

# CRS Report for Congress

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## Military Personnel Financial Services Protection Act: H.R. 5011, 108<sup>th</sup> Congress

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### Summary

H.R. 5011, the Military Personnel Financial Protection Act, was passed by the House on October 5, and is pending in the Senate Committee on Banking, Housing, and Urban Affairs. The bill utilizes both Congress' constitutional Commerce Power authority to enact insurance legislation, and the states' traditional regulation of the insurance industry<sup>1</sup> to create a scheme for regulating the sale of certain life insurance products to military personnel that supporters argue is fairer and more transparent than is currently the case. It amends three primary securities laws -- the Investment Company Act of 1940, the Securities Exchange Act of 1934, and Investment Advisers Act of 1940; invests the states with regulatory authority over "insurance activities conducted on Federal land or facilities in the United States and abroad"; requires sellers of life insurance products on federal facilities to make certain written disclosures to, for example, clarify that the products being offered are not recommended by the government or may be alternatively available through the government; and mandates that the Secretary of Defense maintain an easily accessible list of insurance and securities producers barred from military installations .

A number of state and federal investigators and Members of Congress have become concerned that problems exist in the sale of life insurance and mutual funds to military service members. In particular, the concerns focus on high-cost securities and life insurance products offered in a misleading manner and on excessive sales commissions assessed against the first year of contributions.<sup>2</sup>

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<sup>1</sup> Although Congressional regulation of the insurance industry remains within the scope of the Commerce Power, the 1945 McCarran-Ferguson Act (15 U.S.C. §§ 1011-1015) clarifies that "regulation and taxation by the several States of the business of insurance is in the public interest ..." (15 U.S.C. § 1011). McCarran-Ferguson, however, allows Congressional acts that "specifically relate ... to the business of insurance" to preempt state law or regulation in the area (15 U.S.C. § 1012(b)).

<sup>2</sup> "There is an extensive history of abusive and misleading marketing and sales of financial (continued...)

In response to these concerns, Representative Burns introduced H.R. 5011, the Military Personnel Financial Services Protection Act, in the 108<sup>th</sup> Congress on September 7, 2004; the bill was referred to the House Committee on Financial Services, which reported an amended version on September 29, 2004.<sup>3</sup> The House passed a further amended bill on October 5, 2004;<sup>4</sup> it is presently pending in the Senate Committee on Banking, Housing, and Urban Affairs.

Section 2 of the bill sets out Congressional findings. Among these are statements that military personnel who perform great sacrifices in protecting the United States should be offered only first-rate financial products and should be immune from abusive and misleading sales practices and from exorbitant fees.

Section 3 of the bill would add a provision to the Investment Company Act of 1940,<sup>5</sup> designated as section 27 of that act and codified at 15 U.S.C. section 80a-27, to prohibit any registered investment company 30 days after enactment of the Military Personnel Financial Services Protection Act from issuing any periodic payment plan certificate or for the registered investment company or a depositor or underwriter for a periodic payment plan certificate to sell a periodic payment plan certificate. Under the Investment Company Act a “periodic payment plan certificate” is defined as:

(A) any certificate, investment contract, or other security providing for a series of periodic payments by the holder, and representing an undivided interest in certain specified securities or in a unit or fund of securities purchased wholly or partly with the proceeds of such payments, and (B) any security the issuer of which is also issuing securities of the character described in clause (A) of this paragraph and the holder of which has substantially the same rights and privileges as those which holders of securities of the character described in said clause (A) have upon completing the periodic payments for which such securities provide.<sup>6</sup>

Despite the title of H.R. 5011, the Military Personnel Financial Services Protection Act, section 3 of the bill would prohibit sales by registered investment companies of periodic payment plan certificates to all persons, not just to military personnel. The reason given for this general prohibition is that these plans have largely disappeared from the civilian

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<sup>2</sup> (...continued)

services products on military installations. Problems have included abusive and coercive sales tactics, expensive and outdated products, and a lack of uniform regulatory oversight for on-installation sales.” H.Rept. 108-725 at 7 (October 5, 2004). *See also*, reports, studies, and articles in the NEW YORK TIMES cited in the House Report.

<sup>3</sup> H.Rept. 108-725 (October 5, 2004).

<sup>4</sup> Considered at 150 CONG. REC. H8104-H8110; vote at 150 CONG. REC. H8110 (October 5, 2004).

<sup>5</sup> 15 U.S.C. §§ 80a-1 *et seq.*

<sup>6</sup> 15 U.S.C. § 80a-2(27).

market since the 1980's because of excessive sales charges and have been marketed in recent years for all practical purposes only to military personnel.<sup>7</sup>

Section 4 would amend the Securities Exchange Act of 1934<sup>8</sup> to impose stricter requirements upon a registered securities association concerning registration information of its members. Subsection (i) of section 15A of the Securities Exchange Act<sup>9</sup> would require a registered securities association to establish and maintain a system for collecting and retaining registration information, have a toll-free telephone listing and an electronic process to receive and respond to inquiries concerning registration information on its members, and adopt rules governing the process for making inquiries. The association could charge persons, “other than individual investors,” reasonable fees for making responses to inquiries; and would also be required to adopt rules establishing an administrative process for disputing the accuracy of information provided in response to inquiries. The association would not have any liability for actions taken or omitted in good faith.

Section 5 would amend the Investment Advisers Act of 1940<sup>10</sup> to add to section 204 of that act<sup>11</sup> a provision allowing the Securities and Exchange Commission (SEC) to require an investment adviser to file with the SEC any required fee, application, report or notice through any entity designated by the SEC and to pay the reasonable costs associated with the filing. The entity designated by the SEC for these filings would be required to have a toll-free telephone listing or readily accessible electronic process to respond to inquiries concerning registration information about investment advisers. Reasonable fees could be assessed against all persons “other than individual investors” making inquiries. The entity designated by the SEC would not be liable for actions taken or omitted in good faith. Section 306 of the National Securities Markets Improvement Act of 1996,<sup>12</sup> concerning a requirement that the SEC provide a readily accessible telephonic or other electronic process to receive inquiries about proceedings involving investment advisers, would be repealed.

Section 6 makes state laws regulating the “business of insurance” applicable to “insurance activities conducted on Federal land or facilities in the United States and abroad,” except those which “directly conflict” with applicable federal law, or would not be applicable to “business of insurance” activities conducted on state land. Section 6(b) mediates, in advance, the state v. state choice-of-law issue by declaring that the laws of

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<sup>7</sup> “One securities product being offered to our service members, the contractual plan, has largely disappeared from the civilian market since the 1980s due to its excessive sales charges and the emergence of low-cost products. A 50-percent sales commission is typically assessed against the first year of contributions made under a contractual plan, even though the average commission on other securities products such as mutual funds is less than 6 percent on each sale” (section 2(4)). Although “periodic payment plan” is not defined in the bill, the “contractual plan” described in section 2(4) appears to be the same entity.

<sup>8</sup> 15 U.S.C. §§ 78a *et seq.*

<sup>9</sup> 15 U.S.C. § 78o-3(i).

<sup>10</sup> 15 U.S.C. §§ 80b-1 *et seq.*

<sup>11</sup> 15 U.S.C. § 80b-4.

<sup>12</sup> 15 U.S.C. § 80b-10, note.

the state in which the subject federal facility is located shall govern, unless the facility is located outside of the United States. In that case, if the subject of regulatory activity is an individual, the law of the state in which that individual has been issued a resident license shall be applicable; if the subject of regulatory activity is “an entity engaged in the business of insurance,” the law of the state in which that entity is domiciled shall govern.

Section 7(a) expresses the intent of Congress that within 12 months from the enactment of H.R. 5011 (1) the several states should work collectively with the Secretary of Defense to promote “appropriate” standards that will “protect members of the Armed Forces from dishonest and predatory insurance sales practices while on a military installation”; and (2) each state should identify its own role in furthering the cited protections. Within the same time frame, the National Association of Insurance Commissioners (NAIC) is mandated to conduct a study, after consultation with the Secretary of Defense, on the progress of the states in implementing the activities Congress has urged, and to submit a report of its findings to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs.

Section 8 imposes certain written (“in plain and readily understandable language”) disclosure requirements on insurance entities and insurance agents who sell “any life insurance product to any member of the Armed Forces on a military installation.” The disclosure document must indicate that the product is in no way sanctioned or recommended by the government, that alternative (and subsidized) life insurance may be available through the federal government, and must contain, unless applicable state law otherwise provides, the address and phone number of the state Insurance Commissioner where consumer complaints may be directed. Insurers or insurance agents who intentionally fail to make the required disclosures, as determined by either a state or federal agency or in a final court proceeding, are to be prohibited from engaging in the “business of insurance” with respect to “employees of the Federal Government on Federal land,” except for activities with respect to existing policies or those “specifically” contracted for by the federal or a state government. In the event that a majority of states adopt materially identical standards<sup>13</sup> concerning the required disclosures, those standards are to supplant those set out in Section 8.

Section 9 expresses the sense of Congress that NAIC should, within 12 months of H.R. 5011's enactment, conduct a study of ways in which the quality and sale of life insurance products on military installations might be improved, and submit such study to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs. In the event that NAIC does not submit the requested report, the Comptroller General of the United States is directed to submit a report on the subject to the designated House and Senate Committees within the six months following the expiration of NAIC's 12-month time allotment.

Section 10(a) would, two years after enactment of H.R. 5011 prohibit insurers from entering into or renewing contractual relationships with producers who solicit or sell life insurance on military installations unless the insurer had implemented a system for reporting to the Insurance Commissioners in both the insurers' state of domicile and the

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<sup>13</sup> Defined in section 8(d)(3) as those which “require or prohibit identical conduct with respect to the same activity.”

producers' states of residence significant disciplinary actions taken against the producer by the insurer<sup>14</sup> or any action the insurer knows has been taken by any government entity. In addition, Congress expresses its intent that, within the same time period, the states should collectively implement a system to receive reports of the disciplinary actions described in section 10(a), and to disseminate them to all of the states and to the Secretary of Defense (section 10(b)).

Section 11 mandates that the Secretary of Defense: (1) maintain a list (name, address, other "appropriate" information) of persons in the securities or insurance industries who have been barred, banned, or "otherwise limited in any manner" from engaging in those businesses on military installations (section 11 (a)). The Secretary is further directed to notify federal and state agencies responsible for securities and insurance regulation of the inclusion or removal from the Defense Department list, which is to be kept "current and easily accessible" (section 11(b)); and, within 60 days after the enactment of H.R. 5011, to issue regulations concerning such list, submitting the proposed regulations to the House and Senate committees noted previously prior to any publication in the Federal Register. The final regulations are to become effective 30 days after being submitted to those committees, which submission is to occur not later than 90 days after the enactment of H.R. 5011 (section 11 (c)).

Section 12<sup>15</sup> expresses the sense of Congress that the federal and state agencies responsible for insurance and securities regulation should advise the "appropriate" federal entities concerning the following three items: "significantly increasing" the availability through the federal government of life insurance coverage to members of the Armed Forces; encouraging members of the Armed Forces to become financially literate and to obtain "objective financial counseling" before they purchase life insurance in addition to that available through the federal government; and improving Thrift Savings Plan benefits and matching contributions available to members of the Armed Forces.

Section 13 defines "entity" as including insurers; "individual" as including insurance agents and producers; "state insurance commissioner" as that officer, agency, or "other entity" with primary regulatory authority over persons engaged in the business of insurance in a state. There is no definition of "state."

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<sup>14</sup> "Significant" is not defined in the bill.

<sup>15</sup> The designation of this section as "Sec. 11," as well as the following section as "Sec. 12," would seem to be the result of typographical error, as they directly follow "Sec. 11" and "Sec. 12."