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

before the
Committee on Banking and Financial Services
United States House of Representatives

regarding
HR 10 and Financial Modernization

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George M. Reider, Jr.
Commissioner of Insurance
Connecticut

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NAIC Special Committee on Financial Services Modernization

Introduction

My name is George Reider, and I serve as Commissioner of Insurance in Connecticut. I also serve as President of the National Association of Insurance Commissioners (NAIC). Today, I am testifying on behalf 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.

First, I want to express our appreciation for the work of the Committee on Banking and Financial Services and the leadership of Chairman Leach on HR 10. We support Congressional efforts to modernize and improve Federal laws that govern how banking, insurance, and securities products are regulated in the United States. Achieving that goal, however, will require that Congress preserve current State regulatory authority to protect all Americans who purchase or depend upon insurance for financial security – including those who rely upon bank-related entities for insurance coverage.

If Not Fixed, HR 10 Will Seriously Undermine Insurance Regulation in the U.S.

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. We are concerned that HR 10, as presently written, does not adequately preserve State authority to regulate insurance activities of banks, their affiliates, and even traditional insurers. The bill's defects seem unintentional, but their harmful impact will nonetheless be very real.

Here are three points we ask you to keep in mind when considering HR 10 –

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.

How HR 10 Harms Insurance Regulation

In the name of giving banks and insurers a level playing field, HR 10 directly 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 do not discriminate against banks, and they are applied equally across the board to every company that chooses to offer insurance products to the public.

Section 104 of HR 10 is the major offender. It prohibits 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 bring harm to insurers, policyholders, claimants, and taxpayers. As a result of this prohibition, insurance regulators would be blocked from using our normal tools to review and prevent business affiliations or transactions that hurt policyholders and claimants.

The method used in Section 104 to address inequities is completely backward. Rather than targeting specific laws and regulations, it preempts ALL State authority before giving back some strictly limited powers through language that is both unclear and confusing. We cannot imagine that Congress would agree to such a provision if it stripped Federal banking regulators of their basic authority to protect the public and the Federal deposit insurance system.

There are other culprits in HR 10. Two major subtitles in Title III needlessly undermine State insurance regulation, yet have nothing at all to do with creating a level playing field for banks and insurers. Subtitle B overturns State conversion laws for mutual insurers, while Subtitle C creates a new entity to supervise insurance agents. These attacks on the State regulatory system have no place in a bill which explicitly reaffirms that State insurance powers under the McCarran-Ferguson Act are fully preserved.

Real Examples of HR 10's Harmful Impact

1. My home State of Connecticut was involved last year in the regulatory approval process for the merger between Travelers Insurance and Citibank. As Commissioner, I reviewed the proposed business plan and a complete filing of financial and operating data before making a final decision that the merger should be approved. I met my responsibility to fully review the merger on behalf of the public, and the matter was handled expeditiously with no complaints from the companies making the application. Under HR 10, however, I would be automatically prevented from conducting a proper regulatory review of such a large and influential merger affecting insurance consumers in my State.

2. A recently enacted North Carolina law provides another example. After extensive input from citizen groups, the North Carolina insurance department, and Blue Cross/Blue Shield managers, the State's legislature decided that the $2 billion value of the State's Blue Cross/Blue Shield plan should be put into a trust for the benefit of the public if it is ever sold to private interests. If a bank or bank-affiliated insurer were involved in such a sale, this State law, passed to address local concerns having nothing to do with Federal banking laws, would be preempted because HR 10 dictates that no State law may prevent or restrict a bank from affiliating with an insurer.

3. Pennsylvania enacted a new law in 1996 to correct widespread sales and solicitation abuses found during the State's regulatory examinations of companies marketing life insurance products and annuities. The law sets limitations and minimum standards for illustrations used in marketing such products. It also addresses unfair financial planning practices, and prohibits unqualified agents from holding themselves out as financial planners. Under HR 10, Pennsylvania stands to lose this important tool with respect to the solicitation and sale of life and annuity products by financial institutions, even though the need for the law has been established by State regulators.

4. On a broader level, the NAIC has prepared a chart showing more than 50 basic State insurance laws that HR 10 seems likely to preempt if it is not amended. (See attachment to testimony: "Protecting Insurance Consumers in the United States") The chart identifies NAIC model laws that are the basis for most State statutes covering such critical areas as examinations, audits, reinsurance, capitalization, valuation, investments, liquidations, guarantee funds, agent licensing, and holding company supervision.

Preempting these State consumer protection statutes by changing Federal banking laws will inject needless confusion into the insurance regulatory system, at the very least. The extent of State insurance authority – which is now pretty clear – will 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 in preventing massive insurer insolvencies and answering the demands of consumers.

Progress by State Regulators Depends Upon Maintaining Current Authority

HR 10 threatens the substantial progress now being made by State insurance regulators using our existing authority. While Congress and industry have been talking about modernizing financial services regulation, we have been developing and implementing real changes that promote uniformity and efficiency. The process is working because State insurance authority is well defined and accepted under the McCarran-Ferguson Act.

The NAIC is currently working with the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (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.

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.

State insurance departments and the NAIC are actively implementing an advanced program called State Regulation 2000 that uses the latest technology to allow constant communication and updated data sharing on key licensing, enforcement, and rate filing requirements. We are also promoting uniformity through model laws, and enhancing efficiency by signing declarations of uniform treatment regarding non-resident agents. These administrative declarations exceed the standards in HR 10 by disallowing counter-signature requirements, and establish reciprocity among the majority of States.

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.

How HR 10 Should be Fixed

The NAIC and State regulators strongly urge Congress to amend HR 10 so the bill clearly provides that State insurance departments will maintain their traditional powers to supervise all insurance activities, no matter what type of entity offers them to the public. We believe the House Committee on Banking and Financial Services can fix the insurance regulation problems in HR 10 without adversely affecting the consumer and business benefits which the bill's sponsors hope to achieve. Today, we pledge our strong commitment to help you do just that.

1. Limit the Broad Preemption of State Insurance Authority (Sections 104, 308)

Sections 104 and 308 of HR 10 treat State insurance regulators as enemies of banks, rather than equal partners with Federal regulators in assuring that insurance products are financially sound and marketed fairly to consumers.

Section 104 is particularly onerous because its blanket preemption of State authority extends to other sections of HR 10, as well as to all other Federal laws – past, present, and future. We recommend fixing Section 104 by changing its negative language into a positive legislative statement that State regulators are an essential and equal part of the financial regulatory system for ALL entities which engage in insurance. This

statement preserving general State insurance authority should be followed by narrowly constructed exceptions that supersede specific State laws which obstruct the financial integration provisions in HR 10.

The NAIC will gladly provide the House Banking and Financial Services Committee with suitable language that fixes Section 104. Section 308 should be deleted entirely.

2. Delete the NARAB Provisions in Subtitle C (Sections 321- 336)

The National Association of Registered Agents and Brokers (NARAB) is a special interest provision sought by certain industry groups to evade the State regulatory process. It creates by statute an entirely new organization that would substitute its judgment on agent and broker licensing matters for the decision-making of insurance commissioners empowered by State law. NARAB would exercise quasi-official powers to take over the most important tools which State insurance departments have for controlling fraud and abuse by agents and brokers.

We strongly object to NARAB. If it becomes law, there will be a parade of additional industry groups seeking help from Congress to undermine State authority by slipping amendments into Federal laws. We do not believe Congress should subject itself and State governments to a war of attrition regarding the powers we need to meet our regulatory responsibilities.

NARAB is also unnecessary because the NAIC is now implementing well-designed programs which will achieve the same goals sought by NARAB's proponents. If the NARAB provisions become law, there will be needless regulatory confusion, legal problems, and administrative nightmares regarding the extent of its powers and who actually runs the organization. We urge you to delete the NARAB title from HR 10 because it will cause more problems than it is intended to correct.

3. Delete the Mutual Insurer Provisions in Subtitle B (Sections 308, and 311- 316)

Subtitle B is another attempt by special interests to have the Federal government needlessly intervene in State affairs. In this case, the issue is differing approaches by States using their consumer protection authority to help policyholders of mutual insurers. A number of mutual insurance companies, which are legally owned by their policyholders, want to use short-cuts to convert their business operations to stock ownership in order to raise capital and reward management.

Some States have passed laws which allow mutual insurers to redomesticate by changing to stock ownership without getting approval from their existing policyholders. Other States have refused to permit such short-cuts because they believe it treats policyholders unfairly. In both cases, this is a classic example of States being more attuned to local consumer protection issues than the Federal government. There is no reason for Congress to substitute its judgment for those of the individual States regarding the redomestication of mutual insurers.

4. Refine HR 10 to Make State Insurance Regulators Equal Partners

HR 10 has several provisions which set forth the relationships among the Federal Reserve Board and other regulators. Generally, these provisions grant final approval authority to the Federal Reserve when the jurisdictions of regulatory agencies may overlap. We note that the SEC is given final authority where securities is the primary business involved.

State insurance regulators should be granted equivalent authority to have final approval over the matters for which they are the lead regulator. This seems only fair, since States must bear the costs of any insurer failures which may result from decisions made by Federal regulators.

Conclusions

Three industries – banking, securities, and insurance – are covered by HR 10. Of the three, insurance is the only industry which is entirely supervised by State governments with no Federal financial guarantees. We take pride in our work, our record of accomplishments, and our ongoing efforts to keep abreast of changes in the marketplace which affect insurers and consumers.

As banks increasingly enter non-banking businesses, they have sought to preempt State laws and regulations which they believe are unfair, as well as inconvenient to the ways they are used to doing business in the world of banking. They must realize when they choose to enter insurance that it is a very different business, with different risks and regulatory needs. State insurance regulators and the NAIC will treat bank-related insurance providers the same as any other provider, but we will also insist on applying our generally-applied State consumer protection laws to assure that solvency and fair market conduct requirements are met by ALL insurance providers.

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 banks will be regulated at all if Federal law prevents the States from doing the job. The Federal Reserve Board, OCC, and OTS have each said they do not intend to regulate insurance. If we are prevented from doing it, who will?

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 and Financial Services to help us by fixing HR 10 to preserve the authority we will need to get the job done.