

For Release Upon Delivery  
July 20, 2000, 10:00 a.m.

TESTIMONY OF

JULIE L. WILLIAMS

FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCE AND HAZARDOUS MATERIALS

of the

COMMITTEE ON COMMERCE

of the

U.S. HOUSE OF REPRESENTATIVES

July 20, 2000

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent those of the President.

Summary Statement

Today's testimony addresses several subjects. First, it provides a short overview of the dual banking system. Second, it discusses how the Office of the Comptroller of the Currency (OCC) is implementing the Gramm-Leach-Bliley Act (GLBA) both through the formal development of supervisory policies together with State insurance regulators, and through our less formal, but equally important, efforts to strengthen and maintain the productive working relationships we have established with our State insurance regulator colleagues. Finally, the testimony reports the status of our work to prepare, in consultation with State insurance regulators, the insurance consumer protection regulations required by section 305 of GLBA.

"The dual banking system" refers to the fact that banks may be chartered by either a State or the Federal Government. The development of the system may be traced back to the early years of our Nation. Beginning

in 1863, two separate and independent banking systems were operating in the country -- the State and National Banking systems. Today, our dual banking system is far more complex and can best be described as two interrelated systems in which most State chartered banks are subject to a significant degree of federal supervision and regulation, and where State laws are made applicable, to a varying extent, to federally chartered banks. Indeed, the largest component of State bank supervision and regulation is Federal.

The OCC's oversight of national banks has been interrelated with State insurance regulation for some time and will be even more so following GLBA. GLBA establishes a system of functional regulation that requires each financial regulator to defer to the regulator primarily responsible for supervising particular entities. In general, State insurance regulators will oversee insurance agencies and companies, securities regulators will oversee registered securities firms, and banking regulators will oversee banking organizations. Thus, the OCC has taken a number of actions to coordinate and work with State insurance regulators.

First, the OCC and the National Association of Insurance Commissioners (NAIC) jointly developed a model agreement to share information about consumer complaints with respect to national banks involved in insurance sales activities. To date, the OCC has entered into consumer complaint sharing agreements with 28 State insurance regulators.

Second, the OCC is currently working to develop a broader agreement that will significantly expand the types of information shared by the OCC and the State insurance regulatory agencies. The OCC also is exploring ways to better share information with State insurance regulators about individuals who have committed fraud or have otherwise been subject to OCC enforcement actions.

Third, in an effort to further develop working relationships between the OCC and the State insurance regulators, we also have been engaged in a continuing and productive dialogue with the NAIC and with individual State regulators. To date, regional representatives of the OCC have met with 43 State insurance regulators and OCC staff regularly consults with NAIC staff and the staffs of the State insurance regulators regarding GLBA implementation issues.

Finally, the OCC, as well as the other Federal banking agencies, has had productive discussions with the NAIC regarding the development of

federal regulations to address consumer protection concerns relating to depository institution sales of insurance. The banking agencies have provided a working draft of the proposed rule to the NAIC. On June 29, 2000, representatives of the OCC and the other agencies met with NAIC representatives to discuss the proposal.

#### Introduction

Mr. Chairman and members of the Subcommittee, thank you for inviting the Office of the Comptroller of the Currency (OCC) to participate in this hearing. The significant changes to the financial services industry effected by the implementation of the Gramm-Leach-Bliley Act (GLBA) make cooperation and coordination between regulators at the Federal and State levels more important than ever before. We appreciate this opportunity to share with you the OCC's experience working with State insurance regulators.

As the Subcommittee requested, today I will provide a short overview of the dual banking system. I will then discuss how the OCC is implementing GLBA both through the formal development of supervisory policies together with State insurance regulators, and through our less formal, but equally important, efforts to strengthen and maintain the productive working relationships we have established with our State insurance regulator colleagues. I will conclude my remarks by reporting to you about the status of our work to prepare, in consultation with State insurance regulators, the insurance consumer protection regulations required by section 305 of GLBA.

#### The Dual System of Banking Regulation

"The dual banking system" refers to the fact that banks may be chartered by either a State or the Federal Government. The development of the system may be traced back to the early years of our Nation, when popular, and especially agrarian, animosity towards the establishment of banks by the National Government was very strong. The opposition was based on the widely accepted belief that banks encouraged usury, diverted funds from agriculture, increased speculation, and were responsible for a host of other social and economic evils. Nonetheless, a permanent Federal banking system was established in 1863, when the financial demands of the Civil War, and the need for the consistency and uniformity of a national system, made such action exigent. However, the animus against banks did

not prevent the establishment of State chartered banks, and during the period between 1837 and 1863 many banks were formed under State authority.

By the time the national banking system began in 1863, State chartered banking was an established presence in the United States.

Thus, beginning in 1863, two separate and independent banking systems were operating in the country -- the State and National Banking systems.

In the nineteenth century, a bank could be chartered and regulated by either authority without interference from the other.

Today, our dual banking system is far more complex. Starting with the Federal Reserve Act in 1913, Federal regulatory involvement with the

affairs of State chartered banks began to grow. This involvement was accelerated by the advent of Federal deposit insurance in 1933, so that today virtually all State banks are subject to substantial Federal oversight. At the same time, Federal provisions began to incorporate certain State laws into the Federal regulatory framework, and made these

laws applicable to federally chartered banks. Further, a bank may elect

(with regulatory approval) to convert at any time from State to Federal charter, or Federal to State charter. Thus, instead of having two independent banking systems, the dual banking system today can best be described as two interrelated systems in which most State chartered banks

are subject to a significant degree of federal supervision and regulation,

and where State laws are made applicable, to a varying extent, to federally chartered banks. Indeed, the largest component of State bank supervision and regulation is Federal.

Some have criticized the dual banking system as an overly complex and burdensome institution that imposes conflicting standards on equivalent banking organizations, and which encourages laxity in supervision by having the State and Federal regulatory agencies compete with each other

for chartering business. This complexity is highlighted by the fact that

the dual banking system actually consists of one Federal system and 50 State systems, since each State is free to construct its own regulatory framework.

On the other hand, others have defended the dual banking system as representing Federalism in practice by permitting individual States the flexibility necessary to provide for the banking services needed by their

local communities, and encouraging experimentation and innovation at the

State, as well as Federal, level. Further, some have argued that by providing an alternative chartering mechanism, the dual system provides "checks and balances" against over-regulation by a single monolithic body.

One key aspect of the current system of bank regulation for purposes of the Subcommittee's inquiry today, however, is that the OCC's oversight of national banks has been interrelated with State insurance regulation for some time. Since 1916, national banks have been expressly permitted to sell insurance directly pursuant to the so-called "place of 5,000" provision at 12 U.S.C. 92. After the enactment of GLBA, national banks may also sell insurance through financial subsidiaries without regard to these geographic restrictions. GLBA's Functional Regulation Regime

GLBA establishes a system of functional regulation that requires each financial regulator to defer to the regulator primarily responsible for supervising particular entities. Thus, in general, State insurance regulators will oversee insurance agencies and companies, securities regulators will oversee registered securities firms, and banking regulators will oversee banking organizations.

The functional regulation provisions in GLBA restrict the OCC's ability to require reports, examine and take remedial actions against functionally regulated national bank subsidiaries and affiliates. For example, GLBA requires the OCC to rely, to the fullest possible extent, on reports provided by national bank insurance subsidiaries to their functional regulator. In addition, GLBA permits the OCC to examine a functionally regulated subsidiary or affiliate of a national bank only if:

- (1) we have reasonable cause to believe that the subsidiary is engaged in activities that pose a material risk to the national bank;
- (2) we reasonably conclude -- after reviewing reports obtained from the functional regulator -- that the examination is necessary in order for us to be adequately informed about the systems for monitoring and controlling operational and financial risks that could pose a threat to the safety and soundness of the national bank;
- (3) based on reports or other information, we have reasonable cause to believe that the subsidiary is not in compliance with laws that we have the jurisdiction to enforce.

Other statutory standards substantially limit the ability of the OCC to take enforcement actions against functionally regulated entities.

These provisions effectively place the functional supervisor -- State insurance regulators in the case of functionally regulated national bank insurance subsidiaries, for example -- in a pivotal position to identify activities conducted by a national bank's insurance subsidiary that could compromise the safety and soundness of its parent national bank (or other

parent depository institution). Close cooperation with State insurance authorities is thus not only statutorily required, but is essential for us to fulfill the OCC's primary mission of ensuring the safety and soundness of the National Banking System.

To achieve this goal, the OCC will continue to monitor the impact of subsidiaries' insurance activities on the safety and soundness of parent national banks, by examining banks' systems and procedures for monitoring and controlling risks arising from those activities and by reviewing carefully the information we receive from State insurance regulators. Moreover, the GLBA functional regulation provisions highlight the importance of developing processes to share appropriate information between the OCC and the State insurance regulators and establishing close working relationships with State insurance regulators. The OCC has taken several actions in furtherance of these goals.

#### Information Sharing

The exchange of appropriate and meaningful information not only assists the OCC and State insurance supervisors in identifying individual and systemic risks, but also establishes the foundation for prompt and effective action to address consumer concerns. The OCC recognized the need for cooperative efforts to address consumer concerns well before passage of GLBA. In 1996, the OCC invited State insurance commissioners to the OCC to open a dialogue between two historically distant regulatory systems and to begin exploring ways to better coordinate our efforts. As a result, the OCC and the National Association of Insurance Commissioners (NAIC) jointly developed a model agreement to share information about consumer complaints with respect to national banks involved in insurance sales activities. The OCC then worked with individual State insurance regulators to "customize" the agreement to be consistent to unique features of a particular State's law. To date, the OCC has entered into consumer complaint sharing agreements with 28 State insurance regulators.

These agreements require the OCC to send to the appropriate State insurance regulator copies of all complaints that the OCC receives relating to insurance sales in that State by a national bank. Likewise, the State insurance regulator will send to the OCC copies of all complaints it receives involving a national bank. The agreement also provides that the OCC and the State insurance regulator communicate with

each other to the fullest extent possible on matters of common interest, such as regulatory and policy initiatives.

These agreements enhance consumers' ability to remedy their complaints and facilitate banks' compliance with consumer safeguards by ensuring that the regulator with the appropriate jurisdiction and authority to resolve the complaint will receive and process the complaint.

Complaints received from the States also will assist the OCC in focusing its examination resources with respect to national banks that sell insurance directly. Information about consumer complaints will help examiners spot trends in insurance sales practices among national banks that sell insurance and in the banking industry in general and enable them to take appropriate supervisory steps if any particular bank generates complaints with more than normal frequency.

The OCC's Customer Assistance Group (CAG), located in Houston, Texas, is primarily responsible for implementing these agreements by coordination with the State insurance regulators. The CAG is fully staffed with banking compliance professionals who log, track and resolve national bank customer complaints with the assistance of a call center employing modern call center technology. As of June 30, 2000, the CAG has referred 70 complaints to those States that have signed the agreement and received 3 referrals from State insurance regulators. All referrals received by CAG are processed and sent to the bank for responsive action, and the information is shared with the appropriate State insurance regulator.

In light of the heavy reliance on State insurance regulation that GLBA requires, we are currently working to develop a broader agreement that will significantly expand the types of information shared by the OCC and the State insurance regulatory agencies. We anticipate that these agreements will provide for the sharing of various types of supervisory information in addition to incorporating the existing consumer complaint sharing provisions. For example, we expect the agreement to follow the GLBA provisions and permit each agency to request from the other information regarding: (1) the material risks to the operations or financial condition of a regulated entity; (2) the insurance activities of a regulated entity; or (3) other matters necessary to disclose fully the relations between a regulated entity supervised by the OCC and a regulated entity supervised by the State insurance regulator, provided the information requested is in furtherance of the agency's lawful examination or supervision of the regulated entity. The agreement is intended to

cover the exchange of information involving national banks, national bank subsidiaries, Federal branches or agencies, companies engaged in insurance activities subject to the supervision of the State insurance regulator, and other entities over which the OCC or the State insurance regulator has examination or supervisory authority.

These new, more comprehensive agreements are also intended to cover information relating to enforcement actions. This provision will permit each agency to assess whether the enforcement action poses risks to an entity it regulates that is not subject directly to the enforcement action, and put the agency on notice of possible violations of law or unsafe and unsound practices that may require independent investigation and follow up with the entity it does not regulate. Over the next few months, we expect to work with the NAIC to develop our draft into a model supervisory information sharing agreement that will serve as the basis for agreements between the OCC and each State insurance regulator.

The OCC also is exploring ways to better share information with State insurance regulators about individuals who have committed fraud or have otherwise been subject to OCC enforcement actions. The OCC currently makes this information publicly available through its Web site. For example, the OCC currently lists on its Web site the names of individuals that are the subject of formal enforcement actions, including removals from the industry, orders to make reimbursement, and assessments of civil money penalties.

The OCC has also recently amended its rules relating to national bank corporate activities to include new procedures for sharing with State insurance departments appropriate information relating to initial and continuing affiliations between national banks and companies engaged in insurance activities. The OCC included these procedures following discussions with, and at the request of, NAIC members that they receive some notification when a national bank applies to the OCC to commence insurance operations in a particular State. Under the new procedures, a national bank must describe in its notice or application to the OCC to establish a financial subsidiary or an operating subsidiary, or to make a non-controlling investment in an entity that will engage in insurance activities, the type of insurance activities that the bank is engaged in or will engage in and the lines of business for which the company holds or will hold an insurance license. The OCC will then forward this information to the appropriate State insurance regulator. Maintaining Intergovernmental Working Relationships

As I have described, our original consumer complaint sharing agreement grew out of the contacts we initiated with the NAIC in 1996. In an effort to further develop working relationships between the OCC and the State insurance regulators, we have been engaged in a continuing and productive dialogue with the NAIC and with individual State regulators. To date, regional representatives of the OCC have met with 43 State insurance regulators to identify implementation issues arising from the GLBA functional regulation system. Senior OCC representatives attend NAIC quarterly meetings on a regular basis. These meetings have provided a valuable means for the OCC and State insurance regulators to exchange information about their respective regulatory priorities and supervisory approaches.

OCC staff also has regularly consulted with NAIC staff and the staffs of the State insurance regulators regarding GLBA implementation issues. Senior NAIC and OCC staff have met on several occasions over the past year to discuss the new functional regulation framework. The OCC and the NAIC held an introductory meeting on November 1, 1999. On February 11, 2000, senior OCC, NAIC staff and several State insurance commissioners met to discuss issues such as consultation about affiliations between banks and companies engaged in insurance activities, privacy, consumer protections, a national insurance licensing system, supervision methodologies, and a mechanism for coordination on emerging issues. Also in February, the OCC, the Federal Reserve Board, the FDIC, the OTS, the CFTC, the SEC, the State insurance commissioners, and the State banking commissioners met to discuss Gramm-Leach-Bliley implementation issues.

Going forward, the OCC will build on these relationships as we coordinate our oversight of insurance activities conducted by national banks and their subsidiaries with that of the functional insurance regulators. To this end, the OCC and NAIC are planning a follow-up meeting in August, that I will attend. Among the issues on the tentative agenda for this meeting are: the supervisory information sharing agreement, privacy regulations, insurance complaint resolution procedures, and continuing joint training and outreach opportunities. Insurance Consumer Protection Regulations

The OCC, as well as the other Federal banking agencies, also has had productive discussions with the NAIC regarding the development of federal

regulations to address consumer protection concerns relating to depository institution sales of insurance. Section 305 of GLBA requires the OCC, the Federal Reserve Board, the FDIC, and the OTS jointly to issue consumer protection regulations that apply to retail sales practices, solicitations, advertising, or offers of any insurance product by a bank (or other depository institution) or by any person engaged in such activities at an office of the institution or "on behalf of" the institution. Among other things, the rules must address: (1) specific disclosures that must be made to the consumer before completion of the insurance sale; (2) the physical segregation of the area of insurance activity from the area where retail deposits are routinely accepted; (3) limitations on referrals by persons accepting deposits in the area where such transactions are routinely conducted; and (4) prohibitions on misrepresentations. The agencies are required to publish final regulations no later than 1 year after the enactment of the GLBA.

The banking agencies have provided a working draft of the proposed rule to the NAIC. On June 29, 2000, representatives of the OCC and the other agencies met with NAIC representatives to discuss the proposal. We expect that the agencies' proposal, which will be issued this summer, will reflect the comments and suggestions provided by the NAIC at that time.

#### Conclusion

The notion of "duality" suggested by the designation "dual banking system" does not, either under the law or in practice, mean that today Federal and State banking regulators operate independently of one another within their respective jurisdictional spheres. In the insurance area, the growing involvement of national banks in insurance activities has required a cooperative relationship with State regulators since well before GLBA was enacted. After GLBA, however, the Federal/State relationship assumes greater importance for the safety and soundness of the National Banking System because of the reliance that the GLBA functional regulation framework places on the first-line supervision of insurance activities by the States. The OCC is committed to continuing to work closely with State insurance authorities not only to implement the express requirements of the statute but also to foster regular, open lines of communication that will facilitate the achievement of both Federal and State regulatory objectives. □