EXPECT FOCUS®

LEGAL ISSUES & DEVELOPMENTS FROM JORDEN BURT LLP

VOLUME I WINTER 2013

In This Issue:

- NEW P&C MARKETING CONCERNS
- PERFECT STORM FOR MMFS
- NAIC'S ANNUITY PLAYBOOK
- STOLI LITIGATION LESSONS

25 Years: Fighting the Good Fight

JORDEN BURT LLP

25TH ANNIVERSARY

EXPECTFOCUS® VOL. I WINTER 2013

EXPECTFOCUS® 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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Editor
Michael Kentoff

Production Editor
Lauriell Webb

Graphics and Design
Frances Liebold

Industry Group Editors

Life Insurance
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Advisory Board
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Rollie Goss
Jason Kairalla
Markham Leventhal
Ben Seessel
Dawn Williams

Subscriptions

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

Lauriell Webb
lwe@jordenusa.com

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IN THE SPOTLIGHT

A Note from the Managing Partner

We are celebrating Jorden Burt's 25th year and the editors of *Expect Focus* have asked me to write a short piece for this Silver Anniversary edition. This inside cover space has always been reserved for an analysis of key legal developments relating to the financial services industry. But, given the occasion, I am asserting my prerogative to write instead about the Jorden Burt law firm as an institution and share what I believe is an intrinsic characteristic of our culture and our practice. One that I know has contributed substantially to our success over these 25 years. Understandably you may choose to stop reading at this point. I do hope you don't.

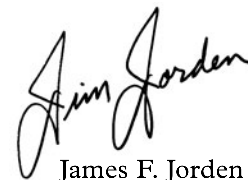
I am an amateur student of Aristotle. (Now I know you really want to stop reading, but there is a point here.) He believed "totum bonum" or ultimate happiness was the goal of life. That goal, according to Aristotle, could only be achieved through conduct reflecting justice, temperance and moral virtue. But none of these elements could be gained without courage. He wrote that courage "is the first of human qualities because it is the quality which guarantees the others." C.S. Lewis said it this way: "Courage is not simply one of the virtues, but the form of every virtue at the testing point."

In the early years of our firm's development (when I had a good deal more free time), I gave annual lectures to our newest lawyers about Jorden Burt – especially, its vision and core values. When I persisted in my references to courage during those lectures, I know that some of our lawyers thought, given my tour in Vietnam, that I was obsessed with the proper use of napalm and firepower (which, metaphorically, I would note, does have its place).

My point? You ask.

Well, this: I believe the Jorden Burt partners have from the get-go appreciated that the truly successful law firm institutions in this country are those in which the partners exhibit courage. We are not talking about bravery here, but rather the courage to engage in teamwork, when selfishly you would prefer to go at it alone; the courage to tamp down impatience and engage in helpful advice to both staff and newer attorneys; the courage to learn from both success and failure; the courage to give clients the right advice, when you know they are not going to like it; to deal fairly with your partners and your associates in accepting responsibility for problems and in allocating credit for success; to have grace and perseverance in the difficult task; the courage to insist on selfless cooperation from every attorney, regardless of their seniority or perceived importance; and finally the courage to believe in the importance of communicating and sharing as a partner in a law firm. At Jorden Burt, I believe our partners have conducted themselves, mostly, if not always, in a manner that demonstrates that kind of courage.

We also realize that this successful 25-year journey would not have occurred without the courage and loyalty of Jorden Burt's clients, with whom we have cultivated and enjoyed a true partnership over years of triumphs, challenges and growth. We have consistently been entrusted with significant and challenging matters by our clients and we are grateful for, and appreciative of, these opportunities. Thank you all very much (and thank you for reading this).



James F. Jorden

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Insurers Seek to Tame a Volatile Environment

BY TOM LAUERMAN

In the aftermath of the 2008 financial crisis, variable annuity issuers have adapted to the mercurial financial environment by providing updated and innovative products to customers seeking asset appreciation and income protection.

Responses to historically low interest rates and volatile equity markets have also been designed to maintain insurers' financial strength, consistent with prudent management of risks, in order to assure the benefits that insurers guarantee to all their contract holders.

Consistent with these objectives, insurers have suspended further sales of certain contracts or benefits. This has included popular benefits such as those providing for guaranteed minimum withdrawal (or income) amounts, enhanced death benefits, and guaranteed minimum accumulation values. Insurers also have modified charge rates, crediting rates, and withdrawal rates under such benefits. Some insurers have restricted use of fixed account options that guarantee high interest rates relative to the current environment.

Product Design Developments

Product revisions have included a wide variety of changes in the investment programs of the funds that are available to support certain variable annuity contract benefits, as well as adding and deleting funds. Also, new contracts have been developed that automatically revise customers' investment allocations according to a stated formlula if specified performance triggers are hit. In revising the investment options that support guaranteed minimum benefit features, insurers frequently aim to manage market volatility in ways that will attract and retain customers.

Other features added to new contract designs in recognition of the current environment have included:

- increased flexibility for the insurer to modify charge rates, crediting rates, and withdrawal rates during the life of the contract; and
- withdrawal rates that vary during the life of the contract, based on fluctuations in an index.

> It is prudent for insurers to ensure that new contract forms they develop, as well as relevant prospectus disclosures, provide the intended degree of flexibility.

Some insurers are placing more emphasis on products under which the customer is credited with a return based on the performance of an index, rather than the performance of any underlying fund. The details can vary widely. For example, the insurer may set limits on how much positive or negative index performance will be credited to the contract. The insurer can provide significant investment guarantees to the customer under these indexed arrangements, while at the same time managing its risks more precisely than would be practical for some benefits under more conventional variable or fixed annuity contracts.

In recent public remarks, Norm Champ, the Director of the SEC's Division of Investment Management, referred to the fact that several insurers have stopped accepting additional premium payments under outstanding variable

annuity contracts. It is prudent for insurers to ensure that new contract forms that they develop, as well as relevant prospectus disclosure, provide the intended degree of flexibility to make these and other changes.

Exchange and Buy-Out Offers

Some insurers have offered to pay or credit specific dollar amounts to customers who are then participating in certain guaranteed minimum benefit features but who agree to surrender or exchange their variable annuity contracts or to terminate a specific feature. Such buy-out offers, and other exchange offers, provide customers with additional alternatives that may be advantageous to them and that they may find attractive, given their current circumstances and current market conditions. At the same time, such transactions may help the insurer to maintain a strong financial position and a secure ability to pay benefits.

Such offers raise numerous potential issues. For example, FINRA suitability requirements apply in most cases where a broker-dealer recommends a surrender, exchange, or other strategy in connection with a variable annuity. Suitability determinations in connection with exchange and buy-out offers can be complex because, in addition to other relevant factors, they may entail an assessment of the potential value to the customer of any applicable guaranteed minimum benefit features under the customer's existing contract in light of the current values under that contract.

Director Champ stated in recent public remarks that **exchanges "raise questions" not only about the suitability of the exchange, but also about the original transaction "where the original transaction was perhaps premised on the value and importance of the living benefits and the exchange removes or reduces those same benefits."** In this regard, Director Champ gave the following advice to insurers with respect to current sales of new contracts:

> **Going forward, the Division urges you to keep in mind steps you may have to take in the future to limit your risk, think through how this affects your customers, and consider how you can make your customers aware of the risks they may face with the product you are selling them.**

In planning an exchange or buy-out offer, other relevant considerations may include:

- SEC requirements for prospectus disclosure and regulation of the terms of certain exchange offers under the Investment Company Act of 1940;
- various provisions of state law, including specific disclosure and "free-look" requirements that apply to certain exchanges; and
- tax considerations, including compliance with applicable Internal Revenue Code requirements where an exchange is intended to be tax free.

LIFE INSURANCE

Alabama to Help Locate Deceased Insureds

BY ANTHONY CICCHETTI

The Alabama Department of Insurance has issued Bulletin No. 2012-11 (dated October 23, 2012) announcing implementation of a search service to assist people in determining the existence of, and possible beneficiary status under, life insurance and annuity contracts having a death benefit issued to Alabama residents. This service contemplates beneficiaries, executors, and representatives of deceased individuals submitting search request forms to the Alabama Department of Insurance.

The Department intends to make lists of such request forms available on a monthly basis, through a secure web site link, to individuals appointed as "Policy Search Coordinators" by Alabama licensed life/annuity insurance companies. **The companies would then be required to search their in-force and terminated policy databases for matches. If a match is found, the company would follow its standard procedure for contacting the beneficiary.** The company also would be required to electronically report each match to the Alabama Department of Insurance on a specified form.

A letter of instruction providing guidance as to what companies must do to participate in the search service and an example of how the service will work is posted on the Department's website at *http://www.aldoi.gov/Companies/LifePolicySearch.aspx*. Both the Bulletin and the letter of instruction required companies to establish an account and designate their Policy Search Coordinators by December 31, 2012.

Duty of Care to Turn on Consumers' "Reasonable Expectations"

BY ANN BLACK & SCOTT SHINE

2013 will see changes to the duty of care owed by those who provide financial or investment advice or provide financial products to consumers. It appears that multiple regulators will use the expectation of the consumer in considering who owes a duty of care and the extent of the duty of care owed in providing financial or investment advice to consumers.

Phyllis Borzi, Assistant Secretary for the Department of Labor's (DOL's) Employee Benefits Security Administration, announced that in the first part of 2013, the DOL will issue a reproposal of its rule defining who is a fiduciary. The reproposal will follow the DOL's 2010 attempt to expand the definition of an ERISA fiduciary, which was withdrawn after it was met with considerable criticism. Assistant Secretary Borzi asserted that "people who hold themselves out as experts are accountable" and must "exercise the standard of care that consumers think they are getting and deserve to get." **The advice offered must be "unbiased" and it "has to be directed [to the consumer] and [the consumer's] best interest."**

In its Fiscal Year 2012 Agency Financial Report, the Securities and Exchange Commission (the SEC) reported that it expects to move forward with recommendations from an SEC staff report to consider a uniform fiduciary standard of conduct for investment advisers and broker-dealers when providing personalized investment advice to retail investors. This recommendation was based upon the finding that "retail customers do not understand and are confused by … the standards of care applicable to investment advisers and broker-dealers when providing personalized investment advice and recommendations about securities." **The report states that investors "have a reasonable expectation that the advice that they are receiving is in their best interest."**

Under Section 1031(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the DFA), the Consumer Financial Protection Bureau (the CFPB) has the authority to declare an act or practice as **abusive if the act or practice takes unreasonable advantage of "the reasonable reliance by the consumer on a covered person to act in the interest of the consumer."**

The CFPB was granted jurisdiction over non-securities licensed persons providing financial advisory services to consumers on individual financial matters or relating to certain proprietary financial products or services. The DFA left it to the CFPB to further define what is abusive, and several commentators have asserted that the CFPB will impose a heightened duty on the non-securities licensed persons providing financial advisory services.

STOLI Litigation: Dare To Be Different

BY DAWN WILLIAMS

Remember: it's OK to think outside of the box. The distinctive fact patterns of two recent cases demonstrate the benefits of imaginative, resourceful lawyering in any STOLI dispute.

The Central District of California recently denied motions to dismiss brought by in-house counsel for a company that had sought to obtain STOLI policies in *American General Life Insurance Co. v. Munshi*. Counsels' involvement was to write the premium checks to the insurer, allegedly to give the impression that the funds were being paid by the company when in fact the transaction was being financed by a third party. The court found that the insurer had sufficiently alleged that the attorneys' actions constituted misrepresentations and were in furtherance of a conspiracy. Lesson: be broad and creative when considering what to allege and what parties to include in STOLI suits.

Dukes Bridge LLC v. Beinhocker demonstrates the benefits of locating potential rifts in the relationships between STOLI conspirators – an insurer is more likely to achieve a favorable outcome if it faces a fractured opposition. In *Dukes Bridge*, two business partners decided to purchase a STOLI policy, hoping to obtain much-needed capital for their business through selling the policy at a later date.

The partners established a trust and obtained premium financing, and as part of the financing agreement, agreed with the trustee that they would do nothing to encumber the policy or to cause it to lapse. The two later became concerned that they would not be able to make money on the deal, so, without the trustee's consent, they took a loan on the policy with the express intent of causing it to lapse, which it did. The premium financer secured summary judgment in its favor in Massachusetts federal district court on its claims against the two partners for breach of contract and breach of fiduciary duty.

Lesson: Be broad and creative when considering what to allege and what parties to include

NAIC Continues Inquiry Into Use of Captives

BY ROLLIE GOSS

When the NAIC Executive Committee charged the Financial Condition (E) Committee with studying insurers' use of captives and special purpose vehicles in November 2011, a subgroup was formed. This subgroup issued a survey to state insurance regulators with respect to commercial insurers domiciled in their respective states that transfer risk to captives or SPVs, seeking comment on various issues, including the basics of each state's laws impacting captives or SPVs, the types of products permitted to be transferred, the business purpose behind such transfers, solvency standards, credit for reinsurance, and other topics designed to provide perspective on the general legal and business environment surrounding the use of captives and SPVs.

Recognizing that captives may present different considerations than other insurers, and that there is a lack of consensus among subgroup members on some issues, the resulting White Paper recommends, inter alia, that: (1) captives not be used by insurers to avoid statutory accounting rules; (2) the use of captives or SPVs to shift risk to the capital markets or to provide alternative forms of business financing be supported; (3) consideration be given to updating SPV Model #789 in light of current securitization solutions; (4) support be given to the IAIS's guidance paper on the regulation and supervision of captives; (5) consideration be given to modifying credit for reinsurance Model #785 to address issues applicable to captives; and (6) there be further study of issues relating to confidentiality and commercially owned captives and SPVs.

At the NAIC Fall Meeting on December 2, 2012, a proposal was adopted to change to principled-based reserving for certain insurance products. **This change may have an impact on some of the captive reserving issues, but the scope of its impact is unclear** due to complex accounting issues and the time frame for state adoption efforts and guidance formulation regarding the reserve rule changes.

LIFE INSURANCE

Global "Modernization" Strolls Ahead

BY ROLLIE GOSS

The global "modernization" of the regulation of financial services companies continues to move forward – in something of a strolling gait. At the national level, the Federal Insurance Office still has not released the report assessing the state of regulation of the insurance industry that was due last January, and also failed to release a similar study of the reinsurance industry that was due in September. There continues to be deliberation, but no decision, as to whether stable value contracts should be regulated as swaps. **The NAIC adopted an ORSA (Own Risk and Solvency Assessment) Model in September, issued a guidance manual and conducted an initial testing of the reporting requirements of that new Model with selected companies.**

On a broader stage, the EU has again delayed the implementation of its Solvency II initiative, now set to take effect in January 2014. The International Association of Insurance Supervisors recently received comments on a draft document setting forth proposed policy measures for globally systematically important insurers, and along with its comparable banking and securities supervisory organizations released a document setting forth high level regulatory principles for global financial conglomerates.

Likely in response to the increased collective regulatory activity, 31 insurance trade associations representing 87% of the worldwide insurance business have formed a new trade association, the Global Federation of Insurance Associations. This new group counts as its members various national and international trade associations for life, health and property and casualty insurance and reinsurance, including the AIA, PCI, ACLI, AHIP and RAA.

Scribner, Hall & Thompson, LLP

Information Reporting of Interest Payments to Nonresident Aliens– The Final Word?

BY JANEL C. FRANK

The IRS is not backing down this time. According to final regulations (T.D. 9584) issued in April, payments of interest made to most nonresident aliens on U.S. deposits, on or after January 1, 2013, is subject to information reporting. This includes interest payments on some deposits maintained by insurance companies. Under section 6049 of the Internal Revenue Code, an information return must be filed with the IRS when the aggregate amount of interest paid to a single payee exceeds $10 in the aggregate in a calendar year. Interest payments to nonresident aliens (except residents of Canada) have been exempt from reporting because such payments are not taxed in the U.S. In 2001, however, the IRS issued proposed regulations (REG-126100-00) that would require reporting to the IRS for interest payments to nonresident aliens. After considerable public outcry, the IRS issued new proposed regulations (REG-133254-02, the 2002 regulations) that limited reporting to residents of fifteen designated countries. In 2011, the IRS issued a third set of proposed regulations (REG-146097-09, the 2011 regulations) that again would require reporting to the IRS for interest payments to all nonresident aliens. Although the IRS appears to concede some ground in the final regulations, the concession is illusory. Under the final regulations, information reporting to the IRS is required for interest payments to nonresident aliens who are residents of countries that have an information exchange agreement with the U.S. There are currently 78 countries that satisfy this requirement, and the number is expected to grow. What is perhaps unusual is that information regarding nonresident alien interest payments is not being sought by the IRS to further tax compliance (because this income is not subject to U.S. tax). Rather, the IRS wants this information for use as a quid pro quo for other countries to enter into information exchange agreements with the U.S. to further its offshore tax compliance programs, such as the Foreign Account Tax Compliance Act (FATCA).

NAIC Reveals Annuity Products Game Plan for 2013

BY ANN BLACK

Several NAIC working groups are set to tackle a host of issues impacting annuity products in 2013. These initiatives reflect the importance that annuities are playing in consumers' retirement playbooks and industry's innovations to provide guaranteed retirement income products to consumers.

Iowa First Deputy Commissioner Jim Mumford continues to quarterback the Annuity Disclosure (A) Working Group (the Annuity Disclosure WG). The Annuity Disclosure WG presented a draft annuity buyer's guide at the Fall National Meeting and requested comments by January 2, 2013. The buyer's guide was redrafted by consumer representatives with comments by industry. The Annuity Disclosure WG anticipates adopting the annuity buyer's guide before the Spring 2013 National Meeting.

Deputy Commissioner Mumford is also quarterbacking the new ERISA Retirement Income (A) Working Group (ERISA Retirement Income WG). It has been tasked with working with the White House Council of Economic Advisors (CEA), Department of Labor (DOL) and other federal agencies, in coordination with the NAIC Government Relations (EX) Leadership Council, to consider possible options to facilitate the use of annuities within defined contribution plans. **During its first huddle on December 1st, the ERISA Retirement Income WG discussed requests by CEA and DOL for additional information about the regulation of annuity providers, the providers' financial soundness, and guaranty fund protection.** In addition, it heard employers' concerns about reliance on the DOL safe harbor in selecting annuity providers and products. In 2013, the ERISA Retirement Income WG will continue to obtain information on these issues and drafting groups within and outside the NAIC to assist it in resolving the issues.

At the 2012 Fall Meeting, the Contingent Deferred Annuity (A) Working Group (the CDA WG) reviewed three different regulatory proposals for CDAs, as follows:

- CDAs should be regulated as variable annuities for purposes of market regulation and consumer protection.
- The appropriate task forces or working groups with appropriate subject matter expertise should review the adequacy of existing laws and regulations applicable to the solvency of annuities as applied to CDAs.
- The creation of a definition for CDAs. CDAs would be defined to mean an annuity contract that establishes an insurer's obligation to make periodic payments for the annuitant's lifetime at the time designated investments, which are not owned or held by the insurer, are depleted to a contractually defined amount due to contractually permitted withdrawals, market performance, fees and/or other expenses.

While the CDA WG heard comments on the various proposals, no proposal was adopted.

The actuaries are also in the game. At the 2012 Fall Meeting, the Life Actuarial (A) Task Force (LATF) discussed options for changing the required reserves for fixed annuities with guaranteed living income benefits. This included making changes to Actuarial Guideline XXXIII (AG 33) or to Actuarial Guideline XLIII (AG 43) to create a level playing field for fixed and variable annuities. LATF also unveiled a proposal to amend AG 33 with respect to a participating fixed annuity product with no cash value. Finally, LATF is considering the work plan to review AG 43 and CARVM for variable annuities and decide whether changes to the requirements should be recommended.

In an audible, and after over six months of no public activity, on December 21st, the Separate Account Risk (E) Working Group (the SARWG) announced a January 9, 2013 meeting to resume its discussion on insulation classification for separate account products. Accompanying its announcement was the SARWG's product review in which it classified various products funded by separate accounts with general account guarantees. The product review included recommendations that several types of annuities funded by separate accounts with general account guarantees not be insulated products.

New Concerns for P&C Marketing: The CFPB, "Suitability," and Social Media

Powerful messages often bring powerful challenges

BY BERT HELFAND

Following a year in which the leading concern of P&C insurers (according to a survey by Munich Re) was "maintaining and growing business," sales and marketing will continue to attract attention. Recent events illustrate two very different ways in which marketing practices can come under attack.

With CFPB in the Picture, Will "Suitability" Become an Issue for P&C Sales?

The Consumer Financial Protection Bureau, created by the Dodd-Frank Act in 2010, has no jurisdiction over insurers. But Section 1031 of the Act authorizes the CFPB to prevent "unfair, deceptive, or abusive" practices by banks in connection with "any" consumer transaction, and more than half of US banks now sell insurance—including consumer auto and homeowner policies. The CFPB is already preparing new disclosure rules for sales of credit insurance, and it is likely to extend its scrutiny to other products.

Last July, in its first public enforcement action, the CFPB ordered Capital One Bank to refund $140 million it had collected for payment protection products—bank products that are similar to (and which compete against) credit card credit insurance. (A similar enforcement action by regulators in the UK was announced in November.) The Bureau found that sales representatives made false claims for the products, but it also complained that they failed to determine whether purchasers were currently employed. Some products protect cardmembers when they lose their jobs, and customers who were unemployed when they bought them are not entitled to benefits.

This detail of the CFPB probe raises the question of whether the Bureau will consider it "unfair, deceptive or abusive" to sell P&C insurance without a reasonable basis to believe it is appropriate to the customer's circumstances and objectives—in other words, that it is "suitable." "Suitability" is a familiar requirement for sellers of annuities and life insurance, but P&C sellers, even if they are agents of the insured, have usually not been found liable for "deception" or "abuse," just because they failed to discover a customer's special needs or disclose information only a few insureds could use.

Such liability is still hypothetical. In *Louisiana Stadium & Exposition District v. Financial Guaranty Ins. Co.*, the plaintiff, a state agency, purchased bond insurance to provide "credit enhancement" for its bond issue. It alleged that the insurer was liable for failing to disclose risky investments that would later undermine its own credit rating, and which thereby rendered its policy unsuitable for the purpose of making the bond issue more appealing to investors. In November, a majority of the Second Circuit rejected this theory—although the decision did draw a dissent suggesting the agency might have stated a claim under Louisiana law.

Nevertheless, there are signs of increased solicitude for even sophisticated customers of financial professionals. In *American Building Supply v. Petrocelli Group*, a business that sold building materials alleged that it had asked its broker to obtain liability coverage for its employees, as required by the company's lease, and that the broker had negligently failed to do so. An appellate court awarded summary judgment to the broker, because the insured had received a copy of the policy without objection. Two weeks after the *Financial Guaranty* decision, New York's Court of Appeals reversed, declaring that even an insured corporation that has failed to read its own policy "should have a right to look to the expertise of its broker."

What could push the law over the edge is an aggressive new regulator overseeing a new distribution channel in which suitability has long been the rule. Since the concept of suitability has itself been beefed up in FINRA's new Rule 2111, this is a possibility that bears watching.

Going After Flo: Insurers Can Lose in Pop Culture Wars

At the opposite end of the spectrum from sales by regulated professionals, insurers like GEICO and Farmers try to associate their brands with images that exist solely in popular culture. Progressive Auto uses "Flo," the star of TV ads who sells policies that look like groceries. **But pop culture is a world in which customers have powerful, and largely unregulated, weapons at their immediate disposal.** Progressive suffered from what was apparently a spontaneous expression of anger, but plaintiffs in future lawsuits will probably also be testing these weapons' capacity.

Kaitlynn Fisher died in a collision at a Baltimore intersection in 2010, and Progressive promptly paid most of the claims under her policy. The other driver, however, had only $25,000 in liability coverage from Nationwide (which also paid promptly), and Ms. Fisher's family also asserted a claim under her underinsured motorist coverage.

That claim was complicated. UIM coverage places a first-party auto insurer in the shoes of the liability carrier of the motorist who injured its insured. From that perspective, Progressive considered that Maryland is a contributory negligence state—meaning the other motorist would not be liable if Ms. Fisher helped cause the accident—and that two witnesses claimed Ms. Fisher had run a red light. Maryland also makes a judgment against the underinsured motorist a prerequisite to a claim for UIM coverage, so, after Progressive tried and failed to settle the UIM claim, the Fisher family had to sue the other driver before they could pursue their own insurer. Nationwide, as required, defended its insured, but since his policy limits had already been exhausted, it had no real stake in the litigation. Progressive, the real defendant, intervened, and one of its in-house attorneys helped conduct the trial.

Ms. Fisher's brother, Matt, is a professional comedian. He addressed these procedural nuances in a Tumblr post, entitled, "My Sister Paid Progressive … to Defend her Killer in Court," which was re-shared more than 10,000 times. Progressive and Flo quickly became targets on Facebook and Twitter. Progressive responded with a "tweet" that included the statement, "We … feel we properly handled the claim within our contractual obligations." Thousands of social media users soon heard that message read by a robotic voice, in a post that said, "Dear Progressive Insurance PR Bot: This is what you sound like, you inhuman monster."

Progressive settled the Fishers' lawsuit in August, but visitors to the "quickmeme" site can still find photos of Flo, holding an empty wallet, using a variety of unprintable phrases to express her lack of sympathy for the departed. What makes Flo powerful as a marketing tool—the fact that she is disconnected from the complex reality of insurance—also makes the attacks that use her more potent. It is not hard to imagine class action plaintiffs trying to launch a similar campaign to exert pressure for a settlement.

Human Body Parts and the Duty to Defend: People are Not Cars, My Friends

BY BERT HELFAND

Illinois courts once considered whether non-OEM body parts could restore a damaged automobile to its "original" condition. This year, Texas upped the metaphysical ante by deciding whether sales of human tissues cause "damage" to "property."

When Debra Alvarez's mother died, she authorized Legacy of Life, an organ donation charity, to harvest certain tissues, to be distributed on a nonprofit basis. Ms. Alvarez alleged that they were sold for a profit, by a company called "Bone Bank Allografts." She sued for damages, on the grounds that she suffered mental anguish, and that the estate was wrongfully deprived of the tissues.

Legacy had a medical professional and general liability policy. Its insurer sought a declaratory judgment in federal court, asserting it had no obligation to defend the claim. Two questions were ultimately certified to the Supreme Court of Texas. In *Evanston Insurance Company v. Legacy of Life*, the Court determined that claims for "mental anguish" are not based on "bodily injury, sickness, or disease," and so that Legacy's policy did not require coverage for that claim.

The policy also covered claims for loss of use of "tangible property," so the Court addressed whether the human tissues were property, either of Ms. Alvarez or of her mother's estate. "Property," the Court observed, is a "bundle of rights," and those who can claim an interest in a cadaver possess only some of the rights in the bundle. The opinion left most of the dreadful alternatives to the reader's imagination: It simply declared that such individuals lack the right to possess the body (other than for burial), the right to use parts of the body (other than in legally authorized transplants), the right to convey body parts (except under Texas's Anatomical Gift Act), and the right to exclude others. Ironically, the rights of the estate—the direct legal successor to the body's former inhabitant—are even more limited: The estate cannot, for example, designate a recipient for parts of the body after its subject has died.

In philosophy, "property dualism" asserts there is an irreducible ontological difference between mind and matter. **Texas has drawn a different boundary, declaring some material objects may not become "property," because they retain a connection to a vanished mind.** Auto parts are "property," but human parts are "quasi-property." "Property" can re-establish a prelapsarian state. "Quasi-property" needs some help.

Moral Hazard: Drawing the Line of Insurability

BY JOHN PITBLADO & BERT HELFAND

In theory, liability insurance covers losses from accidental or fortuitous occurrences, not the consequences of intentional acts. In reality, businesses must often settle claims for acts they deny having committed, and they buy insurance to cover those settlements. Several exclusions try to define the point where coverage ends and moral hazard begins. Courts also engage in their own line-drawing, but with murky results.

Some cases enforce policy language that defines "loss" as something incurred "by reason of" a "wrongful act." Where the insured is sued for unpaid wages, for example, those wages can be deemed a "pre-existing duty" that would obtain, regardless of the insured's conduct. In 2012, this reasoning was applied by the District of Massachusetts, in *Kittansett Club v. Philadelphia Indemn. Ins. Co.*, and the Fourth Circuit, in *Republic Franklin Ins. Co. v. Albemarle County Sch. Bd. Albemarle* held that statutory damages and attorneys' fees are covered, even if liability for wages is not, because they are direct results of wrongful acts.

Other cases hold that "moral hazard" is a defense in itself—that paying "restitution" cannot be a "loss," irrespective of policy language. This line begins in the Seventh Circuit in 2001, in *Level 3 Communications v. Federal Ins. Co.*; that court extended it in 2012, in *Ryerson Inc. v. Federal Ins. Co.* Both cases involved the sale of a business (to an insured buyer in *Level 3*, by an insured seller in *Ryerson*). Both insureds settled suits for fraudulent inducement that sought to rescind the entire sale. Ryerson's policy defined "loss" to include "settlements" of "claims" based on "misleading statement[s]" or "omission[s]." Nevertheless, **the court ruled, "You can't … sustain a 'loss' of something you don't (or shouldn't) have."**

These decisions seem driven by a sense that the insured has "gotten away with fraud." The Southern District of Ohio distinguished Level 3, on the ground that Grange had "retained" money, not "wrongfully acquired" it. But defendants in **both** cases were charged with paying too little, not taking too much. The real difference might be that dozens of other insurers settled the same lawsuit as Grange, making it far less certain that Grange had acted "wrongfully."

What Duty Does A Primary Insurer Owe To An Excess Carrier?

BY JOHN PITBLADO & BERT HELFAND

A primary liability carrier usually owes no duty to excess insurers, even though those insurers bear the cost of excess judgments. If the primary insurer acts improperly, then, in most states, the excess carrier may pursue an equitable subrogation claim—but only to assert breaches of duty to the insured. One recent action threatened to extend that duty, posing the question of whether an insurer with knowledge of an excess policy must help its insured "benefit" from that coverage. The court did not resolve the question, but there are other signs that the rights of excess insurers might be growing.

Primary insurers may soon have to look out for excess insurers' losses

The issue grew out of an injury caused by a weed trimmer manufactured by Sufix, Inc. Sufix had $1 million in liability coverage from Hartford Casualty Insurance Company and $10 million in excess coverage from National Surety Corporation. Hartford engaged in pretrial negotiations and mediation with the injured plaintiff, but, a few weeks before the trial, it rejected a demand for the policy limit. Hartford notified Sufix that it faced a potential excess judgment, but neither Hartford nor Sufix gave notice of these developments to National Surety. A few weeks later, a jury returned an award of $5.8 million.

National Surety sued Hartford for bad faith in the Western District of Kentucky. Among other things, it sought to hold Hartford responsible for the insured's failure to provide timely notice of the possible excess judgment. It originally asserted that Hartford, as primary insurer, had breached a duty to investigate whether the insured had excess insurance. The Sixth Circuit rejected that claim in 2007, finding that such a duty would incorrectly "presume a direct obligation … to the excess insurer." On remand, National Surety argued that Hartford actually knew that Sufix had an excess policy, "yet failed to use this information to benefit Sufix."

National Surety did not spell out how it thought Hartford should have "used" that information, but only one possibility presents itself: Hartford could "benefit" Sufix by advising it to get its excess carrier involved in the defense. National Surety argued, in other words, that Hartford might be liable, because its insured failed to give notice under a policy issued by another company.

In October 2012, in *National Surety Corp. v. Hartford Casualty Ins. Co.*, the Sixth Circuit rejected that argument and granted summary judgment. It did so on the ground that National Surety had failed to establish an element of bad faith under Kentucky law: "consciousness of wrongdoing or reckless disregard." **The Court did not rule out the possibility that, under different circumstances (or in a different state), a primary insurer might be liable for an insured's breach of an excess policy.**

Also in October, in *Great American E & S Ins. Co. v. Quintairos, Prieto, Wood & Boyer*, the Supreme Court of Mississippi held that an excess insurer could bring a subrogation action against the lawyers that represented its insured, but it could not assert a direct claim for malpractice, because it was not a client. But in *Ace American Ins. Co. v. Sandberg, Phoenix & Von Gontard*, the Southern District of Illinois refused to dismiss a similar malpractice claim, on the ground that an excess policy that provides coverage above a self-insured retention might give the insurer the same rights as a primary carrier.

In short, the job of defining the rights of an excess carrier has not yet been completed.

JORDEN BURT AT 25

Over 25 years, we have litigated and tried hundreds of cases for the financial services industry (and others). For the sake of reflection and example, I have accumulated just a handful of cases that have challenged, strengthened, and sustained us over the past decade plus. Throw in a cheap cassette I dug out of my desk and we give you an eclectic mix from the Jorden Burt songbook.

–JFJ

SIDE A - 2000-2005

3rd Circuit - Bonus Annuity Class Action

Decertification and dismissal of nationwide class asserting fraud in connection with sale of bonus annuity products.

8th Circuit - "Vanishing Premium" Class Action

Denial of class certification and dismissal of alleged sales practice claims affirmed.

E.D.N.C. - Securities Act Litigation

Final resolution of twelve year-old pre-emptive lawsuit filed by JB for the defense of insurer who had issued credit insurance on over $300 million of mortgage backed bonds. Led to consolidation of 15 lawsuits and obtained contributions and resolution from lenders, underwriters and distributors for the client.

N.D. Tenn. - Long-Term Care Class Action

Decertification of a class of LTC insurance policy owners.

Del. Super. Ct. - Interest Crediting Class Action

Defeated class certification of nationwide class and obtained complete dismissal in class of insureds claiming improper interest crediting and expense charges under UL insurance policies.

SIDE B - 2006-2013

Tenn. Chancery Ct. - Commercial Contract Litigation

Defense verdict in six week jury trial involving large commercial contract dispute between two insurers, and also an award on our counterclaim in excess of $70 million plus an additional punitive damage award from the jury.

11th Cir. - First Amendment Litigation

District court opinion involving first amendment rights and school board powers to ensure accuracy in library texts affirmed.

S.D.N.Y. - ERISA Class Action

Successful motion to dismiss for lack of jurisdiction under ERISA in putative class action alleging excessive fees and undisclosed revenue sharing payments and successful motion to dismiss under SLUSA of plaintiff's subsequent class actions complaint alleging fiduciary breaches.

E.D. Pa. - Deferred Annuity Class Action

Denial of class certification and dismissal in putative nationwide class case alleging misconduct in sale of deferred variable annuities.

D. Minn. - Bonus Annuity Class Action

Complete defense verdict in six week trial of largest, and one of only a few, class action cases ever tried, involving alleged improper sale of insurance products.

E.D.N.Y. - RICO Class Action

Dismissal of national RICO class action complaint alleging deceptive marketing in connection with credit-card insurance.

9th Cir. - Interest Crediting Class Action

Dismissal of nationwide class action alleging improper interest crediting and expense charges – seminal and widely cited opinion of District Court affirmed.

R.I. - Dividend Crediting Class Action

Rhode Island Supreme Court affirms jury trial defense verdict of class action alleging improper dividend crediting.

U.S. - ERISA Litigation

U.S. Supreme Court case in which Jorden Burt was lead counsel on briefs and argued. Court clarified limited circumstances in which monetary relief is available under ERISA for breach of fiduciary duty claims. A loss which some have called an industry victory.

E.D. Mich. - Equity Value Class Action

Successful federal district court reconsideration and decertification of national class action challenging interpretation of "premiums" in life insurance policies.

7th Cir. - Modal Premium Class Action

Successful defense against claims of modal premium overcharges.

11th Cir. - FICA Class Action

Affirmance of dismissal of class action in which Jorden Burt successfully argued an issue of first impression that no private right of action may be implied under the FICA.

Ark. Cir. Ct. - Credit Life Class Action

Denial of class certification in national action by insureds asserting licensing and fraud claims.

4th Cir. - Industrial Life Class Action

District court denial of class action involving 1.4 million insurance policyowners affirmed.

Ark. - Supplemental Health Insurance Class Action

Arkansas Supreme Court opinion upholding national class action settlement negotiated by Jorden Burt resolving claims of alleged ambiguity in supplemental health insurance policies.

9th Cir. - Variable Life Class Action

SLUSA dismissal of putative variable life insurance class action affirmed.

9th Cir. - Bonus Annuity Class Action

Precedential opinion resulting in reversal of district court order involving injunction prohibiting settlement discussions in related class action cases.

5th Cir. - §§419/412(i) Class Action

District court dismissal of nationwide class action involving alleged RICO and common law fraud claims in sale of insurance products used to fund IRC 419 & 412(i) employee benefit plans affirmed.

3d Cir. - Long-Term Care Litigation

District court's summary judgment opinion dismissing alleged claim for mis-pricing of long term care policies affirmed.

Fl. Cir. Ct. - Hurricane Insurance Class Action

Dismissal of state-wide class action relating to alleged improper handling of hurricane claims.

11th Cir. - "Replacement" Class Action

11th Circuit affirmance of District court's order barring class action involving alleged improper "replacement" issues affirmed.

11th Cir. - FUITPA Class Action

Dismissal with prejudice of statewide class action alleging violation of insurance statute and seeking to void hundreds of thousands of policies.

FINRA Debuts New Dispute Resolution Forum

BY TOM LAUERMAN

FINRA recently announced that its dispute resolution forum is now available for disputes between registered investment advisers that are not member firms and their clients or associated persons. Until now, such disputes were typically resolved in court or through other arbitration forums.

According to FINRA sources, this decision was made in response to lawyers for investors who wanted access to the FINRA dispute resolution system, presumably in the hope it would be less expensive and faster than alternative forums. Nevertheless, gaining experience in these arbitrations also could buttress FINRA's argument that it is the best suited entity to be a self-regulatory organization for investment advisers.

> Gaining experience in arbitration could buttress FINRA's efforts to become an SRO for investment advisers.

FINRA will accept investment adviser disputes on a voluntary basis if the parties agree to arbitrate under the FINRA rules, pay the applicable fees, and sign a special submission agreement. Among other things, the parties must acknowledge that FINRA cannot enforce awards entered against investment advisers that are not FINRA members (because FINRA is not an SRO for investment advisers). The parties also agree to enforce any award in a court of competent jurisdiction pursuant to applicable state or federal law.

FINRA reportedly plans to draw on its current roster of some 6,400 arbitrators, rather than seeking arbitrators who are specially qualified in investment adviser matters. FINRA's mediation services are also available to the parties.

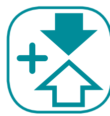
Having an additional forum that is voluntary to resolve disputes can be a good thing for the parties. Nevertheless, it remains to be seen how many parties to investment adviser disputes will agree to use FINRA's forum and how fast and economical that forum will prove to be.

A Swap or Not a Swap?

BY ED ZAHAREWICZ

The Secretary of the Treasury's final determination, issued on November 16, 2012, to exempt foreign exchange swaps and foreign exchange forwards from the definition of "swap" under the Dodd-Frank Act is significant for many financial institutions, including registered investment companies that engage in swap and other derivative transactions. Such funds generally avoid CFTC commodity pool operator regulation by claiming an exclusion under CFTC Rule 4.5. That rule was recently amended to limit the extent to which a fund claiming the exclusion may engage in swaps and other derivatives trading activity and to prohibit the fund from marketing itself as a vehicle for trading swaps or other derivatives. **The determination not to treat foreign exchange swaps and forwards as swaps will be a significant help to many funds in meeting these revised limitations in Rule 4.5.** Fewer funds will be faced with the choice of either reducing their use of foreign exchange swaps and forwards or being subject to CFTC regulation.

The Secretary's determination, first proposed in May 2011, is limited to "foreign exchange swaps" and "foreign exchange forwards," as defined under Title VII of Dodd-Frank; it does not extend to other derivatives such as foreign exchange options, currency swaps, and non-deliverable forwards involving foreign exchange. Notwithstanding the Secretary's determination, foreign exchange swaps and forwards remain subject to certain Title VII requirements. For example, these instruments must be reported to either a swap data repository, or, if none is available for this purpose, to the CFTC pursuant to Dodd-Frank's reporting requirements for uncleared swaps. In addition, any swap dealer or major swap participant that is a party to a foreign exchange swap or forward must conform to Dodd-Frank's business conduct standards.



FINRA to Firms: File Communications to Existing Customers

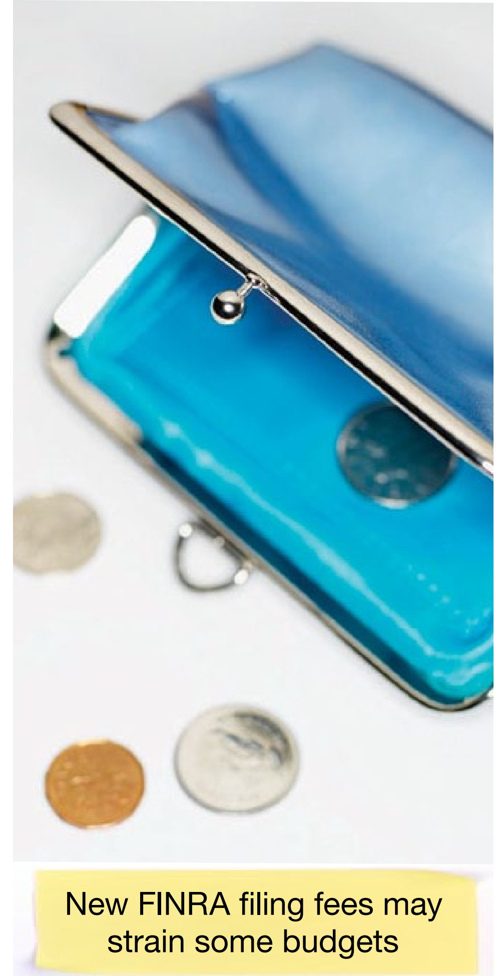
BY ANN FURMAN

When FINRA's new rules governing communications with the public go into effect on February 4, 2013, firms may need an associated increase in their filing fee budget.

Under the old regime, NASD had defined correspondence to include, among other things, written letters, electronic mail, instant messages, and market letters sent to one or more existing retail customers, regardless of their number. However, **FINRA, under the new rules, has revised the definition of correspondence to include only a written (including electronic) communication that is distributed or made available to 25 or fewer retail investors – whether existing or prospective – within any 30 calendar-day period.** Thus, if the same communication is distributed or made available to more than 25 retail investors – including both existing or prospective – within the 30-day period, it is considered a retail communication that will be required to be filed with FINRA.

There are a number of exceptions to the filing requirement, including communications that are posted on an online interactive electronic forum. There is also an exception for communications that do not make any financial or investment recommendation or otherwise promote a product or service of the member. The exact parameters of that exception remain to be seen. Also, it is not clear what substantive comments FINRA will provide to members on their communications to existing customers.

In any case, more filings mean more filing fees, which can add up quickly when, for example, as of July 2012, the fee for filing printed material is $125 plus $10/page for each page in excess of 10 pages. Or, for expedited review (review within three business days), the filing fee is $600 plus $50/page for each page in excess of 10 pages.



New FINRA filing fees may strain some budgets

OCIE Advises Firms on Misuse of Non-Public Information

BY SCOTT SHINE

The SEC's Office of Compliance Inspections and Examinations issued a report describing practices to help broker-dealers and investment advisers maintain policies and procedures reasonably designed to prevent misuse of material non-public information (MNPI). The report is not prescriptive in nature. However, the SEC and other regulators will be reviewing firms' practices in light of the principles and findings in the report. Accordingly, the report will be an important resource for firms in reviewing and assessing their own procedures.

Based on a review of selected examinations conducted by the SEC, FINRA and the NYSE, the report highlighted specific concerns such as significant interactions the regulators observed between groups that routinely obtain MNPI and groups, such as sales and trading units, that might benefit from it. Because such interactions were observed to occur frequently and often went undocumented, the report noted that it might be difficult to trace the occurrence of any inadvertent or even intentional disclosures. Also noted in the report was a lack of internal monitoring of trading activity to identify the misuse of MNPI. **While these concerns did not necessarily suggest securities law violations according to the report, they do perhaps foreshadow a focus of future regulatory examinations.**

The report also identified certain effective practices such as the use of tailored exception reports that take into account the diverse characteristics of different forms of MNPI, as well as policies that review a sufficiently broad range of instruments for potential misuse of MNPI by traders. Such instruments could include, for example, credit default swaps, equity or total return swaps, loans, components of pooled securities such as UITs and exchange-traded funds, warrants, and bond options.

Perfect Storm for Money Market Funds

Reform on the radar

BY TOM LAUERMAN

The potentially life-threatening regulatory maelstrom in which money market funds (MMFs) now find themselves picked up force in November last year when the Financial Stability Oversight Council (FSOC) sought public comment on reforms to address perceived "systemic" risks.

The FSOC Proposal

Under the FSOC proposal, MMFs whose portfolio holdings are not limited to U.S. Treasury securities would be required to choose one of the following three options:

a) Allow the daily value (NAV) of their shares to "float" like other mutual fund NAVs;

b) Maintain a constant NAV and protect against future losses by maintaining a "capital buffer." The amount of the required capital buffer would depend on the risk characteristics of the MMF's assets, but would not exceed 1% for any type of assets. Also, no investor that has an account balance of $100,000 or more would be permitted to immediately withdraw more than 97% of her investment in the fund. Rather, the remaining 3% would be "held back" for thirty days, during which time it would be available to absorb any losses by the MMF that exceeded its capital buffer; or

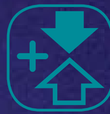
c) Maintain a constant NAV while also maintaining a capital buffer that would be higher than under option b above, but that would not exceed 3% for any type of assets. Under this option c, however, there would not be any "hold back" of amounts that an investor seeks to withdraw. The FSOC is considering under this option also imposing other precautions (such as more stringent investment diversification requirements, increased minimum liquidity levels, and more robust disclosure requirements) that could reduce the required amount of capital buffer.

The FSOC's proposed reforms generally would not affect U.S. Treasury MMFs.

Comments on the FSOC proposal are due by February 15, 2013, and the FSOC would need to evaluate the comments and determine whether to press for these or any other reforms. Under the terms of the Dodd-Frank Act, however, the FSOC would not enact those reforms directly, but would recommend them to the SEC. Dodd-Frank then would require the SEC either to implement such recommendations (or similar requirements that the FSOC deems acceptable) or explain why not within 90 days.

If the SEC did not timely implement any recommended reforms in a manner satisfactory to the FSOC, the FSOC and its members could potentially pursue various other avenues to reduce the perceived systemic risks presented by MMFs.

> Some banking organizations already hold capital against MMF; they are well-positioned should capital buffers be imposed.



SEC Staff Report

The FSOC proposal is very similar to staff recommendations that the SEC's commissioners were considering last summer. Indeed, the FSOC has stated that it would suspend its efforts in this area, if the SEC determines to move forward with its own MMF reform proposals.

The SEC did not publish any reform proposals last summer, however, because three of the SEC's commissioners (Commissioners Aguilar, Gallagher, and Paredes) opposed doing so without additional data and analysis. Specifically, they raised various questions that the SEC's Division of Risk, Strategy and Financial Information subsequently addressed in a report that was released to the public in early December 2012. That report and other developments since last summer (including the FSOC's proposal and the information provided by commenters thereon) make it likely that the SEC will make its own proposal in the near future.

Views from the MMF Industry

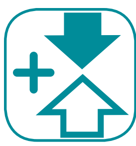
In general, MMFs have strongly opposed the imposition of any capital buffer requirement as a condition of maintaining a constant NAV. Among other things, the investment returns that MMFs currently can earn are too low to comfortably fund such buffers, and most MMF fund sponsors are reluctant to commit their own capital for that purpose.

On the other hand, a senior investment management officer with a major banking organization recently observed that his firm already holds capital against its money market funds and that his firm could be very well positioned if capital buffers were imposed. Banks, of course, also could benefit to the extent that any reforms make MMFs less competitive, thereby causing some MMF investors to migrate into deposit accounts. Such considerations may reduce the incentives for MMF sponsors that are part of banking organizations to oppose capital buffers and other reforms.

Some in the industry also may have grown more comfortable with allowing NAVs to float—at least in some circumstances. Thus, Charles Schwab has put forward a possible compromise under which "institutional" MMFs that invest in corporate instruments (as distinct from MMFs investing in government securities) would be required to float their NAVs, but no capital buffers would be imposed for any type of MMF. Indeed, DWS Investments has for the past two years been offering an institutional MMF with a floating NAV, and Northern Trust is in the process of launching four new MMFs with floating NAVs. Floating NAV MMFs also have been available in connection with some variable insurance products for many years.

A number of MMF sponsors have indicated a willingness to discuss how any requirement for MMFs to float NAVs could be fine-tuned to mitigate its undesirable aspects. BlackRock Inc., however, has commented to the FSOC that a better approach would be to impose a 1% fee on investor withdrawals at times when a MMF's liquidity falls below a prescribed threshold. Others - including the Vanguard Group, The Securities Industry and Financial Markets Association, and certain SEC commissioners - also have expressed some interest in fees or other limitations (gates) on withdrawals in times of reduced MMF liquidity. So far, however, there have not been any public indications that the SEC and other FSOC members will be satisfied that such liquidity fees and gates would adequately address the perceived risks.

In another very recent development, a number of the most prominent fund sponsors have just this month announced that certain of their MMFs will be making public their market-based NAVs for each day on a current Among other things, this enhanced transparency could further reduce the possibility of destabilizing "runs" by investors seeking to withdraw from MMFs in times of stress.



SECURITIES

Harkin or Harken for Index Products

BY JOAN E. BOROS

A threshold question in developing and designing an index insurance product is whether or not it will be registered with the SEC under the Securities Act of 1933 (1933 Act). If unregistered, the next question often is whether to rely on what is commonly referred to as the "Harkin Amendment" or instead to harken back to a traditional analysis under Section 3(a)(8) of the 1933 Act as the basis for not registering.

The fact that index products were the primary motivation behind the Harkin Amendment's inclusion in the Dodd-Frank Act would seem to make it the natural choice; it was intended primarily to counteract the SEC's attempt (in its now vacated Rule 151A) to preclude almost all index annuities from relying on Section 3(a)(8). Moreover, under the Harkin Amendment, it is possible to design products that give investors more exposure to investment gains and losses– and to emphasize that aspect more in

Index insurance products give insurers lots to consider

the marketing program – than may be prudent under a traditional Section 3(a)(8) analysis. In some cases, however, compliance with all of the requirements of the Harkin Amendment may not be possible, or uncertainties may exist that make an insurer reluctant to proceed in reliance on the amendment. For example, some insurers have been concerned whether and how life insurance products must comply with the amendment's "suitability" requirement, which seems to have been drafted more with annuity contracts in mind. In such cases, insurers may design index products to be exempt under a traditional Section 3(a)(8) analysis.

Applying a traditional Section 3(a)(8) analysis to index products, of course, presents its own difficulties and uncertainties—largely due to the fact that most judicial and regulatory articulation of the relevant standards has been in the context of products that are very different from today's index products. Thus, **insurers will likely encounter some challenging decisions when proceeding under the Harkin Amendment or when harkening back to a traditional analysis, as well as when choosing which path to follow.** The Harkin Amendment, however, empowers such choices by specifically making clear that the amendment does not preclude insurers from relying instead on a traditional Section 3(a)(8) analysis; and this applies as much to index products as to any others.

SEC Avoids Confronting Major Periodic Reporting Issues—For Now

BY ABIGAIL KORTZ

The SEC has declined an opportunity to discuss its views or any plans to consider whether its current definition of a "record" security holder allows too many companies to avoid filing periodic reports under the Securities Exchange Act. Although that has long been a subject of concern, in a report mandated by the recently-enacted "JOBS" Act, **the SEC responded only to the specific question Congress asked: namely, whether the SEC needs new "enforcement tools" to enforce its existing rule that prevents circumvention of the periodic reporting requirement.**

Under the JOBS Act, a company must file periodic reports if a class of its equity securities is held of "record" by 2,000 or more persons (which the JOBS Act increased from 500) or by 500 or more persons who are not accredited investors. The SEC's existing anti-circumvention rule requires "beneficial owners" of securities to be counted as record holders for this purpose "[i]f the issuer knows or has reason to know that the form of holding securities of record is used primarily to circumvent" the periodic reporting requirement.

The report acknowledges the difficulty of identifying and investigating potential violations of this anti-circumvention rule. Nevertheless, the report concludes that current enforcement tools are adequate to investigate potential violations.

Among other things, the report notes that the threshold increase from 500 to 2,000 record holders will result in fewer companies being required to file periodic reports and will reduce their motivation to attempt to circumvent the thresholds. Moreover, according to the report, since those changes were only recently enacted, more time will be needed to gauge their impact (including on possible circumvention efforts).

LTC Policy's Unambigous Terms Trump Insured's Subjective Expectation

BY JASON KAIRALLA

According to one federal district court, an insured's subjective expectation that his long-term care insurance policy would cover care in an Alzheimer's facility does not control over the policy's unambiguous definitional provisions. In *Crutchfield v. Transamerica Occidental Life Insurance Company*, the policy at issue expressly provided for three types of coverage: "Nursing Home Care, Adult Day Care, and Home Health Care." Care at the Alzheimer's facility did not meet the definition for any of these coverage types.

The federal district court for the Western District of Kentucky granted summary judgment for the insurer, ruling that, **under the policy's plain terms, the plaintiff was ineligible for care at the facility, and thus the insurer was entitled to judgment as to all of his claims**, including claims for misrepresentation, breach of the duties of good faith and fair dealing, and violations of the Kentucky Unfair Claims Settlement Practices Act and Consumer Protection Act.

Scope of Appropriate Equitable Relief Reaches Supreme Court

BY GLENN MERTEN

Last year, the Supreme Court observed that "appropriate equitable relief" under ERISA § 502(a)(3) could include all the remedies typically found in equity. Since *CIGNA Corp. v. Amara* was decided, numerous appellate courts have weighed in on scope of appropriate equitable relief, including whether a Court has the authority to rewrite the terms of an ERISA plan. A significant circuit split has developed, with the Third and Ninth Circuits holding that a district court has the equitable power under ERISA to rewrite plan terms. In contrast, the Fifth, Seventh, Eighth, Eleventh and DC Circuits have held that express, unambiguous plan terms must control over equitable principles, and courts may not rewrite plan terms to conform to notions of equity.

In June 2012, the Supreme Court granted certiorari in *U.S. Airways v. McCutchen*, in which the Third Circuit vacated summary judgment on behalf of the plan sponsor and held that the trial court must exercise discretion to limit subrogation relief to what is appropriate and equitable. In an amicus brief, **the United States took what it described as a "neutral" position, and attempted to strike a middle ground between the conflicting circuit opinions by arguing that § 502(a)(3) "is best read to recognize both the centrality of plan terms under ERISA and their enforceability, while at the same time preserving the historic powers of equity courts to equitably allocate attorney's fees."** To that end, the government agreed that the Third and Ninth Circuits overreached by granting equitable relief in direct contravention of plan terms, arguing that the word *appropriate* "does not provide courts license to invalidate or decline to enforce plan provisions otherwise permitted by ERISA." On the other hand, apportionment of attorney's fees incurred securing a third party recovery is appropriate under ERISA.

Oral argument in *McCutchen* was held on November 27, 2012, and a decision is expected later this term.

The CFPB Gets Busy: 2012 Highlights and What's Ahead

BY ELIZABETH BOHN

The Consumer Financial Protection Bureau (the Bureau) was busy in 2012, taking several actions in fulfillment of its statutory purpose under Dodd-Frank of implementing and enforcing Federal consumer financial protection laws to ensure "access by consumers to consumer financial products and services," and that markets for such products and services are "fair, transparent, and competitive." To fulfill its statutory purposes, the Bureau is authorized to:

- issue rules, supervise, and enforce Federal consumer financial protection laws; including TILA, RESPA, FCRA, FDCPA, HOEPA, and many others;
- restrict unfair, deceptive, or abusive acts or practices in consumer financial markets;
- create a consumer complaint center;
- research consumer behavior; and
- monitor financial markets for new risks to consumers.

During 2012, the Bureau continued receiving consumer complaints on mortgages and credit cards through its Complaint Center, and began accepting complaints on student loans, credit reporting and debt collection agencies. It also issued guidance and formal regulations, published its supervision manual, conducted examinations, issued enforcement orders assessing significant penalties, and initiated injunction proceedings in Federal Court. These activities were directed primarily at home mortgage lending, credit cards, credit reporting, debt collection, and student loans.

2012 Highlights

Regulation, supervision, guidance and enforcement actions

Third Party Service Providers. In April, the Bureau issued a bulletin regarding third party service providers advising that it considers its authority to extend to third party vendors, and that it expects supervised banks and non-bank covered entities to be responsible for ensuring that their third party vendors and marketers comply with Federal consumer protection laws and do not engage in deceptive sales or marketing practices. As a result, covered-entities may be held responsible and penalized for the actions of their independent contractor/third party vendors, as has already occurred with add-on products discussed below.

Credit Card "Add-on" Products. In June, the Bureau issued a bulletin on the practice of offering "add-on" products with credit cards, including detailed expectations for ensuring that procedures and scripts used in marketing such products clearly describe the products and disclose the risks to the consumers. As previously reported in *Expect Focus*, Bureau investigations of these products led to entry of consent enforcement orders against credit card issuers Discover Bank and Capital One for deceptively marketing credit card add-on payment protection products to customers, which orders assessed monetary penalties exceeding $340 million against the two banks.

Protection of Privileged Information. In July, the Bureau issued its final rule relating to the confidential treatment of privileged information shared with it in the course of its supervisory or regulatory processes. Under the final rule, the submission of privileged information to it or shared with other federal or state agencies in the course of the Bureau's supervisory or regulatory processes will not waive or otherwise affect any privilege that may be claimed by the person submitting the information and entitled to the privilege.

Supervision Manual. In October, the Bureau released version 2 of its Supervision and Examination Manual, which explains how it examines consumer financial service providers and determines if companies are complying with consumer financial protection laws. Detailed examination procedures are divided by both product and statute.

Larger Participants in Credit Reporting and Debt Collection. In addition to its authority to supervise entities in the residential mortgage, private education lending, and payday lending markets, the Bureau is authorized to supervise nonbank "larger participant[s]" of markets for other consumer financial products or services, as it defines by rule. In July, it issued rules defining "larger participants" in the consumer reporting and debt collection markets to facilitate its supervision of those industries. The definition of a "larger participant" is based upon the receipts generated from those businesses. Credit Reporting agencies with annual receipts in excess of $7 million and debt collection agencies with receipts exceeding $10 million fall within the "larger participant" definition. In October, the Bureau began taking consumer complaints on credit reporting, and began supervising larger participants in the debt collection market.

Mortgages. The Bureau focused intently on home mortgages in 2012. One of its first tasks was issuing proposed

new rules and forms revising and integrating disclosure requirements of TILA and RESPA. These are expected to take effect later in 2013. Its "ability to repay" rule, adopted in January, requires heightened underwriting due diligence for home mortgage lenders to ensure that borrowers have the ability to repay. The rule also sets product feature and underwriting requirements for "qualified" (generally lower risk, lower priced, conventional) mortgage products, which are entitled to a presumption that the consumer has the ability to repay. New rules regulating mortgage servicers and the foreclosure process were also adopted in January. Among other requirements, these new rules restrict the ability to proceed with foreclosures while negotiating with borrowers, require that loss mitigation options be offered to certain homeowners to avoid foreclosure, and require servicers to provide additional notifications to borrowers before placing and charging for what the Bureau refers to as "force-placed" insurance.

The Bureau also issued regulations intended to prevent deceptive mortgage marketing practices and sent warning letters to several mortgage lenders and brokers advising them to clean up potentially misleading advertisements, particularly those targeted toward veterans and older Americans. It also announced formal investigations of six companies it believed may have committed more serious violations in their marketing practices. In December, the Bureau obtained injunctions in California against operators of mortgage loan modification scams. In its complaint, the Bureau asserted that the companies had ripped-off thousands of struggling homeowners across the country, taking in more than $10 million by charging consumers for services that falsely promised to prevent foreclosures or renegotiate troubled mortgages. The court issued injunctions halting the operations of both businesses and froze their assets while the cases move forward.

What's Ahead?

The Bureau appears here to stay as a vigorous regulator and enforcer of consumer financial protection laws in traditional consumer credit markets, including mortgages, credit cards, and student loans. However, as it continues to receive consumer complaints and research consumer behavior in order to identify other consumer financial products which have a "material impact on consumers" as mandated by Dodd-Frank, regulations for other financial products and services should be anticipated.

For example, in the fall, it launched a public inquiry on elder financial abuse to learn about how older Americans and veterans may be financially exploited. As part of this investigation, the Bureau has sought comment from the public on issues including evaluation of financial advisor certifications and designations, provision of financial advice and planning. Responses to this inquiry have included complaints about financial advisors marketing unnecessary annuities and other financial products to the elderly.

Expect the Bureau to seek to identify financial products which specifically impact the elderly, the military, and students, while it continues vigilant supervision, regulation and enforcement with respect to traditional credit and related add-on products. It will also be shaping a new standard in consumer protection in determining what is an "abusive" practice as prohibited by Dodd-Frank, distinct from the traditional, more familiar standard of "unfair" or "deceptive" practice, and issuing regulations to curb such practices.

Arbitration Roundup

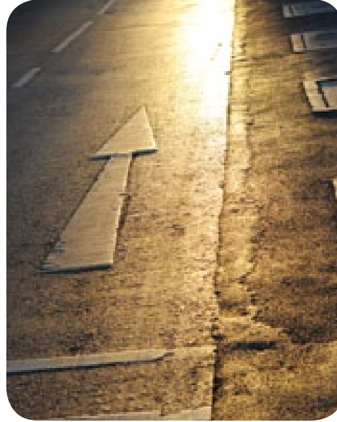
Waiver of right to arbitrate found prior to discovery

BY LANDON CLAYMAN

In federal courts a party generally will not be found to have waived the right to arbitrate unless (1) it has acted inconsistently with that right, and (2) there has been a sufficient showing of prejudice by the party seeking to avoid arbitration. In most cases, waiver will be found only when the arbitration demand comes long after the lawsuit commenced, and when both parties have engaged in extensive discovery. However, the Third Circuit in *In re Pharmacy Benefit Managers Antitrust Litigation* concluded there was a waiver of the right to arbitrate even though no discovery had taken place. Following a discussion of six non-exclusive factors that guide the prejudice inquiry, the court ruled a waiver was established, primarily because the party seeking arbitration delayed filing its motion for almost a year while aggressively seeking a dismissal on the merits, albeit without conducting discovery.

The doctrine of equitable estoppel sometimes provides an exception to the general rule that one who is not a party to a contract containing an arbitration agreement cannot enforce its terms against one who is a party. One circumstance when the doctrine of equitable estoppel permits a nonsignatory to enforce the arbitration provision against the signatory is when the signatory relies on the terms of the contract to assert its claims against the nonsignatory. In *Bahamas Sales Associate, LLC v. Byers*, the Eleventh Circuit emphasized that a "but-for relationship" between the contract and the claims against the nonsignatory is insufficient for equitable estoppel to apply. **It is not enough that the contract is factually significant to the claims; equitable estoppel requires an actual dependence of the claims on the underlying contract.**

The Supreme Court has chosen to review the Second Circuit's decision in *American Express Co. v. Italian Colors Restaurant*, to decide whether, after *AT&T Mobility LLC v. Concepcion*, the Federal Arbitration Act allows courts to invalidate arbitration agreements that do not permit class arbitration of federal statutory claims.



JORDEN BURT is pleased to announce that **Todd Fuller**, **Jason Patrick Kairalla**, **Ben Seessel**, and **Jonathan Sterling** have been elected partners of the firm. Their partnership became effective January 1, 2013.

Todd M. Fuller (Miami office) focuses his practice on defending financial services companies in complex federal and state court litigation, including class actions, and multi-district litigation proceedings throughout the United States. Mr. Fuller received his B.S/B.A. from the University of West Virgninia and his J.D. from the University of Miami School of Law, magna cum laude.

Jason Patrick Kairalla (Miami office) focuses his practice on defending complex individual and class-action cases on behalf of banks, insurance companies, investment firms, and other financial services institutions. He received his B.B.A. and M.B.A. from the University of Miami School of Business Administration, with high honors, and his J.D. from the University of Miami School of Law, magna cum laude.

Ben V. Seessel (Connecticut office) focuses his practice on complex civil litigation and the defense of financial institutions and other sophisticated businesses. He received his B.A. from Rutgers University and his J.D., magna cum laude, from the University of Miami School of Law.

Jonathan C. Sterling (Connecticut office) specializes in employment law at Jorden Burt, with a concentration on defending organizations, municipalities and individuals against claims of discrimination, harassment and retaliation. Jonathan received his B.A. from Colby College and his J.D., with honors, from the University of Connecticut School of Law.

Over Twenty-Five Years Later, ECPA Remains Relevant

Congress works to keep the Act up-to-date

BY JASON MORRIS

The 25th anniversary of Jorden Burt LLP nearly coincides with the twenty-sixth anniversary of the Electronic Communications Privacy Act (ECPA), which was signed into law on October 21, 1986. The ECPA was adopted to address, at the federal level, the legal privacy issues that evolved with the growing use of computers and other electronic communications by the general marketplace. Twenty-six years after its signing, the ECPA still has implications for financial institutions in the areas of employee email monitoring and government investigations.

The ECPA generally prohibits the unauthorized interception or retrieval of electronic communications while in transit, or when in storage. However, as the Third Circuit discussed in *Fraser v. Nationwide Mutual Insurance Co.* (2003), the ECPA does not prohibit an employer from retrieving employee emails that are stored on employer-provided systems.

Under a portion of the ECPA known as the Stored Communications Act (SCA), governmental entities, pursuant to an administrative subpoena or court order, may require third-party "provider[s] of electronic communication service[s]" to disclose the contents of electronic communications that have been in "electronic storage in an electronic communications system" for more than 180 days to the government entity, with delayed notice (up to 180 days after issuance of the court order) to the consumer under certain circumstances. Disclosure of electronic communications that have been in storage for 180 days or less requires a search warrant. Accordingly, **financial institutions that both utilize a third-party provider of electronic communication services and have document retention policies that do not require deletion of emails prior to the emails turning 180-days old face an increased risk of their electronic communications being accessed by the government without the institutions' knowledge.**

Recently, the Senate Judiciary Committee unanimously approved a bill that would require a search warrant to obtain electronic communications stored with "provider[s] of electronic communication service[s]." This effort may be in response to ECPA critics who state the SCA portion of the ECPA is outdated. These critics argue that the current 180-days standard no longer accurately reflects the realities of the 2012 marketplace, where the ubiquitous use of email and the ready availability of free third-party email storage, differ significantly from the 1986 marketplace, where a minimal amount of emails older than 180-days existed.

JORDEN BURT was recently recognized by our clients as a 2013 Go-to Law Firm at the Top 500 Companies. We were nominated by in-house counsel at a Fortune 500 company for our work in contracts litigation. Special thanks to our clients for your continued support.

JORDEN BURT was recently recognized in *The BTI Client Service A-Team 2013*. Thank you to our clients, who mentioned us without prompting, as leaders in client service.

EXPECT FOCUS®

From Bricks and Mortar to AdWords and Beyond

BY ABIGAIL KORTZ & DIANE DUHAIME

Technological innovations over the past 25 years have brought about steep changes in trademark cases. In the 1980s, for instance, the typical trademark infringement case centered on a likelihood of confusion analysis concerning businesses that provided similar goods or services within the same geographical area (e.g., whether the use of an Illinois bank's logo that contained the term CITY was likely to cause confusion with Citibank's use of the mark CITI in Illinois).

By the mid-1990s, the commonplace use of the Internet began to change the nature of trademark infringement cases. For instance, in 1999, the Ninth Circuit held that the unauthorized use of another's trademark, MovieBuff, as a key word in "metatags" constituted a form of "initial interest" confusion. Also along with the growth of the Internet came "gripe site" or "sucks site" trademark infringement claims, and "cybersquatters." Initially, cybersquatters were persons who purchased domain names that contained a famous trademark, and then attempted to make a huge profit by offering to sell such domain names to the legitimate trademark owners. Because cybersquatters did not always make commercial uses of domain names in a manner that would cause a likelihood of confusion among Internet users, trademark owners were unable to prevail in trademark infringement claims against such cybersquatters. Consequently, the Anticybersquatting Consumer Protection Act of 1999 was enacted, which established a cause of action for the bad faith registration, trafficking, or use of a domain name confusingly similar to a trademark.

In addition, Google's advertising service, called "AdWords," has been the focus of extensive trademark infringement litigation in recent years. As courts have reached differing conclusions concerning the legality of AdWords, the issue is potentially ripe for Supreme Court review.

Mobile devices, mobile apps, virtual worlds, social media sites, and other technologies have heightened the variety of trademark offenses and, as compared to the 1980s, trademark owners today can experience serious difficulties with identifying and/or pursuing trademark offenders. If the last 25 years is any indicator, future technologies are certain to bring even more challenges for trademark owners.

Is Electronic Contracting Becoming Ubiquitous?

BY PAUL WILLIAMS & DIANE DUHAIME

Over the past two decades, the law has evolved to embrace several dramatic advancements in technology. With the wide availability of the internet in the 1990s and increasing software sophistication, electronic business transactions became highly desirable and legal developments made them a reality. Significant developments included:

- **The Uniform Computer Information Transactions Act (UCITA)**, a 1999 model law that governs computer information transactions, such as software licenses acquired by consumers through clickwrap and shrinkwrap software license agreements.
- **The Uniform Electronic Transactions Act (UETA)**, another 1999 model law, sets forth procedures designed to promote electronic transactions. Under UETA, an electronic record, signature or contract may not be denied legal effect for the sole reason that the medium in which the record, signature or contract was created is electronic.
- **The Electronic Signatures in Global and National Commerce Act (E-Sign)**, a federal statute passed in 2000, for the purpose of facilitating the use of electronic signatures and records. E-Sign supports UETA by preempting inconsistent state electronic transaction laws, and permitting states to enact UETA without preemption, subject to meeting certain requirements.

Correspondingly, software companies have developed products for easy and secure electronic contract formation. For instance, with the release of the iPad in 2010, the opportunity for electronic contract formation reached a new zenith.

Those seeking to challenge electronic contracts typically argue that they did not read or assent to all the terms in the online form, or that the "adopted" electronic signature was not their own. These challenges usually fail. Like the Massachusetts federal district court in *Hager v. Vertrue, Inc.*, **many state and federal courts are satisfied with technology that shows when and where consumers viewed electronic contracts, and are comfortable with the consumer's adoption of an electronic signature**. Challengers face an increasingly high hurdle proving that an electronic transaction was invalid. The cost and time savings offered by electronic contracts, and their burgeoning legal validity, indicates they are the way of today and the future.

CONGRATULATIONS!

Miami Associate, **Cliff Gruhn**, has been nominated by the Cuban American Bar to the Young Lawyer's Section of the Florida Bar to be considered for a young lawyer's award for his pro bono work.

JORDEN BURT®

MARK YOUR CALENDAR

March 7-8, 2013

Practising Law Institute's Investment Management Institute, March 7-8, 2013

Gary Cohen, partner in the Washington DC office, will moderate the panel, "Hot Topics in Insurance Products and Services" at the Practising Law Institute's Investment Management Institute 2013 seminar. The seminar will take place March 7-8, 2013 in New York, NY. For more information and to register, please visit *www.pli.edu*.

March 20-22 2013

LOMA/LIMRA Regulatory Compliance Exchange, March 20-22, 2013

Anthony Cicchetti, partner in the Connecticut office, will present a session at the LOMA/LIMRA Regulatory Compliance Exchange March 20-22 in Las Vegas, NV. His session is titled "Insurance Product Sales Practices Cases – An Overview" and will outline recent regulatory and private litigation activity involving claims of improper practices in the sale of insurance company products. For more information and to register, please visit *www.loma.org* or *www.limra.com*.

April 24-26, 2013

ABA Section of Litigation's Annual Conference, April 24-26, 2013

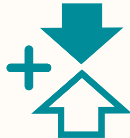
Sonia O'Donnell, partner in the Miami office, will present alongside Third Circuit Court of Appeals Judge, the Honorable Joseph Greenway during the Appellate Practice Committee Meeting during the ABA Section of Litigation's Annual Conference April 24-26, 2013 in Chicago, IL. The Meeting will provide CLE credit to participants, and is titled "Avoiding Ethical Pitfalls in Appellate Practice." For more information, please visit *www.americanbar.org/groups/litigation*.

ANNOUNCING!

The Property & Casualty Industry Group at Jorden Burt is pleased to announce the launch of their blog, **PropertyCasualtyFocus.com**. The blog will keep its readers informed on the latest trends in litigation and regulatory developments in the property and casualty industry. To begin enjoying PropertyCasualtyFocus.com, please visit *http://www.propertycasualtyfocus.com*.

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

Life Insurance



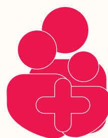
Securities

Reinsurance

Consumer Finance & Banking

Property & Casualty Insurance

Investment Companies & Advisers



Health Care

For more information, visit our website at www.jordenburt.com.

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