RECORD OF SOCIETY OF ACTUARIES
1986 VOL. 12 NO. 3

STATUS OF BANK DEREGULATION

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- o What is the current position of the Treasury Department on deregulation?
- o Should banks underwrite insurance?
- o Partnerships between agents and financial institutions
- o Persistency and expense considerations
- o Tie-in sales

MR. GARY E. HUGHES: I think any time that you have a discussion of banking deregulation, and certainly the question of bank insurance authority, you will encounter some very strongly held views and some very divergent points of view. It seems that bankers, brokers, investment companies and insurance companies all maintain that their position is the correct one, in that it has regulatory prudence, benefits consumers and is in the interest of competition. You are going to hear some interesting points of view that are going to contrast fairly sharply, but this whole issue is a matter of perspective. There are good arguments, both pro and con, on banks entering the insurance business, and you should keep that in mind.

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I would like to give you a sense of the legislative and regulatory environment in which this debate is taking place. I would like to touch on the activities in Congress, a little bit on activities in State Legislatures, certainly what the Federal bank regulatory agencies are doing, and finally a little bit on what the Courts have done in this area.

Before I go any further, let me identify two terms that you are going to hear as the panel goes on. Many of you may know what these mean, some of you may not. The first is non-bank bank and the second is the South Dakota or state enabling legislation loophole.

The term *bank* is defined in the Federal Bank Holding Company Act. The Bank Holding Company Act is a Federal Statute that governs the activities of bank holding companies. A bank holding company is any entity that owns one or more banks. For example, if an insurance company were to buy a bank, the Federal statute would define the insurer as a bank holding company. Under that Act, a bank is defined as an institution that does two things: It accepts demand deposits; and it makes commercial loans.

The definition is phrased in the conjunctive, so any institution that does not conduct both of those activities would at least technically not be a bank for purposes of the Federal Bank Holding Company Act. Indeed, most non-bank banks that have come about have ceased making commercial loans. They will take demand deposits and make consumer loans, but they do not engage in commercial lending.

There are two primary uses for non-bank banks. First, they are used by non-banking institutions, such as insurance companies or broker dealers, to gain entry into the banking business without being regulated as a bank holding company. Second, and probably most important in the legislative forum, they are used by banks and bank holding companies as a way to avoid interstate banking limitations. The Douglas Amendment to the Bank Holding Company Act, which has been around for years, places very strict limitations on the ability of banks to acquire other banks across state lines. The Douglas Amendment limitations that apply to banks do not apply to non-bank banks. So, by setting up a non-bank bank, a holding company can achieve de facto interstate banking.

Non-bank banks can be either nationally chartered or state chartered institutions. A non-bank bank seeking a national charter has to get the approval of the Comptroller of the Currency. A non-bank bank that wants a state charter will simply need to get the approval of its domestic bank regulator.

The South Dakota, or state enabling legislation loophole, refers to an ambiguity in the Bank Holding Company Act concerning the reach of that Act's bank insurance limitations. In 1982, as part of a major banking bill, Congress amended the Bank Holding Company Act by strictly limiting the insurance activities that can be conducted by bank holding companies and, clearly, their non-bank subsidiaries. The question immediately arose as to whether those insurance limitations also applied to a bank that was part of a bank holding company complex. The theoretical debate over whether that loophole existed or not took on a more practical bent in 1983 when Citicorp was able to persuade the South Dakota Legislature to amend its banking law to give South Dakota banks authority to engage in all aspects of the business of insurance. Soon after that, Citicorp and several other bank holding companies applied to the Federal Reserve Board for approval to buy banks in South Dakota for the purpose of entering insurance business.

With those definitions in mind, let me put Citicorp aside for just a moment and turn to the efforts of Congress to deal with what is clearly an increasingly confusing situation in the financial services marketplace. The topic of this panel is banking deregulation, and I think if this panel were being held in 1981 or 1982, everyone in the room who has followed this subject would probably agree that Congress was going to pass some form of banking deregulation bill in the very near future. When the Reagan Administration came in, it made deregulation one of its top priorities. Speaking primarily through the Treasury Department, in 1981 the Reagan Administration surfaced a very broad, very sweeping deregulation proposal. The heart of that proposal was the elimination of virtually all the barriers that presently prohibit banks from engaging on a full basis in real estate, insurance and securities activities. The proposal was very warmly embraced by the banking community. One of the primary reasons was that at that time Congress was also phasing out interest rate ceilings. This was causing the cost of banks' money to go up rather significantly. Bankers felt that by getting a number of new powers, they would be able to offset interest rate deregulation with these new profit centers. While new bank powers were almost uniformly opposed by all non-banking competitors, everyone did feel that Congressional action was inevitable.

Today, though, Congress is probably further away from granting banks new powers than at any time in the last 10 years. I think it is instructive to look at some of the reasons why that dramatic turnabout has occurred.

First, there is the fact that serious problems began to crop up in the banking industry and dampened Congress' enthusiasm for new powers. There was the well publicized problem of the Butcher Bank some years ago. That was followed by the situation with Penn Square. Then you had the collapse of Continental Illinois. Recently, you had the crises in the Maryland and Ohio thrift industries. All of this led to record bank failures. With the deepening problems of the agriculture and energy banks, the failures are at even higher records this year. Quite simply, Congress began considering ways to strengthen the banking industry and to strengthen the role of bank regulators. Calls for new powers, which realistically or at least theoretically, would impose additional risks on banks, lost their appeal to the legislators. In fact, the problems with the energy and agricultural banks have prompted Congress to consider some dramatically different legislation.

There is the so-called regulators bill that has been drafted by the Federal Reserve, the FDIC and the Comptroller of the Currency. It has been introduced in both the House and Senate, and is supported by the Reagan Administration. The focus of that regulators bill is on emergency acquisitions of troubled institutions. One of the key points is that the bank regulators would like to see interstate banking constraints overridden in emergencies in order to permit a healthy bank to acquire a troubled out-of-state bank and to acquire it before it fails rather than after. Under current law, a commercial bank has to be closed before it can be acquired by an out-of-state bank.

Another key provision of the regulators bill is that it would extend this type of emergency acquisition relief to many smaller banks. I think that currently you can only have that type of emergency acquisition if the bank has at least $500 million in assets. The regulators bill would lower that figure to $250 million. The bill also contains a number of provisions that would encourage weakened institutions to seek private assistance before the FDIC has to step in. There is some concern that the Federal Deposit Insurance Fund would be under substantial strain if steps like this are not taken.

In a similar vein, Congress is considering legislation that would infuse cash into the Federal Savings and Loan Insurance Corporation. There is a very real concern that unless something along those lines is done quickly, the FSLIC is going to go bankrupt over the next several years. To remedy this, the Treasury Department and the Federal Home Loan Bank Board have sent draft legislation to Capitol Hill that would generate some $25 billion over the next five years for the FSLIC in order to cover projected losses in that industry.

For several years one of the driving forces in the banking industry for deregulation was interstate banking. This is something that large banks want very badly. The pressure for Congress to do something about interstate banking has eased somewhat as a result of a Supreme Court decision that upholds the ability of states to form regional interstate compacts.

An interstate compact is a situation that involves two or more contiguous states agreeing to lift the prohibitions on interstate banking and permit reciprocal banking mergers across their state lines without opening the flood gates to money center banks. As the popularity of the interstate compacts increased and the money center banks were increasingly excluded from those compacts, the large banks launched several legal attacks against interstate compacts, primarily under the Commerce and Equal Protection Clauses of the U.S. Constitution. When those cases were finally consolidated and went to the Supreme Court, the Court upheld the authority of states to enter into these limited and restrictive interstate compacts. The states, in fact, have been moving forward with this, and because there is growing interstate banking, albeit a form of interstate banking that excludes many money center banks, there is far less pressure on Congress to facilitate the implementation of interstate banking.

Certainly no discussion of the pressures on Congress to do something in this area would be complete without a discussion of non-bank banks. The mood of

Congress always seems to have been one of concern over these institutions, largely because they avoid statutory and regulatory limitations that are placed on similarly situated full service banks.

It is very difficult for Congress to deal with non-bank banks in the legislative forum because there are so many points of view on that one issue.

The large banks favor non-bank banks because these institutions have the ability to engage in interstate banking notwithstanding Federal prohibitions and notwithstanding the limitations of interstate compacts. The small banks definitely want the non-bank bank loophole closed, because they want the money center banks out of their markets. The Treasury Department, on behalf of the Administration, has endorsed non-bank banks primarily on the grounds of enhanced competition and benefits to consumers. The Federal Reserve Board is vigorously opposed to non-bank banks because to legitimize them would undermine the agency's jurisdiction under the Bank Holding Company Act. The Fed also has some concerns with safety and soundness if there is a proliferation of non-bank banks. The insurance industry is a bit more ambivalent on non-bank banks, but would be willing to support legislation to close that loophole provided the South Dakota or state enabling legislation loophole were closed at the same time. A very effective and aggressive group of nonbanking companies have been lobbying for non-bank banks, and include amongst their ranks Sears and American Express. They want that avenue kept open so that they, in fact, can advertise themselves as purveyors of a full range of financial services.

The pressure on Congress to act on non-bank banks ebbs and flows depending on what the courts are doing in this area. There have been some decisions striking down the legitimacy of non-bank banks, others upholding it. I think that the legal questions were finally resolved in January when the Supreme Court decided the *Dimension Financial* case, and, in doing so, legitimized non-bank banks. The immediate effect of that decision was a call on Congress to address the situation, since there was a feeling that these banks would proliferate unless Congress closed off the non-bank bank avenue.

As a footnote to this, the Comptroller of the Currency is under an injunction that prohibits the granting of any new national non-bank bank charters. This came up in a court case in the Eleventh Circuit in Florida. At issue was whether the Comptroller of the Currency has the authority to charter anything other than a full service bank. The Eleventh Circuit was of the view that the Comptroller did not have the authority to charter a non-bank bank.

Despite the Supreme Court's decision, there has not been a proliferation of non-bank banks. The comptroller moratorium is one reason. There is certainly a concern that Congress may step in and eliminate these banks. Beyond that there is a question of whether they really have all that much utility.

In the area of interstate banking, regional compacts have diminished the need for non-bank banks, and I think with some other entities, such as the American Expresses of the world, the utility of a non-bank bank is still an experiment, and the marketplace will decide if it is going to work.

In addition to all of these considerations, consumer interests have applied pressure on Congress to put some consumer oriented provisions in any bill that emerges from Congress this year. The primary areas of concern to the consumers are disclosure, credit card interest rates and funds availability; that is, the time a bank can hold funds before a check is cleared.

Let me narrow the discussion a bit and take up some of the issues that are of particular concern to the insurance industry. By far the most important thing on our legislative agenda is closing the South Dakota loophole. I think the industry believes that legislation to do this is still necessary, even though the Federal Reserve Board last year denied Citicorp's application to buy a bank in South Dakota. In denying that application, the Federal Reserve Board concluded the sole purpose of the transaction was to evade insurance prohibitions of the Bank Holding Company Act. The Federal Reserve Board has express authority to deny any application that would involve an evasion of the purposes of the Bank Holding Company Act. The Fed rendered its decision on this narrow ground and found it unnecessary to address the broader question of whether the Fed, through the Bank Holding Company Act, can regulate the activities of state banks that are owned by bank holding companies.

For insurers, the trade off for closing the South Dakota loophole appears to be closing the non-bank bank loophole. The rationale is that if banks are going to be precluded from entering the insurance business via South Dakota, insurers ought to be prevented from entering the banking business through non-bank banks. I think that as a matter of overall legislative strategy, we support this *quid pro quo* approach to loophole closing. But it goes without saying that those insurance companies that have non-bank banks, particularly ones that have had them for some years, are increasingly reluctant to give them up. So there is a lot of horse trading going on, particularly in the area of grandfathering these institutions. And if Congress does pass legislation to close the non-bank bank loophole, those institutions that have them all hope that theirs will be grandfathered and that they can keep them. I think virtually all of the bills pending before Congress that would close that loophole have some type of grandfather provision, but as the legislative package emerges, the issue of grandfathering is going to be one of the keys to whether it is politically viable.

Let me say a few words on the liability insurance crisis, because this has had a major effect on the issue of bank insurance activity. The banks have used the capacity shortage as a forum for making the argument that they ought to be allowed into the insurance business. Banks argue that they will add capacity and, in doing so, ease the crisis. If you listen very closely to what they say, however, you will hear that they are really not interested in getting into the more risky P&C coverages. What they really would like to get into is the life insurance and annuity markets.

A practical outgrowth of this situation is the difficulty banks have been having getting directors and officers, insurance, and blanket bond coverage. Many institutions and groups are setting up offshore insurance companies to write their own coverage. The insurance regulators and Federal bank regulators have approved this course of action.

As a simple lobbying strategy, we are seeing banks set up captive insurers. They argue before Congress and State legislatures that they have increasing experience in the insurance area, that there have not been any catastrophes as a result of their entering the business, and therefore, that their authority ought to be broadened. They have certainly done that in the credit insurance area. They have made the assertion, although I do not think it is a logical one, that because banks are permitted to be involved in credit insurance, they have extensive "expertise" in the underwriting of life insurance. I am not sure that the banks appreciate the difference between "writing" credit insurance and "underwriting" life insurance.

The capacity crisis has also had an important effect at the state level. Several states, including Florida and Ohio, have laws pending that would permit banks to enter the reinsurance markets, primarily on an intrastate basis. In New York, the legislature has been considering legislation to phase in full bank insurance authority over a period of years. That legislation was pretty much dead, but as a result of the capacity crisis, the Governor has appointed a special task force to review the issue.

One thing that I cannot stress enough is the importance of the federal bank regulators. They can do a lot of things to broaden the authority of banks to conduct insurance activities, even in the absence of legislation. Both the Comptroller of the Currency and the FDIC are on record as stating that they believe it is essential for banks to have new powers. They have to diversify, they have to compete. Both agencies have issued rulings and regulations that would facilitate banks' entry into the insurance, securities and real estate businesses. The Federal Reserve Board is a little more conservative, in that it does have some safety and soundness concerns over bank insurance underwriting, but it is also on record as expressing very little concern in the area of bank insurance agency activity.

Let me give you some examples of these agency decisions. The Comptroller of the Currency recently approved the acquisition by Citibank of a municipal bond guarantee insurance company, notwithstanding our arguments that the acquisition was prohibited by the Bank Holding Company Act. This acquisition is presently being challenged in litigation against the Comptroller. In addition, the Comptroller has issued a letter ruling stating that because variable annuity contracts are securities under the federal securities laws, they are not insurance for purposes of the federal banking laws. Therefore, reasons the Comptroller, they are the type of product that can be sold by a national bank.

I am not aware of any national bank that has done this, but in any event the Comptroller has said it is legal. The Federal Reserve Board recently approved another application by Citicorp to engage in mortgage completion insurance, which is a fairly dramatic expansion of existing credit insurance authority. All of these activities by the federal regulators serve to nibble away at the existing statutory barrier between banking and insurance even in the absence of a banking bill.

Having said all this, the real question is, "Is there going to be a banking bill this year, and, if so, what is going to be in it?" I do not presume to know the answer to these questions. Quite a bit is happening right now in both the House and the Senate.

Last year the House Banking Committee passed HR20, a bill designed primarily to close the non-bank bank loophole. It would eliminate all non-bank banks that were established after May 1984, and in doing so, grandfather about 109 institutions. HR20 would also give the Federal Home Loan Bank Board greater control of the investment activities of state chartered thrifts and would prohibit tandem sales between a thrift and a non-depository parent. This bill has been opposed vigorously by both large banks and by thrifts.

Before a bill is voted on by the full House of Representatives, it has to go through the Rules Committee, and those lobbying in favor of non-bank banks and against some of the thrift provisions have managed to keep HR20 bottled up in Rules. Last week it appeared that the Rules Committee was going to let HR20 out, but the Democratic Caucus met and voted overwhelmingly to keep it there.

As I said, the regulators bill has been introduced in the House. It was supposed to be marked up in the Banking Committee this week, but the housing bill is still on the floor of the House, and so the mark up has been put off until next week. It is not clear what a marked up regulators bill is going to include. It could include HR20, it could include the South Dakota loophole closer as well as a number of other provisions. It is then a question of whether the Rules Committee will approve such a broad package and send it to the House floor for a vote. If it is just a regulators bill that comes out of the Banking Committee, Rules is expected to approve it. Then there would be pressure to add a lot of floor amendments, adding such things as non-bank bank loophole closers and South Dakota loophole closers. I would say the chances are now less than 50% that something significant will come out of the House Banking Committee this year.

On the Senate side, it is a little different. Jake Garn, Chairman of the Senate Banking Committee, has always favored what he calls an omnibus approach. He is drafting a very broad based bill that he hopes to have out by June 15, 1986. It will include the regulators bill and help for the FSLIC. He has always pushed for new powers for banks, primarily in the securities area, and it is anticipated that his bill will give banks authority to underwrite commercial paper, municipal revenue bonds, mortgage backed securities, and possibly insurance. The Banking Committee itself, though, is far less inclined to grant new powers, and if the Garn bill comes out of the Senate Banking Committee, it probably will be stripped of powers. It probably will have the South Dakota and non-bank bank loophole closers in it and could very well have some consumer provisions.

In the event both the House and Senate pass some form of banking bill, both pieces of legislation will go to a House/Senate Conference Committee. That Committee will have to determine whether to agree on a narrow bill assisting regulators and bailing out the FSLIC or whether to go with Garn's omnibus approach. All of this may take place over the next month or so, and it is going to be a very interesting process to watch.

MS. JANET E. BELKIN: In reviewing the format of the program, Joanne and I agreed that I would first present the reasons for maintaining the current division among members in the financial services community and then Joanne would rebut them from the Sears experience. This led to some discussion about which was the affirmative and which was the negative position, which led to further talk about what the question really was. I like to think that it should be phrased not as to whether banks should be deregulated but rather whether we should protect a financial services system that has served us well for almost 50 years, or whether we should look for trouble. I subscribe to the theory of "If it ain't broke, don't fix it."

As you may have noted from Gary's comments, the current situation concerning bank entry into insurance is not really one of deregulation, but rather one of reregulation. The aim is not to wipe out most of the statutes, as it was when the airline industry was deregulated, but rather to change the regulation so that there are other methods of dealing with financial services. It seems to me foolish to replace one set of regulations with another just for the purpose of change.

Those with differing views might argue that change has already taken place by evolution, and that it therefore should be legitimatized by legislation. I am particularly surprised when I hear lawyers make this argument, because it seems to imply that the role of legislation is merely a "rubber stamp" and perhaps people like Walter Wriston, one of the prime movers in integration of financial services, should really be making our legislative policy. An extension of that theory would legislate insider trading and attempt to regulate the sale of confidential information.

The ACLI policy and The Equitable view are fairly straightforward on this issue. We believe that banks should not be permitted into the business of insurance, whether through sales or underwriting. We believe that banks and insurers have separate and distinct roles to play in the financial services community. While these roles may have expanded in the past five years, we believe that any expansion which would permit banks and insurers to enter each other's businesses would be detrimental to both industries and to the consuming public as well. We are pleased that our views are shared by some regulators who know the insurance and banking industry. For example, insurance commissioners and the Federal Reserve.

We can identify four areas which must be focused upon when evaluating the reregulation or deregulation of banks. These are: 1) the question of risk and public policy concerning the taking of risk; 2) the unique roles of banks; 3) the capacity of the current system of regulation to take on additional areas; and 4) the question of competition and benefit to consumers. I will deal with those, and I will also touch on some of the cooperative ventures which we believe will serve the same purposes or a better purpose than the reregulation of banks.

First I will discuss the question of risk. Much has been said about the inability of banks to cope with the risks that they already handle. The fact that 1985 has seen the greatest number of bank failures since the depression, and that 1986 seems even worse (there have been 53 bank failures to date) is used as positive proof that granting insurance powers or any expansion of powers to banks is unwise at best and harmful at worst. We agree, but we do not mean to imply that it is the expanded powers or lack of them that have caused banks to fail. We recognize that bank failures are mainly a question of mismanagement, poor decision-making, and, perhaps, an inability to deal with the long term results of actions.

Public policy is to avoid failure of the banking industry and is the fundamental reason for the restrictions on banks when engaging in Commerce. In light of this policy, it seems foolhardy to give even greater powers and a greater scope of activity to managers who cannot handle what they already have. No CEO would do this within his company. Promotions hardly come to those who cannot handle the task that they are already given, and we do not believe it should be done in the regulatory area either. One might ask, can't this be handled by a downstream holding company, or an upstream holding company in which a bank and an insurer could be merely affiliates rather than in direct line with them doing the same business? Aside from the fact that this would create a number of problems for your mutual companies, holding companies have been known to mask the problem of one of its entities, allowing the entire system to disintegrate slowly from within until it falls apart, and I need not tell any of you that Baldwin-United is a perfect example. Approximately one-fifth of the premiums paid to Baldwin's insurance companies were invested completely in its affiliates and, when the whole thing fell apart, the insurer went down with it. We also cannot assume that a bank will spin off or let an insurer fail if it is in trouble, or that an insurer will do the same for a bank. Walter Wriston had said that it is inconceivable that any major bank would walk away from any of its subsidiaries or its holding company. If your name is on the door, your capital funds are going to be behind it in the real world, and we have no method to show that this is not true.

But even if a company were willing to, the question is further complicated because more and more states are requiring the corporate parent of an insurer seeking a license in that state to guarantee the maintenance, the capital and surplus anywhere from 5 to 10 years or longer of the subsidiary insurance company. If this is the case and if the parent wishes to walk away from the subsidiary, regulatory conditions would prevent it, and the parent would be required to use the holding company capital which would come from the bank to bolster the insurance company. As a member of two guaranty fund boards, I also remind you that the guaranty fund system is solely dependent upon the assessments of the remaining and solvent insurers who are members of the fund. We cannot rely on infusion of federal funds, state funds or any other kind of fund other than that of our own industry. I personally would not want to encourage any additional exposure which would increase the risks of the funds that I am on. Also the people residing in the state would be adversely affected since most states have a premium tax offset, so when an insurer does pay an assessment to bail out an insolvent insurer, that money is really to some degree a cut in the taxes of the people of that state.

The second issue is the question of uniqueness. It has long been argued that banks have a unique place in our financial and economic system and that they control the money supply, and with few exceptions, are the major providers of credit. As we increasingly become a nation of debtors in our personal and business expenditures, this law serves to greatly increase consumer dependency on banking institutions.

The bank is not only unique in the role it plays, but it is unique in the privileges it holds. It has the federal safety net, which makes it almost impossible for the less fortunate members of the financial services industry to come to that so-called "level playing field." The federal safety net provides that discount window at the Fed, and in the role of lender of last resort, it enables situations such as the Bank of New York borrowing money to cover a huge overdraft over a weekend until it got all of its computers and everything else back in shape. When E. F. Hutton tried to cover some of its overdrafts, this was not considered appropriate behavior. This practice of non-legislated, "the sky is the limit," over-the-weekend federal bailouts seems to be one limited to the banking industry. Chrysler was debated in Congress at length before any guarantees were given to it, and it certainly took more than one weekend to provide financial aid to New York City. Donald Regan as Secretary of the

Treasury has said, "We do not believe that non-depository institutions' activities should be conducted through a subsidiary or service corporation in which a bank or thrift has a direct equity investment." The investment would be saved with federal assistance not available to non-depository institution competitors and at a cost advantage to the bank or thrift, so we think that this makes the whole competitive scene extremely difficult.

I had also mentioned the regulatory question. Insurance Departments are presently generally understaffed and underfunded. Its members are experts in insurance, not banking, and have to review hundreds of annual reports which are filed each year. For a new insurer to be licensed in all 50 states is a three year process, and policy forms keep backing up until approval is months off, and I guess you people know that far better than I do. With this kind of understaffing, overworking and underfunding, you cannot really expect insurance regulators to properly evaluate the stability of banking affiliates of insurance companies or the security of the holding company. Nor can they avoid looking at that, since so many banking institutions have failed, and there is a direct effect on the remainder of the holding company. Whereas an already overworked regulatory system would become an impossible one, this of course would lead to someone suggesting that federal or state banking authorities take over the examination of insurance affiliates as well in reviewing bank holding company systems. This of course will lead to if not duplicate regulation, possibly even triplicate regulation.

Banks have claimed that they wish to provide insurance as a service to their customers, and their customers have been eager for such services. In the life industry at least, we have seen no indication to that effect. But if the bank really wishes to provide a form of one-stop shopping for the customers, this can be accomplished without having the bank own the agent or insurer. Generally the lack of success, for example, in placing agents in banks would seem to belie that claim as well. There has certainly been no great rush of bank customers to any of the agencies that have been established in banks. The Equitable is involved in two major banking relationships and this is the case.

Instead, we suggest that the real reason that banks are looking for another profit center is that banks are doing so frequently at the expense of the consumer. Banks are frantically trying to make up the margins they lost when they asked for and got interest rate deregulation on the rates. We believe that the inevitable consequence of implementing expanded powers for banks will not be increased market competition as they claim, but rather the predictable excesses of market control. The laws of supply and demand simply do not play a role when dealing with the captive market that banks have. Although one could probably argue that this is less true as to interest rates or deposits, it is certainly true where credit is concerned.

One example is the Minnesota Title Company which was doing 81% of the title insurance business of a Minnesota savings and loan. In March 1979, the thrift bought a 52% interest in a small title insurance company, and within one year the business going to Minnesota Title dropped to 9.8% and the bank-owned company increased its share from 12% to over 83%. It seems highly unlikely that such a transfer of business occurred from anything but perceived debt coercion whether or not it actually existed.

Claims of increased competition are also belied by activity of the bank. Congressman Mario Biagi, in discussing the increased and somewhat usurious credit card interest rates, noted that "the banking industry is lobbying heavily in Washington and elsewhere to be allowed to enter into new non-banking services like insurance and real estate. I am very concerned, as I know many of my colleagues are, that if banks are going to stick it to the consumer in the form of exorbitant credit rates, why should we expect them to act any differently when dealing in insurance or real estate." Congressman Schumer added that deregulation of banking has been an utter failure; they have not competed.

Consumers certainly do benefit from competition, but competition already exists in the insurance industry. New products are produced at great speed and approved at slower rates. In order for companies to stay competitive, agents are recruited regularly either by companies or independent agencies, and they certainly are interested in selling a competitive product because that is how they make their living. Agent barriers are low, if you can pass the exam, you can be an insurance agent. But buyers of insurance will still require knowledge of their needs and an understanding of what products would meet these needs. Banks are not geared to that kind of presentation, they deal in long lines and impersonal tellers. Loan officers are not friends of the customer but rather holders of the power of credit and knowing services of bank transactions; there is no follow-through other than to make sure that your payment is put in. I will further discuss the differences in culture when I talk about the joint ventures.

In an insurance transaction at a bank, will or even can the needs and choices of the consumer be investigated? Not if cold cost efficiency is the hallmark of the operation, and as you can see banks have begun more and more to use fees for service. An example of the very different approaches in marketing a product can be seen by how some of the expenses are handled. For example, in life insurance underwriting at The Equitable and a number of other insurers, the medical costs involved are paid by the insurer, not by the person applying for the insurance. Yet in a banking transaction such as a mortgage loan, not only are the costs paid by the consumer, but very frequently it is almost impossible for him to know what costs he is paying until he is practically there. Your average consumer has to deal with concepts such as points which are virtually meaningless and to him only means an added cost. The bank bears virtually no expense in the transaction, and the customer has very little option when he can pay.

Earlier I noted that if banks were primarily interested in providing services for a customer, this could be done without the bank entering the business of insurance, either directly or indirectly. The most common way in practice is to have insurers or insurance agencies rent space in bank lobbies -- in return either for a percentage of commissions earned on the business done under the lease or for a flat monthly rental rated to the square footage rented and the services provided by the bank. This issue began with a letter from the Comptroller of the Currency which approved such percentage leases and determined that banks were not doing the business of insurance, but were merely conducting normal business practice. The following caveats were included in his letter: that there must be a complete separation between bank and insurer; that even the appearance of coercion in buying must be avoided; and that an insurer providing space must not provide insurance to the leasing bank. It strongly advised that banks not rent space to insiders or their families. This letter was the basis for the first such joint venture, the Craddock Agency, a general agency in Tennessee, which agreed to sell Aetna products in a space rented from a national bank.

The result was a fury in the financial services industry which has only begun to settle. Banks and some insurers were pleased with the potential and profit and new customer access. Insurance commissioners were infuriated that the Comptroller felt that he could decide what was best for agents, and the agents, particularly the independent ones, were furious at even this small step of cooperation between banks and insurers. In fact, it is a fair statement that most opposition to such arrangements were spurred on by agents or groups representing them.

Some insurance commissioners permitted percentage leases, but demanded no interaction between the bank and insurance representatives. This meant no visibility at all, you were to go through a private entrance, you could not be seen by the bank tellers, no introductions, etc. Connecticut required a ceiling on the annual rate, so it could be percentage rate but not to exceed X amount. The Commissioner, in doing so, noted that these ventures on the premises of the banks were tending to provide a service to the bank customers and therefore was not to provide a profit to the bank, and if it was service that they wanted, that is what should be provided. Other states prohibited percentage leases and permitted flat rents, claiming that percentage rate leases really involve the sharing of commission with non-licensed entities.

Although these leases have increased the availability of insurance products for bank customers and have been a major step in starting one-stop shopping, they have not been an overwhelming success. Part of this is due to the very different cultures of banking and insurance industries -- cultures which don't really mix. Banks tend to see themselves as somewhat passive in their role. Bank officers frequently wait for the customer to come to them for loans or service, they do not contact the customer when new products are available. Insurers tend to be more aggressive and recognize the need to go out and find the customer and identify the need. Therefore, there has frequently been a lack of rapport and little synergy between bankers and insurance agents within a bank branch.

In The Equitable's experience, the most successful of the programs have been those located in local banks serving small closely knit communities. Those programs have worked well perhaps because there is greater synergy and there is greater acceptance by the bank of the insurance personnel. These programs are an example of the progress that can be made in cooperative activities between banks and insurers. Other more successful approaches have involved the use of bank customer lists and stuffing bank mailings with insurance literature. This combination seems to have worked well. It provides the bank customer with additional information, alternatives and an opportunity to make additional contact on his own. These are not to be confused with the group mailings which one can apply to by mail; these are still on an individual agent basis. It permits the insurance agents to operate in the environment they are most comfortable in, and away from the bank floor. It is interesting that the method that really has had a fair degree of success is the one in which banks and insurers have made physically separate and totally independent.

In closing I repeat that we, the life insurance industry, seek no advantage to reregulating the financial services industry so as to remove or even greatly reduce the barriers between banking and insurance. We do not deny that cooperation between them could be desirable, but we are opposed to any changes in basic structures of the industry. Such changes can serve only to reduce competition and concentrate financial power in the hands of very few. We cannot believe that this is in the best interest of either the American consumer or the American economy.

MS. JOANNE M. DERRIG: It is probably going to come as a surprise to none of you that as an attorney working for Allstate Life Insurance Company, a wholly owned subsidiary of Sears, Roebuck and Company, my "pitch" today is one in favor of further bank deregulation. Part of the Sears gospel is embodied in the so-called Sears "Family Bank Bill," which has been introduced by Representative Stan Lundine of New York and now has over 30 co-sponsors. That bill is not called the "Consumer Bank Bill" for nothing. Sears would like very much for all of you to forget the term "non-bank bank" and to start using "consumer bank" or "family bank" in its place. I saw yesterday in the *Wall Street Journal* that someone was speculating how different things might have turned out if, when the stock brokerage community was deregulated several years ago, people made reference to what are now called "discount brokers" as "non-broker brokers." You can understand that Sears shares that concern and would like very much for all of us to call it the "consumer" or "family bank."

Briefly, in case you do hear about the bill, it includes a bit of something for everyone. Sears is hoping that it can attract attention by meeting the needs of different constituencies. Different consumer groups' interests are represented in different portions of the bill. It does address some of the capitalization and solvency concerns that you have been hearing about in this session.

It requires that a consumer bank have a minimum amount or percentage of its portfolio in small business and family loans. It would require all consumer banks to engage in "lifeline" banking, something very dear to the heart of the senior citizen community. Apparently a number of commercial banks are requiring fees for services which has made a number of services unavailable to the senior citizen market. The bill also addresses a problem that is perceived by many. A number of banks are holding on to checks for longer than is necessary, in order to benefit from the "float" that is available while the funds are being held. Those are just some of the features addressed by the so-called Sears Family Bank Bill that you might be hearing about.

It was several years ago that Sears concluded that its future lay in the delivery of a broad spectrum of financial services to America, starting with its 25 million credit card holders. Demographics and the changing values of our society, as well as technological advances in the delivery of these kinds of services, brought Sears to conclude that the synergies to be had from jointly delivering a range of financial services could result in greater consumer satisfaction and convenience. Sears embarked on the latest leg of this program by acquiring Coldwell Banker in 1981, and a week later, Dean Witter Reynolds. You might recall the media reaction when those acquisitions were announced. Slogans such as "Buy Your Stocks Where You Buy Your Socks" indicated the immediate reaction these acquisitions had. Now that several years have passed, however, you are hearing a different reaction. The early returns from the Sears Financial Network Centers located in many Sears stores and the Discover Credit Card program has caused the reaction of our competitors to be not quite so flip as they once were.

Uphill battles in entering new markets are nothing new to the Sears family. Sears' early history reflects efforts by small town merchants to keep the Sears catalog from being delivered in those towns. When Sears decided to establish retail stores, efforts were made to impose restrictive zoning and other impediments. Sears formed the Allstate Insurance Company in 1931 in an effort to do nothing more than to take advantage of the Sears customer who was buying batteries and tires. Why not car insurance? Allstate Insurance established a Life Company in 1957. Along came another finance company, a mutual fund, a mortgage bank and a California savings and loan association. So as you can see, the acquisitions of Coldwell Banker and Dean Witter Reynolds were nothing more than further steps down the road toward integrating the delivery of various financial services.

The gospel according to Sears is that the marketplace is the best regulator. It believes that no financial institution should be restricted in its ability to enter new markets, except for the most compelling public policy reasons. If banks are to be permitted entry into other businesses, they must do so subject to the same regulatory and financial requirements as the rest of their competitors with no special financial advantages. If banks are to be permitted entry into the insurance business, we believe they must do so through a separate corporation fully subject to state regulation. Opponents of banking and insurance affiliations assert that there is a long historic national policy of separating banking and commerce, intended to apply to all forms of banking and all forms of commerce. Our reading of history leads us to a different conclusion.

Legislation which restricts the non-banking activities of banks originated in 1933 with the Glass-Steagall Act. It should be noted that this Act applies only to commercial banks, only to Federal Reserve member banks. Over the years, a number of efforts have been made to expand those restrictions applicable to banks. These have been repeatedly rejected by the Congress. As recently as 1982, Congress reaffirmed its decision that only commercial banks, not savings and loans or other institutions, are to be limited by the Bank Holding

Company Act. In 1956, Congress limited non-banking activities in which banks could engage in activities which were directly related to banking. This test was liberalized in 1970 to activities which are now closely related to banking. Permissible non-banking activities include the ownership of credit life and health insurance companies and limited insurance agency powers. Today there are 16 bank holding companies located around the country engaged in underwriting and agency activities for both life and property and casualty lines of insurance. Under the grandfather provisions of the Bank Holding Company Act there are no insurance agency limits which are placed on commercial banks located in towns having populations of a fewer than 5,000 persons. In 1982, the Garn St. Germain Act further liberalized insurance agency activities as to commercial bank holding companies having assets of less than $50 million. So as you can see, the long historic national policy of separating banking and commerce is limited. It includes only commercial banks, not savings and loans, not consumer banks, not savings banks and is limited only to the insurance activities of commercial banks.

With good reason, our regulators are concerned about recent developments in the area of financial services deregulation at both the state and federal levels. Their principal concerns relate to unfair competition or coercion issues as well as solvency and concentration of risk concerns. With regard to unfair competition and coercion, the regulators are concerned about the use of economic leverage by the banks on their customers to force them to buy insurance from affiliated agencies or insurers. The problem with this concern as we see it, is that it overlooks the fact that insurance is sold today by many different lenders, not only commercial banks. Other types of insurance products are sold by lenders and their affiliates in a number of areas. For example, property insurance is sold in connection with mortgage loans and is offered today by credit unions, by savings and loans and by mortgage brokers. Auto insurance is available through auto dealers, through banks, through savings and loans, finance companies and credit unions. Other forms of commercial insurance are offered today through the finance affiliates of manufacturers. Many of the 3,000 savings and loans in existence have insurance agency subsidiaries. There are the commercial banks that are grandfathered under the Bank Holding Company Act which I just mentioned, and there are the banks that are selling insurance in towns having populations of fewer than 5,000. So it does not take you too long to figure out that the arguments in favor of not permitting banks to sell insurance products because of the coercion issue cannot be limited to banks only. After all, life insurance companies sell insurance in connection with their lending activities so that same argument could easily be levied at us. The same potential for coercion exists in all of these situations.

The answer to the problem is to regulate the transaction, not to prohibit the affiliation. In the past, the insurance industry has been content to rely upon regulation as a means of policing and preventing coercion rather than prohibiting such sales. We feel that the potential for coercion can be adequately addressed by regulation.

We are all concerned about solvency implications of mixing banking and insurance, which is another argument usually made in challenging insurer and banking affiliation. However, it should be recognized that the mix of banking and insurance already exists, as I mentioned before. There are 1,100 bank holding companies which today own credit life and health insurance companies. In addition, a number of insurance holding companies own consumer banks and savings and loans. There are bank holding companies engaged in insurance underwriting under the grandfather provisions of the Bank Holding Company Act, and there are savings bank life insurance operations in existence as well. A National Association of Insurance Commissioners Advisory Committee on Integrated Financial Services examined the mixing of banking and insurance, and potential solvency concerns in the context of banking and property and casualty underwriting, which is viewed by many as being the most volatile risk combination that you could dream up. It found no evidence to sustain arguments against combining them due to coincident business cycles.

Critics point to the risk of bank failures and the financial position of banks as a result of third world loans in arguing solvency concerns. The way we see it, it is important to remember that the troubled banks are all commercial banks, at least insofar as the third world loans are concerned; that there are many commercial banks in very sound financial condition; and that many do not have any third world loans outstanding. Consumer banks or non-bank banks, because they have a greater diversification of loans, do not present the same portfolio problems. Yet critics often fail to distinguish between non-bank banks and commercial banks in making these arguments.

In reviewing the question of whether insurers should be permitted to own banks or savings and loans, the NAIC decided not to recommend any changes to the Model Holding Company Act in that area. To date, almost half the state insurance laws do not prohibit such an affiliation. The remainder would permit the regulator to decide whether the insurer should be allowed to own a depository institution. Only two or three states' insurance laws outright prohibit an insurer from owning a bank. About 20 states do attempt to prohibit an affiliation between a bank and insurance agent, but most of the states permit an independent agent to contract with the bank. It only goes to show that we can regulate for solvency and do not need to prohibit affiliation as a matter of NAIC policy.

One other development at the NAIC level deserves mention. Recently the NAIC adopted and strengthened the Model Unfair Trade Practices Act provision dealing with coercion of debtors. That provision regulates the sale of insurance in conjunction with a loan transaction. It does not prohibit an affiliation between a financial institution and an insurer or an insurance agent. The Act does not seek to adopt the restrictions included in several regulations that Janet made reference to earlier, which are aimed at prohibiting the sale of insurance or limiting the sale of insurance on bank premises. So the question for regulators as we see it is, does the mix of banking and insurance present public policy or regulatory concerns that rise to the level that requires an outright prohibition against such an affiliation? The NAIC has chosen to leave that decision to the individual states.

Most recently, efforts at selling insurance on bank premises through unaffiliated insurers or agencies has come under fire from the agents' groups. About a dozen states have considered regulations or legislation which is ostensibly designed to prevent coercion in violation of various states' solicitation laws. It is our view that most of these provisions are mostly proposals that tend not to regulate but to prohibit, in effect, such ventures. For example, a number of those proposals include some of the same features, and I am sure some of you are familiar with them. The proposals include prohibitions on the rentals of space based on percentage of premium, whether or not the bank's activities rise to the level of solicitation. The regulations often require that the agent be walled off in some way, ostensibly to keep the bank's employees from exerting any sort of visual influence over bank customers. The way we see it, these provisions operate to keep the public from ever seeing the agent in the first place. The proposals typically provide that the bank may not use its mailings to announce the presence of the agency, to carry agency name or vice versa. Again the question here is whether these activities rise to the level of solicitation by the bank. The bank is typically not permitted to endorse the insurance product, the insurer or the agency even though the NAIC's existing Model Ad Rules permit paid endorsements if disclosures are made. Bank customer lists must be made available to all agents on the same terms and conditions under these proposals. We see this kind of provision as destroying or diluting the value of the list, since it must be made available to everyone under the same terms and conditions. These prohibitions serve to protect the agent rather than the consumer.

Finally, the restrictions against sales on the premises of the bank holding company and its affiliates apply even if the bank owned by the bank holding company does no business in the state and even where no lending is done on the bank's premises. It is hard to understand how coercion could take place if no lending is taking place at that particular branch or location. We believe that the regulations in this type of legislation go far beyond that which is necessary to protect the public interest from coercion or from solicitation by unlicensed persons. They are little more than restraints on competition designed to protect turf rather than the public. Sears believes that banks and insurers should be allowed into each other's businesses, subject to appropriate regulation. The changes in the holding company law as approved by the NAIC are adequate to protect the solvency of insurers. We see no reason why consumer banks should be restricted from owning insurers or agencies and no reason why insurers should not be allowed to acquire consumer banks.