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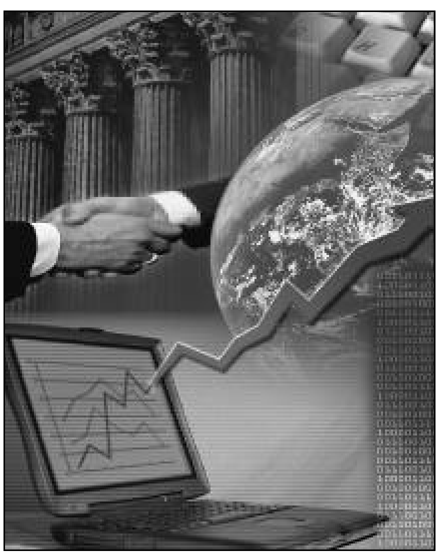
Bank Insurance Regulation—An Update

by James R. Thompson

For over a decade, the banks and the insurance companies have been involved in some marketing problems on the sale of insurance policies (mainly life and annuities) through banks and savings institutions. This has been a source of constant and intricate regulatory conflict. Currently, the states regulate insurance products. They license agents and regulate market conduct. They deal with the solvency and investment practices of insurance companies.

Insurance products enjoy certain advantages relative to banks. The inside buildup of cash value is the main one. This means that a return of, say, 5% is 5%, but with a bank savings account, unless it is an IRA, it is lessened by the interest income being included in personal income tax.

Banks, in the other hand, have certain advantages over insurance companies on raising capital; mainly they are the source of it. They lend each other money at the prime rate. Insurance companies are usually not so lucky.



When each institution had its own bailiwick, and knew the rules, there was no problem. Competition for the savings dollar of the consumer has changed that. In the '80s, insurance companies began to go after the savings dollar through annuity vehicles. Mutual funds, brokers, and banks also competed. Insurance companies began trying to get places selling insurance products in banks. But, what if the banks could issue their own insurance policies? What exactly is an insurance policy? Who would regulate this?

Without legislation, banks will try to design "insurance" products and sell them. Will the Office of the Controller of the Currency or some other federal authority try to allow this and thus create a jurisdictional dispute? If banks sell a product that is classed as insurance, it should come under state regulation. This means market conduct, investments and everything else.

To solve this situation, Congress has been working on legislation. The House has come up with H.R.10 and the Senate with S.900. They are different, and they are being reconciled as we write.

Smaller Companies

BEFORE PROCEEDING FURTHER, we should ask ourselves why the Smaller Insurance Company Section should take an interest in this? "Smaller" has always been a relative term. There are about 9,000 banks, and it is estimated that maybe 100-200 will get involved in selling or developing insurance. They may end up by working with subsidiaries or buying up insurance companies and putting them in a holding group. Banks have more capital than insurance companies, and these few big ones may end up buying, controlling or forming their own.

The other banks, if they get involved at all, will probably let some insurance companies sell their products in the banks. Although it might seem that the insurance companies whose names have appeared in current bank-insurance liaisons are fairly large, in the future, there may be some niche players. Note elsewhere in this issue the article on the importance of technology in operating efficiency. Smaller companies can use PCs-LANs efficiently and enhance their ability to compete. Some may develop a niche of using this technology to work efficiently with regional and local banks. This will be a new marketing opportunity for smaller companies. Thus, there is some interest in how the relations between banks and insurance companies will work.

Other smaller companies may feel left out. Will they be able to survive in a society in which some companies work well with banks? Will the bank-insurance liaison work well? These questions are of interest to smaller companies.

Summary of the Bill

I TALKED WITH Allen Caskie of the American Council of Life Insurance (ACLI). In its efforts to keep up with this, ACLI has produced a comparison of the current versions of the two bills. I have excerpted some of the provisions.

States' authority to regulate bank insurance affiliations

THE SENATE BILL (S.900) has the usual general authority to review and approve proposed acquisitions so long as they do not discriminate because a bank is involved. Under the House bill (H.R.10), states may not prevent or restrict, but may require information and may reject only based on issues of capital, solvency, and managerial fitness. The states are pushing for the Senate Bill.

States' authority to regulate bank insurance sales and cross-marketing

BOTH CONTAIN EXPLICIT requirements for a state insurance license, but there is a nondiscrimination test for sales or cross marketing. The House bill gives explicit functional regulation for banks' insurance sales through small town locations.

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Bigger Is Not Always Better
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Two examples will illustrate.

I once worked for a small life subsidiary of a distant, giant manufacturer. Fortunately, we were usually quite autonomous. But, I remember the day when corporate engineering showed up with the parking lot signage. The signs were beautiful and very substantial. They were built to the same standards and quality as those used at the corporate palace. Economies of scale certainly applied because we could never have purchased such opulent signs for the expense that was allocated to us. But in our small town, there was no need for any signs.

Competitive term is sold with inexpensive advertising. However, I have known more than one company that used an expensive, glossy, multicolor, multipage term brochure because corporate standards suggested one for each product. Again, the cost was lower due to centralized economies of scale but too high because the expense was out of touch with the market.

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There is one counter argument to the idea that centralizing functions isolates them from market economics. In theory, a very good communication, cost allocation, and budget system could restore market pressure to remote expenses. Williamson says that the cost of such a system quickly exceeds the savings it can produce as organizational complexity increases.

I think the future is good for small, focused insurance companies because we have marketing, service and expense advantages that come from being in touch with our consumers.

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Definition of insurance

THE ACLI WAS involved in negotiating this. Both bills are the same. It defines insurance with reference to the federal tax code.

Insurance underwriting

THIS IS A MAJOR issue. Both bills stipulate that insurance can only be written by holding company subsidiaries. The Senate bill, however, allows an exception for small banks (for banks, it is less than $1 billion of consolidated total assets). Will the Treasury or the Fed have jurisdiction over this? This may be a deal-breaker. Obviously, the insurance industry wants to maintain control over the underwriting. The only hope of smaller companies that might get involved in providing products for this market is to make sure the insurance industry has this control.

Other Issues

THESE BASIC ISSUES involve clarifying the roles of the banks and insurance companies and who will regulate them. Insurance has generally been regulated by the states, and large banks have generally been regulated by federal law.

There are many aspects of federal law that do not apply to insurance companies. The Democrats are trying to include various issues in this regulation. Some of these are: downstream commercial investments, the control of takeovers of recently demutualized insurers, the application of the Community Redevelopment Act (CRA), application of domestic violence, and the privacy of medical and financial information.

According to Allen Caskie, much of the compromising will be partisan with Democrats trying to insert these provisions, and the Republicans trying to keep them out and focusing on the bank—insurance issues. We should all be watching how this turns out. If nothing has been finalized by the time you received this issue, you should contact your state representative with your views.

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