Testimony of James D. McLaughlin
On Behalf of the American Bankers Association
Before the
Committee on Banking, Housing and Urban Affairs
United States Senate

July 13, 2004

Mr. Chairman and members of the Committee, my name is James D. McLaughlin, Director, Regulatory and Trust Affairs of the American Bankers Association (ABA). The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

I am glad to be here today to present the views of the ABA on the impact of the Gramm-Leach-Bliley Act (GLB Act) on our businesses and customers. Consumers of financial services are a diverse group, ranging from individuals, small businesses, churches and schools to large corporations and governments. The specific needs of each customer group differ, but they all expect – and deserve – efficient and convenient provision of financial services.

In 1999, Congress addressed the inefficiencies in the then-current structure and regulation of financial services by taking a forward-thinking approach to financial services regulation. By enacting the GLB Act, Congress streamlined the regulatory approval process and let market forces dictate what combinations of financial services would be most appropriate. Thus, by any measure, the GLB Act was one of the most significant laws affecting the financial services industry, providing the framework for the next century. It was not, however, a sea change. Dynamic market forces, aided by changing technologies and demographics, were already changing the market. While we do not know what future innovations will take place, we do know that free and fair competition creates an atmosphere that encourages innovation. The GLB act was an essential ingredient in bringing about such competition.

In my statement today, I would like to emphasize three points:

- The GLB Act was critical to modernizing our financial system, making it more sensible and straightforward, removing inefficiencies in structure and regulation, and letting market forces dictate what combinations of financial services would be appropriate;

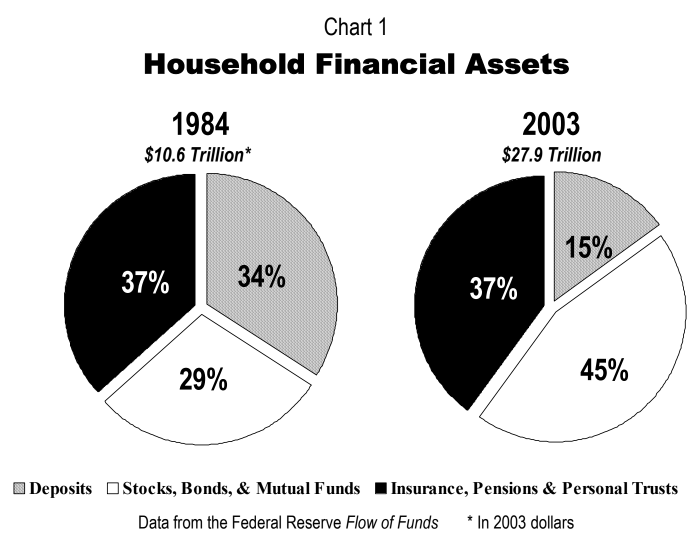
- The GLB Act has worked well, benefiting customers, diversifying incomes of financial firms, and posing no new risks to the financial system or the deposit insurance funds; and

- More can be done to fully realize the benefits of the GLB Act, including preserving the regulatory flexibility given to the Federal Reserve and Treasury to adjust to a dynamic financial services market; assuring that regulatory proposals on broker "push out" address key industry concerns; providing a sensible cross marketing approach for merchant banking activities; encouraging the Federal Home Loan banks to fully embrace the expanded collateral provisions in the Act; and creating uniformity of insurance regulation and supervision.

I will touch on each of these points in the remainder of my statement.

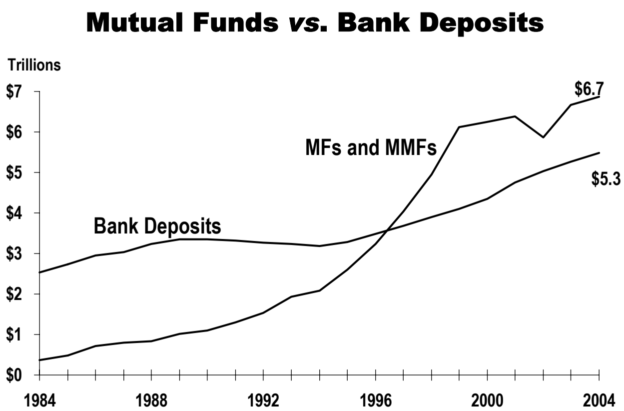
I. The GLB Act was critical to modernizing our financial system

Economics, demographics and technology created a whole new genre of financial consumers. Over the last twenty years, customers put a premium on efficiency and convenience; they are not intimidated by automated delivery systems; they are willing to use a wide variety of service providers – not just banks – to meet their financial needs; and they are much more active managers of their savings and investment dollars than previous generations. As a result, the mix of assets held by households changed significantly (see Chart 1).



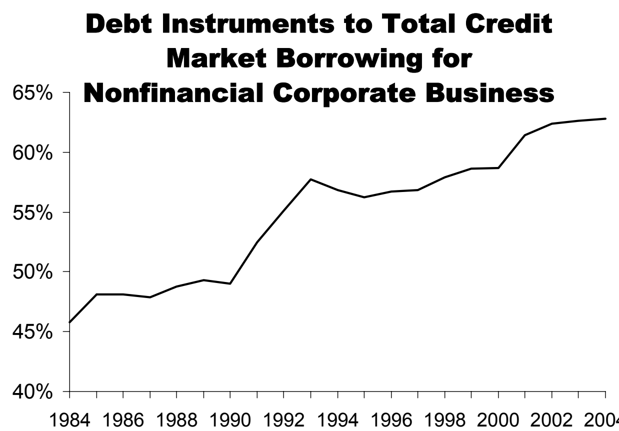
Financial firms began to adapt to these changes. Securities firms offered a full array of loan and loan-substitute products and mutual funds (that compete directly with deposits). Today, mutual and money market funds exceed bank deposits by $1.4 trillion (see Chart 2). Large corporate borrowers increasingly went directly to the financial markets for funding (See Chart 3). Diversified firms, like General Electric, offered a wide array of financial services – earning a substantial portion of their income from them. While the competing products were similar, the regulation was not.

Chart 2



Data from the Federal Reserve *Flow of Funds*

Chart 3



Data from the Federal Reserve *Flow of Funds*

Internationally, U.S. financial firms were in danger of falling behind foreign competitors, which typically were able to provide securities, insurance and real estate services within "universal" banks. This gave foreign financial firms a competitive edge over the U.S. in attracting global financial business.

Banks were forced to be creative in finding ways to combine services, often in convoluted and expensive ways. Regulatory decisions helped – such as those permitting the establishment of so-called Section 20 Subsidiaries to allow bank holding companies to engage to a limited extent in securities underwriting and the approval for national banks to engage in the sale of insurance from towns of 5,000 – but were not enough. Regulatory decisions were often challenged in court, slowing the evolution of the market. And the strict limits placed on the activities in which they could engage prevented U.S. banks – and their customers – from reaching all customers demanding these services. Thus, customers of banks were unable to take advantage of a full menu of financial services.

Responding to the need to modernize the financial system and after many years of deliberation, Congress enacted the Gramm-Leach-Bliley Act. It broke down decades-old barriers, allowed bank-affiliated firms to recognize the synergies associated with full affiliation of banking with underwriting and agency activities in securities and insurance. It also broadened the definition of financial services to enhance competition among all providers and it streamlined the approval process for acquisitions.

To avoid the need for Congress to continually referee disputes among financial service providers, the GLB Act gave to the Federal Reserve and the Treasury authority to define new activities that are financial in nature, or incidental to financial activities. This was designed to assure that regulation remains responsive to the evolving marketplace in financial services and to assure there was a level competitive playing field. As will be discussed briefly below, the real estate lobby has worked to derail this essential process in order to protect its own business interests rather than those of consumers of real estate services.

Importantly, while more efficient combinations can occur as a result of the GLB Act, they can do so without excessive risk taking or additional exposure to the FDIC fund. Several provisions help to ensure any risk is controlled and poses no threat to the deposit insurance fund. First, new products and services can now be provided to customers, thus helping to diversify income and improve the overall health of the financial institution. Second, the newly permissible activities, for the most part, are placed in financial subsidiaries or affiliates of the holding company, which are legally separate entities from the bank and thus pose no risk to insured deposits. Third, to utilize any of the new powers authorized in the GLB Act, all of the banks of the banking organization must be well capitalized and well managed and continue to be so. Failure to maintain these standards means that they would have to divest themselves of the new activity. And fourth, the Act also requires the large insured financial institutions have at least one issue of outstanding subordinated debt that is rated within the three highest investment grades. This provision was adopted "in order to bring market force and discipline to bear on their operation and the assessment of their viability" and applies, by regulation, to the largest 50 institutions.

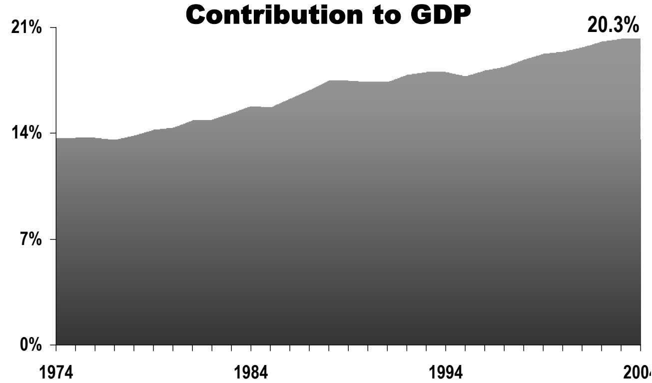
The GLB Act also kept banking and commerce separate, giving the Federal Reserve the authority to determine when some nonfinancial activities are complementary to financial services.

II. The GLB Act Has Worked Well, Benefiting Customers and Posing No New Risks

By ratifying and rationalizing the regulatory structure of what was already occurring in the marketplace, the GLB Act has already been successful. The diversification of income sources most certainly helped many banks through the periods of slow economic growth while at the same time posing no new risks to the financial system or the deposit insurance funds. In fact, the banking industry has posted strong earnings since the enactment of the GLB Act, and now has capital and reserves exceeding $900 billion. The financial services industry continues to be a major driver in our economy, now accounting for over 20 percent of GDP (see Chart 4). Jobs within banking, and financial services generally, have continued to be created even during the recent slow economic times (see Chart 5).

Chart 4

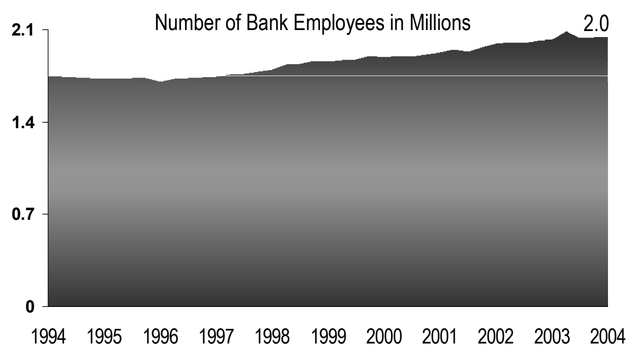
Financial Services Sector Contribution to GDP



Data from the U.S. Bureau of Economic Analysis

Chart 5

Banks Have Added 33,000 Jobs Per Year Since 1994



Data from the U.S. Bureau of Labor Statistics

As of July 2004, 647 financial holding companies – a new financial structure established in the GLB Act – had been formed (about 12 percent of banking organizations, holding 80 percent of the domestic banking-industry assets). There are many reasons for establishing a financial holding company (FHC). Some banks just wanted the streamlined approval process for acquisitions. Others wanted the market to know that their bank was well-capitalized and well-managed – a requirement to forming an FHC. Others were interested in merchant banking. About 25 percent are engaged in insurance agency activities and 5 percent in insurance underwriting (unrelated to the extension of credit).[1] Generally, all the BHCs with Section 20 subsidiaries have converted to FHCs. The reason for this is simple: these firms would no longer have to calculate the 75-to-25 ratio of permissible to impermissible income for a bank holding company – a burdensome and wasteful exercise.

While not all financial firms have rushed to become a financial holding company, they could if they so choose in the future. This is a critical point: the success of the GLB Act should not be judged by the number of financial holding companies or whether the combination of activities that firms now offer were a direct result of the GLB Act. Rather it is the very ***option*** to undertake combinations of activities to meet the needs of customers that is the measure of success. Importantly, the streamlined approval process for non-depository acquisitions has made a tremendous difference. FHCs now notify the Federal Reserve ***after*** the acquisition. Banking firms are now more competitive because they are able to make quick business decisions and implement programs to meet the changing market needs. No longer do they have to wait many months for regulatory approval of an acquisition, thereby losing business to firms that did not have such impediments. This is the way a dynamic, competitive market is supposed to work.

It should also be remembered that banks and other financial firms had already established relationships with securities and insurance firms prior to enactment of the GLB Act. The removal of the arbitrary restrictions, such as the eligibility revenue limits, has helped expand existing businesses that banks had underway. Smaller banks have used the GLB authorities to expand insurance brokerage activities without the artificial constraint of locating in a town of 5,000 residents.

There have been other benefits as well. About two dozen FHCs have used the GLB Act authorities to establish merchant banking operations. As the economy gains momentum, merchant banking activity is expected to increase. Many members of the ABA and the ABA Securities Association regard the authority to engage in expanded merchant banking activities as the single most important new power granted by the GLB Act. As a result, our members have a strong interest in ensuring that they can engage in merchant banking activities to the full extent allowed under the law. A particular concern, explained in more detail in Section III of this testimony, relates to provisions that restrict cross-marketing with respect to merchant banking for some firms (affiliated with

[1] As of June 2003, 52 percent of banks below $1 billion in assets were selling insurance with 33 percent selling general insurance (products other than credit related insurance and annuities).

securities companies) but not for others (affiliated with insurance companies). A sensible approach by Congress to cross marketing that is not based on ownership of one financial firm or another is needed.

The GLB Act established a two-way street allowing banking companies to efficiently enter securities, insurance and other financial businesses as well as allowing these financial firms to enter the banking business. This enhances competition within the financial services market as all firms have the opportunity to provide a full range of financial services. It should be noted in this context, that the BHC Act continues to impose a more stringent anti-tying standard on bank and financial holding companies than on other firms competing in the financial services market.

In spite of the fact that non-bank financial firms offer bundled products, that they can form a FHC just like banking firms, and that banking firms are subject to more stringent anti-tying standards, some observers have claimed that banking organizations' ability to providing bundled services is somehow unfair, or even in violation of anti-tying statutes. These claims are serious and unfortunately are too often accepted without legal understanding or economic analysis. Two recent papers help to fill this analytical void. The first, "Legality of Relationship Banking Under Bank Antitying Restrictions" by Covington & Burling concludes that there are many permissible approaches for banks to expand customer relationships, including cross-selling and cross-marketing, engaging in certain forms of discount pricing based on the volume of services purchased, and legal tying involving traditional bank products under statutory and regulatory exceptions. This broad range of permissible relationship banking practices is consistent with the limited scope of section 106, the anti-tying restrictions of the antitrust laws, and benefits of bundled products and services.[2]

The second paper, "Tying and Subsidized Loans: A Doubtful Problem" by Donald J. Mullineaux, DuPont Chair in Banking and Financial Services at the University of Kentucky, analyzes whether tying makes any sense from an economic perspective and evaluates the so-called evidence of tying that is based on comparisons of relative interest rates on syndicated loans and other types of financial contracts. This paper concludes that tying is not a rational strategy in today's financial

[2] "Memorandum: Legality Of Relationship Banking Under Bank Antitying Restrictions," Covington and Burling, Washington, D.C., May 28, 2003. This paper and the one by Dr. Mullineaux were supported by the American Bankers Association and the ABA Securities Association. The views expressed herein are strictly my own and do not necessarily represent the views of the American Bankers Association, ABASA or its members.

environment and that no valid inferences about tying can be drawn from simple comparisons of rates on loans with those on bonds or credit default swaps.[3]

To summarize, the law no longer constrains the natural evolution of the financial services market – that will be the legacy of the GLB Act. The market will continue to evolve slowly as firms experiment and innovate, trying to find the best combination of services to meet the needs of their customers. Importantly, new combinations of services have been provided without excessive risk taking or additional exposure to the FDIC fund.

III. More needs to be done to fully realize the benefits of the GLB Act

There are several issues of concern that limit or threaten the benefits of fair and open competition envisioned in the GLB Act:

- The flexible regulatory process designed to allow financial institutions to enter new lines of business must be allowed to work as envisioned in the Act;
- The banking industry has serious concerns over a new proposal by the Securities and Exchange Commission (SEC) regarding Regulation B (a.k.a., broker "push-out" rules) that should be addressed;
- A sensible cross-marketing approach for merchant banking activities is needed;
- More rapid adoption of expanded collateral provisions for Home Loan Bank advances provided for in the GLB Act is needed to facilitate small business and small agri-business lending, and;
- Insurance regulatory reform is the next natural legislative step following the GLB Act to modernize the financial services industry.

[3] "Tying and Subsidized Loans: A Doubtful Problem" by Dr. Donald J. Mullineaux, Director, School of Management DuPont Chair in Banking and Financial Services, Gatton College of Business and Economics, University of Kentucky, May 2003.

Regulatory Flexibility to Adjust to the Marketplace Should Be Preserved

In the more than 15 years of debate prior to enactment of the GLB Act, Congress often found itself in the middle of arguments between financial services industries about who should do what. The result was gridlock and an out-of-date financial system that did not reflect changes in consumer needs or in the use of technology. Congress also recognized that the statutory standard for regulatory approval of new activities for bank holding companies — the "closely related to banking" standard — was woefully inadequate in an economy transformed by technological progress.

To be sure that the pro-competitive goals of the GLB Act continued to be met in a dynamic marketplace, Congress: (1) established a flexible regulatory process that would permit the financial industry to "compete effectively with any company seeking to provide financial services in the U.S." without the need for further legislation; and (2) set forth a new, considerably broader, standard to enable banks and bank holding companies to remain competitive no matter in what direction financial services evolved. That new standard — activities that are financial in nature or incidental to a financial activity — was intended to provide the flexibility Congress knew would be necessary. In an abundance of caution, those activities, even very low risk agency activities, can only be conducted in FHCs or financial subsidiaries.

Unfortunately, this important provision has been derailed, at least for now, in one of first proposed rulings under this Act, having to do with real estate brokerage and management services. The merits of this proposal are not the subject of this hearing, and I will not belabor this matter beyond pointing out that real estate brokerage firms are competing directly with banks in providing financial services. They have even admitted so in testimony before this committee and yet are working to frustrate the pro-competitive process that Congress put into place in the GLB Act. What is central to this hearing is that an extremely important provision of the GLB Act – one that appropriately delegates responsibilities to the two agencies most familiar with the financial services industry – is not working. As a result, Congress has once again become embroiled in another competitive issue – the very thing it sought to avoid. We urge Congress to let the Treasury and the Federal Reserve undertake their responsibilities to assure that the financial services market remains fair and competitive.

Concerns Remain over Regulation B (Broker "Push-Out" Rules) Proposed by SEC

As part of its financial modernization scheme, the GLB Act removed the blanket exemption from SEC registration for banks that engage in securities activities. The blanket exemption was replaced with a set of narrow exceptions for bank "broker" and "dealer" activities. Under the GLB Act, any securities activities that fall outside of the exceptions may no longer be handled directly in the bank and, for practical reasons, must be "pushed out" into an SEC-supervised securities affiliate of the bank. The SEC delayed implementation of its rules several times, eventually putting in place a temporary exemption that effectively preserved the blanket exemption until the new rules could be rewritten. This action was very appropriate as the banking industry made clear that the rules suggested at that time, in a variety of respects, were burdensome, disruptive, costly, and unworkable.

In late 2002, the Commission took a dual track approach and issued final rules implementing the "dealer" part of the exceptions only. The "dealer" exception rules, including an exemption for securities lending activities, were issued in February 2003, and compliance became mandatory on September 30, 2003. On June 17, 2004, the SEC made public the proposed "Regulation B" rules to implement the bank exceptions from the definition of "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934, as amended by Title II of the GLB Act. In crafting proposed Regulation B, the SEC sought input from the ABA, the ABA Securities Association, and others. Bank trust officers, employee benefit professionals, custody managers, securities professionals, and private bankers all share a keen interest in the practical application of these rules.

While the proposal, in most respects, is a significant improvement over the earlier proposal, much work remains to be done. The regulation defines and clarifies a number of the statutory exceptions from the definition of "broker" and grants several new exemptions from the "broker" definition to banks and certain other financial institutions (which would supplement the statutory exceptions). Among the key issues that still need to be addressed are the following:

- The complexity of the "chiefly compensated" test under the trust and fiduciary exception;
- The inability of banks to offer order-taking to many new custodial clients after July 30, 2004, including, most importantly, IRA custodial accounts;
- The incompatibility of the employee benefit plan exception with current pension plan operations;

- The uncertainty posed by the proposal to current bank bonus and referral fee plans;
- The impact the rule will have on bank sweep programs; and,
- The proposal's refusal to treat equally thrifts and commercial banking organizations.

Over the last three years, the ABA has worked closely with the SEC on these issues and the proposal, in most, but not all respects, is a significant improvement over the earlier one. We appreciate the SEC's responsiveness to many of our concerns and hope that these additional problem areas can be adequately addressed in the next several months so that our member banks and savings institutions can continue to offer products and services, such as IRA accounts and pension plan services, which our customers have come to enjoy. During this process, we would hope that the Congress would continue to exercise its oversight responsibilities.

A Sensible Cross-Marketing Approach for Merchant Banking Activities Is Needed

There are two important changes in law that are needed that apply to the new merchant banking powers authorized under the GLB Act. The first change would allow ***all*** FHCs engaged in merchant banking activities to cross-market products and services offered by both the bank and the portfolio company in which the investment is made so long as the financial holding company has a non-controlling investment stake in the portfolio company. The second change would permit all FHCs, whether or not their investment in the portfolio company was controlling, a limited ability to cross-market bank and portfolio company products and services. This latter change is necessary to ensure that FHCs affiliated with securities underwriting firms are not unfairly disadvantaged vis-à-vis those FHCs affiliated with insurance underwriting firms.

As background, the GLB Act generally imposes cross-marketing restrictions on FHCs engaged in merchant banking activities. The Act prohibits a depository institution controlled by an FHC from marketing any product or service of a company in which the FHC has made a merchant banking investment. The reverse is also true: the company in which the FHC has invested may not market the products and services of the FHC's affiliated depository institution to its customers.

An exception from this prohibition is provided, however, for merchant banking investments ***made by insurance companies*** owned by an FHC. Thus, insurance underwriting firms that affiliate with depository institutions are able to cross-market through statement stuffers or Internet websites products to or through the company in which they have made a merchant banking investment. Moreover, products and services offered by the company in which the insurance underwriting firm has invested also may be marketed via the depository institution that is affiliated with the insurance underwriting firm.

Nearly all of the members of the ABA Securities Association are FHCs that are able to make merchant banking investments because of their affiliation with ***securities firms***; very few, however, own insurance companies that could engage in the type of insurance company merchant banking permitted by the GLB Act. As a result, our FHC members could not take advantage of the website/statement-stuffer exception, while other FHCs with insurance company merchant banking operations would be permitted to do so.

There is simply no rational or public policy reason for this plain competitive inequity. The ability to cross-market through Internet websites is important to banks. Current business practices often require an FHC to invest in an Internet firm in order for its banks' products to be posted on or linked to that firm's website.

Taken together, the amendments suggested above would allow banks to cross-market bank products and services to customers of a portfolio company and vice versa, so long as the FHCs investment stake was non-controlling (which is defined as owning or controlling 25 percent or more of the total equity or any class of voting securities). In addition, we believe that even where a control situation existed, limited cross-marketing through websites and statement stuffers should be permitted for all FHCs.

Such changes will not only put our members on an equal footing with those insurance underwriting firms that engage in merchant banking, they will also allow ***all*** FHCs to engage in cross-marketing so long as their merchant banking stake is non-controlling. This latter provision is very important to level the playing field between FHCs and other non-FHC financial firms not similarly constrained by the GLB Act's bar on cross-marketing.

Federal Home Loan banks Should Fully Embrace the Expanded Collateral Provisions of the GLB Act

Title VI of the GLB Act included a provision long advocated by the ABA that expanded categories of eligible collateral for community financial institution members of the Federal Home Loan Banks (FHLBs) to include "secured loans for small business, agriculture, or securities representing a whole interest in such secured loans."[4] Unfortunately, the acceptance of small business, small agri-business and small farm collateral for loan advances by the Federal Home Loan Banks (FHLBs) has been spotty at best. In regions of the country where agricultural lending is a major line of business for member banks of the individual FHLBs, there has been some acceptance of the collateral. The Dallas and Topeka Federal Home Loan Banks have increased lending on this collateral the most, each accepting over $2 billion in small business, small agri-business or small farm collateral thus far this year. The Des Moines Bank has accepted $1.1 billion in this collateral thus far this year. However, even in these areas, agricultural loans (real estate secured and non-real estate secured) continue to be heavily discounted for collateral advances. The individual FHLBs assured the public that as they gained experience with these loans that the discounting would be reduced if the loans performed as anticipated – and some have begun to do so. As an example, on July 1, 2004, the Dallas Bank increased the acceptable limit on this type of collateral from two times a member's Tier 1 capital to three times the member's Tier 1 capital. We applaud this move and encourage other FHLBs to follow suit.

In regions where agricultural lending does not dominate the business lines of the member banks, there has been little or no acceptance of these loans for collateral advances. Banks in these regions generally have required that members exhaust all other acceptable collateral before accepting the new categories.

To be fair to the FHLBs, some of the slowness is a result of the slowed down in the agricultural and rural economy due to a rapid decline in farm commodity prices and a decline in the manufacturing sector. Member banks have needed less borrowed funds to meet loan demand. Today, agricultural commodity prices have recovered, and a robust farm real estate market is occurring in all regions of the

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[4] 12 USC 1430(a)3E. Community financial institutions are FDIC insured institutions with less than $530 million in assets (adjusted for inflation from $500 million at the time of enactment). The FHLBs' regulator, the Federal Housing Finance Board, implemented this provision in 2000 allowing the FHLBs to accept small business, small agri-business and small farm collateral.

country. We are disappointed that more of the FHLBs are not positioned to meet what could potentially be a renewed need for lendable funds.

A related issue that is particularly disappointing to us is the on-going problem our members have faced when attempting to use Small Business Administration (SBA) and United States Department of Agriculture (USDA) guaranteed loans as collateral for FHLB advances. The Federal Housing Finance Board has made it clear that these loans, backed by the full faith and credit of the United States government, are eligible collateral for purposes of borrowing from the FHLBs. However, due to technical issues related to SBA and USDA regulations on the terms and conditions of the federal guarantees, most FHLBs place ***no value*** on the "full faith and credit" guaranty of the federal government. At best, some of the FHLBs discount the federal guaranty and give the pledging banks no break on the collateral haircut; at other FHLBs, these loans are not acceptable collateral at all. Despite efforts of both the ABA and representatives from several FHLBs, officials that administer the loan programs at USDA and SBA have been less than willing to resolve this issue. Guaranteed loans are extended to the most economically vulnerable small farmers and small business people, and they deserve the best rates and terms possible. USDA and SBA should be encouraged to modify their regulations to solve this problem.

Insurance Regulatory Reform

The most significant work left undone by the GLB Act is modernization of the state system of insurance regulation. The American system of insurance regulation was set in place at about the same time as Allied forces were fighting the Battle of the Bulge in 1945. In March of that year, Congress delegated its authority to regulate insurance to the states with the passage of the McCarran-Ferguson Act.[5] This system is now more than half a century old and in dire need of modernization.

Congress began to recognize this need in 1999 by including a provision within the GLB Act that encouraged the states to adopt either uniform or reciprocal licensing standards for insurance agents. The so-called NARAB provision called for the establishment of a national licensing standard and required that standard to be adopted by a majority of the states.[6]

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[5] 15 USC Section 6701

[6] The National Association of Insurance Commissioners (NAIC) created the NARAB Working Group in December 1999 to help States implement Subtitle C requirements in Title III of the Gramm-Leach-Bliley Act. That subtitle requires State insurance regulators to meet Federal statutory requirements affecting insurance agent licensing, and provides for establishing

Accordingly, we were hopeful that a ***uniform*** licensing regime would be created, but that has not happened. Instead, a reciprocal licensing regime has been created, and while a majority of states have enacted this system, significant variations in licensing standards are still permitted. Unfortunately, the goal of creating just one set of licensing standards to which all insurance agents must adhere has yet to be realized.

On a more positive note, NARAB's inclusion in the GLB Act began the discussion of why Congress is needed to resolve the problems inherent in the state insurance regulatory system. Although NARAB's success is limited, the states would not have achieved even such little uniformity as currently exists absent a congressional mandate to do so. However, the narrow scope of the NARAB provision (i.e., addressing only agent licensing) left unaddressed the myriad other problems of state insurance regulation that urgently need reform. The most glaring among them are:

- Non-uniform or duplicative agent and company licensing criteria;
- Inconsistent market conduct standards;
- Non-uniform privacy standards;
- Price controls; and,
- Prior approval barriers to product introduction and innovation.

All of these are fundamental problems associated with product availability and cost that duplicative and inefficient state regulation has created.

Witness the fact that most states require prior approval of insurance products and rates before the product can be sold. The same product – term life insurance, for example – must be modified to meet the different requirements imposed by every state and as a result, can take as long as two years to roll out a new product nationally.

Regulation of this sort impedes product innovation and introduction as the cost of complying with so many different laws restricts the ability of smaller companies to enter the marketplace. Similarly, rate regulation, or price controls as they should more appropriately be known, prevent some insurers from offering their products at prices that are profitable. Accordingly, highly regulated states, like

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a new organization named the National Association of Registered Agents and Brokers (NARAB) if the States fail to achieve the goals set forth in Subtitle C. The mission of the NARAB Working Group is to coordinate State regulatory actions related to NARAB, so that we can fully and promptly comply with all requirements in the GLB Act.

Massachusetts and New Jersey, have a fraction of the insurance companies offering products for sale compared to states like Illinois and South Carolina where market forces set prices.

One solution to these problems endorsed by the ABA and its insurance affiliate, the American Bankers Insurance Association (ABIA), is to create an Optional Federal Charter (OFC) for insurance companies and agencies. Like the dual-banking system, an OFC would provide an alternative to the current state-by-state system of regulation and create the uniformity and efficiency that is unattainable under state regulation. Perhaps as important, an OFC would preclude or diminish the harmful effects of having state regulators create many different interpretations of a federal standard. If uniformity is the goal, we can see no benefit to replacing the universe of differing state laws with a universe of differing state interpretations of a federal law.

By leaving the state system intact, however, an OFC would preserve state regulation for those companies and agents preferring that system while providing choice for those that prefer the uniformity and efficiency of a single federal regulator and the uniform regulations federal oversight would provide. As with the dual-banking system, providing this sort of choice for the insurance industry will create a critical dynamic that inures to the betterment of insurance regulation as a whole and insurance consumers in particular.

The problems inherent in state insurance regulation grow worse every day. We urge this Committee to examine state regulation of insurance in separate hearings and to debate solutions to these most urgent problems.

Conclusion

The GLB Act has helped to remove an obstacle to efficient provision of financial services. It responded to the needs of consumers and has increased the competition among financial service providers, each vying to design new and creative products by rebundling the four basic financial services – transactions services, intermediation, risk management and advice. In this new competitive environment, customers look to suppliers who can provide combinations of services tailored to meet their needs. As Senator Phil Gramm said at the signing ceremony for this Act: "The world changes, and Congress and the laws have to change with it….We have learned that we promote economic growth and we promote stability by having competition and freedom."