

Testimony of the
Special Committee on Financial Services Modernization
of the
National Association of Insurance Commissioners

Before the
Committee on Banking, Housing, and Urban Affairs
United States Senate

Regarding
Financial Services Modernization

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Testimony of George Nichols III, Chairman NAIC Special Committee on Financial Services Modernization

Introduction

My name is George Nichols, and I serve as Commissioner of Insurance in Kentucky. I also serve as Vice President of the National Association of Insurance Commissioners (NAIC) and Chairman of the NAIC's Special Committee on Financial Services Modernization. The NAIC established this Special Committee in 1996 to assist State insurance regulators as they continue to meet the demands of the Nation's rapidly evolving marketplace for financial products.

We appreciate the opportunity to testify on financial services legislation before the Committee on Banking, Housing, and Urban Affairs. State insurance regulators and the NAIC support Congressional efforts to modernize and improve Federal laws that govern how banking, insurance, and securities products are regulated in the United States.

We are also very pleased that Chairman Gramm, the Committee, and its staff are taking a fresh look at ways to achieve financial modernization without letting today's sensible consumer protection regulations get lost in the shuffle. Retaining the public's trust in safe markets will require that Congress carefully preserve current State regulations which protect Americans who purchase or depend upon insurance for financial security – including those who rely upon bank-related entities for insurance coverage.

States Have An Equal Stake In Federal Financial Services Modernization

As the primary regulators of insurance in the United States, State governments are equal partners with the Federal government in assuring that financial integration of banking, insurance, and securities products is handled prudently. Here are three points we ask you to keep in mind when considering Federal legislation affecting insurance –

1. There is no Federal regulatory agency for regulating the business of insurance. If the Federal government prevents the States from supervising insurance adequately, this vital consumer protection function won't get done at all.
2. Individual States and their citizens bear the costs associated with regulating insurance providers, including the costs of any insolvencies that occur. State governments thus have a powerful incentive to do the job well, and the record shows they have done so.
3. Please be careful when re-writing Federal banking laws. The use of overly broad language and imprecise drafting can easily undermine essential State consumer protection laws which apply to ALL insurance providers. The potential costs to State governments, taxpayers, policyholders, and claimants could be enormous.

Some people have framed the political debate over financial modernization as a conflict between Federal and State regulation, or between the banking and insurance regulatory systems. The real issue, however, is whether insurance-related activities of financial services companies will be regulated at all if Federal law prevents the States from doing the job. The Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) have each said they do not intend to regulate insurance. If we are prevented from doing it, who will?

Financial Services Legislation Should Be Guided By Common Sense Principles

The Committee asked the NAIC to present its views and recommendations regarding the principles that should guide financial services legislation. My testimony identifies three key principles which we believe should be the basis for any Federal legislation intended to modernize financial supervision.

The Committee also asked us to evaluate the draft legislative proposal prepared by the Committee's staff to see if it meets the principles of sound legislation. My testimony includes our comments on the Senate staff proposal under each of the principles discussed below. In addition, I will offer the NAIC's views on important insurance-related provisions in HR 10, because that bill has dominated Congressional debate on financial services legislation for more than two years.

Sound legislation depends upon sound principles and common sense. Although many financial products – especially insurance – are quite complex, the principles for legislating a sound financial regulatory system are really very straight-forward.

First, Federal Legislation Should Establish A Regulatory Process That Is Fair

Sound legislation should set up a legal PROCESS which is fair to everyone involved. Those involved in the process definitely include the millions of people and companies in the United States who actually spend money to buy insurance. Shaking up the regulatory system must not result in shaking down consumers.

A good financial services law must also permit sensible administration of its objectives by government regulators as new commercial products and fact situations emerge. Change is inevitable. Regulatory laws should give government agencies the flexibility to keep pace with fast moving businesses.

As national banks enter non-banking businesses, some of them are seeking to preempt State regulations which they believe are unfair, as well as inconvenient to the ways they are used to doing business in the banking world. They must realize when they choose to enter insurance that it is a very different business, with different risks and regulatory needs. State regulators are committed to treating bank-related insurance providers the same as any other provider, but we will insist that they follow the consumer protection laws covering solvency and fair market conduct which apply to ALL insurance providers.

Senate Staff Proposal – The Senate staff has put together a legislative solution that is largely focused on establishing a regulatory process that works. NAIC has suggested changes to the sections on insurer affiliations, activities, and legal deference in court which, if adopted by the Committee, will make the process fair to all parties and flexible for regulators. Not only is this approach the best route to a successful regulatory system, but it avoids approximately 300 pages of confusing and unhelpful technical language set forth in HR 10.

HR 10 – HR 10 focuses on achieving specific end results based upon current markets and products. Major amendments to the bill will be required to turn it into a sensible process for supervising financial services providers now and in the future. The NAIC is working to make HR 10 more oriented toward a process that is workable on a lasting basis.

Second, State Authority To Regulate Insurance Must Be Fully Preserved

The NAIC and State regulators strongly urge Congress to insist that Federal legislation clearly preserve the traditional powers of State insurance departments to supervise all insurance activities, no matter what type of entity offers them to the public.

So far, Congressional proposals to permit financial services integration have sought to overcome any contrary State laws by attacking the very core of State regulatory authority. These proposals broadly prohibit States from doing almost anything which might “prevent or restrict” the ability of banks to affiliate with insurers or engage in the insurance business, even if a bank’s activities would bring harm to insurers, policyholders, claimants, and taxpayers. As a result of this overkill approach, insurance regulators would be blocked from using our normal tools to review and prevent business affiliations or transactions that hurt policyholders and claimants.

We cannot imagine that Congress would agree to legislation that stripped Federal banking regulators of their basic authority to protect the public and the Federal deposit insurance system. Because the fundamental purpose of Federal and State financial regulation is to prevent or restrict commercial activities for the public’s benefit, we take such actions routinely for good reasons. Preempting all State regulatory authority in order to address a few inequities is throwing the baby out with the bathwater. The right way to accomplish this objective is to preserve all State authority first, and then to target specific problem laws and regulations for Federal preemption.

Federal preemption of general State authority will inject needless confusion into the insurance regulatory system, at the very least. The extent of State insurance authority – which is now pretty clear – would surely be questioned and tested, not only by banks and their affiliates, but also by traditional insurers which have complied with present laws for many years. It makes no sense to undermine a State regulatory system that has worked very well at answering the demands of consumers while preventing massive insurer insolvencies.

Senate Staff Proposal – The original draft is generally oriented toward preserving State regulatory authority, but critical improvements are necessary. The NAIC is impressed that Senate staff have seemed willing to make changes to meet our concerns regarding affiliations, activities, and judicial review. Allowing banks to conduct insurance activities from operating subsidiaries is another concern of State regulators.

HR 10 – HR 10 needlessly tramples on State insurance powers having nothing to do with Federal banking and securities supervision. In the name of giving banks and insurers a level playing field, the bill preempts large chunks of the general consumer protection authority enacted by State legislatures to protect customers and claimants of ANY insurance provider. These important laws and regulations do not discriminate against banks.

Third, States Must Remain Equal Partners In Financial Services Modernization

While Congress and industry talk about modernizing financial services regulation, State and Federal regulators are actively developing and implementing real changes that promote uniformity and efficiency. The process is working because State insurance authority is clearly defined under the McCarran-Ferguson Act and existing law. Continued progress by regulators depends upon the States maintaining their authority.

The NAIC is currently working with the OTS, the OCC, and the Conference of State Banking Supervisors (CSBS) to develop written agreements for cooperating and exchanging information on regulatory matters. In December, our Special Committee on Financial Services Modernization considered, subject to final approval, a model consumer complaint cooperation agreement developed jointly by NAIC and OCC.

Separate agreements with OTS and CSBS covering information and cooperation on examination and enforcement matters are expected to be considered and approved soon. When completed, these agreements will serve as models for individual States to use as a basis for establishing ongoing working relationships with Federal and State banking regulators. Written agreements and informal cooperation are already being implemented by active personal contacts among the NAIC, State insurance departments, and Federal banking agencies.

Training and education are additional areas where State insurance regulators are cooperating with Federal agencies. The NAIC has arranged all-day meetings with top technical leaders at the Federal Reserve Board, OTS, and State insurance departments. Special training classes are now being designed by NAIC experts to help Federal regulators perform their duties better by working with insurance regulators. Federal and State participants in these hands-on exchanges have all agreed that they are exactly what is needed to make functional regulation work.

In the push to remove marketing and operating restrictions on financial services, Congress must be careful not to prevent States from implementing the actual reforms we are accomplishing today under existing laws.

Senate Staff Proposal – If NAIC’s suggested changes on preemption of State laws dealing with affiliations and insurance activities are implemented, the Senate staff legislative proposal will allow the States to continue working productively as equal partners with the Federal government. The devil is always in the details, but we are pleased to hear that positive and substantial improvements are being made to the original draft released last week.

HR 10 – HR 10 relegates State insurance regulators to a backup role as junior partners with the Federal government. The bill’s broad preemption of essential State powers to conduct basic regulatory functions is unacceptable and counter-productive to Congressional efforts to modernize financial services regulation.

Recommended Changes For Improving The Senate Staff Proposal

We believe the Senate Committee on Banking, Housing, and Urban Affairs can easily avoid insurance regulation problems without adversely affecting the consumer and business benefits which modernization proponents hope to achieve.

Here are our recommendations on important issues which are not presently addressed satisfactorily in the Senate staff proposal –

1. Make it clear that State authority to conduct full reviews of insurer affiliations is preserved in Section 104, so long as they do not have the practical effect of discriminating against banks.
2. Change the judicial review section to allow Federal courts to give equal deference to the parties during any court review of legal differences between State and Federal regulators.
3. Banks should not engage in insurance activities through operating subsidiaries.

The staff proposal is silent as to the authority of State insurance regulators over insurance operating subsidiaries of national banks. In light of this silence, we are concerned that State insurance protections would be preempted by Federal law.

Because of its corporate structure, a Federal bank regulator is going to have a much greater interest in the financial health of an operating subsidiary than in a holding company affiliate, and a much greater incentive to directly regulate the operating subsidiary.

We recommend that banks not be permitted to engage in insurance underwriting activities in operating subsidiaries. This type of corporate organization raises serious concerns about the separation of the bank and its insurance subsidiary, and could negatively impact the financial health of the insurer, and ultimately involve State guarantee funds.

State regulators are concerned that allowing operating subsidiaries of small banks to engage in insurance underwriting activities will give them a competitive advantage, and that large banks will argue to have the same powers in the future.

4. There should be a definition of insurance in the Senate staff proposal.

It is important to have a definition of insurance that covers current products. Such a definition will preserve the State regulatory framework and give predictability to the industry. As presently written in the Senate staff proposal, OCC actions already taken with respect to bank insurance activities will be grandfathered, but other potential insurance activities are left in a regulatory limbo. It is important to ratify the present situation to maintain some certainty regarding the regulatory framework for current products.

Conclusions

Overall, we like the legislative approach toward Federal financial modernization set forth in the Senate staff proposal. It is a bold program focused on setting up a modern regulatory process that is fair to all parties. The staff proposal is also a refreshing change from the needless complexity and negative approach of HR 10.

Nonetheless, there are important changes which must be made in the Senate staff proposal to maintain the role of State insurance regulators as effective partners of the Federal government. We are pleased that the Committee and its staff seem open to making the changes which are necessary.

We want to continue keeping unsound or rogue insurance operations from damaging consumers, banks, and insurance companies. Doing that job will also protect Federal and State governments from unnecessary financial exposures caused by weak and insolvent institutions. Accordingly, State insurance regulators and the NAIC ask the Committee on Banking, Housing, and Urban Affairs to help us by preserving the authority we need to get the job done.