Insurance Consumer Protection

The Gramm-Leach-Bliley Financial Services Modernization Act (the Act) was enacted on November 12, 1999. Section 305 of the Act required the federal banking agencies (the Agencies) to prescribe and publish in final form, consumer protection regulations that apply to retail sales practices, solicitations, advertising, or offers of insurance products by depository institutions or persons engaged in these activities at an office of or on behalf of the institution. It directed the Agencies to include specific provisions relating to disclosures, advertising, sales practices, the physical separation of banking and nonbanking activities and domestic violence discrimination.

In addition to directing the Agencies to publish a regulation for the sales of insurance products, the Act establishes rules governing regulation of certain functionally regulated entities, including insurance companies. These rules govern when and how you may examine and request reports from organizations engaged in insurance activities. (See the discussion on functional regulation later in this Section).

LINKS

OTS, the Office of Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board issued a joint final rule entitled, "Consumer Protection for Depository Institutions Sales of Insurance" (ICP rule) on December 4, 2000. It took effect on October 1, 2001. OTS codified the rule at 12 CFR 536. The final rule applies to all retail sales practices, solicitations, advertising, or offers of any insurance product or annuity by a depository institution or any person that is engaged in such activities at an office of the institution or on behalf of the institution.

This Section discusses various aspects of the regulation and how it relates to mitigating consumer protection issues that may arise from insurance sales activities.

INSURANCE ACTIVITY

The business of insurance sales is an area federal thrift institutions have engaged in through related organizations, such as service corporations.

Therefore, the area of insurance sales is not a new form of business to the thrift industry. An institution may engage in insurance activities for several reasons. These include the potential to increase earnings through fee income, promote cross selling opportunities of services and products, and diversify its investments.

Insurance activities, like any other business activities, present a variety of risks to the institution and to consumers. Risks to the institution include regulatory, reputation, market share, and legal. Consumer risks involve purchasing insurance products through misleading sales practices used to confuse and blatantly deceive a consumer. An example of this is selling an insurance product or annuity to a consumer by representing that the product is fully insured by the FDIC. This is a misleading sales practice that leads consumers to misunderstand the actual nature of the insurance product.

Thrift institutions may participate in insurance activities through a variety of organizational structures. In this section, we discuss the main types of organizational structures through which the thrift institution or person(s) at an office of or on behalf of the institution, solicits, advertises, offers, or sells insurance products or annuities. The Agency also discusses (in detail) the permissibility of insurance sales and types of insurance products in the Examination Handbook, Section 720 – Insurance.

Permissible Insurance Activities

Thrift institutions may provide insurance products or annuities to consumers through a variety of delivery arrangements. In this section, we discuss the following types of sales arrangements:

- Direct sales (includes sales through an operating subsidiary).
- Third-party arrangements:
  - Affiliate sales
  - Non-affiliate sales.
  - Service corporation sales.

Direct Sales

Federal thrift institutions may engage in the sale of credit life and disability insurance, and fixed-rate annuities on an agency basis (solely upon order and for the account of customers). When exercising this authority, the thrift institution must comply with all applicable federal, and state laws, as well as certain policies and conditions imposed by the OTS.

Third-Party Arrangements

OTS permits thrift institutions to enter into third-party arrangements to sell or offer insurance products or annuities. Third-party arrangements provide an institution with the expertise and services it otherwise would have to develop or purchase. Additionally, the range of products and services offered by third parties can address the specific needs of the institution.

In establishing these arrangements, the thrift institution may look to affiliated or nonaffiliated third parties to market or sell insurance products.

Sales of an Affiliate's Insurance Products

The sale of an affiliates' insurance or annuity products by a thrift institution is a growing business practice. Over the past several years, the Agency has granted federal thrift charters to several insurance companies. In the current financial service arena, insurance companies have taken on diverse business purposes. Generally, the business plans call for interstate marketing activities and cross selling of insurance services to customers of the thrift institution.

Sales of a Nonaffiliate's Insurance Products

Nonaffiliate third party arrangements are not new to thrift institutions. Institutions have used non-affiliated third parties to perform a variety of services and functions. The most common ones being loan servicing, internal loan review, compliance reviews, external audits, as well as a multitude of others. With the ever-changing financial services industry, many thrift institutions look to non-affiliate third party arrangements to provide insurance products and/or annuities. Institutions view these arrangements as a business strategy for gaining a competitive edge in their marketplace by producing and delivering products that customers may go elsewhere to purchase.

Service Corporations

Service corporations provide an institution with a variety of benefits, one of which is the ability to conduct a variety of insurance activities on a pre-approved basis. An institution's service corporation can establish a licensed insurance agency through which it may sell automobile, health, life, property, credit life, and mortgage life and disability insurance, and fixed rate annuities.

A service corporation may also rely on a third party arrangement to market, sell, or otherwise provide insurance products or annuities. These activities can be conducted at the thrift institution or branch offices. However, if an institution utilizes its service corporation's third party vendor to provide sales of insurance products or annuities, neither thrift management nor service corporation management can abdicate responsibility for maintaining oversight of the program to the third party vendor.

Controlling Risks Associated with Third-Party Arrangements

Regardless of the type of third party arrangement (affiliate, nonaffiliate or service corporation) the institution uses to conduct its insurance or annuity sales program, institution management must establish a comprehensive compliance-monitoring program to control all aspects of the sales program and to ensure compliance with all applicable laws and regulations.

Institutions engaged in or planning to engage in the sale of insurance products or annuities through third parties, must exercise sound management practices and appropriate due diligence when implementing an insurance sales program; including, the assurance that sales activities are performed in

a responsible manner. Keys to responsible selling activities are adequate consumer protection, qualified employees, and appropriate sales practices by sales representatives. Additionally, there must be effective internal controls to facilitate both sales and their oversight.

An important element of controlling third party arrangements are the terms of the written contract or agreement between the parties. Management must ensure the agreement outlines what the institution and third party provider will do to market and sell insurance products or annuities; identify the duties and responsibilities of each party; describe third party activities permitted at an office of or on behalf of the institution; specify the duties and responsibilities of employees; identify training to be performed, and indicate compensation arrangements.

An institution relying on a third party arrangement (affiliated or nonaffiliated parties) must understand its role in the compliance process and closely monitor the arrangement to ensure compliance with the terms of the written agreement, applicable laws, and regulations. Active oversight by management is required to ensure third party sales representatives are not conducting inappropriate or prohibited sales practices targeted at confusing consumers looking to purchase an insurance product or annuity. This type of oversight must include implementation of policies, procedures, and internal controls that identify the role of third party providers, and address areas of risk presented by their sales activities. The adequacy of management's internal controls for monitoring and managing compliance in addressing areas of risk is the primary focus of OTS's review.

Compliance Risks in Selling Insurance Products

The most critical element in developing or entering into a program to sell insurance or annuities is that management recognize and understand the potential risks associated with such a program.

These risks may include the following:

- Consumer protection risk. Prohibited sales practices, misleading advertisements, or failure to provide proper disclosures misinforms consumers and sows confusion that leads buyers to misunderstand the insurance product or annuity being purchased. Failure to afford the consumer protections required by law undermines consumer welfare and increases dissatisfaction that erodes customer loyalty. Consumer protection risk includes the hazards associated with litigation expenses and damages arising from the assertion of individual causes of action.

- Reputation risk. The institution's reputation may suffer from inappropriate sales practices. Reputation risk is the risk arising from negative public opinion. This risk may affect the institution's ability to establish new customers, or to continue servicing existing customers.

- Regulatory risk. The institution has regulatory exposure for noncompliance with applicable laws and regulations, including the imposition of fines by state insurance regulators.

- Counterparty risk. An institution exposes itself to this type of risk when using a third party provider to conduct insurance or annuity sales. To limit this type of risk, an institution must establish monitoring to assure the counterparty is meeting its compliance standards and that sales activities are performed in a responsible manner.

Institution management must identify and understand these risks, given the structure of the institution's insurance or annuity sales program and then must take appropriate steps to manage those risks.

BACKGROUND INFORMATION ON FUNCTIONAL REGULATION

The Gramm-Leach-Bliley Act established rules, referred to as functional regulation, designed to minimize duplicative regulatory oversight of certain functionally regulated entities. Insurance companies and insurance agencies are included in the list of functionally regulated entities. Their primary regulators are the State insurance commissioners. However, with respect to the sale of insurance by depository institutions, the Act directed federal banking agencies to adopt regulations concerning consumer protections and to directly oversee these regulations (See Part 536 of the OTS regulations).

Essentially, functional regulation does not impede your ability to examine insurance sales activities carried out by thrift institutions or thrift holding companies for compliance with the ICP rule.

However, it may affect your ability to examine affiliates that are functionally regulated entities engaged in selling insurance or annuities at an office of or on behalf of a thrift institution.

Under functional regulation a banking agency may require reports from, examine, and take certain other actions with respect to affiliates that are functionally regulated entities, if certain conditions apply. You should consult with your regional office and review the latest agency guidance regarding examining functionally regulated entities, before finalizing your examination plan.

Information Sharing Agreements

As part of functional regulation, the Act encouraged information sharing among all regulatory agencies to reduce and prevent regulatory overlap. Accordingly, the Agency and the National Association of Insurance Commissioners (NAIC) developed and approved an information sharing agreement that has been executed by virtually all state insurance commissioners. The agreement covers the sharing of certain types of information between OTS and state insurance regulators, and outlines the standards that are followed in order for information sharing to take place.

CONSUMER PROTECTION CONCERNS RELATING TO INSURANCE SALES

Prohibited Sales Practices

Although the ICP Rule prohibits certain sales practices by institutions or by anyone selling insurance products or annuities at an office of or on behalf of the institution, State insurance laws may afford additional consumer protections. State insurance regulators can consider certain sales practices not addressed by the ICP rule as being unethical or illegal. If you identify such practices, refer potential state law violations through your regional office to the State insurance regulator for action.

As mentioned earlier, the Agency coordinates the sharing of information with state insurance departments. This sharing of information can evolve around the unethical and sometimes illegal sales practices used to confuse and mislead consumers. Additionally, consumer complaints alleging violations of the federal regulation that raise issues under State law will be shared with State regulators pursuant to information sharing agreements.

SCOPE OF THE REGULATION

Thrift institutions and other depository institutions have become increasingly involved in selling insurance products or annuities to consumers. The ICP rule establishes strict consumer protections in connection with the retail sale of insurance products or annuities to consumers.

The ICP rule applies to any thrift institution selling, soliciting, advertising, or offering insurance products or annuities to a consumer. It also applies to any other individual or entity (including a subsidiary or affiliate of the institution) selling, soliciting, advertising, or offering insurance products or annuities to a consumer at an office of or on behalf of the thrift institution. Under the ICP rule, the institution or any other individual or entity (including subsidiaries or affiliates) is considered to be a "covered person" when the individual or entity sells, solicits, advertises, or offers an insurance product or annuity and at least one of the following applies:

- The person represents to a consumer that the sale, solicitation, advertisement, or a offer of any insurance product or annuity is by or on behalf of the thrift institution;
- The thrift institution refers a consumer to a seller of insurance products or annuities and the institution has a written contractual arrangement to receive commissions or fees derived from the sale; or
- Documents evidencing the sale, solicitation, advertising, or offer of an insurance product or annuity identify or refer to the thrift institution.

The provisions of the regulation prohibit certain sales practices and misrepresentations and require disclosures to be made in connection with the sale of any insurance product or annuity to a consumer.

These provisions enhance consumer protection and lessen the possibility of confusion that insurance products often present to consumers.

The regulation deals with three key areas: (1) prohibited practices, (2) disclosures and advertising, and (3) separation of banking and nonbanking activities.

Prohibited Practices (12 CFR 536.30)

Antitying and Anticoercion Prohibitions

Tying typically involves requiring a consumer to purchase a "tied product or service" from a thrift institution or an affiliate. However, these practices are generally illegal under section 5(q) of the Home Owners' Loan Act (12 U.S.C 1464(q)). The ICP rule makes clear that tying the availability of credit to the purchase of an insurance product or annuity is a prohibited practice.

Insurance and annuity sales practices must comply with the anti-tying and anti-coercion prohibitions of the ICP rule. Under the ICP rule, a thrift institution or any person at an office of the institution, or acting on behalf of the institution, may not engage in any sales practice that would lead a consumer to believe that an extension of credit, in violation of the anti-tying provisions under section 5(q) of the Home Owners' Loan Act, is conditional upon either:

- The purchase of the insurance product or annuity from the thrift institution or any of its affiliates; or
- An agreement not to obtain or a prohibition on the consumer from obtaining the insurance product or annuity from an unaffiliated entity.

Prohibition on Misrepresentations

A second prohibited practice is the misrepresentation of the characteristics of insurance products or annuities. Misrepresentations made through sales practices or used in advertisements are strictly prohibited in the sale of insurance products or annuities. Under the ICP rule, a thrift institution, or any person at an office of the institution, or acting on behalf of the institution (or a subsidiary of the institution), may not engage in any sales practice, or use any advertisement that may mislead a consumer or otherwise cause a consumer to reach an erroneous belief with respect to:

- The fact that insurance products or annuities are not backed by the federal government, or a thrift institution;
- The fact that insurance products or annuities are not insured by the Federal Deposit Insurance Corporation;

- The fact that in the case of insurance products or annuities which involve investment risk, that there is an investment risk, including the potential to lose principal value; or

In the case of a thrift institution or subsidiary of a thrift institution at which insurance or annuity products are sold or offered for sale, the fact that:

- The approval of any extension of credit to a consumer may not be conditioned on the purchase of an insurance product or annuity by the consumer from the thrift institution or a subsidiary of a thrift institution; and

- The consumer is free to purchase the insurance product or annuity from another source.

Domestic Violence Discrimination

The third prohibited practice covered in the ICP rule is domestic violence discrimination (536.30(c)). This prohibited practice includes any practice that considers domestic violence as a criterion in any decision with regard to the offering, selling, underwriting, pricing, renewal, or payment of claims of any life or health insurance product.

Disclosures and Advertisements

In order to address concerns of prohibited and inappropriate sales practices involving misrepresentation, tying of products and coercion, covered persons must provide certain disclosures to consumers. The regulation requires two types of disclosures - insurance and credit.

Insurance disclosures are required before the completion of the initial sale of any insurance product or annuity. Credit disclosures are required at the time the consumer applies for an extension of credit in connection with which an insurance product or annuity is solicited, offered, or sold.

All disclosures must be readily understandable, meaningful, conspicuous, simple, direct, and designed to call attention to the nature and significance of the information provided. While the ICP rule does not contain model forms for disclosures, it does provide examples of the types of methods to use that call attention to the nature and significance of the information contained in the disclosures.

Adherence to the disclosure provisions of the regulation is the foundation of a well-balanced insurance sales compliance program. It is essential that consumers be made to understand potential risks associated with insurance or annuity products.

Insurance Disclosures

When offering a consumer an insurance product or annuity, a thrift institution or the person engaged in insurance sales at an office of the institution or on behalf of the institution must disclose that:

- The insurance product or annuity is not a deposit of, or other obligation of, or guaranteed by a thrift institution, or any affiliates of a thrift institution;

- The insurance product or annuity is not insured by the Federal Deposit Insurance Corporation (FDIC) or any other agency of the United States, a thrift institution or an affiliate of a thrift institution; and

- In the case of an insurance product or annuity involving investment risk, that there is investment risk associated with the product including the possible loss of value.

There are however, some instances, where the first or second disclosures may not be accurate and would therefore not be required. An example of this is the disclosure that the product is not insured by any federal agency when it actually is, such as Federal Flood Insurance, which is backed by FEMA.

Generally, the insurance disclosures discussed here must be provided both orally and in writing before completion of the initial sale of any insurance product or annuity. However, several exceptions apply to the delivery of these disclosures

Exceptions to providing insurance disclosures are as follows:

- Oral disclosures are not required when a sale of an insurance product or annuity is conducted through the mail;

- If the sale is conducted by telephone, the written disclosures may be provided by mail within three business days, beginning on the first business day after the sale (Note: Oral disclosures must still be provided);

- Written disclosures may be provided electronically, if the consumer affirmatively consents AND the disclosures are provided in a form that can be printed out or stored electronically by a consumer; and

- Oral disclosures are not required when written disclosures are provided electronically.

Credit Disclosures

In connection with an application for extension of credit, with which a thrift institution intends to offer, solicit, or sell an insurance product or annuity, additional disclosures must be provided at the time of application. Under these circumstances, a thrift institution or the person engaged in insurance sales at an office of the institution or on behalf of the institution must disclose that the thrift institution may not condition an extension of credit on either:

- The consumer's purchase of an insurance product or annuity from the thrift institution or any of its affiliates; or

- The consumer's agreement not to obtain, or a prohibition on the consumer from obtaining, an insurance product, or annuity from an unaffiliated entity.

Credit disclosures must be provided orally and in writing at the time a consumer applies for an extension of credit with which an insurance product or annuity is solicited, offered, or sold. However, several exceptions apply to the delivery of credit disclosures.

Exceptions:

- If the consumer applies for credit through the mail, oral disclosures are not required;
- If the consumer applies for credit over the telephone, the written disclosures may be mailed to the consumer within three business days beginning on the first business day after the application is taken (Note: Oral disclosures must still be provided);
- The consumer expressly agrees to receive written disclosures electronically in a form that can be retained or obtained later, such as by printing or storing them electronically; and
- Oral disclosures are not required when written disclosures are provided electronically.

Consumer Acknowledgment

A thrift institution or any other individual or entity at an office of the institution or acting on behalf of the institution must obtain a written acknowledgement of receipt from the consumer at the time insurance or credit disclosures are provided or at the time of the initial purchase. These acknowledgements must be provided in paper form or in electronic format. However, oral acknowledgments are permitted for telephone transactions, provided the thrift institution or person at an office of the institution or acting on behalf of the thrift institution, maintains sufficient documentation showing the acknowledgment was received and makes "reasonable efforts" to obtain a written acknowledgment from the consumer.

Consumer acknowledgment is a key component of the regulation because it provides documented proof that the consumer received the disclosures before purchasing the insurance product or annuity.

Advertisements

Advertisements and promotional material for insurance products or annuities generally must include the insurance disclosures. However, short form model language insurance disclosures can be used in visual media, such as television broadcasting, ATM screens, billboards, signs, posters and in written advertisements and promotional materials, such as brochures. Examples of approved short form disclosures are:

- Not a deposit;
- Not FDIC insured;
- Not insured by any Federal Government Agency;
- Not guaranteed by the thrift institution; and
- May go down in value.

Short form disclosures can only be used for insurance disclosures and do not apply in the case of credit disclosures. The credit disclosure must be provided in full text each time it is required. Disclosures made through electronic media, such as those posted on a thrift institution's web site, must be configured to ensure the consumer affirmatively consents to the required disclosure to complete the transaction. This assures the disclosure is being "meaningfully provided" to the consumer. (See 12 CFR 536.40(c)(6)(iii)).

Disclosures are not required in advertisements and promotional material when the advertisements and promotional materials are considered of a general nature. Advertisements and promotional material are general in nature when describing or listing the products offered by the institution. For example, an institution may list "credit life" or "home owners" insurance as products available from the institution, without making the disclosures. However, the regulation does not explain what types of information on products may be included in an advertisement deemed to be of a general nature.

SEGREGATION OF FUNCTIONS

Selling or offering insurance products or annuities on the premises of an institution may give the impression that these products are FDIC insured or guaranteed by the institution. In order to minimize consumer confusion, insurance sales activities are required "to the extent practicable" to be "physically segregated" from the areas in which the institution routinely accepts retail deposits from the public. The federal banking agencies clarified that the area where an institution routinely receives retail deposits is generally limited to the teller lines and teller windows.

Areas where insurance products or annuity sales take place must be clearly delineated, and distinguished from the teller lines and teller windows. However, in situations where physical space is limited, preventing sales from being conducted in a distinct area, the management of the institution has a heightened responsibility to ensure appropriate measures are in place to minimize consumer confusion.

Referral Fees

Institution employees, such as tellers and in limited circumstance platform personnel, who accept deposits from the public in an area where such transactions routinely take place, may refer a consumer seeking to purchase an insurance product or annuity to a qualified person selling that product. A

qualified person must be appropriately licensed under applicable state insurance licensing standards with regard to specific insurance products or annuities being sold or recommended. The deposit taking person making the referral (typically a teller) is entitled to receive compensation, ONLY when two conditions occur:

- First, the compensation paid for the referral is no more than a one-time, nominal fee of a fixed – dollar amount for each referral; and

- Second, the compensation is paid regardless of whether a sale results from the referral.

A thrift institution must ensure that its employees receive adequate training regarding the strict limitations on their referral activities. In general, such employees are not permitted to discuss general or specific characteristics of insurance products or annuities being offered, advertised, or sold by the institution or on behalf of the institution.

Consumer Grievance Process

Any consumer who believes that a thrift institution or any person at an office of the institution or acting on behalf of the institution violated the requirements of the regulation may file a complaint with the appropriate OTS Regional office or the Washington, DC headquarters.

REFERENCES

OTS Rules and Regulations

Part 536	Consumer Protections in Sales of Insurance.

Office of Thrift Supervision Bulletins

TB 23-2	Interagency Statement on Retail Sales of Nondeposit Investment Products
TB 23-3	Joint Interpretations of the Interagency Statement on Retail Sales of Nondeposit Investment Products

Home Owners Loan Act - (12 U.S.C. 1464(q))

Office of Thrift Supervision Guidance

New Directions Bulletin – 00-03: Functionally Regulated Affiliates (August 8, 2000)