TESTIMONY OF

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ON

BANKS AND INSURANCE ACTIVITIES

BEFORE THE

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

12:30 p.m.
May 12, 1988
Room 2359A, Rayburn House Office Building

Mr. Chairman and Subcommittee members, we appreciate the opportunity to be here today to address the issue of insurance activities in the banking industry. We are pleased that the Subcommittee has taken the initiative to address this very timely and important issue.

Background

Before discussing the insurance activities of the banking industry and the Federal Deposit Insurance Corporation's views on that subject, I would like to provide some background on the structure and regulation of the United States 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 solely 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 federal 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 federal 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.

There is considerable debate today about the jurisdictional reach of the provisions of the Bank Holding Company Act that govern the nonbanking activities of bank holding companies and the Federal Reserve Board's authority to extend the activity limitations contained in that Act to state-chartered

banks and their direct subsidiaries. The Federal Reserve Board believes that the nonbanking activity provisions of that Act, including those that limit bank holding company insurance activities, do not apply to state-chartered banks in a holding company system. We and the preponderance of the legal community agree with this analysis. However, the Board takes the contrary position with respect to the direct subsidiaries of such banks, claiming that they have the authority to apply the activity limitations to the banks' subsidiaries. With this we disagree both as a legal and policy matter. But, the Federal Reserve Board's position on the extent of its authority over nonbanking subsidiaries of state-chartered banks that are in bank holding companies has yet to be tested in the courts.

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.

I cannot emphasize enough the importance of this last benefit. The competitive environment facing the banking industry is intense and rapidly changing. To date, the Congress has been reluctant to adopt legislation that would enable banks to adapt to the new financial environment. However, many states have not been reluctant to take steps 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.

Furthermore, a growing number of states grant their commercial banks broad equity investment authority. This authority generally is limited only by the amount of the investment, rather than the type of activity. In those instances where controlling equity investments are permitted, they can be used as a vehicle to enter new lines of business. In view of the limitations customarily imposed on the amount of such investments, however, banks generally are able to acquire controlling interests only in small firms engaging in activities that do not require substantial capitalization.

Insurance Authority and Activities

Let me now turn to insurance activities. The focus of my remarks will be the insurance authorities of state-chartered banks, since those are the banks within the regulatory and supervisory jurisdiction of the FDIC.

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.

Policy Considerations

Insurance authorities granted by the states to state-chartered banks and their subsidiaries could be limited at the federal level by the Congress, by the FDIC under its statutory authority and, perhaps, by the Federal Reserve Board. Thus, let me comment on the wisdom and desirability of placing restrictions on insurance powers granted by the states.

As described above, the FDIC does not have the authority to confer any power on, or authorize any activity for, state-chartered banks. These authorities are solely within the jurisdiction of the states. In fact, the banks supervised by the FDIC -- state-chartered nonmember banks -- are not required to seek the FDIC's approval prior to exercising any power granted by their chartering authority. The FDIC, however, can prohibit or restrict the

exercise of any state-authorized activity undertaken directly or indirectly by a 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 insurance activities pose risks that would form the basis for imposing any 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. Thus, 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.

FDIC Position

The FDIC's preference at this time would be that there be no federal legislation (with the exception noted below) dealing with insurance activities of state-chartered banks. Any federal legislation that addresses this area would interject a federal presence into insurance and state banking -- two areas traditionally regulated by the states.

Thus, the most favorable outcome for states' rights and the dual banking system would be to maintain the status quo with respect to the involvement of the federal government in the insurance activities of state

banks. The insurance activities of free standing state-chartered banks and their subsidiaries would continue to be regulated solely by the states. Similarly, although subject to a possible contrary determination by the courts, state-chartered banks that are in bank holding companies also would be able to continue to perform any insurance activities authorized by the state. However, it is less clear whether subsidiaries of such banks have similar authority. Thus, the FDIC believes that if there is <u>any</u> federal legislation, the most helpful legislation would be to clarify that the insurance activity limitations contained in the Bank Holding Company Act <u>do not apply</u> to the subsidiaries of state-chartered banks that are in a bank holding company system.

We recognize, however, that there may be federal legislation considered during this Congress to restrict the insurance activities of banks, including those of state-chartered banks that are in holding companies. While we do not favor such legislation, there are some approaches that we would find less objectionable than others and that could be viewed as not seriously jeopardizing the rights of the states and the dual banking system.

The best approach would be the one that has surfaced recently in an amendment offered by Congressman Gerald Kleczka of Wisconsin. That amendment would limit the insurance activities of state-chartered banks and their subsidiaries to the boundaries of their home states. A state-chartered bank would be permitted to offer insurance <u>only</u> to residents of the state, persons employed in the state or persons otherwise present in the state. However, the amendment also would recognize specifically 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.

Another, but less preferable, option would limit -- but not totally prohibit -- a state-chartered bank that is owned by an out-of-state holding company from engaging in insurance activities. Under this option, it would be left for the states to determine the extent to which out-of-state holding companies could own state banks that conduct insurance activities. Like the Kleczka amendment, this approach also would limit the geographical area in which state banks could offer insurance to the state in which the bank is located.

A third approach, which the FDIC does not favor, is the one reflected in the Senate-passed bill that was recently referred to this Committee. That language would not only limit insurance activities to the boundaries of the state in which the state-chartered bank is located, but also would prohibit the bank from engaging in any state-authorized insurance activity if the bank's parent is not located in the same state. We believe that this approach is unfair and anticompetitive and would seriously infringe on states' rights and jeopardize the dual banking system. Moreover, the Senate-passed bill also would undermine the competitive position of national banks in the system.

Therefore, 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 provide a clarification of the fact that the activities of state-chartered banks and their subsidiaries 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.