TESTIMONY OF

L. WILLIAM SEIDMAN
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

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

10:00 a.m.
September 9, 1988
Room 2123, Rayburn House Office Building

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 only 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 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.