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Session 8GS
Integration

Moderator: Errol Cramer
Panelist: Mary Jane Cleary*

MR. ERROL CRAMER: I would like to introduce our lunch speaker, Mary Jane Cleary. Mary Jane Cleary serves as Insurance Fellow/Risk Management specialist at the Office of Thrift Supervision (OTS). In that position, she advises the senior staff in regard to state insurance regulation and related issues in insurance company applications for Thrift charters. She establishes and directs joint training with the NAIC and state regulators. She serves as liaison with the state insurance and state securities regulators. Prior to joining OTS, Mary Jane was vice president of Travelers Property and Casualty, and she has held other positions within insurance industry organizations. She began her career in insurance with an appointment as a Director of Insurance for South Dakota. Mary Jane is a graduate of the University of Wisconsin and the University of South Dakota School of Law.

MS. MARY JANE CLEARY: I want to thank Errol for asking me to speak. Though Errol and I had not met previously, we have had conversations over the phone. He was good enough to help out my agency in learning about risk-based capital for life insurance companies. We're still working on that issue.

I appreciate the opportunity to talk to you about the integration, which is just beginning in the financial services industry. I can approach this topic from what I think is a fairly unique perspective that I've had as an insurance regulator. I've also worked in the insurance industry and am now working for a federal banking agency.

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* Ms. Cleary, not a member of the sponsoring organizations, is an Insurance Risk Management Specialist, from the Office of Thrift Supervision (OTS) in Washington, D.C.

First, I'd like to give a little bit of information about my agency. The Office of Thrift Supervision used to be the savings and loan regulator. However, when the savings and loans went through their crisis during the late 1980s and early 1990s, the industry got a bad name and these institutions didn't want to be called "savings and loans" anymore, though there are a few of those left. We now call ourselves the Office of Thrift Supervision; however, most of the time, you'll see our organizations called something like Savings Association or Federal Savings Bank, or simply by the initials FSB. For instance, Errol works for Allstate Financial Group and the name of their Thrift is Allstate FSB.

I'd like to give a little bit of information about OTS and the other banking regulators. The Office of Thrift Supervision regulates all thrifts (savings and loans) or savings association holding companies and the thrifts they contain. This is unlike the Federal Reserve Board regulating the holding companies for any organization that has a national bank charter. The national banks are regulated by the Office of the Comptroller of the Currency (OCC). There are also state institutions. The OTS regulates the state savings banks along with the state banking regulators. So there is an amount of dual regulation. That is probably going to be even more regulation in the near future with the financial services integration activity.

I was hired as a Fellow at the OTS because, starting in the latter part of the 1990s, OTS began receiving many applications from insurance companies. The insurance companies, both life and health and property and casualty, were asking for thrift charters to supplement the products that they could sell to their existing customer base. In particular, life companies were requesting our charters to keep the money from going out the door once somebody became a beneficiary of a life policy. We have had a lot more requests from life insurance companies than from property and casualty companies.

We have a total of 41 insurance entities that have our charters and five still have outstanding applications. We also have one insurance trade association, the National Association of Mutual Companies (NAMC), that has one of our charters, and we have a pending application from another trade association, the Independent Insurance Agents of America. In addition, we also have a number of other commercial entities that have our charters. For instance, most of the big securities firms, such as Merrill Lynch, have a thrift charter and firms like GM and Ford have applied for one of our charters.

If you are interested in seeing an overview of the organizations and holding companies with thrift charters, you can go to our Website (www.ots.treas). It is very informational and has been reorganized to be more user friendly. You can find a list there of everybody who has an application in or has been granted a thrift charter since approximately January of 1997.

Of the list of insurance companies that have our charters, there are approximately 14 or 15 that have what is called "trust only power." They have not asked to sell regular bank products; they simply want access to a thrift in order to be able to do their trust activities on a nationwide basis. That is a key reason why so many insurance companies applied for one of our charters. That was regarded then as a loophole in the law. By getting a thrift charter, they didn't have to deal with every state individually to do trust-related business on a nationwide basis.

The thrift charter application is a very extensive process. The paperwork is tremendous and, because our organization didn't understand a lot of the uniqueness about the insurance industry, it has taken generally about 18 months to two years for an application to go through our organization. This is probably about how long it takes to go through an insurance department charter request. Regardless, our people are getting much better now. They're getting more training, and they understand the issues more, so it has been a really good experience for them and for me.

Some of the insurance companies that have our charter as "trust only power" are asking to expand into full power. They have to ask our permission because most of the regulation in banking is permissive; in other words, if you want to do something, you generally have to ask permission first from the regulator. This is unlike insurance regulation that might permit certain actions without filing for permission. It is a different culture for the banking people to get used to and, in turn, for the insurance companies to get used to.

For example, one very large insurance company violated the conditions of its charter almost immediately after getting it. When we issue a charter, there are many conditions attached; mostly, it has to do with the fact that, for the first three years, we want to know how well the company's business plan is working and being adhered to. In order to know what the rest of the company is doing as it affects the thrift, we need to know about any changes your company is making. This particular company did not notify us when it wanted to make a change to one of its business operations, which was to sell part of it. It got its hand slapped and it probably won't do that again. Fortunately, that's not typical.

Practically every insurance company that has received a thrift charter has taken a lot more time to roll out the use of those bank products than they might have expected. For instance, State Farm Life Insurance Company realized there would be differences in running a thrift compared with running an insurance company, even though it has extensive business experience. State Farm practiced on its employees. It started by asking its employees to use its thrift and then worked out the kinks in the system before it started rolling it out on a state-by-state basis. It is doing that on a very limited rollout. I recently read that it has expanded to a few more states and is now selling bank products and is cross-marketing.

An insurance company with one of our charters, The Principal Financial Group out of Des Moines, Iowa, has an Internet-only bank. It should be noted that we are the regulators with the most Internet-only banks, including e-Trade and other companies. Principal, like State Farm, is another example of a company that had its employees use the bank online in order to see how it was all going to work out. Its request for a charter was to be able to cross-market; that is, to have its insurance agents sell limited bank products, and to sell its insurance products to its banking customers who are not current insurance customers.

As a result of this cross-selling of bank and insurance business, I was hired to get OTS involved in dealing with the state insurance regulators. I am the main OTS liaison between the NAIC and between each of the state insurance departments. We are at the point where we are doing cross-training; that is, our people, mainly the examiners, attend many of the financial classes that the NAIC offers for insurance regulators. From our side, we unfortunately have a limited selection of courses of interest to the insurance regulators. Nevertheless, we do other kinds of training for the insurance regulators, and that has worked out very well because it also establishes a relationship whereby we get to better understand each other. For example, teaching what constitutes statutory accounting for banks was a real learning experience for them, as was the bank market conduct exam process.

Regarding other regulators, we are just getting up and running with the state securities regulators. However, we have been dealing with the state banking regulators for a long time. We already have had confidential information sharing agreements for some period of time. We have recently start going to state insurance departments, on a state-by-state basis, to get an agreement in place about how we will share complaints when they come in. For example, if they get a complaint about insurance sold via a thrift, they need to know with whom they should deal at OTS.

The OTS organization has its headquarters office in Washington, D.C., with about 200 people. We also have five regional offices around the country. You may find it interesting that, of the approximately 1,100 total employees we have, about two-thirds are bank examiners. We have relatively few staff people. Most everybody is out in the field doing examinations and that’s because, unlike insurance companies, the law mandates that we do an on-site examination of each thrift nearly every year or 18 months, but it is mostly done every year.

Now I would like to talk a bit about the new Gramm-Leach-Bliley (GLB) Securities Modernization Act and how it relates to the functional regulator concept. The new law allows for a holding company to have as subsidiaries a thrift, an insurance company and, perhaps, a securities company, or even multiples such as CitiGroup where you have two thrifts. There is at least one bank, if not two, as well as possibly other regular commercial entities. The law allows that the person who was initially the main regulator, whether someone from the insurance, state securities, or OCC side, to be the functional regulator. If the other regulators want information from that entity, they need to work through the functional regulator first. First and foremost, we have to respect the proprietary rights and the jurisdiction of the functional regulator.

A variety of state insurance departments have already signed regulatory cooperation agreements. We just got New York's agreement, and that's obviously one of the most important because New York and Illinois and Texas are the three states that have multiple cases of insurance companies with thrift charters. There might be other states with a multiple number of trust charters. For example, Minnesota has ReliaStar Financial Group with a thrift, and it was recently purchased by the ING Group that also has a thrift. I'm not sure how that will end up.

Gramm-Leach-Bliley also required the various regulators to develop two new sets of regulations. The first one, and the one you heard most about is privacy. We developed, but have not yet put into effect, our privacy rules that cover a customer either who's buying insurance within that thrift, or the insurance company who is selling bank products to that particular customer. The regulators decided, based upon the industry input from both the insurance side and the thrift side, that it was too soon to put all of this in place because a lot of it is paperwork. The privacy regulations are in place but do not take effect until July 1, 2001.

The other set of related rules is what's called "Consumer Protection for Sales of Insurance Products in Financial Institutions." Those are currently drafted and in the *Federal Register* for comment. We want to know, as do all of the other federal agencies and the state insurance regulators as well, how do you in the industry think this transaction is going to work once we get it up and running? This is designed to protect all of us as consumers. For example, think about going into a thrift or a bank and buying health insurance or long-term-care products. You are probably going to be required to fill out a form giving information about your health. The issue then becomes who are they going to share that health information with, and will that information sharing potentially keep you from getting a mortgage or a loan some place down the line? There are many interesting issues that all of us, as consumers, let alone regulators and industry people, have to pay attention to.

I think this is a very exciting time to be in the financial services business. I think you will probably see more happening in the area of privacy. The Europeans have much more stringent privacy regulations, and the European Union (EU) is asking that the United States go along, too. It will be interesting to see how it all comes out.