Statement of Glen Milesko

On Behalf of the

American Bankers Insurance Association

Before the

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

Of the

Committee on Financial Services of the

United States House of Representatives

June 18, 2002

Mr. Chairman and Members of the Subcommittee:

My name is Glen Milesko, and I am the President and Chief Executive Officer of Banc One Insurance Group. I am here today on behalf of the American Bankers Insurance Association ("ABIA").[1] My testimony today also reflects the views of the American Bankers Association.

ABIA's members are banking organizations, insurance companies and third party administrators engaged in the business of insurance. Banc One Insurance Group, for example, is one of the nation's leading bank providers of insurance. It is comprised of a nationally licensed, full line insurance agency with over 5,000 licensed agents; a multi-state insurance agency, a life insurance company, one life and two property and casualty reinsurance companies; one multi-state direct credit life insurance company; and an international life reinsurance company located in Dublin, Ireland.

ABIA Supports Optional Federal Insurance Chartering

ABIA appreciates the opportunity to appear before the Subcommittee as it examines the regulation of insurance and the option of federal chartering for insurers and

[1] The American Bankers Insurance Association (ABIA) is a separately chartered trade association and non-profit affiliate of the American Bankers Association representing more than 250 of the nation's largest banks and insurers. ABIA's mission is to develop positions and strategies on bank-insurance related matters, represent those positions before state and federal governments and in the courts, and support bank-insurance related programs and activities through research, education and peer group information sharing.

producers. Over four years ago, ABIA developed its own "blueprint" for the optional federal chartering of insurers and producers. That blueprint called for the creation of an insurance regulatory system patterned after the dual banking system.

We believe that any insurer and any producer should be able to voluntarily choose to be regulated either by the Federal Government or by state governments. Such a system is not intended to replace state regulation – but to be an alternative to state regulation. This option has worked well in the banking industry, and we see no reason to believe it could not work well in the insurance industry.

When we first developed our blueprint, Congress was actively debating the Gramm-Leach-Bliley Act. Therefore, we put the blueprint on the "back burner" until action on that bill was complete. Once the Gramm-Leach-Bliley Act was finalized, we made optional federal chartering a priority for our Association. We converted our blueprint into a specific legislative proposal, and unveiled it at a conference organized by the American Enterprise Institute.

As you might expect, our proposal received a mixed reception. While the proposal received some quiet encouragement from certain sections of the insurance industry, it was roundly criticized by several insurance trade groups and state insurance regulators. Also, some in the insurance industry wondered why a banking association was concerned about insurance regulation. The fact is that the banking industry is actively engaged in the business of insurance. As of year-end 2001, there were approximately 1900 banking institutions engaged in the business of insurance, mostly through agency operations. The total premium volume for insurance policies and annuities sold by those institutions was

approximately $50 billion. It was through this involvement in the business of insurance that ABIA's banking members concluded that state insurance regulation was not suitable for all insurers and producers, especially those firms engaged in activities in multiple states.

It is now apparent that ABIA's concerns are widely held. The leading trade associations for property and casualty insurers and the life insurers also have developed proposals for optional federal insurance chartering. While their proposals reflect concerns unique to their respective organizations, the similarities between our proposal and their proposals are striking. Their proposals, like ours, are designed to permit insurers to voluntarily select a single regulator and a single set of regulations, rather than 55 regulators and 55 different sets of rules.

Given this convergence of interests, ABIA recently joined with the American Council of Life Insurers and the American Insurance Association - under the umbrella of the Financial Services Coordinating Council - to develop a common optional federal chartering proposal. The first step in that cooperative effort was the development of a set of principles, around which any legislative proposal should be structured. The principles provide for the establishment of a federal insurance regulatory authority within the Treasury Department that would be headed by a person appointed by the president and confirmed by the Senate for a fixed term. This regulatory authority would regulate exclusively federally chartered insurers and producers. State chartered insurers and producers would continue to be regulated by state regulators. Federal insurers and producers, not taxpayers, would be responsible for the ongoing costs of federal supervision

and regulation. A copy of the joint principles is attached to my statement and a more detailed discussion of them can be found in the Statement by the Financial Services Coordinating Council that also is being presented today.

Consumer Protections and Optional Federal Chartering

You have asked that ABIA specifically address how optional federal chartering would affect consumers. We are pleased to do so. ABIA's member companies are driven by the needs and demands of consumers, so we recognize that any optional federal chartering proposal must be responsive to those needs and demands.

ABIA believes that optional federal chartering will benefit consumers in three primary respects:

- *It will assure consumers access to sound insurance products with consistent consumer protection standards;*
- *It will be responsive to the changing needs of consumers; and*
- *It will create a dynamic tension between state and federal regulators that is in the best interests of the consumers of insurance.*

The remainder of my statement discusses each of these consumer benefits.

Optional Federal Chartering Will Assure Consumers Access to Sound Insurance Products with Consistent Consumer Protection Standards

Optional federal regulation of insurers and producers can fully and fairly protect the rights and interests of the consumers of insurance through the establishment of federal

solvency and market conduct standards.

Federal Solvency Standards

ABIA believes that any optional federal chartering bill should require federally chartered insurers to meet strict solvency standards. For example, federally chartered insurers should be required to meet risk-based capital standards, which ensure that federal insurers are adequately capitalized and which impose sanctions on federal insurers that fail to meet applicable capital standards; to follow investment standards, which require a federal insurer to invest assets prudently and which place quantitative limits on investments in subsidiaries engaged in activities not permissible for the insurer; and to comply with dividend restrictions, which prevent insolvent federal insurers from paying dividends. Such federal solvency standards would give consumers confidence that a federally chartered insurer will be able to pay claims on its policies.

The federal insurance regulator also should be given adequate authority to enforce compliance with federal solvency standards. This should include the authority to require federally chartered insurers to file regular reports on their operations and financial condition; the authority to regularly examine federally chartered insurers, and to the extent appropriate, their affiliates; and the authority to initiate an enforcement action against federally chartered insurers that fail to comply with applicable standards. Such enforcement powers should be patterned after those available to federal banking regulators, which include the power to remove officers and directors and to impose civil money penalties of up to $1 million a day.

The combination of federal solvency standards backed by regular examinations and enforcement actions would signal to consumers that federally chartered insurers are safe and sound.

Federal Market Conduct Standards

Federally chartered insurers — and federally licensed producers — should be subject to federal market conduct standards. Such standards would protect consumers by preventing unfair methods of competition and unfair and deceptive acts and practices in the advertising, sale, issuance, distribution and administration of insurance policies.

Critics of optional federal chartering often claim that a federal insurance regulator would not be able to adequately police sales and claims practices by federal insurers or producers. Some of these critics even cite the hundreds of thousands of consumer complaints filed annually with state insurance regulators in support of this claim. Federal regulation of the banking industry shows, however, that federal agencies can effectively enforce consumer protection standards.

Today, thousands of banks are offering a variety of products to consumers through hundreds of thousands of branches, ATMs, loan production offices and other outlets throughout the United States. These banks are subject to federal consumer protection statutes such as the Truth-in-Lending Act, the Truth-in-Savings Act, the Fair Credit Reporting Act, and the Equal Credit Opportunity Act. The federal banking agencies, which are responsible for enforcing compliance with these various consumer protection laws, have been able to fully and effectively enforce compliance with the laws. They have

done so through a combination of regular examinations and the threat of enforcement actions. Federal market conduct standards for insurance monitored through regular examinations and the potential for significant enforcement action should work equally well for the consumers of insurance.

In fact, the combination of federal market conduct standards monitored through regular examinations and the potential for enforcement actions should provide insurance consumers better protection than currently exists in many states. The number of consumer complaints filed annually with state insurance commissioners is not a sign of successful state market conduct regulation. Those complaints indicate that something is wrong with state market conduct regulation — otherwise consumers would not need to file so many complaints. The fact is that several states do not conduct market conduct examinations, especially of producers, and this allows certain insurers and producers to engage in practices that are harmful to consumers. Additionally, since there is no central licensing and registration, "rogue" insurers and producers can move from state to state undetected. A recent example is the Frankel case, which allowed an unscrupulous individual to defraud several state regulators and embezzle $200 million before being detected. Federal market conduct standards, regular examinations and the threat of enforcement actions would effectively deter such harmful practices.

One so-called consumer protection that should **<u>NOT</u>** be part of any optional federal chartering proposal is rate regulation. As a general rule, we believe that consumers will be better served if federally chartered insurers are not subject to price controls. Price controls may be appropriate in non-competitive markets. In such situations, a single firm or a

group of firms may be able to set and hold prices at unreasonable levels. The insurance industry, however, is a competitive industry. There are thousands of insurers operating in the United States, and there are no significant barriers to entry for new companies. In such a competitive market, competition between firms will protect consumers from unfair pricing schemes.

The consumer benefits associated with competitive rates are more than just speculative. Several states already have moved away from rate regulation, and, in those states, there is evidence that rates have fallen on certain products. For example, a recent study by Scott Harrington for the AEI-Brookings Joint Center for Regulatory Studies entitled "Insurance Deregulation and the Public Interest" found that auto insurance is less costly and more available in 14 states that do not require prior approval of rates than in 27 other states that do require prior approval.

We do not suggest, however, that any optional federal chartering proposal leave the matter of rates entirely to market forces. We recognize that even in the most competitive of markets, price collusion can exist. Therefore, ABIA supports the application of federal anti-trust laws to federally chartered insurers. The application of these laws would guarantee that rates are set fairly by market forces.

Also, we recognize that the problem for many consumers is not cost, but access. Some consumers cannot obtain needed insurance at any price. The states have adequately addressed this issue through the establishment of so-called "residual" insurance programs, which require insurers to provide certain categories of property and casualty coverage, such as auto and homeowners insurance, to consumers who cannot obtain such insurance

in the open market. Federally chartered insurers that write such policies should be required to participate in such state programs, subject to all applicable state rules, including rate limitations.

Optional Federal Chartering Would Be Responsive To the Changing Needs of Consumers

In addition to providing consumers with sound products in a fair manner, optional federal chartering will meet the changing needs of consumers by giving them access to new and more uniform products. Under the current state system of insurance regulation, it can take months, if not years, for a company to introduce a new product in every state. Such delays are an inevitable result of a system in which every state has an opportunity to review and approve insurance products. With a single federal insurance regulator, however, it would be possible for a federally chartered insurer to introduce a new product without delay. This will enable federal insurers to design new products as the needs of consumers change.

Additionally, optional federal chartering would allow new products, and the delivery of those products, to be more uniform. For example, under an optional federal chartering system, the same life insurance policy could be offered in every state.[2] Similarly, it would permit a company to use the same policy form, same disclosure statements, and same administrative procedures throughout the United States. Uniform

[2] We assume, however, that even with an optional federal charter there could be state-by-state variations in property and casualty policies consistent with applicable state law.

policies and sales practices would reduce consumer confusion, especially for those consumers that move from state to state for professional or personal reasons. An added benefit of uniform administration of insurance products on a national basis is that companies can achieve greater economies of scale thereby reducing costs to the insurer, which can be passed on to the consumer.

Having a federal regulator would also provide for swift responses to consumer needs during times of crisis, such as the recent terrorist attacks or during a natural disaster. A federal regulator could respond with "one voice" rather than relying upon 55 separate regulators to collectively agree to a solution.

Uniform regulation also will facilitate delivery of insurance products over the Internet. As we all know, the Internet can reach consumers, regardless of where they are located. To date, however, the use of the Internet to deliver insurance products has been complicated by variations in state insurance sales laws. A single federal sales practice standard obviously would not be subject to such complications and, thereby, would expand consumer access to insurance products through the Internet.

Optional Federal Chartering will create a dynamic tension between state and federal regulators that is in the best interests of the consumers of insurance.

The commonly agreed upon model for optional federal chartering is the dual banking system. Under that system a bank can voluntarily choose either state or federal regulation. Since the dual banking system has been in place for over 135 years, the best way to judge how optional federal chartering for insurers and producers would affect consumers of insurance is to take a closer look at the dual banking system. A discussion of

the dual banking system and the benefits it has brought to banking regulation and supervision is attached to my statement.

It is interesting to note that the authors of the dual banking system were President Lincoln and his Secretary of the Treasury, Salmon Chase. Apparently, Lincoln, as a young man, recognized that a national banking system was important to the economy. Therefore, after he became President, he worked with Secretary Chase to secure enactment of the National Bank Act, which provided for the chartering and regulation of national banks.

While there is evidence that President Lincoln intended national banks to replace the then existing system of state banks, that has not been the case. Today, approximately two-thirds of all banks are state-chartered, and those banks control approximately 40 percent of all banking assets. Therefore, contrary to the concerns of state insurance regulators, optional federal regulation will not replace state regulation.

Moreover, the dual banking system has created a healthy tension between state banking departments and their federal counterparts, including the Comptroller of the Currency. This healthy tension has stimulated the development of new products and services for consumers and new and better supervisory techniques by both state regulators and the OCC. It has also fostered more efficient supervision as the respective regulators vie to keep their costs of regulation reasonable. Said another way, the dual banking system has not precipitated a race to the bottom in regulation.

Critics of optional federal chartering will, nonetheless, cite the savings and loan crisis as a failure of the dual banking system. We would not attempt to defend that

scandal. We would suggest, however, that the causes of the savings and loan crisis are many and complex. More importantly, following the savings and loan crisis, Congress passed two laws, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and the Financial Institutions Regulatory Reform and Enforcement Act (FIRREA), to redress deficiencies in the regulation of state and national banks and savings associations, and we assume that any optional federal chartering bill that is considered by Congress will incorporate many of those safeguards.

In sum, we see no reason to believe that the dynamic tension inherent in a dual regulatory system would not produce a strong supervisory environment for insurance firms and lead to the development of new products and services for insurance customers, just as it has done for the banking industry and banking customers.

National Standards

Finally, I would like to make an observation on one alternative to optional federal chartering, the creation of federal standards to be applied by the individual states. This concept could take two forms, neither of which is preferable to optional federal chartering.

On the one hand, federal standards could serve as minimum standards for the states, permitting states to layer further regulation on top of those mandated by the federal government. Under this scenario, federal standards would fail to achieve the uniformity and efficiency of regulation sought by ABIA and other advocates of optional federal chartering. In fact, minimum federal standards only would exacerbate the current patchwork of differing laws with which insurers and producers have to deal by merely

adding another layer of regulation to the existing balkanized system of state regulation.

On the other hand, federal standards could be mandatory and exclusive. As such, the federal standards would not be an alternative to state regulation; they would replace state regulation. This alternative would intrude on the states to a much greater degree than an optional federal regulator which would leave state regulation untouched and the state system to its own devices. Instead of creating regulatory alternatives brought about by an optional federal charter and the healthy dynamic such alternatives engender, mandatory federal standards would spell the demise of state regulation, a result the critics of optional federal chartering are trying to avoid.

Summary

In closing, I wish to again thank you for the opportunity to appear here today. This is an important issue for the members of ABIA, and if we can be of any further assistance to you as you consider optional federal charters, I hope you will call upon us.

Financial Services Coordinating Council

Representing America's Diversified Financial Services Community

Principles for Federal Insurance Regulation

The Financial Services Coordinating Council was formed by the four principal trade associations representing the major financial sectors of the U.S. economy to address issues of common concern at both the federal and state levels.

Its members are the American Bankers Insurance Association/American Bankers Association, American Council of Life Insurers, American Insurance Association, and Securities Industry Association. These organizations represent thousands of large and small banks, insurance companies, agencies and agents, and securities firms that, taken together, provide financial services to virtually every household in America.

Given the national and international market for insurance products, the time has come to provide a federal option for the chartering and regulation of insurance firms. The lack of regulatory uniformity, coordination and responsiveness in the state-based insurance regulatory system is unnecessarily costly and burdensome and has resulted in negative competitive implications for insurance companies, insurance agencies, and their customers. The securities and banking industries have long been subject to regulation by the Federal government, which is designed to protect the interests of consumers, regardless of where a product is sold or where the consumer resides. The federal chartering and regulation of insurance firms would extend uniform regulation to all areas of insurance, particularly with respect to products, producers, solvency, and market conduct protections to consumers.

Optional federal chartering and regulation should be based upon the following principles:

<u>The Federal Charter</u>

- *National Treatment* --- Insurers must have the option of obtaining a single charter that would allow them to do business in all jurisdictions.
- *Universal* --- The federal charter must accommodate all lines of insurance and must be equally available to all insurers, regardless of corporate form (stock, mutual or fraternal) or size, and must provide for the federal

chartering or licensing of insurance producers (agents and brokers) and insurance agencies.

- *Convertible* --- Insurers must have an unqualified right to convert both from a state to a federal charter and from a federal charter to a state charter, and a holding company must be permitted to control both a federally chartered and a state chartered insurer.

- *Specialized* --- The federal charter must take into account the inherent differences among different lines of insurance – life, health and property-casualty.

- *Dynamic* --- The federal charter must permit federal insurers to respond quickly to changes in the market place, consumer demands and technology.

The Federal Regulator

- *Single Regulator* --- The federal insurance regulatory authority should be a discrete bureau within the Treasury Department headed by an individual appointed by the President and confirmed by the Senate for a fixed term (on a par with the OCC and OTS).

Federal Regulation and Supervision

- *Financial/Solvency Regulation* --- A federal insurer must be subject to strong solvency regulation and supervision (e.g., capital and reserve levels, investments and accounting).

- *Regulation of Insurance and Forms* --- Federal law should establish an expeditious process for addressing policy forms, which encourages innovation and does not delay the development and marketing of new products. Federal law should rely upon competitive market forces to establish premium rates, rather than government price controls.

- *The Costs of Regulation* --- Federal insurers and producers, not taxpayers, should be responsible for the ongoing costs of federal supervision and regulation.

Consumer Protections

- *Market Conduct Standards* --- Federal insurers and producers must be subject to strong market conduct regulation and supervision.

- *Guarantee* --- Federal insurers and their customers must enjoy the same high level of protection in the event of an insolvency as state chartered insurers and their customers, and the existing insurance guaranty mechanisms must remain in place and accommodate the participation of federal insurers.

- *Antitrust* --- While exclusions from federal anti-trust laws provided by the McCarran-Ferguson Act should not apply to federally chartered insurers, limited safe harbors should be provided for legitimate joint activities.

- *Special Needs* --- Federal insurers should participate in state programs designed to meet the insurance needs of consumers who cannot obtain insurance. Federal insurers also should be free but not required to continue existing investment programs benefiting low and moderate income communities.

Relationship to State Regulation

- *Optional* --- The federal charter must be optional since the availability of a viable state insurance regulatory system is integral to the dual chartering concept.

- *Exclusive Regulation* --- A federal insurer or producer must be regulated exclusively by the federal insurance regulator in all areas defined by statute as being within the jurisdiction of the federal regulator. Conversely, state chartered insurers and producers must be regulated exclusively by state regulators.

- *Taxes* --- Federally chartered insurers must remain subject to the authority of the states to impose premium or corporate income taxes. Choice of charter should not affect the overall state and federal corporate or policyholder tax burdens of individual insurers.

- *Fair Treatment* --- States must be prohibited from discriminating against federal insurers and producers.

THE BENEFITS OF CHARTER CHOICE

THE DUAL BANKING SYSTEM AS A CASE STUDY

> ***"Diversity increases the chances that innovative approaches to policy problems will emerge… A sole regulator, not subject to challenge from other agencies, might tend to become entrenched, conservative, and shortsighted."[1]***
>
> U.S. Treasury Department

The United States has the strongest and most innovative banking system in the world, in large part because banks have the choice of being regulated by the state or federal government. This choice creates a healthy dynamic tension among regulators, resulting in a wider range of products and services available to consumers, lower regulatory costs, and more effective, more responsive supervision.

Dual chartering of banks has over a 130-year history in our nation. It was in 1863, after 80 years of solely state regulation, that the federal government began chartering and regulating banks. The National Bank Act signed that year did not replace the state system, as many people expected. It offered banks the choice of having a state or national charter.

Simply put, dual chartering in banking has strengthened the state charter, fostered innovation in financial products, and enhanced financial supervision.

Dual chartering in banking has strengthened the state charter.

The institution of the federal banking charter in the 1860s has strengthened the state charter, forcing the states to continually improve the charter. The "death" of the dual banking system has been forecasted on many different occasions, yet dual chartering continues to thrive. For example, in the 1800s, each state bank had the authority to issue its own currency in the form of bank notes. To discourage the issuance of state bank notes and to promote a uniform currency, the federal government imposed an annual 10 percent tax on such notes in 1864.

Some believed that state note taxation would end the states' experimentation in regulating banks. However, these expectations were wrong. The state bank response was to develop the checking account – still the dominant means of making payments almost 130 years after its inception.

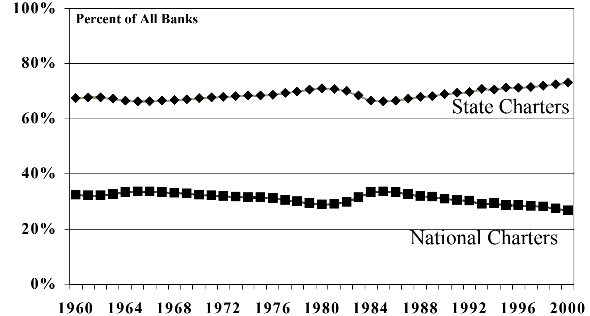
Federal Reserve Board Chairman Alan Greenspan, reflecting on this piece of banking history, noted the continued strength of the state charter:

> Any forecast at that time would quite reasonably have concluded that state banks would become historic relics. Such a projection, however, would have been quite wrong, beginning what has become an unending stream of such erroneous forecasts about the demise of state banks. Forced to find a substitute for notes, state banks

pioneered demand deposits. Within ten years after the note tax, state banks had more deposits than national banks--a lead maintained until 1943. By 1888, only 20 years after the low point, there were more state banks than national banks (approximately 3,500 vs. 3,100), a lead maintained to this day.[2]

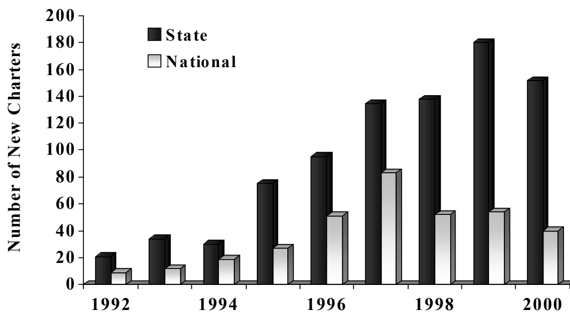
Today, over 70 percent of banks currently operate under the state charter. "I cannot overemphasize the benefits of the dual banking system," said former FDIC Chairman William Isaac. "The history of banking in this country reveals ebbs and flows in the attractiveness and dominance of the state-chartered and nationally-chartered banking systems, as the respective legislative and regulatory bodies were more or less responsive to changing conditions in the industry."[3]

Over Seventy Percent of Banks Have State Charters



Source: Conference of State Banker Supervisors

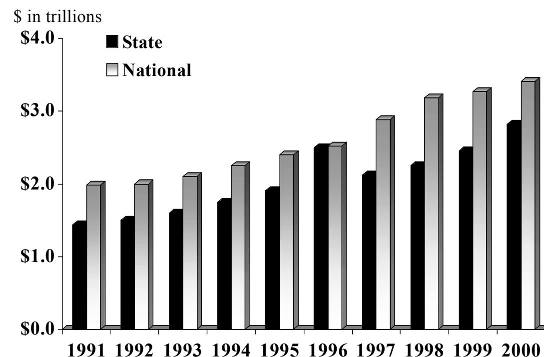
New Charters of National vs. State Banks



Currently, the state charter is the charter of choice for the majority of organizers of new banks, pointing to its continued viability. In 2000, 152 new state banks began operations, compared to just 40 new national banks, continuing a trend that has persisted since 1985.

The preference for the state charter during the 1990s has caused the state bank share of total bank assets to increase from 42 percent to over 45 percent during the decade. Despite increasing their share of overall industry assets, state-chartered banks are on average smaller than their national bank counterparts. However, this should not connote fear that state banks will be dominated by national banks. Among the 100 largest commercial banks, 45 have state charters. Ultimately, the business model employed by the commercial bank best determines the selection of charter type.

Assets of State vs. National Charters



AMERICAN BANKERS INSURANCE ASSOCIATION

Dual chartering fosters innovation in financial products.

For over a century, allowing charter choice has compelled state and federal regulators to continually improve the characteristics of their charters, leading to the current wide array of products and services available to consumers. Again it was William Isaac who said, "A decentralized regulatory structure can provide more opportunity and incentive for experimentation and innovation by banking firms and regulators alike."[4]

Many bank products and services that now seem commonplace evolved as a result of the regulatory competition fostered by the dual banking system. Innovations like variable rate mortgages, home equity loans, and interest-bearing transaction accounts, even the checking account, first appeared in banks under the jurisdiction of state regulators. Through initiatives of federal regulators, banks have been able to sell annuities, expand securities and mutual fund activities, and certify the security of Internet transactions – all to the benefit of bank customers.

Studies have actually argued that *not* having both federal and state charters in banking would inhibit financial services competition and its benefits for consumers. A 1986 study, for instance, concluded, "the dual banking system [has] mitigated the tendency of regulators to stifle innovation and restrict new entrants."[5]

Dual chartering fosters better financial supervision.

Providing a choice between regulators gives a broad perspective and guards against rigidity. This regulatory flexibility is important in maintaining bank competitiveness in this era of financial modernization, where banks, securities firms and insurance companies are combining operations under a single financial holding company. According to Professor Edward Kane, "… overlapping federal and state regulators looks in the short-run like wasteful duplication; but leads in the long-run to better-adapted regulatory rules."[7]

Some observers have argued that dual chartering reduces the attentiveness of regulators to safety and soundness issues. This has not been the case with banking. To the contrary, regulatory choice provides important checks and balances.

"A system in which banks have choices, and in which regulations result from the give and take involving more than one agency, stands a better chance of avoiding the extremes of supervision."[6]

Federal Reserve Chairman Alan Greenspan

Permitting financial institutions a choice of charter forces regulators to update and improve examination techniques and examiner training, lest supervised institutions abandon them out of frustration. Regulators are forced to maximize efficiency. If a regulator does not control costs, institutions may shift charters to escape exorbitant supervisory fees. Moreover, regulatory authorities are encouraged to take a healthier, more positive posture on financial innovation and risk-taking when there are charter alternatives. *Regulatory choice drives down costs and*

increases the speed with which new products and services are developed.

Federal Reserve Chairman Alan Greenspan agrees: "Banking supervision and regulation can only benefit from the variety of viewpoints and checks and balances of a system of more than one regulatory authority. A system in which banks have choices, and in which regulations result from the give and take involving more than one agency, stands a better chance of avoiding the extremes of supervision... A single regulator, charged with responsibility for safety and soundness, is likely to have a tendency to suppress risk taking. A system of multiple supervisors and regulators creates checks on this propensity."[8]

An equally important strength of the dual system according to Isaac, is that it "embodies a system of checks and balances between two levels of government and helps to ensure the decentralization of decision-making power. It serves as a safety valve against concentration of power in the hands of a few decision-makers, who can become imperceptive or complacent, and against the potential for abusive or simply unwise actions."[9]

This decentralization of decision-making in bank regulation has created an environment where state and federal legislative bodies and banking regulators must work together on regulatory and other policy matters that enhance financial supervision. There are many examples of state-federal cooperation. State and federal legislative bodies worked together to form the basis for first regional and then nationwide interstate banking. State-federal regulatory working groups operate across the nation on an ongoing basis to detect and deter bank fraud and share regulatory findings. Other examples include the development of consistent bank supervisory examination reports across state and federal bank regulatory agencies. State and federal agencies also accept each other's examination reports as if they were their own, and share examination report software and other technology, reducing the potential duplication of effort that could occur if there was not a high level of cooperation between them.

Conclusion: Dual chartering works.

The bottom line is that dual chartering works. It has strengthened the state charter, forcing the states to improve the charter in order to remain competitive. It also has fostered innovation in financial products, leading to the current wide array of products and services currently available to consumers. And, it has led to better financial supervision by providing a variety of viewpoints and checks and balances in our system of financial regulation.

Chairman Greenspan has argued that the absence of the dual system could actually hurt consumers, and the economy: "when there is no choice of regulatory agency, rigid policies and interfering regulatory micro-management can develop."[10] The alternative to dual chartering is thus potentially poorer services and less financial support for consumers, businesses, and ultimately, the national economy.

[1] U.S. Department of the Treasury, Modernizing the Financial System, February 1991, page XIX-6.

[2] Alan Greenspan. *Our Banking History.* Annual Meeting and Conference of the Conference of State Bank Supervisors, Nashville, TN, May 2, 1998.

[3] William M. Isaac, Director, FDIC, "Address to the 79th Annual Convention of the Conference of State Bank Supervisors," April 28, 1980.

[4] William M. Isaac, Director, FDIC, "Some Reflections on Our Dual Banking System," (Address to the Georgia Bankers Association), May 7, 1979.

[5] *E.g.*, George Benston, Robert Eisenbeis, Paul Horvitz, Edward Kane and George Kaufman, *Perspectives on Safe and Sound Banking*, 1986, page 277.

[6] Alan Greenspan, "No Single Regulator for Banks," *Wall Street Journal*, December 15, 1993.

[7] Edward Kane, The James Cleary Professor in Finance at Boston College, "Technological and Regulatory Forces in the Developing Fusion of Financial-Services Competition," *Journal of Finance* 39(3), July 1984, 759-773.

[8] Alan Greenspan, "No Single Regulator for Banks," *Wall Street Journal*, December 15, 1993. *See also,* U.S. Department of the Treasury, *Modernizing the Financial System*, February 1991, page XIX-6 (arguing that a multiplicity of regulators brings broader perspective to financial services regulation. According to the study "the existence of fewer agencies would concentrate regulatory power in the remaining ones, raising the danger of arbitrary or inflexible behavior. . . . Agency pluralism, on the other hand, may be useful, since it can bring to bear on general bank supervision the different perspectives and experiences of each regulator, and it subjects each one, where consultation and coordination are required, to the checks and balances of the others' opinion.).

[9] William M. Isaac, Director, FDIC, "Address to the 79th Annual Convention of the Conference of State Bank Supervisors," April 28, 1980.

[10] *E.g., BNA Banking Report*, March 7, 1994 (Greenspan arguing that having no alternatives in financial regulation can hurt financial consumers and the economy).

STATEMENT OF

THE FINANCIAL SERVICES
COORDINATING COUNCIL

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT SPONSORED ENTERPRISES
OF THE
COMMITTEE ON FINANCIAL SERVICES
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

ON

INSURANCE REGULATION AND
COMPETITION FOR THE 21ST CENTURY

June 18, 2002

The Financial Services Coordinating Council (FSCC) was formed by the four principal trade associations representing the major financial sectors of the U.S. economy to address issues of common concern at both the federal and state levels. Its members are:

- The American Bankers Association (ABA)/American Bankers Insurance Association (ABIA)—the ABA represents 90% of the assets of US commercial banks and over 200 thrift institutions. The ABIA is a separately-chartered affiliate of the ABA whose membership is composed of banks that underwrite and sell insurance as well as insurance companies that deliver product through the bank channel.

- The American Council of Life Insurers (ACLI)—The ACLI represents 435 life insurance companies, accounting for approximately 80% of the assets of all US life insurers and 83% of the assets of the insured pension business.

- The American Insurance Association (AIA)—The AIA represents 410 insurers who provide all lines of property/casualty and write more than $67 billion in premiums annually.

- The Securities Industry Association (SIA)—The SIA's 700 member security firms manage the accounts of 93 million investors directly and indirectly through corporate, thrift and pension plans, and employ approximately 750,000 individuals in the US.

Together, these organizations represent the overwhelming majority of financial services firms and provide financial services to virtually every household in America.

We appreciate the opportunity to address the Subcommittee on the topic of insurance regulation and the challenges facing both insurers and their regulators in the rapidly evolving financial services marketplace.

What the Previous Hearings Have Shown

Over the last few weeks, the Subcommittee has heard a wide range of views from insurance associations, companies, agents, regulators, legislators, and consumer advocates, all with very definite opinions on the condition of the insurance regulatory system, what it is that needs to be improved, and how that improvement can be accomplished.

Everyone, including state insurance regulators, agrees that there are significant problems with the current system in terms of lack of uniformity, administrative and compliance burdens and widespread inefficiency. Most would also agree that, if left unaddressed, these problems will ultimately result in insurers being less competitive and, more importantly, in vital insurance products and services being less innovative and less readily available. The fact is that insurance has grown from a local or regional business to one that extends from coast to coast and around the world. The current regulatory system was neither designed for nor intended to accommodate the national if not global scope of today's insurance business.

Specific Problems of the State System

The insurance regulatory environment has remained largely unchanged since 1945, when the McCarran-Ferguson Act statutorily established the principle of Congressional deference to state insurance regulation. Yet, insurers and insurance producers (agents and brokers) are coping with unprecedented and dramatic changes in the legal, political, economic, and technological environments in which they do business.

For all types of insurers, the current fifty-one regulatory system is a patchwork of individual state requirements that impose significant direct and indirect costs, including:

- higher compliance costs associated with non-uniform regulations and multiple enforcement requirements;
- complex corporate structures needed to accommodate unique regulatory regimes;
- delayed implementation of new products and pricing changes, due to prior approval requirements coupled with multi-state regulatory delays; and,
- anti-competitive regulations in many states that emphasize government price controls; create barriers to interstate commerce through entry and exit requirements; and stifle the introduction of innovative products.

Consumers would have more provider and product choices if insurers had the flexibility to offer products, and charge prices, that reflect their underlying cost structures and the demands of the market.

Regulatory inefficiency results in international trade consequences as well. As more US insurers seek to do business abroad, they are encountering increasing

resistance to license applications from foreign insurance regulators based solely on the burdensomeness of the balkanized insurance regulatory system in the US. The number one item on the European Union's annual list of global trade barriers is the US state insurance regulatory system. There are also reports that some countries may shortly file an action with the World Trade Organization, asserting that the US insurance regulatory system amounts to a non-tariff trade barrier. Whether or not the action is successful, it points out the increasingly international aspect of the insurance business and the patent unsuitability of the existing regulatory framework to address multi-national issues.

A Comprehensive Approach to Insurance Regulatory Modernization Is Needed

While those testifying in these hearings to date seem to understand the problems inherent in the current regulatory system, they diverge with respect to the appropriate remedy. Some have suggested that Congress should just stay on the sidelines and let the states continue unassisted in their sincere but as yet largely unproductive efforts. Others would urge piecemeal, incremental federal measures aimed at encouraging the states to become more uniform in a handful of the more egregious problem areas over a period of years—a band-aid approach that ignores the severity, scope and urgency of the situation. Still others would institute federal minimum standards, leading to mandatory federal regulation in key areas for every insurer while not providing the uniformity or relief from unnecessary administrative burden that insurers and insurance producers desperately need.

The FSCC, on the other hand, firmly believes that providing an optional federal charter for insurers, insurance agencies and insurance producers is the only way that regulatory uniformity and efficiency can be achieved, and consumer interests served, in a comprehensive and timely fashion. The optional federal charter concept is supported not only by the four FSCC member organizations and their thousands of member companies, but also by the Council of Insurance Agents and Brokers, the Financial Services Roundtable, the Financial Services Forum and a growing list of individual companies and agencies.

What an Optional Federal Charter Will Accomplish

There are four principal goals that the FSCC believes would be achieved with an optional federal charter for the insurance industry. Each goal would result in the betterment of the industry; its ability to compete with other financial services providers, and the consumers it serves.

One goal is uniformity, consistency and efficiency of regulation and supervision. A federal charter would provide insurers and producers with "one stop" regulation

and supervision, rather than the patchwork of regulation and supervision by multiple jurisdictions as is the case today. This is particularly important to those organizations operating nationwide or in multiple states, and is even more compelling as product is offered over the Internet. A single point of regulation and supervision simplifies operations, eases regulatory compliance, promotes efficiency and vastly improves the ability of insurers to respond to consumer and marketplace demands in a timely and uniform fashion.

A second goal is open competition and the reduced costs and increased consumer benefits that would result. Rate regulation through government price controls and prior approval of product introduction by government agencies are anachronisms that need to be eliminated if insurers are to compete effectively with other financial services providers (banks, securities firms and mutual funds) and bring products to market in a timely fashion. The formal approval requirements in almost all states seriously jeopardize insurers' ability to get products to market in a timely fashion in all jurisdictions where they have customers or potential customers. As has been testified to repeatedly, it can take up to two years to get approvals for all markets in which an insurer desires to offer a product, and it is not at all unusual for approvals to be untimely, not uniform, or to be denied in certain markets.

Rate regulation is another anachronism to the highly competitive insurance market. For the most part, rate regulation has been nonexistent in the banking sector for almost two decades. Price controls do not protect consumers. The competitive dynamics of a free market are much better protectors of consumers. And, the consumer benefits associated with competitive rates are more than just speculative. You have heard many times throughout these hearings – both from those supportive of an optional federal charter and those opposed – that rate regulation is bad for consumers, and that fact seems to be borne out by comparing the contrasting experiences for personal lines of insurance (homeowners and auto) in Illinois (which is free from rate regulation) with those of New Jersey and Massachusetts (which are not).

Under the optional federal charter concept, the federal regulator would provide strong solvency, consumer protection, and market conduct oversight. Moreover, the federal regulator's involvement would be restricted to oversight of federally chartered insurers and producers. The federal government *would not* preempt the types of substantive insurance reparations (e.g., automobile, liability, workers' compensation) systems that states have; their tax systems; or their residual markets.

A third goal is the choice that is inherent in the enactment of a federal charter option. It is the FSCC's view, reinforced by the experience of its members with

the dual banking system, that having choice between two alternative regulatory regimes – i.e., between state and federal – works to the betterment of both. The very essence of a dual system is the choice that comes from having alternatives. The experience with the dual banking system has demonstrated that choice, and the healthy tension that results from choice, has stimulated the development of new products and services for consumers, new and better supervisory techniques and more efficient supervision.

Further, as described in more detail in ABIA's testimony, the experience with the dual banking system has been just the opposite of the fears expressed by state insurance commissioners and those who oppose choice. Since the enactment of the national bank charter in 1863, the result has not been to undermine the state charter, but instead to strengthen it. Now, some 140 years later, almost 70% of banks operate under state charters, including some very large institutions like JP Morgan Chase. We strongly believe that the dual banking system can serve as an excellent prototype for insurance regulation and that the benefits that have inured to the banking industry and its customers from that system can be replicated for the insurance industry and consumers of insurance through the adoption of an optional federal charter.

The fourth and final goal is to establish a federal presence with insurance expertise in the increasingly important Washington arena. Like the banking and securities industries, insurance is a critical segment of the nation's economy, which, as noted by Chairman Oxley in his opening statement, accounts for 6 ½ % of all consumer spending. In addition to providing protection for virtually every American through life insurance and annuities, health, automobile, homeowners, personal and commercial liability and worker's compensation insurance, just to name a few, it is also the source of much of the nation's long-term capital, the largest investor in corporate debt, a major purchaser of local state and federal bonds, and a principal source of financing for hotels, shopping centers, office buildings and multiple family housing.

The time has passed when the nation can afford not to have federal expertise on an industry this complex and important to the economy. As Congress grappled with the fallout from September 11, the lack of federal sources of insurance knowledge and expertise quickly became apparent. The federal agency, which would be established under the optional federal charter concept, would eliminate this increasingly unacceptable void in federal awareness and understanding of insurance.

Opposition to the Concept of an Optional Federal Charter

Some witnesses arguing against a federal charter have described a laundry list of outcomes they fear will ensue, as if it were a radical new concept with no precedent in the annals of regulation. Compound regulation, mandatory federal charters, state revenue shortfalls, crushing social investment requirements, legislation spinning out of control with oppressive federal mandates, were all seen as strong possibilities.

As described above, however, what the optional federal charter is designed to emulate is the successful dual banking system that has served the nation extremely well since 1863. This is not an untested idea that popped into the mind of a management consultant while shaving this morning.

Moreover, the key word that optional federal charter opponents have chosen to ignore is "optional." If the legislation became burdened with unattractive federal mandates of whatever stripe, the industry would withdraw its support, and the bill would fade. This is not an effort to achieve federal regulation at any cost. As a backstop, if a bill with oppressive provisions somehow were enacted into law, no insurer would elect to take the federal option. If the bill were to be enacted but, against all odds, the states ultimately reached all of the efficiency objectives for which they are striving, fewer companies would feel the need to opt for a federal charter.

Any objective assessment of the problems described in these hearings would lead to the inescapable conclusion that it serves no practical purpose or rational public policy objective for an insurance company that is doing business nationwide (or, for that matter, a company that would like to be doing business nationwide) to be forced to comply with 51 different regulatory standards in **any** facet of its business operations, much less in **every** facet. Speed-to-market, advertising, mergers and acquisitions, price controls, market conduct, and company and agent licensing are just a few in a long list of problem areas for insurers and producers.

Even so, the concept of an optional federal charter has not received universal approval. Critics fall into one of four general categories:

- Small property/casualty companies doing business in such a limited geographical area that uniformity among state regulatory regimes is not an issue, and which, therefore, would be unlikely to consider a federal charter option even if it were available.

- A few larger property/casualty companies that prefer not to deal with changes in the system or the enhanced competition that change might bring.

- Those who are primarily concerned about regulatory or political turf.

- Self-appointed consumer advocates who oppose federal regulation, but who, until recently, could think of little good to say about state regulation.

In any event, the members of the FSCC and an increasing number of other financial services organizations believe that there is a compelling case for the optional federal charter and that prompt action is warranted. While action this year is unlikely, we hope that patience, persistence and sound reasoning will move this issue to the front burner in the next Congress.

Broad Outlines of Consensus Legislation

Three groups – the American Bankers Insurance Association, the American Council of Life Insurers, and the American Insurance Association - have each drafted its own version of an optional federal charter bill that reflect the priorities and principles of their industries and members. As noted above, these three groups along with other FSCC members have now reached agreement on a set of common principles which, if reflected in any optional federal charter legislation, would assure broad-based support for the measure from the financial services industry. A copy of these principles is appended to this statement. Taking this a step further, these three groups have nearly completed work on harmonizing and blending their separate bills into a single piece of draft legislation that all would support. The following discusses generally how this unified draft implements the common policy principles.

National Treatment – This is the cornerstone of the federal charter option. Insurers, insurance agencies and individual insurance producers would be able to get the uniformity of law, regulation, interpretation and enforcement that a federal charter affords in order to do business effectively across state lines and around the country. Under this federal charter, inconsistencies from state to state in all aspects of insurance regulation are largely eliminated.

Universal – The federal charter accommodates all lines of insurance (life/annuities, property/casualty, and health) and is available to insurers regardless of corporate form (stock, mutual, fraternal, reciprocal mutual holding company). The charter also extends to the chartering or licensing of insurance producers (agents and brokers) and insurance agencies.

Convertible – Insurers would not be prevented from selecting the type of charter (state or federal) that best meets the needs of their markets, products, and strategic plans. Insurers would be able to convert from a state to a federal charter or from a federal to a state charter, and insurance holding companies would be permitted to control both a federally chartered and a state chartered insurer. Qualification standards (state or federal) would, of course, always have to be met for any conversion.

Specialized – Today, different lines of insurance are, in many key respects, regulated quite differently by the insurance departments of the states, reflecting the unique characteristics of each of these lines. The substantive regulatory provisions of the draft bill reflect these differences in many areas. Additionally, the federal insurance regulator, both in terms of the charters it grants and the laws and regulations it administers, would have authority to differentiate among lines of business in similar fashion.

Dynamic – The ability to compete effectively in today's marketplace depends on a company being able to adapt quickly to changes in consumer demands, evolving technology, and marketplace forces. This flexibility depends to a great extent on a dynamic system of regulation able to accommodate changing circumstances. In drafting an optional federal charter, we sought an appropriate balance between those things that should appropriately be embedded in statute and those that are better left to the discretion of the regulator. We have worked hard to assure that fundamental institutional solvency and consumer protections are grounded in statute while at the same time affording the regulator ample ability to tailor aspects of the regulatory system to meet ever-changing needs and circumstances.

Single Regulator – The federal insurance regulatory authority is organized as a discrete office within the Treasury Department headed by an individual appointed by the President and confirmed by the Senate for a fixed term. Given the needs and circumstances of the insurance business, and the anticipated need to fine tune this new regulatory system, we believe this form and location of the regulator is more appropriate than an independent agency or an agency headed by a multi-member commission. The federal insurance regulator would be on a par with, but not a part of, the OCC and the OTS.

Financial/Solvency Regulation – It is essential that the federal regulator subject insurers to strong solvency regulation and supervision. The draft provides for solvency regulation based on risk-based capital standards, appropriate reserve levels, investment standards, and conservative accounting protocols. For at least an initial period of five years, the draft provides that almost all these standards would have to parallel model law standards adopted by the NAIC and found in most states today.

Regulation of Insurance Products and Forms – A significant shortcoming of the present insurance regulatory system is its inability to let companies get innovative policy forms approved and to market in a timely manner. For federally chartered insurers, the process for qualifying products for sale would be streamlined and made far more efficient. It also would reflect the unique characteristics of particular lines of insurance. For example, regarding life insurance products, individual product standards would be established by regulation and companies would make informational filings with the regulator along with a formal certification that the applicable standards have been satisfied. In the property/casualty area and for most life insurance products, competitive market forces rather than government price controls would be employed to set rates and premiums.

Cost – Other than initial startup costs (which are derived through a loan from Treasury that the regulator would repay), the ongoing costs of the new federal insurance regulator would be paid by those companies, agencies, and insurance producers opting for federal chartering, licensing and oversight. Taxpayers will not shoulder these costs.

Optional, Not Mandatory – The draft legislation makes clear that the federal charter is an optional alternative to, and not a mandatory substitute for, state oversight. Many insurers, insurance agencies, and individual insurance producers will wish to remain subject to state regulation. Others may conclude that federal regulation is more in keeping with their operations. The legislation simply affords choice. All groups that are advocating an optional federal charter are supportive of contemporaneous efforts to enhance the present state-based system of insurance regulation. A dual charter environment must have a viable, efficient state component to be successful.

Exclusive Regulation - The draft legislation provides for a federal system of regulation that is exclusive. That is, if an insurance company wishes to opt for a federal charter, the states would generally have no role with respect to matters of insurance regulatory oversight relative to that company. As drafted, all insurance companies, state and federal, would, however, under most circumstances participate in the present state-oriented insurance guarantee mechanism. Importantly, other **non-insurance** aspects of state law would continue to apply to national insurers just as they apply to national banks (e.g., employment laws, contract laws, escheat laws, and so on). Additionally, with respect to property/casualty insurance, several specific aspects of state insurance law would apply to national insurers (e.g., residual markets, pooling arrangements, and the substantive provisions state insurance reparations laws, such as state workers' compensation and personal auto insurance). All proponents of a federal charter

option strongly oppose dual state/federal regulation of insurers, where a single company would simultaneously be subject to aspects of both state and federal oversight.

Taxes – The legislation explicitly provides that national insurers would remain subject to the authority of the states to impose premium or corporate income taxes. This assures that states will continue to receive the revenues they presently derive from insurers, even those that opt for a federal charter. Choice of charter would not materially affect state revenues nor would it affect the overall corporate or policyholder tax burdens of individual insurers.

Consumer Protections – The proponents of an optional federal charter recognize that legislation implementing this concept will not and should not advance unless strong consumer protections are included. The consensus draft reflects this understanding. Among the provisions of the draft legislation are the following: strong market conduct regulation and supervision; an insurance guaranty mechanism affording insurance policyholders the same high level of protection in the event of an insolvency as state chartered insurers (plus the added benefit of federal minimum standards for coverages and other key features with which all states would have to comply); the elimination for national insurers of the present federal antitrust exemption provided by the McCarran-Ferguson Act, except where they are still required to operate under state law or are participating in state authorized and regulated "advisory organization" activities; stringent investment standards mirroring the best of those found presently in state statutes; the same valuation standards that are used by the states to assure that companies have adequate reserves to pay customers' claims; more uniform and regular financial and market conduct examinations than required by states today; and, importantly, uniform consumer protection standards (e.g., sales and marketing practices of companies and agents) that would apply in all jurisdictions and not change depending on the state in which a consumer resides.

Additional Consumer Protection Consideration

Some witnesses describing themselves as consumer advocates have questioned whether, under a federal charter, consumers would be adequately protected. In this context, it is often implied that there is at present a very high level of consumer protection that might be jeopardized if companies were to switch to a federal charter.

The issue of adequate consumer protections is unquestionably an appropriate concern in any discussion of a federal charter option. Yet, we must be clear on the nature of the comparisons being drawn between what we have today and what we might have tomorrow. The fact is, we are not comparing an unknown new federal

system of consumer protection with a state-based system that today receives high marks from national consumer advocates.

Over a decade ago, the Consumer Federation of America initiated a survey of state insurance departments designed to assess the adequacy of their resources to effectively regulate the insurance industry. In an August 2000 press release, Robert Hunter, Director of Insurance for CFA, stated that based on CFA's most recent survey, "It is unfortunate to see that over half of the states, representing 56% of the population score C or below. . . . Over half the states are more than 40% below the minimum needed to fully protect consumers."

We have no doubt that should Congress enact optional federal chartering legislation, it would insist on high standards of consumer protection. It is quite reasonable, then, to assume that under a system of federal insurance regulation, where uniform, high consumer protection standards apply equally all across the country, consumers would enjoy better protections than they do today. That would certainly be our goal for a federal charter.

A Broad Consensus Exists for Moving Forward with an Optional Federal Charter

More often than not, sweeping financial services legislation results in major industries being pitted against one another and little broad consensus for action. It is almost without precedent, then, that the proposal for an optional federal charter finds a far different and quite unique set of circumstances. The insurance and banking industries, historically antagonists on most issues of this nature that come before Congress, are in accord, not only on the areas of concern that must be addressed, but on the substantive approach for a legislative solution. Indeed, there is no disagreement on the utility of an optional federal insurance charter among the insurance, banking and securities industries. And while the insurance industry itself has different views on the matter, there is nonetheless extremely strong and broad support for a federal charter from the life insurance, property/casualty insurance and insurance agent segments of the business. And again, this support reflects not only agreement on the nature of the problems, but also on the details of a legislative solution.

The American Bankers Association/American Bankers Insurance Association, the American Council of Life Insurers, the American Insurance Association, the Financial Services Roundtable, the Council of Insurance Agents and Brokers, the Financial Services Forum – all support Congress moving forward with legislation providing an optional federal charter for insurers, insurance agencies, and insurance producers.

Conclusion

We urge Congress to weigh very carefully the serious regulatory problems that confront the insurance industry today and hinder its ability to effectively serve the public by providing the products and services that are so vital to this country and its economy. We also urge Congress to consider the unprecedented, broad consensus that has formed around our draft optional federal charter legislation. Please take advantage of the opportunity this unique commonality of interest provides and move ahead quickly with this extremely important legislation.

We appreciate your consideration of our views.