Statement of Glen Milesko

On Behalf of the

American Bankers Insurance Association

Before the

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

Of the

Committee on Financial Services of the

United States House of Representatives

June 18, 2002
Mr. Chairman and Members of the Subcommittee:

My name is Glen Milesko, and I am the President and Chief Executive Officer of Banc One Insurance Group. I am here today on behalf of the American Bankers Insurance Association (“ABIA”). My testimony today also reflects the views of the American Bankers Association.

ABIA’s members are banking organizations, insurance companies and third party administrators engaged in the business of insurance. Banc One Insurance Group, for example, is one of the nation’s leading bank providers of insurance. It is comprised of a nationally licensed, full line insurance agency with over 5,000 licensed agents; a multi-state insurance agency, a life insurance company, one life and two property and casualty reinsurance companies; one multi-state direct credit life insurance company; and an international life reinsurance company located in Dublin, Ireland.

**ABIA Supports Optional Federal Insurance Chartering**

ABIA appreciates the opportunity to appear before the Subcommittee as it examines the regulation of insurance and the option of federal chartering for insurers and

\[1\] The American Bankers Insurance Association (ABIA) is a separately chartered trade association and non-profit affiliate of the American Bankers Association representing more than 250 of the nation’s largest banks and insurers. ABIA’s mission is to develop positions and strategies on bank-insurance related matters, represent those positions before state and federal governments and in the courts, and support bank-insurance related programs and activities through research, education and peer group information sharing.
producers. Over four years ago, ABIA developed its own “blueprint” for the optional federal chartering of insurers and producers. That blueprint called for the creation of an insurance regulatory system patterned after the dual banking system.

We believe that any insurer and any producer should be able to voluntarily choose to be regulated either by the Federal Government or by state governments. Such a system is not intended to replace state regulation – but to be an alternative to state regulation. This option has worked well in the banking industry, and we see no reason to believe it could not work well in the insurance industry.

When we first developed our blueprint, Congress was actively debating the Gramm-Leach-Bliley Act. Therefore, we put the blueprint on the “back burner” until action on that bill was complete. Once the Gramm-Leach-Bliley Act was finalized, we made optional federal chartering a priority for our Association. We converted our blueprint into a specific legislative proposal, and unveiled it at a conference organized by the American Enterprise Institute.

As you might expect, our proposal received a mixed reception. While the proposal received some quiet encouragement from certain sections of the insurance industry, it was roundly criticized by several insurance trade groups and state insurance regulators. Also, some in the insurance industry wondered why a banking association was concerned about insurance regulation. The fact is that the banking industry is actively engaged in the business of insurance. As of year-end 2001, there were approximately 1900 banking institutions engaged in the business of insurance, mostly through agency operations. The total premium volume for insurance policies and annuities sold by those institutions was
approximately $50 billion. It was through this involvement in the business of insurance that ABIA’s banking members concluded that state insurance regulation was not suitable for all insurers and producers, especially those firms engaged in activities in multiple states.

It is now apparent that ABIA’s concerns are widely held. The leading trade associations for property and casualty insurers and the life insurers also have developed proposals for optional federal insurance chartering. While their proposals reflect concerns unique to their respective organizations, the similarities between our proposal and their proposals are striking. Their proposals, like ours, are designed to permit insurers to voluntarily select a single regulator and a single set of regulations, rather than 55 regulators and 55 different sets of rules.

Given this convergence of interests, ABIA recently joined with the American Council of Life Insurers and the American Insurance Association - under the umbrella of the Financial Services Coordinating Council - to develop a common optional federal chartering proposal. The first step in that cooperative effort was the development of a set of principles, around which any legislative proposal should be structured. The principles provide for the establishment of a federal insurance regulatory authority within the Treasury Department that would be headed by a person appointed by the president and confirmed by the Senate for a fixed term. This regulatory authority would regulate exclusively federally chartered insurers and producers. State chartered insurers and producers would continue to be regulated by state regulators. Federal insurers and producers, not taxpayers, would be responsible for the ongoing costs of federal supervision
and regulation. A copy of the joint principles is attached to my statement and a more detailed discussion of them can be found in the Statement by the Financial Services Coordinating Council that also is being presented today.

Consumer Protections and Optional Federal Chartering

You have asked that ABIA specifically address how optional federal chartering would affect consumers. We are pleased to do so. ABIA’s member companies are driven by the needs and demands of consumers, so we recognize that any optional federal chartering proposal must be responsive to those needs and demands.

ABIA believes that optional federal chartering will benefit consumers in three primary respects:

- It will assure consumers access to sound insurance products with consistent consumer protection standards;
- It will be responsive to the changing needs of consumers; and
- It will create a dynamic tension between state and federal regulators that is in the best interests of the consumers of insurance.

The remainder of my statement discusses each of these consumer benefits.

Optional Federal Chartering Will Assure Consumers Access to Sound Insurance Products with Consistent Consumer Protection Standards

Optional federal regulation of insurers and producers can fully and fairly protect the rights and interests of the consumers of insurance through the establishment of federal
solvency and market conduct standards.

**Federal Solvency Standards**

ABIA believes that any optional federal chartering bill should require federally chartered insurers to meet strict solvency standards. For example, federally chartered insurers should be required to meet risk-based capital standards, which ensure that federal insurers are adequately capitalized and which impose sanctions on federal insurers that fail to meet applicable capital standards; to follow investment standards, which require a federal insurer to invest assets prudently and which place quantitative limits on investments in subsidiaries engaged in activities not permissible for the insurer; and to comply with dividend restrictions, which prevent insolvent federal insurers from paying dividends. Such federal solvency standards would give consumers confidence that a federally chartered insurer will be able to pay claims on its policies.

The federal insurance regulator also should be given adequate authority to enforce compliance with federal solvency standards. This should include the authority to require federally chartered insurers to file regular reports on their operations and financial condition; the authority to regularly examine federally chartered insurers, and to the extent appropriate, their affiliates; and the authority to initiate an enforcement action against federally chartered insurers that fail to comply with applicable standards. Such enforcement powers should be patterned after those available to federal banking regulators, which include the power to remove officers and directors and to impose civil money penalties of up to $1 million a day.
The combination of federal solvency standards backed by regular examinations and enforcement actions would signal to consumers that federally chartered insurers are safe and sound.

**Federal Market Conduct Standards**

Federally chartered insurers — and federally licensed producers — should be subject to federal market conduct standards. Such standards would protect consumers by preventing unfair methods of competition and unfair and deceptive acts and practices in the advertising, sale, issuance, distribution and administration of insurance policies.

Critics of optional federal chartering often claim that a federal insurance regulator would not be able to adequately police sales and claims practices by federal insurers or producers. Some of these critics even cite the hundreds of thousands of consumer complaints filed annually with state insurance regulators in support of this claim. Federal regulation of the banking industry shows, however, that federal agencies can effectively enforce consumer protection standards.

Today, thousands of banks are offering a variety of products to consumers through hundreds of thousands of branches, ATMs, loan production offices and other outlets throughout the United States. These banks are subject to federal consumer protection statutes such as the Truth-in-Lending Act, the Truth-in-Savings Act, the Fair Credit Reporting Act, and the Equal Credit Opportunity Act. The federal banking agencies, which are responsible for enforcing compliance with these various consumer protection laws, have been able to fully and effectively enforce compliance with the laws. They have
done so through a combination of regular examinations and the threat of enforcement actions. Federal market conduct standards for insurance monitored through regular examinations and the potential for significant enforcement action should work equally well for the consumers of insurance.

In fact, the combination of federal market conduct standards monitored through regular examinations and the potential for enforcement actions should provide insurance consumers better protection than currently exists in many states. The number of consumer complaints filed annually with state insurance commissioners is not a sign of successful state market conduct regulation. Those complaints indicate that something is wrong with state market conduct regulation — otherwise consumers would not need to file so many complaints. The fact is that several states do not conduct market conduct examinations, especially of producers, and this allows certain insurers and producers to engage in practices that are harmful to consumers. Additionally, since there is no central licensing and registration, “rogue” insurers and producers can move from state to state undetected. A recent example is the Frankel case, which allowed an unscrupulous individual to defraud several state regulators and embezzle $200 million before being detected. Federal market conduct standards, regular examinations and the threat of enforcement actions would effectively deter such harmful practices.

One so-called consumer protection that should NOT be part of any optional federal chartering proposal is rate regulation. As a general rule, we believe that consumers will be better served if federally chartered insurers are not subject to price controls. Price controls may be appropriate in non-competitive markets. In such situations, a single firm or a group
of firms may be able to set and hold prices at unreasonable levels. The insurance industry, however, is a competitive industry. There are thousands of insurers operating in the United States, and there are no significant barriers to entry for new companies. In such a competitive market, competition between firms will protect consumers from unfair pricing schemes.

The consumer benefits associated with competitive rates are more than just speculative. Several states already have moved away from rate regulation, and, in those states, there is evidence that rates have fallen on certain products. For example, a recent study by Scott Harrington for the AEI-Brookings Joint Center for Regulatory Studies entitled “Insurance Deregulation and the Public Interest” found that auto insurance is less costly and more available in 14 states that do not require prior approval of rates than in 27 other states that do require prior approval.

We do not suggest, however, that any optional federal chartering proposal leave the matter of rates entirely to market forces. We recognize that even in the most competitive of markets, price collusion can exist. Therefore, ABIA supports the application of federal anti-trust laws to federally chartered insurers. The application of these laws would guarantee that rates are set fairly by market forces.

Also, we recognize that the problem for many consumers is not cost, but access. Some consumers cannot obtain needed insurance at any price. The states have adequately addressed this issue through the establishment of so-called “residual” insurance programs, which require insurers to provide certain categories of property and casualty coverage, such as auto and homeowners insurance, to consumers who cannot obtain such insurance in the
open market. Federally chartered insurers that write such policies should be required to participate in such state programs, subject to all applicable state rules, including rate limitations.

Optional Federal Chartering Would Be Responsive To the Changing Needs of Consumers

In addition to providing consumers with sound products in a fair manner, optional federal chartering will meet the changing needs of consumers by giving them access to new and more uniform products. Under the current state system of insurance regulation, it can take months, if not years, for a company to introduce a new product in every state. Such delays are an inevitable result of a system in which every state has an opportunity to review and approve insurance products. With a single federal insurance regulator, however, it would be possible for a federally chartered insurer to introduce a new product without delay. This will enable federal insurers to design new products as the needs of consumers change.

Additionally, optional federal chartering would allow new products, and the delivery of those products, to be more uniform. For example, under an optional federal chartering system, the same life insurance policy could be offered in every state. 2 Similarly, it would permit a company to use the same policy form, same disclosure statements, and same administrative procedures throughout the United States. Uniform

---

2 We assume, however, that even with an optional federal charter there could be state-by-state variations in property and casualty policies consistent with applicable state law.
policies and sales practices would reduce consumer confusion, especially for those consumers that move from state to state for professional or personal reasons. An added benefit of uniform administration of insurance products on a national basis is that companies can achieve greater economies of scale thereby reducing costs to the insurer, which can be passed on to the consumer.

Having a federal regulator would also provide for swift responses to consumer needs during times of crisis, such as the recent terrorist attacks or during a natural disaster. A federal regulator could respond with “one voice” rather than relying upon 55 separate regulators to collectively agree to a solution.

Uniform regulation also will facilitate delivery of insurance products over the Internet. As we all know, the Internet can reach consumers, regardless of where they are located. To date, however, the use of the Internet to deliver insurance products has been complicated by variations in state insurance sales laws. A single federal sales practice standard obviously would not be subject to such complications and, thereby, would expand consumer access to insurance products through the Internet.

Optional Federal Chartering will create a dynamic tension between state and federal regulators that is in the best interests of the consumers of insurance.

The commonly agreed upon model for optional federal chartering is the dual banking system. Under that system a bank can voluntarily choose either state or federal regulation. Since the dual banking system has been in place for over 135 years, the best way to judge how optional federal chartering for insurers and producers would affect
consumers of insurance is to take a closer look at the dual banking system. A discussion of the dual banking system and the benefits it has brought to banking regulation and supervision is attached to my statement.

It is interesting to note that the authors of the dual banking system were President Lincoln and his Secretary of the Treasury, Salmon Chase. Apparently, Lincoln, as a young man, recognized that a national banking system was important to the economy. Therefore, after he became President, he worked with Secretary Chase to secure enactment of the National Bank Act, which provided for the chartering and regulation of national banks.

While there is evidence that President Lincoln intended national banks to replace the then existing system of state banks, that has not been the case. Today, approximately two-thirds of all banks are state-chartered, and those banks control approximately 40 percent of all banking assets. Therefore, contrary to the concerns of state insurance regulators, optional federal regulation will not replace state regulation.

Moreover, the dual banking system has created a healthy tension between state banking departments and their federal counterparts, including the Comptroller of the Currency. This healthy tension has stimulated the development of new products and services for consumers and new and better supervisory techniques by both state regulators and the OCC. It has also fostered more efficient supervision as the respective regulators vie to keep their costs of regulation reasonable. Said another way, the dual banking system has not precipitated a race to the bottom in regulation.

Critics of optional federal chartering will, nonetheless, cite the savings and loan crisis as a failure of the dual banking system. We would not attempt to defend that
scandal. We would suggest, however, that the causes of the savings and loan crisis are many and complex. More importantly, following the savings and loan crisis, Congress passed two laws, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and the Financial Institutions Regulatory Reform and Enforcement Act (FIRREA), to redress deficiencies in the regulation of state and national banks and savings associations, and we assume that any optional federal chartering bill that is considered by Congress will incorporate many of those safeguards.

In sum, we see no reason to believe that the dynamic tension inherent in a dual regulatory system would not produce a strong supervisory environment for insurance firms and lead to the development of new products and services for insurance customers, just as it has done for the banking industry and banking customers.

**National Standards**

Finally, I would like to make an observation on one alternative to optional federal chartering, the creation of federal standards to be applied by the individual states. This concept could take two forms, neither of which is preferable to optional federal chartering.

On the one hand, federal standards could serve as minimum standards for the states, permitting states to layer further regulation on top of those mandated by the federal government. Under this scenario, federal standards would fail to achieve the uniformity and efficiency of regulation sought by ABIA and other advocates of optional federal chartering. In fact, minimum federal standards only would exacerbate the current patchwork of differing laws with which insurers and producers have to deal by merely
adding another layer of regulation to the existing balkanized system of state regulation.

On the other hand, federal standards could be mandatory and exclusive. As such, the federal standards would not be an alternative to state regulation; they would replace state regulation. This alternative would intrude on the states to a much greater degree than an optional federal regulator which would leave state regulation untouched and the state system to its own devices. Instead of creating regulatory alternatives brought about by an optional federal charter and the healthy dynamic such alternatives engender, mandatory federal standards would spell the demise of state regulation, a result the critics of optional federal chartering are trying to avoid.

**Summary**

In closing, I wish to again thank you for the opportunity to appear here today. This is an important issue for the members of ABIA, and if we can be of any further assistance to you as you consider optional federal charters, I hope you will call upon us.