TESTIMONY OF

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ON

TITLE III OF H.R. 5094

BEFORE THE

SUBCOMMITTEE ON COMMERCE, CONSUMER PROTECTION,
AND COMPETITIVENESS
COMMITTEE ON ENERGY AND COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES

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Mr. Chairman and Subcommittee Members, we appreciate the opportunity to be here today to testify again on the issue of insurance activities in the banking industry. We are pleased that the Subcommittee is readdressing this issue subsequent to the House Banking Committee favorably reporting H.R. 5094, the Depository Institutions Act of 1988.

Before discussing the insurance provisions contained in Title III of H.R. 5094 and the Federal Deposit Insurance Corporation's views on that Title, we would like to provide some brief background on the structure and regulation of the United States banking system and the current insurance authorities of state-chartered banks. Please refer to Appendices A and B for excerpts from my May 12, 1988 testimony before this Subcommittee for a more in-depth discussion of these two areas.

The Dual Banking System

Charters to operate banks may be obtained from either state or federal authorities. Under current law, the powers and authorities of state-chartered banks are established by the states, while those for national banks are determined under federal law. Today, there is some degree of federal regulation and supervision of all banks which are a part of the deposit insurance system. It is important to remember, however, that state-chartered banks are first and foremost chartered, regulated and supervised by state authorities at the state level. But, if those institutions desire federal deposit insurance, they must operate in a safe and sound manner as determined by the insurance fund -- the FDIC.

The principal federal regulator and supervisor of any individual bank is determined by whether it is a federally chartered bank ("national bank"), a state-chartered bank that is not a member of the Federal Reserve System ("state nonmember bank") or a state-chartered bank that is a member of the Federal Reserve System ("state member bank"). The Comptroller of the Currency charters and supervises about 4,600 national banks. The FDIC is the principal federal supervisory authority with respect to state-chartered nonmember banks, which make up about 8,000 or roughly 60 percent of the total number of banks. The Federal Reserve Board is the principal federal supervisor for the approximately 1,100 state-chartered member banks.

Thus, our Nation provides for local, as well as Federal, jurisdiction over the chartering, powers and activities of financial institutions. This system of combined state and federal authorities is what is known as the "dual banking system." During its long existence in this country, the dual banking system has proven to have many benefits. It provides autonomy to the states to tailor their respective banking systems to the particular attributes and needs of their own regions, thereby allowing each state to provide for a banking system that is responsive to local consumers. Another important benefit that has been provided by our dual banking system is the opportunity it has afforded for developing a multiplicity of innovative approaches to banking problems and issues.

In the face of an intense and rapidly changing competitive environment many states have taken the initiative to modernize the commercial banking industry. The result of their actions is a significantly expanded range of permissible financial activities -- including, insurance, real estate and securities -- for banks in some states. These and other innovations by the states over the years have been very beneficial for the banking industry and consumers. Thus, we believe strongly in the dual banking system and that federal legislation should not jeopardize that system.

State Insurance Authority and Activities

Before turning to H.R. 5094, it is important to underscore the fact that many banks (and thrifts) already are in the insurance business. This brief overview of bank insurance activities will focus on the insurance authorities of state-chartered banks, since those are the banks within the jurisdiction of the FDIC. A fuller discussion of these authorities, and bank experience with them, is set forth in Appendix B.

The state laws that authorize insurance activities for state-chartered institutions vary. In five states, state-chartered commercial banks are specifically permitted to engage in general insurance underwriting. This underwriting authority extends well beyond merely the underwriting of credit-related insurance. Furthermore, insurance brokerage activities are permitted for commercial banks in 15 states. In nine other states, commercial banks are permitted to sell insurance, but only in communities of fewer than 5,000 people.

Moreover, several states located in the Northeast permit state-chartered savings banks to offer insurance products. In fact, savings banks in Connecticut, Massachusetts and New York have been underwriting or selling life insurance for years, with what only can be described as very favorable results for the banks and consumers. With respect to other types of insurance, savings banks in a number of states are permitted to engage in general insurance agency activities.

What has been the track record of state-chartered institutions offering insurance products? By any objective standard, the track record has been good. Two examples of state-chartered institutions offering insurance products are summarized in Appendix B -- life insurance offered by savings banks in the Northeast and the insurance activities of commercial banks in Wisconsin. These two examples illustrate the benefits that can accrue to institutions and consumers alike when banks are permitted to engage in the insurance business.

Title III of H.R. 5094

Under current federal law, national banks are authorized to engage in the business of insurance where it is incidental to the business of banking. They also may engage in insurance activities in towns of fewer than 5,000 people. Bank holding companies, which are regulated by the Federal Reserve Board, generally are prohibited by the Bank Holding Company Act from being in the insurance business. There are limited exceptions to this rule -- which are specifically enumerated in the Act -- for such things as credit-related insurance and insurance activities in small towns.

Although the Bank Holding Company Act imposes severe restrictions on the insurance activities of bank holding companies, these restrictions do not now reach the direct activities of a state-chartered bank in a bank holding company. Furthermore, as will be discussed below, there is substantial disagreement in the legal community as to whether those restrictions apply to the subsidiaries of banks in a bank holding company system.

Title III of H.R. 5094 would make dramatic changes to that current state of affairs by specifically applying the insurance restrictions of the Bank

Holding Company Act to banks and subsidiaries of banks within bank holding company systems and by setting forth, at the federal level, the nature and extent of insurance activities that are permitted for such banks and their subsidiaries. Thus, H.R. 5094 would restrict the ability of state-chartered banks to pursue, and benefit from, state-authorized activities designed to provide better and more cost-efficient insurance services for consumers.

More specifically, H.R. 5094 would continue to allow free-standing state-chartered banks to engage in insurance activities permitted by state law. However, if the bank is in a holding company, significant new restrictions would apply. A state-chartered bank would be permitted to offer insurance that is authorized by state law, only if the parent company of that bank is located in the bank's home state. Thus, if a state authorizes an out-of-state bank holding company to acquire a state bank and engage in insurance activities in that state, Federal law would permit acquisition of the state bank, but would prohibit the bank from continuing the state-authorized insurance activities. Furthermore, if the state bank wants to provide insurance, it can only provide the insurance to residents of its home state, persons employed in the state and persons otherwise present in the state.

So far, what has been described is identical to the Senate-passed bill, S. 1886. The House Banking Committee went one step further, however, and prohibited state-chartered banks owned by bank holding companies from underwriting insurance.

Thus, under H.R. 5094 only free-standing state-chartered banks are permitted to engage in state-authorized insurance activities without any federal restrictions. The bill also includes a number of grandfathering provisions that apply to specific bank holding companies.

FDIC Position

To date, the FDIC has seen no evidence that insurance activities pose risks that would form the basis for imposing any federal restrictions on the insurance activities authorized for state banks. Similarly, the FDIC believes that there is no evidence to support the need for federal legislation that limits the authority of state-chartered banks and their subsidiaries to undertake insurance activities permitted by state law. In fact, the FDIC has the authority to prohibit or restrict the exercise of any state-authorized activity undertaken directly or indirectly by a state nonmember bank if the FDIC determines that the exercise of the authority is inconsistent with the purposes of the Federal Deposit Insurance Act or the safety and soundness of the bank. To date, the FDIC has seen no evidence that warrants the exercise of that authority.

Therefore, the FDIC cannot support Title III of H.R. 5094. We believe it is unfair and anticompetitive to limit state-authorized insurance activities to the boundaries of the state and to prohibit a bank from engaging in any state-authorized insurance activity if the banks' parent is not located in the same state. This approach seriously infringes on states' rights and jeopardizes the dual banking system.

If there is any federal legislation in the area of insurance, we believe it should be fashioned so as not to diminish the rights of the states to regulate in the two areas traditionally within their jurisdiction -- namely, insurance and state banking. If sensitivity to the rights of the states is maintained in this legislative process, not only will states' rights be preserved, but so will the dual banking system.

In our previous testimony before this Subcommittee on May 12, 1988, we stated our preference -- namely, that there be no federal legislation explicitly restricting the insurance activities of banks, particularly those of state-chartered banks that are in holding companies. We continue to adhere to that position. Thus, when the House Banking Committee proceeded with legislation in this area, we supported an amendment offered by Representative Garcia of New York to strike Title III of H.R. 5094.

As an alternative, we also were able to support the approach offered by Congressman Gerald Kleczka of Wisconsin. As with the provisions of Title III, that amendment would have limited the insurance activities of state-chartered banks and their subsidiaries to the boundaries of their home states. Therefore, state-chartered banks would be permitted to offer insurance <u>only</u> to residents of the state, persons employed in the state and persons otherwise present in the state. However, the amendment also would specifically recognize that state banks and their subsidiaries could engage in such activities, even though they are in a holding company system and no matter where the holding company is located.

Unfortunately, both of these amendments were defeated. When this Committee considers H.R. 5094, we would support an amendment to strike Title III and, secondarily, an amendment like that offered by Congressman Kleczka. However, as indicated above, we cannot support Title III in its current form.

Another area of concern raised in our previous testimony was recently the subject of an United States Court of Appeals ruling. The debate concerns the jurisdictional reach of the Bank Holding Company Act and the extent to which the activity restrictions of that Act apply to the direct subsidiaries of banks in a bank holding company system. By way of background, the activity restrictions, including those that limit bank holding company insurance activities, do not apply to state-chartered banks in a holding company system. However, with respect to the direct subsidiaries of such banks, the Federal Reserve Board asserts that they have the authority to apply the activity limitations to the banks' subsidiaries. We disagree with this as a legal matter and believe that as a policy matter it would undermine the benefits of the dual banking system.

On August 23, 1988 the U.S. Court of Appeals for the District of Columbia held that the establishment of a municipal bond insurance subsidiary (AMBAC) by Citibank -- a national bank that is a subsidiary of Citicorp -- was covered by the Bank Holding Company Act's activity restrictions and thus required the prior approval of the Federal Reserve Board. The Court interpreted the language of the Bank Holding Company Act to require Federal Reserve Board approval for applications involving bank holding company direct or indirect subsidiaries other than banks -- including direct subsidiaries of banks in holding company systems. While the Appeals Court ruling states only that the Federal Reserve has jurisdiction over national bank operating subsidiaries, we are concerned that the court would take a similar position with respect to subsidiaries of state-chartered banks. We believe that the decision is a wrong interpretation of the law and that it will have serious negative implications for the dual banking system. Thus, we recommend that the decision be overturned by legislation at the earliest opportunity.

In summary, the FDIC's preference at this time is that there be no federal legislation addressing the insurance activities of state-chartered banks, unless it is to reverse the AMBAC decision and thereby clarify the fact that the activities of state-chartered banks <u>and their subsidiaries</u> are not subject to Federal Reserve Board jurisdiction or the activity limitations of the Bank Holding Company Act. However, if legislation is deemed necessary, the FDIC would recommend strongly that it be fashioned so as to preserve states' rights and the dual banking system.

Thank you. I would be pleased to respond to any questions.

Background on the Dual Banking System

Charters to operate banks may be obtained from either state or federal authorities. National banks, which are federally chartered, must join the Federal Reserve System. However, membership in the Federal Reserve System is optional for state-chartered banks.

Under current law, the powers and authorities of state-chartered banks are established by the states, while those for national banks are determined by federal law. State law also governs the activities of direct subsidiaries of state-chartered banks.

National banks are regulated and supervised only at the federal level by the Office of the Comptroller of the Currency. However, state-chartered banks are subject to regulation and supervision at both the state and federal levels. If a state-chartered bank is not a member of the Federal Reserve System (such banks are termed "state nonmember banks"), then its principal <u>federal</u> supervisor is the FDIC. On the other hand, if a state-chartered bank elects to join the Federal Reserve System (such banks are termed "state member banks"), then it is subject to regulation and supervision by the Federal Reserve Board. Thus, the principal <u>federal</u> regulator and supervisor of any individual bank is determined by whether it is a national bank, a state nonmember bank or a state member bank.

Of the approximately 13,700 insured banks in the United States, the FDIC has the principal federal supervisory authority with respect to only the state-chartered nonmember banks. These banks, however, make up approximately 8,000, or about 60 percent, of the total. They account for about one-fourth of the banking industry's assets. The FDIC also is the federal supervisor for about 485 FDIC-insured savings banks. The Federal Reserve Board is the principal federal supervisor for the approximately 1,100 state-chartered member banks. The Comptroller of the Currency supervises about 4,600 national banks.

Banks also may belong to a bank holding company system. Bank holding companies and their nonbanking subsidiaries are regulated by the Federal Reserve Board. The principal reasons for forming a bank holding company are: (1) as a funding mechanism for its subsidiaries; (2) as a vehicle to engage in nonbanking activities that the Federal Reserve has determined, under the law, to be closely related to banking; (3) as a vehicle for interstate operations; and (4) in the case of one bank holding companies, for tax purposes.

Though the banking system and its regulatory structure is admittedly complex, it provides important benefits. Our "dual banking system" provides for local, as opposed to national, jurisdiction over the chartering, powers and activities of state-chartered institutions. Local autonomy permits the states to tailor their respective banking systems to the particular attributes and needs of their own regions and allows them to provide for a banking system that is responsive to local consumers. Another important benefit provided by our dual banking system is the opportunity it affords for developing a multiplicity of innovative approaches to banking problems and issues.

Insurance Authority and Activities

Many banks (and thrifts) already are in the insurance business. Before summarizing permissible insurance activities at the state level, let me just touch on the federal rules governing insurance activities. National banks are authorized by Federal law to engage in the business of insurance where it is incidental to the business of banking. They also may engage in insurance activities in towns of fewer than 5,000 people. Bank holding companies generally are prohibited by federal law from being in the insurance business. There are limited exceptions to this rule for such things as credit-related insurance and insurance activities in small towns. Federally chartered savings and loan associations and federally chartered savings banks, however, are empowered to sell insurance through entities known as service corporation subsidiaries.

The state laws that authorize insurance activities for state-chartered institutions vary. In five states, state-chartered commercial banks are specifically permitted to engage in general insurance underwriting. This underwriting authority extends well beyond merely the underwriting of credit-related insurance. In three of these states -- Massachusetts, New Jersey and North Carolina -- banks are allowed to underwrite insurance due to the general equity investment authority contained in state law. State-chartered banks in Florida may underwrite insurance as a result of an interpretation of the state's statute. Finally, South Dakota permits its state-chartered banks to "engage in all facets of the insurance business."

Insurance brokerage activities are permitted for commercial banks in 15 states. Nine other states permit commercial banks to sell insurance in communities of fewer than 5,000 people.

Moreover, several states located in the Northeast permit state-chartered savings banks to offer insurance products. Savings banks in Connecticut, Massachusetts and New York have been underwriting or selling life insurance for years. With respect to other types of insurance, savings banks in a number of states are permitted to engage in general insurance agency activities through state "leeway" laws, which permit savings banks to invest a percentage of assets (usually one to three percent) in any investment that is "prudent" and not otherwise prohibited.

What has been the track record of state-chartered institutions offering insurance products? By any objective standard, the track record has been good. Let me cite two examples, beginning with the insurance experience of savings banks.

By way of background, the first savings banks in the United States were established by states in the Northeast region early in the 19th century. The primary purpose behind the creation of savings banks was to encourage thrift on the part of the working class and to provide savings facilities where none had existed. Most of the approximately 485 FDIC-insured savings banks still are located in the Northeast, with about one-half of them in Massachusetts.

Savings banks in Connecticut and New York have been offering insurance products for many years, and those in Massachusetts have been in the insurance business since 1907. The insurance programs were established with the objective of offering inexpensive life insurance protection to individuals. New insurance products were added in subsequent years which "complemented" other services offered by the savings banks. Preliminary data for 1987 indicate that savings banks in these three states provide about $22 billion of insurance coverage to approximately 2 million policyholders.

A description of the operation of savings bank insurance programs in Massachusetts is enlightening. The Massachusetts enabling legislation permits operating savings banks to establish an "insurance department" within the bank to issue policies or to act as agent for other savings banks that assume such liabilities. The Savings Bank Life Insurance Council serves as a (nonmanagement) central body that sets rates, offers actuarial consultation and provides other support functions.

The life insurance department is maintained separate and distinct from the operating bank and, while there is commonality of name and quarters, there is no commingling of assets or funds. The savings bank is "reimbursed" from premium income for appropriate expenses such as rent, investment advice and employee salaries. The department maintains its own records and has its own accumulated "surplus" account plus reserves which are used to pay claims. All "profits," after reasonable expenses are met and there has been an addition to the department's surplus account for the period, are returned to policyholders in the form of dividends. The department is supervised and regulated by the Massachusetts Commissioner of Insurance and investment powers of the department are consistent with those available to other life insurance companies operating in Massachusetts.

No significant problems associated with savings bank life insurance (SBLI) have arisen in the states that authorize it. Equally important is the fact that consumers have benefited. An article in the June, 1987 issue of Consumer Reports stated that SBLI policies offered in New York, Massachusetts and Connecticut have consistently ranked high in life-insurance surveys conducted by Consumers Union. The article noted that such policies are low in cost since they are sold through banks, eliminating the expensive insurance-agency system that is used to sell other policies.

The insurance experience of commercial banks also is favorable. The track record of banks in Wisconsin provides a case in point. State-chartered commercial banks in Wisconsin have had insurance agency authority since the 1940s. Under Wisconsin law, state-chartered banks can sell any kind of insurance for which they are licensed. These insurance activities are licensed and regulated by the State Commissioner of Insurance. Approximately one-fourth of the 400 state-chartered banks in Wisconsin are involved in selling insurance.

The competitive environment in Wisconsin involving banks and insurance companies is particularly lively. Whereas a growing number of commercial banks offer insurance products, many insurance firms offer such commercial bank products as consumer loans, IRAs and home mortgages.

In summary, the two examples provided here -- life insurance offered by savings banks and the insurance activities of banks in Wisconsin -- illustrate the benefits that can accrue to institutions and consumers alike when banks are permitted to engage in the insurance business.