SENATE COMMITTEE
ON
ECONOMIC DEVELOPMENT

FINANCIAL MODERNIZATION

INTERIM REPORT TO THE
77TH TEXAS LEGISLATURE

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To- Department of Banking
Texas Department of Insurance
Texas Department of Savings and Loan
State Securities Board
Consumer Credit Commission
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EXECUTIVE SUMMARY

This report addresses the third interim charge to the Senate Economic Development Committee (Committee) which states: "Monitor trends affecting the convergence of the banking, securities, and insurance industries including market forces and federal government activity. The Committee shall make recommendations for statutory or regulatory changes at the state level as necessitated by changes in federal law or industry trends. The Committee shall also evaluate pending federal legislation affecting financial institutions, specifically in the area of bankruptcy, analyzing how potential changes affect Texas law." This interim charge was issued prior to enactment by Congress of the Gramm-Leach-Bliley Act of 1999, also know as the Financial Services Modernization Act. Speaker Pete Laney assigned similar interim charges to the House Committee on Financial Institutions and the House Committee on Insurance.

The Gramm-Leach-Bliley Act of 1999, passed by Congress in November of 1999, changes long-standing federal laws to allow for mergers and affiliations among the banking, securities and insurance industry. The requirements of the new law are very complex and involve very technical regulatory requirements. Therefore, Senator David Sibley (Chairman of the Senate Economic Development Committee), Representative Kip Averitt (Chairman of the House Committee on Financial Institutions) and Representative John Smithee (Chairman of the House Committee on Insurance), by letter dated March 31, 2000, requested that the Banking Commissioner, in consultation with the Insurance Commissioner, Securities Commissioner and Savings and Loan Commissioner, study the impact of the new federal statute on Texas law and report any findings and recommendations to the three committees (*See Appendix A*).

The Committees' letter instructed the Commissioners to study those portions of GLBA that preempt Texas statutes and rules, and to develop consensus recommendations that would provide a means for the Texas chartered banking system to be innovative in financial services. The letter further indicated that privacy issues relating to GLBA should be excluded from the agencies' study and report.

The agencies' study and report generally covered: (1) Preemption of state laws and statutory changes required by GLBA; (2) information sharing and cooperation between functional regulators and broad-based interagency agreements; (3) clarification of the authority of Commissioners in the area of new financial services; and (4) clarification of the activities permitted for state chartered financial institutions. The agencies' report was submitted to the three legislative committees on August 15, 2000.

This report is partly based on the agencies' report to the committees. The Committee commends the Department of Banking, the Department of Insurance, the Savings and Loan Commission, and the State Securities Board for their extensive work on the study and report on implementation of GLBA in Texas.

The Committee first met on November 1, 1999 to consider the convergence of banks and insurance companies and actions underway in Congress at that time concerning financial services

modernization. On November 12, 1999, Congress enacted the new federal law on financial services modernization, commonly known as the Gramm-Leach-Bliley Act of 1999 (GLBA). The Subcommittee on Consumer Credit Laws (Subcommittee), a subcommittee appointed to make recommendations to facilitate access to private sector business capital, met on April 25, 2000, in part to consider the effect of GLBA on consumer credit laws in Texas. The report of this subcommittee recommended monitoring the progress of federal and state regulators promulgation of privacy rules connected to the Gramm-Leach-Bliley Act of 1999.

On May 15, 2000, the full Committee held a joint hearing with the Senate Committee on Health to consider issues surrounding privacy and the availability and appropriate dissemination of personally identifiable information. Lastly, the Committee met on October 17, 2000, to consider subcommittee reports and recommendations on implementation of the Gramm-Leach-Bliley Act. The Committee adopted the recommendations made at the committee meeting. All the recommendations are directed at compliance with the Gramm-Leach-Bliley Act. A summary of the recommendations follows.

SUMMARY OF RECOMMENDATIONS

LEGISLATION TO CONFORM STATE LAWS TO REQUIREMENTS OF THE GRAMM-LEACH-BLILEY ACT OF 1999

PROPOSAL ONE

Amend the Licensing Laws for Insurance Agents to Comply with the Provisions of the Gramm-Leach-Bliley Act.

ISSUE

The Modernization of Licensing Insurance Agents.

BACKGROUND

Congress enacted the Gramm-Leach-Bliley Act (GLBA), also known as the Financial Service Modernization Act, on November 12, 1999. GLBA, in part, requires at least a majority (29) of the states to adopt agent licensing laws that are uniform or allow reciprocity among the states prior to November 12, 2002. Failure to do so will result in the creation of a new self-regulatory organization, the National Association of Registered Agents and Brokers (NARAB), that will institute uniform licensing of agents at the expense of state control of that function.

PROPOSED CHANGE

Enact legislation to modify the licensing laws for insurance agents in Texas to conform to GLBA requirements for reciprocity by re-introducing S.B. 956 from the 76th Legislative session with minor modifications necessary to comply with GLBA.

POLICY IMPLICATIONS

This proposal would allow Texas to comply with the reciprocity requirements under GLBA and be counted as one of the majority of states enacting the required changes in law. The revisions to the laws would also permit streamlining of the agents' licensing function at TDI and would establish equal treatment in agents' licensing requirements for all financial institutions.

PROPOSAL TWO

Amend the Affiliation Provisions of the Insurance Code to Limit the Review Period to 60 days.

ISSUE

Review Time for Affiliations between Banks, Securities Firms and Insurance Companies.

BACKGROUND

GLBA provides for full affiliations between banks, securities firms, insurance companies and other financial companies. The Act also provides flexibility in structuring these new financial affiliations through a holding company structure or a financial subsidiary. Title 1, Section 104 of GLBA provides for states to review affiliations during the 60 days prior to the effective date or change of

control. Texas Insurance Code, Art. 21.49-1 in some cases provides the Texas Department of Insurance (TDI) a longer period of time to review affiliations. This provision could be interpreted as preventing or restricting affiliations which is prohibited under the provisions of GLBA.

PROPOSED CHANGE
Amend Texas Insurance Code, Art. 21.49-1 to shorten the review time for affiliation filings to 60 days.

POLICY IMPLICATIONS
Texas laws will conform with GLBA concerning the review period allowed for affiliation filings. Also, TDI will be required to review and take action on all affiliation filings within 60 days, thereby shortening the review period in some cases.

PROPOSAL THREE

Amend the Finance Code to Require Additional Disclosure Concerning ATM Fees.

ISSUE
Notice of fees by automated teller machines (ATMs).

BACKGROUND
The ATM Fee Reform Act of 1999, a series of amendments to the "Electronic Fund Transfer Act" (15 U.S.C. §§1693 et seq.), was enacted under GLBA, Title VII, Subtitle A. When an ATM charges a fee for providing services to customers of other institutions, these provisions of GLBA require the ATMs to notify customers of the existence of and the amount of the fee. Disclosure must appear on the machine itself and either on the screen or in a paper document printed out by the ATM. This must occur at a point that allows the customer to cancel the transaction without a fee. No surcharge may be imposed unless the notices are made and the consumer elects to proceed with the transaction.
The Electronic Fund Transfer Act explicitly preempts state law that is inconsistent with the Act, to the extent of the inconsistency. Texas law provides that ATMs may charge a fee if there is disclosure that a fee is charged, and the disclosure is made in a manner that allows the customer to cancel the transaction with no fee. Therefore, Texas law is inconsistent with the federal law to the extent the federal law is more specific concerning the content of the notice and how the notice must be provided.

PROPOSED CHANGE
Amend Finance Code, §59.202 to conform to the ATM Fee Reform Act of 1999, to ensure that notice of the ATM Fee is provided as required by the Act.

IMPLICATIONS
This proposal would provide consumers who use ATMs additional disclosure of the fees charged for use of the machine. ATMs that do not currently provide notice on the machine or on the screen and that do not disclose the amount of the fee will be required to add the additional notices and the amount of the fee in their disclosure.

PROPOSAL ONE

Enact New Privacy Laws on Non-Public Personal Financial Information as Required by GLBA.

ISSUES

Privacy of Non-Public Personal Financial Information.

BACKGROUND

Under the provisions of GLBA, states are required to adopt requirements on privacy and disclosure of non-public personal financial information applicable to the insurance industry. Federal regulators are required to adopt privacy regulations for other financial institutions. Seven federal regulatory agencies have already adopted privacy rules as required by GLBA. These rules are all very similar even though adopted by seven different federal regulators. The federal privacy rules apply to all financial institutions other than insurance companies; financial institutions must be in compliance with the federal rules by July 1, 2001. Insurance companies will be subject to the privacy requirements enacted by each and every state in which the insurance companies operate.

As a result of GLBA requirements for states to adopt privacy requirements for insurance companies, the National Association of Insurance Commissioners (NAIC) developed and adopted a model privacy regulation entitled "Privacy of Consumer Financial and Health Information Regulation." This model was developed by the NAIC in an effort to aid states in adopting consistent privacy requirements for insurance companies from state to state.

PROPOSED CHANGE

Enact privacy legislation relating to the use of non-public personal financial information. Such changes are required under the provisions of GLBA and should be based on federal law, federal rules enacted by the federal agencies, and the model regulation entitled "Privacy of Consumer Financial and Health Information Regulation" adopted by the National Association of Insurance Commissioners. For a general summary of the proposed privacy requirements see *Appendix H*.

IMPLICATIONS

Consumers will have more control over use of their non-public personal financial information. Insurance companies will have to modify their procedures and practices to conform to all of the new requirements relating to privacy. If the states' requirements relating to non-public personal financial information differ, insurance companies will have to modify their procedures and practices to comply with the differing state requirements. Financial institutions (other than insurance companies) will be required to comply with one set of privacy requirements because they are subject to only one set of federal rules on privacy. To the extent that states' privacy requirements vary, the cost of compliance for insurance companies will likely be greater than that for other financial institutions.

PROPOSAL TWO

Enact legislation to enable state agencies that regulate financial institutions to share regulatory information while maintaining confidentiality.

ISSUE

Confidentiality

BACKGROUND

GLBA authorizes a great deal of coordination and information sharing between federal banking regulators and other functional regulators (state agencies). The purpose of sharing regulatory information is to facilitate the ability of each regulator to evaluate the potential impact of the activities and financial condition of an entity's affiliates on matters within the agency's jurisdiction.

PROPOSED CHANGE

Amend the Finance Code, Insurance Code, Texas Securities Act and Government Code to provide the Department of Banking, Texas Department of Insurance, and State Securities Board authority to share regulatory information with each other, and with federal regulators. Include a provision to ensure that when regulatory information is confidential and shared with another agency, the shared regulatory information remains confidential. The legislation should also authorize the use of interagency agreements between the state agencies and between state and federal agencies.

IMPLICATIONS

This proposal would clarify that state agencies may share regulatory information with each other and with federal regulators and that the shared information, if confidential, remains confidential. Sharing of regulatory information may benefit regulated industries by enhancing the coordination of regulatory examinations. When agencies share information about regulated entities and their affiliates, the agencies may not have to conduct as many of their own examinations of affiliates.

BACKGROUND

ENACTMENT OF THE GRAMM-LEACH-BLILEY ACT OF 1999

On November 12, 1999, Congress enacted the Gramm-Leach-Bliley Act ("GLBA") also commonly known as the Financial Services Modernization Act. The Act reforms the regulation of the financial services industry and eliminates many longstanding regulatory restrictions that existed in the financial services industry prior to passage of the new law. The Act breaks down barriers among the banking, insurance and securities industry by repealing portions of the Glass-Steagall Act of 1933 and re-writing Federal banking laws (Bank Holding Company Act ("BHC") of 1956). It also delineates the regulatory responsibilities of federal and state regulators and preserves functional regulation. GLBA permits financial services companies to merge and engage in a variety of new business activities, while attempting to address the regulatory issues raised by such combinations. In addition, GLBA preempts state laws that discriminate against banks and bank holding companies; provides minimum privacy requirements to protect consumers' financial information; requires states to adopt privacy requirements for the insurance industry; and requires states to adopt uniform insurance agent licensing laws.

Prior to the enactment of GLBA, the functional powers among banks, insurers, and securities firms were entirely separate. In 1934, federal law separated securities and commercial banking and in 1955, federal law separated insurance and commercial banking. The separation of powers was designed to prevent the failure of one entity from spreading to other entities. This regulatory separation is not shared by other countries and has been considered an impediment to efficient competition in our global economy.

During the two decades prior to enactment of GLBA there were many attempts at legislation to modernize regulation of the financial services industries. There were also a number of major developments occurring during that time that highlight the scope of change in financial institutions. Some of those developments include:

- securities, insurance, and retailing companies acquired "nonbank banks;"
- South Dakota and Delaware banks were authorized to engage in insurance underwriting;
- Section 20 affiliates of major banks engaged in investment banking;
- national banks began selling insurance out of "town of 5000" offices;
- Mellon Bank acquired the Dreyfus mutual fund complex;
- the VALIC and Barnett Supreme Court decisions validating regulatory approval of national bank insurance activities resulted in an end to the "fortress insurance" opposition to reform;
- over 50 insurance and securities firms acquired thrifts and became "unitary" S&L holding companies; and
- Citigroup was created by a combination of Travelers/Salomon Smith Barney and Citcorp.[1]

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[1] Gibson, Dunn, Crutcher, LLP; Financial Services Modernization Working Summary No. 4 (December a6, 1999)

In addition to the changing nature of the financial services industry, federal agencies and courts greatly expanded the insurance and securities powers available to banking institutions through expansive interpretations of federal banking laws.[2] The changes occurring in the financial services industry and the federal interpretations of law created a strong impetus for change in the federal laws regulating the financial services industry.

The enactment of GLBA followed several years of difficult and lengthy negotiations, and as a result, the provisions of the federal law embody a patchwork of compromises among many trade organizations and federal lawmakers. GLBA did not specifically address all regulatory issues, but instead, left a number of those issues to federal and state regulators. New regulations and/or changes to existing statutes must be adopted to address the remaining regulatory issues.

IMPACT ON STATES

Generally, from a state perspective, GLBA impacts Texas as follows.

- GLBA eliminates long standing restrictions that prohibited common ownership of entities that engage in insurance, securities, and banking activities.
- GLBA preempts state agent licensing laws that prevent or significantly interfere with the ability of a depository institution to engage in the sale, solicitation or cross marketing of insurance. GLBA directs the states to develop more uniform and efficient insurance agent licensing laws. If the states fail to adopt laws consistent with the GLBA mandate, the Act provides for the establishment of a national-level, self-regulatory insurance body, the National Association of Registered Agents and Brokers (NARAB).
- GLBA directs that functional regulation concepts will govern the regulation of these combined businesses and activities. Congress chose the concept of functional regulation to establish the general regulatory parameters for the primary regulatory agencies at both the federal and state levels and to provide a process for the resolution of differences among the regulators. Functional regulation is intended to avoid duplicative regulatory burdens on the industries and, at the same time, maintain existing and applicable functional regulatory expertise where needed. As a result, to the extent that a bank, its holding company or its affiliates engage in insurance or securities sales, either as agent or principal, the entity will be subject to regulation by multiple state and federal regulators. For this reason, GLBA preserves a framework to facilitate coordinated and delineated functional regulation by the applicable federal and state regulators. In addition, GLBA provides for the sharing of confidential information among state and federal regulators.
- GLBA sets minimum requirements for privacy of non-public personal financial information and requires that applicable federal and state authorities adopt rules to implement the privacy provisions of the law.

[2] Michael W. Teichman; Reed, Smith, Shaw &McClay, LLP; The Gramm-Leach-Bliley Act; An Insurance Overview

In order to retain state control in several key areas of regulation addressed by GLBA, Texas will need to enact new laws and/or adopt new rules to address the following issues:

- privacy of non-public personal financial information;
- uniform or reciprocal agents' licensing;
- ensuring that confidential regulatory information remains confidential when shared between state regulatory agencies and with federal regulatory authorities;
- ATM Fees; and
- reduction of review period for affiliation filings.

CONFORMING STATE LAWS TO THE REQUIREMENTS OF THE GRAMM-LEACH-BLILEY ACT OF 1999

The Gramm-Leach-Bliley Act of 1999 (GLBA) contains several different and potentially overlapping provisions, but Section 104[3] most directly and comprehensively addresses preemption of state laws. GLBA, Section 104 preempts any state law that prevents or restricts an insured depository institution (state or national) from affiliating with an insurance or securities firm, or that prevents or significantly interferes with the ability of an insured depository institution to engage in the sale, solicitation, or cross marketing of insurance. The ATM Reform Act of 1999, which was enacted under Title VII, Subtitle A of GLBA, also supercedes certain state laws relating to ATM fees that are inconsistent with the federal law. Section 306[4] and certain other GLBA provisions, however, specifically permit state law restrictions that exceed those in federal law and address subjects that are possibly within the scope of Section 104. GLBA preemptions generally apply for the benefit of "depository institutions," "insurers" and their "affiliates."

A "depository institution" is a bank or savings institution or foreign bank with U.S. operations, including, without regard to whether its deposits are federally insured: (1) a national bank, federal savings bank, federal savings association state savings association, or state bank organized in the District of Columbia; (2) a state commercial bank, banking association, trust company, savings bank, savings association, industrial bank, or another banking institution engaged in the business of accepting deposits (other than funds held by an insured depository institution in a fiduciary capacity), whether organized under Texas law or the laws of another state; and (3) a foreign bank that maintains a branch, agency, or commercial lending company in the United States. Therefore, for purposes of GLBA, a depository institution is not limited to an entity commonly understood to be a "bank." Moreover, it appears that a depository institution need not be physically present in Texas to have an "affiliate" that offers nondeposit financial services and products in Texas.

The definition of "insurer,"[5] for purposes of preemption, is equally broad, including "any person engaged in the business of insurance." Thus the term includes insurance companies (underwriters), regardless of the type or nature of its charter or business, agents, adjusters, risk managers - a list without significant limits.

Finally, an "affiliate"[6] is any person or entity controlling, controlled by, or under common control with a company. GLBA's preemptive effect reaches not only to a depository institution affiliate, but also

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[3] 15 U.S.C. Section 6701

[4] 12 U.S.C. Section 6715

[5] 12 U.S.C. section 6715(g)(4)

[6] 12 U.S.C. Section 6715(g)(1)

to any entity or person "associated" with a depository institution. Exactly what constitutes a "person who has an association with any such depository institution or affiliate" is open to interpretation, but in context, would appear to cover joint venture, contractual, or other relationships among individuals, companies, or other persons engaged in financial or other activities. Because the language of GLBA is not entirely clear, litigation to test the scope and effect of state law preemption under GLBA appears likely in the foreseeable future.

INSURANCE AGENTS LICENSING

ISSUE

Modernization of the Licensing of Insurance Agents

OVERVIEW

Currently, each state, including Texas, establishes its own insurance agent licensing requirements. As a result, requirements vary from state to state. GLBA seeks to bring greater uniformity to insurance agent licensing across the states. Under the provisions of GLBA, in order for states to retain authority over the agent licensing function, at least a majority (29) of the states must adopt agent licensing laws that are uniform or allow reciprocity among the states prior to November 12, 2002. Failure to comply with these provisions of GLBA will result in the implementation of a new self-regulatory organization, the National Association of Registered Agents and Brokers (NARAB) as provided for under Title III, Subtitle C of GLBA. If NARAB is implemented then it will be responsible for the uniform licensing of insurance agents and states will lose their existing control of that function.

On January 18, 2000, the Insurance Commissioner issued Commissioner's Bulletin B-0005-00 as a partial and temporary means of providing guidance on insurance agent licensing under GLBA (*See Appendix F*). The bulletin identified several state laws that are inconsistent with GLBA. However, the bulletin did not address every preempted state law since the Commissioner does not have the statutory authority to do so.

The 76th Legislature considered legislation, SB 956 by Senator Madla, to modify the agents licensing laws. Due to an unrelated amendment added late in the session, the bill was vetoed. SB956 was intended to change the agents licensing laws to comply with financial modernization legislation that was under consideration by Congress at that time, because it was anticipated that the federal legislation would become law. Subsequent to the 76th Legislative Session, Congress enacted the legislation on financial modernization, now generally known as the Gramm-Leach-Bliley Act.

GLBA preempts many of the current Texas laws relating to insurance agents licensing, such as the statutory definition of "bank, the "place of 5000" licensing requirement, and the licensing requirements for corporate and managing general agencies. *These Texas statutes as well as a number of other agents licensing statutes are inconsistent with GLBA and are therefore preempted.*

PROPOSED CHANGE

Enact legislation to modify the licensing laws for insurance agents in Texas to conform to GLBA requirements for reciprocity by re-introducing S.B. 956 from the 76th Legislative session with minor modifications necessary to comply with GLBA.

POLICY IMPLICATIONS

This proposal would allow Texas to comply with the reciprocity requirements under GLBA and be counted as one of the majority of states enacting the required changes in law. The revisions to the laws would also permit streamlining of the agents' licensing function at TDI, reduce the number and type of agent license required, and would establish equal treatment in agents' licensing requirements for all financial institutions.

AFFILIATIONS

ISSUE

Review Time for Affiliations between Banks, Securities and Insurance Companies.

OVERVIEW

As previously noted, GLBA provides for full affiliations between banks, securities firms, insurance companies and other depository institutions. The GLBA approach is to protect functionally regulated affiliates of banks from demands by banking regulators for funds to go into banks, and to protect FDIC funds from functionally regulated affiliates. GLBA, Section 111,[7] among other things, prohibits the Federal Reserve Board from setting capital requirements for functionally regulated financial holding companies that are not depository institutions. GLBA, Section 112[8] sets up the legal framework for functional regulation. Among other matters, the Federal Reserve Board may not require insurance companies or securities firms to provide funds or other assets to subsidiary depository institutions under its "source of strength" doctrine, if the insurance company's or securities firm's primary regulator determines that transferring funds would jeopardize the parent company. The Federal Reserve Board must notify the primary regulator (of an insurance company or of a securities firm) before requiring transfers of funds; if the regulators object, the Federal Reserve Board may require the parent company to divest itself of the depository institution.

Also, under GLBA, a bank holding company may become a financial holding company by filing an election with the Federal Reserve Board under the BHC Act to engage in additional activities authorized by GLBA.

CURRENT LAW

Finance Code - Section 202.004 of the Finance Code requires a bank holding company doing business in Texas to file with the DOB a copy of any application or notice submitted to the Federal Reserve Board if the application or notice involves an office located or to be located in Texas. Therefore, a bank holding company's notice, to the Federal Reserve Board, of election of the financial holding

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[7] 12 U.S.C. 1844(c)

[8] 12 U.S.C. 1844

company status must be filed with the DOB. Texas law also captures a notice filed by a financial holding company to expand or engage in new activities, including activities that have not yet been determined by the Federal Reserve Board to be "financial in nature or incidental to such financial activity" or "complementary to a financial activity."[9]

Under Finance Code Section 202.004, the DOB may hold a hearing to aid in determining whether to approve the acquisition or activity proposed in the notice or application. The Banking Commissioner may choose not to approve the proposed acquisition or activity if he finds that it will likely cause adverse effects detrimental to the public interest, including undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. If the Banking Commissioner disapproves the proposed acquisition or activity, he must file a response to the application or notice with the Federal Reserve Board and he may also request a hearing. If the hearing is granted, the Banking Commissioner must present evidence to support his disapproval of the proposed acquisition or activity. If the Federal Reserve Board disagrees with the Commissioner's determination, the Commissioner may accept the adverse decision or appeal it pursuant to Section 9 of the BHC Act.[10]

Finance Code Section 202.005 authorizes the DOB to examine a bank holding company that controls a Texas bank, as if the holding company were a Texas state bank, and to bring an enforcement action for violation of applicable laws as if the company was a state bank. The DOB routinely participates with the Federal Reserve Board in examining a bank holding company that controls a state bank to keep informed regarding the activities and financial condition of the parent company and affiliates of the state bank.

Current state laws relating to banks, savings and loans, and other state chartered financial institutions do not prevent or restrict the affiliations contemplated by GLBA.

Insurance Code - Texas insurance law does not distinguish between different types of holding companies. If an insurance company is "controlled by" another entity, then that insurer is considered to be a part of an Insurance Holding Company System. Likewise, any holding company that owns an insurer (such as a bank holding company or a financial holding company) is considered to be an Insurance Holding Company System for the purposes of the functional regulation of insurance.

Title 1, Section 104 of GLBA,[11] provides for states to review affiliations during the sixty (60) day period prior to the effective date of the affiliation or sixty (60) days prior to the date on which the

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[9] 12 U.S.C. Section 1843(k)(1)-(4)

[10] 12 U.S.C. Section 1848

[11] 15 U.S.C. 1011 et seq.

change of control is effective. Texas law does not prevent the types of affiliations contemplated by GLBA; however, Insurance Code, Article 21.49-1 provides TDI more than sixty (60) days to review affiliations, in some cases. *Therefore, the current statute could be interpreted to prevent or restrict an affiliation, particularly in the event TDI's review of an affiliation exceeded sixty (60) days.*

PROPOSED CHANGE

Amend Texas Insurance Code, Art. 21.49-1 to shorten the review time for affiliation filings to 60 days.

POLICY IMPLICATIONS

Texas laws will conform with GLBA concerning the review period allowed for affiliation filings. Also, TDI will be required to review and take action on all affiliation filings within 60 days, thereby shortening the review period in some cases.

ATM FEES

ISSUE

Notice of fees charged by automated teller machines (ATMs).

OVERVIEW

The ATM Fee Reform Act of 1999, a series of amendments to the "Electronic Fund Transfer Act" (15 U.S.C. §§1693 et seq.) was enacted under GLBA, Title VII, Subtitle A. When an ATM charges a fee for providing services to customers of other institutions, these provisions of GLBA require the ATMs to notify customers of the existence of the fee and the amount of the fee. Disclosure must appear on the machine itself and either on the screen, or in a paper document printed out by the ATM. This must occur at a point that allows the customer to cancel the transaction without a fee. ATM owners are exempt from liability if the posted notices are damaged or removed. Financial institutions must also notify customers, when they issue an ATM card, that ATMs of other institutions may charge for services. Machines that lack the technological capability to disclose the notice on the screen or to issue the disclosure in a paper notice are grand fathered until December 31, 2004.

The Electronic Fund Transfer Act explicitly preempts state law that is inconsistent with the Act, to the extent of the inconsistency.

CURRENT LAW

Texas Finance Code, Section 59.202, provides that ATMs may charge a fee if there is disclosure that a fee is charged, and the disclosure is made in a manner that allows the customer to cancel the transaction with no fee. Because the Texas law is not specific concerning the content of the notice and how the notice must be provided, it is inconsistent with the federal law to the extent the federal law is more specific.

PROPOSED CHANGE

Amend Finance Code, §59.202 to conform to the ATM Fee Reform Act of 1999, to ensure that notice of the ATM Fee is provided as required by the Act.

IMPLICATIONS

This proposal would provide consumers, who use ATMs, additional disclosure of the ATM fees charged for use of the machine. ATMs that do not currently provide notice on the machine or on the screen and that do not disclose the amount of the fee will be required to add the additional notices and the amount of the fee in their disclosure.

GLBA PRIVACY REQUIREMENTS AND CONFIDENTIALITY OF AGENCY INFORMATION

PRIVACY

ISSUE

Privacy of non-public personal financial information.

OVERVIEW

According to the Office of the Attorney General, Texas currently has over 500 laws in place that touch on the issue of privacy and/or confidentiality. At the request of the House Committee on State Affairs, the Attorney General's Office prepared a report on current Texas laws and rules on privacy. A copy of the report is available on the Attorney General's website at www.oag.state.tx.us.

According to a recent White Paper from the Independent Bankers Association of Texas: "Privacy - what information is collected and with whom it is shared - has achieved front burner status in the United States. Recent enactments of Congress, including the Gramm-Leach-Bliley Act with Title V covering privacy issues and the Health Insurance Portability and Accountability Act have given privacy star status. These enactments plus the recent attention of the media have served to bring this matter fully to the attention of the public, who now respond to surveys with opinions that privacy is their number one issue!"[12]

While privacy of personal information is a concern for the public, it is also a concern for private companies and governmental agencies that access personal information. Telemarketers, direct marketers, insurers, providers, hospitals, financial institutions, government, employers, information bureaus, businesses, and researchers all have a desire or in some cases, a need, to access personal information. The Internet and technology make personal information more readily accessible to the public, to private companies and to government. The GLBA Conference Committee Report indicates that Congress believed that the development of new technologies that facilitate consumers' access to the broad range of products and services available through online media should be encouraged, provided that such technologies continue to incorporate safeguards for consumer privacy.

In October of this year, the Online Privacy Alliance and Dell sponsored a panel discussion for Texas high-tech businesses and state lawmakers. The purpose of the panel discussion was to provide attendees the opportunity to hear about the future of privacy regulation and what business should be doing now. Federal Trade Commissioner Orson Swindle, a member of the panel, told the group, "Privacy is on the move. If you don't tend to the issue, the government will." Commissioner Swindle also said that he did not think a government solution would be the right solution. He indicated that the Federal Trade Commission had been focusing on self-regulation by the industry and encouraged

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[12] Karen Neeley, J.D.; Long, Burner, Parks, McClellan & DeLargy, P.C.; "Dealing With the Privacy of Consumer Financial Information: The Community Bank's Action Plan"

the private sector to move forward in those efforts. The Alliance for Responsible Information Practices has indicated that industry regulation holds great promise without the potential downsides associated with government regulation.

Congress has enacted at least fourteen laws related to the use of consumer data, according to testimony from the AG's office. Some of the enactments by Congress that address privacy and access to financial records include: the Truth-in-Lending Act, the Truth-in-Savings Act, the Fair Credit Reporting Act, the Health Insurance Portability and Accountability Act (HIPAA), the Electronic Transfer Act, the Expedite Funds Availability Act, the Equal Credit Opportunity Act, the Electronic Communications Privacy Act, the Children's Online Privacy Protection Act and the Gramm-Leach-Bliley Act (GLBA). With respect to privacy requirements, this report will concentrate primarily on the privacy requirements of GLBA in responding to the Committee's interim charge relating to convergence of the banking, securities and insurance industries under GLBA.

Privacy requirements were one of the most contentious areas of concern when Congress debated GLBA in 1999. The primary area of contention related to whether the law should require financial institutions to provide consumers an "opt-in" or "opt-out" choice with respect to sharing of non-public personal financial information. "Opt-in" would mean that a financial institution could not share a consumer's personal financial information unless the consumer affirmatively chooses for the institution to have the right to share their information. "Opt-out" would mean that a financial institution could share a consumer's personal financial information, with non-affiliated third parties, unless the consumer chooses for the institution not to have the right to share their information. As finally enacted, Title V of GLBA requires financial institutions to provide consumers an "opt-out" choice. Section 502(b) of GLBA, provides that:

> "...a financial institution may not disclose personal information to a nonaffiliated third party unless - (a) such financial institution clearly and conspicuously discloses to the consumer, in writing or in electronic form or other form permitted by the regulations prescribed under section 504, that such information may be disclosed to such third party; (b) the consumer is given the opportunity, before the time that such information is initially disclosed, to direct that such information not be disclosed to such third party; and (c) the consumer is given an explanation of how the consumer can exercise that nondisclosure option."[13]

Under the provisions of Title V of GLBA, federal regulators were required to adopt federal regulations relating to financial privacy. Seven federal agencies, including the Federal Reserve Board, U.S. Treasury, Securities and Exchange Commission, Comptroller of the Currency, FDIC, Office of

[13] 15 U.S.C.A. Section 6802(b) (1999).

Thrift Supervision, and the National Credit Union Association, have developed privacy regulations to govern the use of consumer and customer financial information. These federal regulations, although developed by seven different federal regulators, are very similar. The regulations were adopted on May 12, 2000, and will be effective November 13, 2000; however, the regulations provide for enforcement of the requirements to be postponed until July 1, 2001. Therefore, financial institutions should have ample time to make the changes necessary to comply with the new federal privacy requirements.

At the state level, GLBA requires that states adopt regulations relating to the insurance industry's use of financial information and privacy of such information. If a state does not take action, then such state would be prohibited from enacting insurance consumer protections that are stronger than those adopted by federal banking regulatory agencies. Insurance companies will be subject to the privacy requirements enacted by each and every state in which the insurance companies operate.

Privacy requirements are further complicated as a result of another federal statute, the Health Insurance Portability and Accountability Act of 1996 (HIPAA), which requires all health plans, health care clearinghouses, and many health care providers, (collectively, the "Covered Entities") to implement privacy requirements for health information. HIPAA provided that Congress should enact privacy requirements for health information on or before August 1999 and in the event Congress did not act, then the Health Care Financing Administration (HCFA) was required to adopt regulations. HCFA proposed rules establishing standards for privacy of individually identifiable health information on November 3, 1999. The proposed standards would apply to electronically transmitted health information maintained by a Covered Entity, including such information when it is in non-electronic form. These proposed rules have not yet been adopted; HCFA is in the process of evaluating the numerous comments received concerning the proposed rules and finalizing the rules for adoption.

As a result of the federal rules on privacy adopted by federal financial industry regulators to comply with GLBA and federal rules that are being finalized by HCFA to comply with HIPAA, the National Association of Insurance Commissioners developed an NAIC model rule entitled Privacy of Consumer Financial and Health Information Regulation. The NAIC model is patterned after GLBA privacy requirements and federal rules adopted by regulators of financial institutions with respect to non-public personal financial information. With respect to health information, the NAIC model generally provides that financial institutions must obtain authorization prior to disclosing any non-public personal health information. This model was developed by the NAIC in an effort to aid states in adopting consistent privacy requirements for insurance companies from state to state.

In response to insurance industry concerns about when privacy requirements apply to insurance companies, the Insurance Commissioner issued a Commissioner's Bulletin B-0056-00, dated October 26, 2000, on the compliance date of privacy provisions under GLBA, Title V. The bulletin indicated that any proposed rules by TDI would not require compliance prior to July 1, 2001.

There were a total of four hearings before the Committee and Subcommittee during which various aspects of GLBA, including privacy, were discussed. The testimony generally encouraged the legislature to take a "wait and see" approach to legislation on privacy since federal regulations on health privacy had not been finalized and Congress is still considering additional legislation on privacy. Testimony from a consumer group encouraged the legislature to move forward on privacy legislation. Other testimony called for a "level playing field" for all financial institutions to ensure that one type of institution does not gain a competitive advantage over another type of financial institution as a result of differing privacy requirements. Testimony indicated that banks must comply with only one set of privacy regulations, but insurers have to comply with each states' privacy requirements, so the insurance industry is encouraging states to adopt a consistent set of privacy requirements across all states.

PROPOSED CHANGE

Enact privacy legislation relating to the use of non-public personal financial information. Such changes are required under the provisions of GLBA and should be based on federal law, federal rules enacted by the federal agencies, and the model regulation entitled "Privacy of Consumer Financial and Health Information Regulation" adopted by the National Association of Insurance Commissioners. Generally, the privacy provisions applicable to the insurance industry with respect to non-public personal financial information should include requirements to the following effect:

- **(a)** **Notice** - Each licensee shall clearly and conspicuously give notice to each consumer of its policies for collecting and sharing the consumer's non-public personal financial information. The notice must, at least, be given to ongoing customers at least annually.
- **(b)** **Opt-Out Choice** - Each licensee shall provide consumers an "opt-out" choice (i.e. the right to "opt-out" of the licensee disclosing the consumer's personal non-public financial information to non-affiliated third parties) subject to certain exceptions. The exception: the "opt-out" choice with respect to disclosures doesn't apply to affiliates under GLBA. However, under the Fair Credit Reporting Act there is currently a requirement for an "opt-out" choice with respect to sharing of application information with affiliates.
- **(c)** **No Disclosure of Account Access Information** - A licensee shall not disclose the account access information of consumers to third party marketers.
- **(d)** **Security -** Each financial institution shall have an established privacy policy (that complies with federal and state laws/rules) to ensure security and confidentiality of customer records, to protect against hazards to the security of customer records and to protect against unauthorized access to such information
- **(e)** **Access to Records** - Consumers shall have access to any personal non-public financial records maintained by a licensee and shall have the right to correct any incorrect information in those records.
- **(f)** **Non-Discrimination** - A licensee shall not unfairly discriminate against any customer or consumer who has opted out from the disclosure of his or her non-public personal financial information.

IMPLICATIONS

Consumers will have more control over use of their non-public personal financial information. Insurance companies will have to modify their procedures and practices to conform to all of the new requirements relating to privacy. If the states' requirements relating to non-public personal financial information differ, insurance companies will have to modify their practices and procedures to comply with the differing state requirements; financial institutions (other than insurance companies) will be required to comply with one set of privacy requirements because they are subject to only one set of federal rules on privacy. To the extent that states' privacy requirements vary, the cost of compliance for insurance companies will likely be greater than that for other financial institutions.

CONFIDENTIALITY

ISSUE

Confidentiality of shared regulatory information.

BACKGROUND

GLBA authorizes a great deal of coordination and information sharing between federal banking regulators and other functional regulators (state agencies). The public policy underlying GLBA encourages each federal banking regulatory agency and each functional regulatory agency, to exchange useful regulatory information, subject to written agreements that require reasonable efforts to maintain the confidentiality of exchanged information. The purpose of sharing regulatory information is to facilitate the ability of each functional regulator to discharge its regulatory responsibilities with respect to an entity within an affiliated group, by permitting the agency to assess the potential impact of the activities and financial condition of an entity's affiliates on matters within the agency's jurisdiction. Sharing of useful regulatory information can also be expected to benefit regulated industries by enhancing the coordination of regulatory examinations. An agency otherwise empowered to examine an affiliate that is primarily regulated by another agency can coordinate its activities with the other agency, such as by first attempting to obtain needed information from the primary agency that regulates the affiliate before conducting its own examination of the affiliate.

The types of information that would need to be shared, include: examination reports, information on transactions and relationships between a regulated insurer or securities firm and an affiliated depository institution, information regarding the financial condition of an entity, risk management policies, operations of a holding company that controls an insurer or a securities firm, and consumer complaints that are subject to regulation by another regulator.

GLBA addresses functional regulation at the federal level, but it necessitates a state-level response to ensure the coordination of state-level functional regulation. Due to the newly permitted affiliations between the various financial institutions, including insurance companies, state regulatory agencies have an increased need to share information among themselves and with federal regulators. *The preservation of the confidentiality of this shared regulatory information is not adequately addressed in existing state laws.*

OPERATION OF EXISTING LAWS

In general, the appropriate federal banking regulators may not provide any information entitled to confidential treatment under federal regulations or other applicable law to a state functional regulator unless the state regulator is enabled under state law to keep the material confidential and is compelled to take all reasonable steps to preserve the confidentiality of the share information. The federal regulators are also directed to treat any information obtained from a state regulator in a reciprocal fashion. Any interagency sharing of information or material between the regulators is explicitly stated to not constitute a waiver of, or otherwise affect, any privilege to which such information is otherwise subject.

Existing state and federal statutes have for many years addressed information sharing between federal banking regulators and state banking regulators, including the Texas Department of Banking (DOB) and the Texas Savings and Loan Department (TSLD), and between DOB, TSLD, and banking regulators from other states and countries, as well as other Texas regulatory agencies. Existing state laws validate and protect information sharing between DOB, TSLD, and other state and federal agencies and expressly authorize procedural agreements with other regulators regarding the handling and protection of confidential information, including Finance Code Sections 31.301, 31.303, 89.052, 96.352, 181.301, 181.303, and 201.007.

A number of statutes govern the treatment of regulatory information maintained by TDI. For example, Insurance Code, Article 1.15, Section 9 provides that examination reports and information obtained during the course of an examination are confidential by law. Article 1.15, Section 7 allows the Insurance Commissioner to use information developed during an examination to further any legal or regulatory action considered appropriate in the exercise of discretion. A variety of other state laws relating to TDI's maintenance of information also exist.

Section 28 of the Texas Securities Act protects information received from another law enforcement or regulatory agency, such as: interagency notes, memoranda, reports or other communications consisting of advice, analyses, opinions or recommendations, subject to release only pursuant to court order. The State Securities Board (SSB) may, in the exercise of discretion, disclose confidential information to a governmental authority approved by SSB rule, a quasi-governmental authority charged with overseeing securities activities approved by rule, or to a receiver appointed under Section 25-1 of the Securities Act. The SSB has adopted rules, 7 TAC Sections 131.1 and 131.2 to permit such disclosures to assist in the detection or prevention of violations of law or to further administrative, civil or criminal action.

Chapter 552 of the Government Code is commonly know as the “Open Records Act” or the “Public Information Act.” While an agency's information made expressly confidential by law is excepted from public release pursuant to this law, the statute does not explicitly address the effect on confidentiality of such information when shared among state agencies. The Office of the Attorney General has issued several opinions over the years that conclude confidentiality is not lost as a result of

information sharing.[14] Therefore, state agencies sharing confidential regulatory information have relied on these opinions to ensure that confidentiality is not lost when sharing information.

The separately developed and independent nature of existing state laws governing interagency sharing of confidential information raises uncertainties regarding more global applicability. Although there are Attorney General opinions that uphold the confidentiality of shared regulatory information, the consequences of agencies' freely sharing regulatory information are not entirely determinable under the existing laws.

GLBA provides for federal regulators to share confidential information with state regulators, but only if the state regulators can maintain the confidentiality of the information. *Language in existing state laws is not sufficiently clear to ensure that state regulators are allowed to maintain the confidentiality of shared information.*

PROPOSED CHANGE

Amend the Finance Code, Insurance Code, Texas Securities Act and Government Code, to provide the Department of Banking, Texas Department of Insurance, Texas Savings and Loan Department, and State Securities Board, authority to share regulatory information with each other, and with federal regulators. Include a provision to ensure that when regulatory information is confidential and shared with another agency, the shared regulatory information remains confidential. The legislation should also authorize the use of interagency agreements between the state agencies and between state and federal agencies.

IMPLICATIONS

This proposal would clarify in state law that state agencies may share regulatory information with each other and with federal regulators and that the shared information, if confidential, remains confidential. The legislation would provide the necessary underpinning to the interagency coordination that is essential to a system of functional regulation. Sharing of regulatory information may benefit regulated industries by enhancing the coordination of regulatory examinations and other regulatory activities. When agencies share information about regulated entities and their affiliates, this could eliminate the need for agencies to conduct their own examinations of affiliates.

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[14] See, e.g. Op. Atty. Gen. Nos. M-713 (1970), H-242 (1974), and H-917 (1976).