the Fourth Circuit held that because McCarran-Ferguson is limited to domestic affairs, Chapter 2 of the FAA falls outside of its scope, and it affirmed the order compelling arbitration in Sweden.

U.S. Businesses Beware: Canada's Anti-Spam Law To Impose New Obligations, Expand Potential Liability

BY JOHN HERRINGTON

Canada's Anti-Spam Law (CASL), passed as Bill C-28 in December 2010, establishes new requirements for any party using electronic messaging for marketing in Canada. Specifically, CASL prohibits marketers from sending unsolicited commercial electronic messages—including text messages and messages sent via social media—to or from Canada unless the sender has obtained either explicit or implied consent from the intended recipients. The implementation and enforcement regulations promulgated pursuant to CASL were adopted in March 2012 and are scheduled to become effective at some point in early 2013 (the date has not yet been specified).

In 2003, the United States passed its own equivalent anti-spam law, the CAN-SPAM Act, which, thus far, has established the existing accepted industry practices for U.S. marketers. The CASL is tougher and more expansive than the CAN-SPAM Act. For instance:

CASL	CAN-SPAM Act
CASL dictates that recipients must first "opt-in" before receiving messages.	The CAN-SPAM Act requires marketers to provide recipients an opportunity to "opt out" of receiving future commercial electronic messages.
The maximum penalty for a CASL violation is $1,000,000 CDN per violation for an individual offender and $10,000,000 CDN per violation for a corporation.	The maximum penalty for a CAN-SPAM Act violation is $16,000 USD per violation.
CASL allows for a private right of action seeking statutory and punitive damages.	The CAN-SPAM Act does not provide an individual private right of action.

To stave off potentially crippling fines, companies that send commercial electronic messages to Canada or from Canada are well-advised to revisit their on-line marketing programs and policies to ensure CASL compliance.

ICANN Reveals the Applied-For Generic Top Level Domain Names

BY MICHAEL KENTOFF

Calling June 13, 2012 "New gTLD Reveal Day," the Internet Corporation for Assigned Names and Numbers (ICANN) posted the listing of the submitted generic top-level domain (gTLD) applications, revealing 1,930 applications by 1,155 applicants seeking 1,409 different new generic top level domains (gTLDs). Some of the more popular gTLDs – such as .insurance, .bank, .blog, or .app. – have multiple applicants and competition promises to be fierce.

As discussed in the prior Expect Focus article, "Will Your Company Participate in the Expanded Generic Top-Level Domain Registration Program?" (Summer 2011), the new gTLD program presents potential trademark and security concerns. A careful review of the entire application list is therefore warranted by any business concerned that some proposed gTLD names might violate their legal rights. How companies identifying objectionable applications choose to proceed will require an understanding of the protective procedures put in place by ICANN.

"New gTLD Reveal Day" triggered a 60-day comment and 7-month objection period. The available objections fall into the following groups: (1) there is "string" confusion with another gTLD; (2) the proposed gTLD violates the legal rights of another; (3) the proposed gTLD is of limited public interest (a morality and public order objection); and (4) the non-applicant community represented by the gTLD has objections to the proposed gTLD. **While comments during the 60-day period provided by ICANN are free, filing a formal objection, which is adjudicated by arbitration, may cost anywhere from a few thousand to tens of thousands of dollars, depending on whether the objection reaches a hearing.**

NLRB Offers "Guidance" On Social Media Policies

BY MICHAEL PETRIE

The National Labor Relations Board has taken a lead role in defining the boundaries of appropriate social media policies. In August 2011, and again in January 2012, the Board's Office of General Counsel issued reports analyzing NLRB cases arising in the context of employer policies governing employee use of social media. These reports send the message to employers (union and non-union alike) that the Board will not hesitate to find unlawful those policies that infringe upon employees' rights to engage in protected concerted activity regarding wages, terms and conditions of employment, as guaranteed by Section 7 of the National Labor Relations Act. An employer's policy can run afoul of the Act if it either *explicitly* restricts protected concerted activity, or if an employee would reasonably construe the policy as prohibiting protected concerted activity.

The prevailing theme in the first two reports has been that many employer social media policies are over broad because they fail to contain limiting language that explicitly permits employees to engage in protected activity. On May 30, 2012, the Board issued a third report containing six new case examples of policies found to be unlawful, and one policy found lawful, which the Board suggests will provide employers with "guidance" on how to craft appropriate and lawful social media policies. The Board's advice to employers: work rules must not be ambiguous as to their application to Section 7 protected activity, and policies should contain limiting language or adequate context to clarify to employees that the policy does not restrict Section 7 rights. **When possible, policies should be clarified as to their limited scope by including examples of clearly illegal conduct or unprotected conduct such that they could not reasonably be construed as applying to Section 7 activity.** Although the Board's guidance appears like common sense, a review of the results in the case examples suggests that the Board's standard is overly strict. As yet, no court has approved the Board's interpretations. Nevertheless, employers should review their social media policies and, if necessary, update them with language that explicitly informs employees that their Section 7 rights are not restricted.

CONGRATULATIONS!

Jorden Burt is pleased to announce that **Sonia Escobio O'Donnell**, Partner in the Miami office, has been appointed to the American Bar Association 2012-2013 Section of Litigation Leadership as Co-Chair of the Appellate Practice Committee.

Anthony Cicchetti, Partner in the Connecticut office, has received certifications from LawVision Group for having completed training programs in "Legal Project Management: What Every Lawyer Needs to Know" and "Legal Project Management Skills Training."

Robin Sanders, Associate in the Washington office, has been appointed Chair of the American Bar Association Tort Trial and Insurance Practice Section's Life Insurance Law Committee for 2012-2013.

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JORDEN BURT

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