

PUBLIC HEARING

before

ASSEMBLY BANKING AND INSURANCE SUBCOMMITTEE

on

DEPOSITORY INSTITUTION REGULATION

Held:
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Room 346
State House Annex
Trenton, New Jersey

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Assemblyman Louis F. Kosco, Vice Chairman
Assemblyman Ralph A. Loveys

ALSO PRESENT:

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ASSEMBLYMAN NICHOLAS J. LaROCCA (Chairman): Good morning. We are pretty much organized, and this is just a preliminary statement. We are going to try to accommodate everyone time-wise. We are waiting for the Commissioner of Banking, or her designee, to appear. That is why we are having this little lull for a few minutes. Commissioner Parell has assured staff that she is on her way.

I trust that everyone has signed in. We have a list here so that staff will know who wishes to testify. We are trying to arrange a priority schedule of who is to speak and at what time.

I would now like to call this hearing to order. This is a hearing being held pursuant to Assembly Resolution 89, which was duly adopted by the Assembly to hold hearings on this particular subject. I will go into that in a minute. In the meantime, I would like to introduce the staff and the others on this Subcommittee. I am Assemblyman Nicholas J. LaRocca. I have been appointed Chairman of this Subcommittee. The Vice Chairman is Assemblyman Louis Kosco, and the other member is Assemblyman Ralph Loveys. We also have with us today Dr. Paul Nadler, who is Professor of Economics at Rutgers University - Newark. I think most of you know the rest of the staff.

We just received a call that the Commissioner of Banking is on her way.

In my opinion, this is one of the most important subjects of our times. I have never read or heard so many disputes and so many different philosophies as to what is good for the public. I am just going to hit some of the highlights to show you the conflicts in philosophies, the conflicts in thinking between the various industries, the effect of deregulation, and then, more importantly -- or just as important -- the public sector down the line. I know everyone here is a lobbyist; everyone here represents a certain viewpoint, and that is good. That is our system; however, my colleagues on the Subcommittee are here to represent the public. We want to see what is good for the public, and what impact it will have on them.

This does have a fancy title. It is a "study of depository institutions' regulation and deregulation." That is quite a big subject. The purpose of this and subsequent hearings is to gather

background information on depository institutions' regulation and deregulation with respect to interstate banking, product diversification, and related issues. The subject matters to be taken up are not necessarily in any order, because this is the first hearing. More hearings will be held throughout the State where the agenda may be a little bit more specific.

The focus of these hearings, and how they affect New Jersey, will be the recent trends in the financial services industry, their impact on the depository institutions, and the trend toward greater market concentration and service diversification by depository institutions. Then there are the problems of liquidity and assets crises of depository institutions and the response to these problems both on the Federal level and on the State level. There are also the effects of all of these developments on the traditional two-tier system we have. You have the Federal regulators in Washington, and you have the State regulators. As you can see, there is what I would call a clash. This goes back to the days when I was in college 50 years ago, states' rights versus Federal rights. The continual battle there through all of these years has been between the federalists and the anti-federalists. This is what these hearings are all about, to see how this affects the public.

We will also consider alternative strategies which have been adopted by other states in response to the developments I have discussed. We have no specific bill in mind. This is not the type of hearing where there is proposed legislation and we listen to testimony in favor of the bill, against the bill, or possibly amend the bill. We have no such bill in mind. At the conclusion of all of these hearings, after a report is made, it may be that we will have some legislative proposal to cure some of these problems.

From the public sector, there is also one other item that is important; that is, the excessive holding periods on deposits of checks. That is something that all of us on the Subcommittee have been receiving a lot of mail about. There has also been testimony before other committees. That, too, will have its proper place.

As you can see, the subject is very broad. Today, we are going to try to listen to the viewpoints of the many contradictory philosophies, and we will be more specific later on.

Now, breaking away from the prepared script, I think everyone has read about these problems and, reducing it to plain English-- After practicing law for 48 years, it is kind of hard to get down to plain English. I have learned all of the English common-law methods and all the Latin. But, this is very important, at least for the public sector. We have these problems. Now you can go into K-Mart, and you can go into Sears Roebuck to buy insurance. You can get a mortgage application and process your mortgage in a K-Mart supermarket. I don't know. Is that good for the industry and for the people of the State? Is it bad for the industry and for the people of the State? That is the purpose of these hearings.

Then, there are a lot of big definitions. What is a bank? In my day it was very easy to define a bank. I don't have to elaborate; a bank was a bank. You know, it was on the corner; it serviced the community. I would go in and I was able to cash my checks. They knew everybody, and everybody knew everybody else. Today, I can't even cash a check in my bank because they will ask me, "What is your number?" I don't know what the heck my number is there, and they change tellers everyday. Well, with that loophole in the definition of a bank, you can see all the problems. I don't have to tell you what everyone has been doing. Everyone has jumped in. Now you have non-banks. Who has jumped in? All the big banks in New York and Pennsylvania. They have all jumped the gun. I don't have to belabor the fact that there is that loophole. I suppose that is the game. I have learned it in the practice of law. All I have said is, "Well, go in. File the application." The Federal Reserve people in Washington have been entertaining a lot of applications. The New York Banking Commissioner has entertained applications from New Jersey banks, and vica versa. Is that good? I don't know. What about the impact of interstate banking? The Chase has over 22 consumer lending offices in 10 states. Manufacturers Hanover has 650 consumer lending offices in 43 states. Citicorp has only 91 loan offices, as they call

them. Of course, in Washington you have the team of Garn-St. Germain, and they have their ideas on the subject. Lord forbid that they make it retroactive. I think there is going to be a lot of consternation regarding all of these applications.

I think these banks use the strategy of, "Well, let's file, and then let's see what happens. We'll worry later." That is something that bothers me; it bothers all of my colleagues on the Subcommittee. I think it also bothers the Department of Insurance and the Department of Banking, as it is their province, also, to regulate these things. Brokerage houses are buying banks. Maybe it is good; maybe it is bad. After discussing this with my colleagues, we really do not know. We have no set opinion, except maybe our own personal philosophies; however, those will not enter into it. We are here to hear all viewpoints.

What makes this difficult is that a lot of it is already here. There are brokerage houses which own banks right now. They may be non-bank banks. Sometimes I don't know what that is, but there is a legal definition for it. Should you go into the securities underwriting business? I don't know. I see my friends here from Prudential. They have already gone into that. They bought Bache. Should the banks go into underwriting securities? Again, I don't know. Should the banks sell life insurance, and vice versa, should the insurance companies go into the banking business?

I see our Commissioner of Banking has arrived, so I will conclude now. I know one of her pet subjects is-- Maybe regional banking is something to be considered. I don't know. All I am saying is, this is the forum for all of these problems. Of course, there are also different viewpoints from the New Jersey Savings League, the New Jersey Bankers Association, and the Mortgage Bankers Association. They all have different viewpoints. This also comes back to a lot of friends of mine, and friends of yours in the industry. There are those who favor State regulation. I think they call themselves the "hungry bankers." Then you have the First National State, Bob Ferguson, and the others. They are interested in nationwide.

My last comment is this: It could very well be, looking into the future, that every banking business and every insurance business may soon be controlled by a board -- a super, super board -- Chicago, California, and New York, where they would make all of the decisions regarding banking because it is going to be Federal. The states may not have anything to say about it. Again, is that good for the public? Is that good for the citizens of New Jersey? That is the purpose of this hearing.

Before I ask the first speaker, who will be the Commissioner of Banking, to come forward, I would like to ask the other two Assemblymen on the Subcommittee if they wish to say a few words. Are there any comments?

ASSEMBLYMAN KOSCO: No, I came to listen.

ASSEMBLYMAN LaROCCA: The first witness will be the Commissioner of Banking, Mary Little Parell.

COMMISSIONER MARY LITTLE PARELL: Good morning, Chairman LaRocca, Assemblyman Kosco, Assemblyman Loveys, all members of the panel, and all members of the public who have come to hear the testimony at this opening hearing this morning.

ASSEMBLYMAN LaROCCA: Everything will be recorded; that is the purpose of the microphone. Those who have written statements, as usual, will submit them to the members of the Subcommittee for incorporation into the transcript that will be forthcoming at the conclusion of all of the hearings.

COMMISSIONER PARELL: It is a pleasure to appear before you today to discuss the outlook for New Jersey's financial services industry. It is an honor to be invited to present the opening remarks for the work of this Subcommittee. I commend you for the impressive list of speakers whom you have invited for this hearing. I think it bodes well for the progress of this Subcommittee that you have invited those most knowledgeable in this industry in this State to appear before you as your hearings progress. I know that you will also take your case to the consumers of this State through this series of public hearings. For that, of course, you are also to be commended.

This Subcommittee and the Legislature have exercised great foresight in convening this task force to identify the effects of industry deregulation on New Jersey's banking and thrift institutions, and, most importantly, on New Jersey's consumers.

The banking industry is indeed undergoing considerable change. Much of our existing fundamental banking law was passed half a century ago. Back then, banks were effectively confined within state boundaries, commercial banking and investment banking were separated, and price ceilings were imposed on what banks could pay their depositors and charge their customers. Given the circumstances of the early 1930s, the pressures to closely regulate the industry were understandable.

But this same structure of regulation -- built during times of confusion, abuse, and insecurity -- has proven inadequate and too antiquated to adapt to today's financial world. I think a quote taken from an article in The Bankers Magazine appropriately summarizes today's struggle with our outdated regulatory system, and this is the quote:

"Erected in the era of the handwritten ledger book, the structure of regulation was not intended to regulate a world in which the ledger is a floppy disk, and the information in it can be transmitted anywhere around the world at the speed of light. The electronic age is rendering state borders, national boundaries, and even distance itself meaningless in the transfer of money and information about money."

The current regulatory structure is obviously out of touch with the times and needs to be substantially modernized. The United States banking industry is heading toward increased competition in every sector, competition which cannot be sustained without the flexibility afforded it by deregulation.

A bank, as you know, is no longer just an institution that serves its depositors by providing loans and returning interest for the use of their money. Banks have changed their operations, their outlook, and their way of doing business substantially. They are now open 24 hours a day via automated teller machines. They have expanded

their services so that a consumer can buy stocks, bonds, certificates of deposit, and money market funds all at one stop, their bank. Bank loan services have expanded into a vast range of flexible options for the consumer.

At the same time, competition for banking customers is fierce, both within the traditional banking world and from other quarters such as commercial retailers, securities, real estate, and insurance firms. The financial world as we know it is in a revolution, a revolution which I believe can be beneficial to New Jersey's economy, its banking industry, and its consumers.

But, as legislators and regulators, we have been called upon to monitor and guide these developments because we know that as a less regulated industry unfolds into new enterprises, yesterday's solutions will not be able to answer tomorrow's questions.

How has deregulation benefited New Jersey's banking system? I was pleased to report to Governor Kean recently that the banking industry in 1984 grew to its healthiest point in the past five years, an achievement made possible, at least in part, as a result of the deregulated marketplace. Statistics compiled by our Department prove the point. Deregulation helped to boost total assets for commercial banks chartered by our Department from \$13.0 billion in 1983 to a projected \$13.8 billion by the end of 1984, a solid 6% increase in assets. State-chartered savings banks had over \$11.5 billion in assets as of mid-1984, almost a 3% increase in growth. And, the insured savings and loan associations chartered by our Department grew by 11.2% to more than \$20 billion in assets. I believe that if you check the statistics for the federally-chartered commercial banks and thrifts, you will find a similar pattern of growth in our State.

The overriding reason for these outstanding results is simple: New Jersey boasts an extraordinarily healthy economy and banking system. Unfettered by bad agricultural, foreign, or energy loans, New Jersey's banking industry has mirrored the extraordinary growth of the State's economy. It could not have been accomplished, however, without deregulation.

Deregulation has also done much to foster the development of new consumer products. The climate for the consumer lending market has significantly brightened because of the many changes in the financial services industry due to loosened regulatory restrictions. Moreover, so that consumers may always be benefited by an active banking community, the Department has pledged to continue to serve New Jerseyans by ceaselessly promoting the orderly development of New Jersey as a financial center. A healthy, competitive financial industry is essential if we are to continue in the ongoing development of our State as an economic force in the region.

I will now detail, for the benefit of all here, the major steps in the deregulation process. These steps are well-known to those of you who have been working in the banking field. The first major step in deregulating the financial services industry took place in 1980, when, to ease the money crunch, Congress passed the Depository Institutions Deregulation and Monetary Control Act, DIDMCA for short. The New Jersey Legislature followed suit by passing legislation which eventually became P.L. 1981, c. 103, to eliminate commercial usury ceilings in the State. Eliminating the rate restriction has proven that, by giving the market the ability to set interest rates based on money availability and competition, the consumer has been afforded higher earning rates and greater borrowing opportunities.

The second step in deregulating financial products in New Jersey was the introduction of the money market deposit accounts and the super-NOW accounts as enabled by the passage of the Federal Garn-St. Germain Depository Institutions Act of 1982. Both of those financial instruments have proven to be effective tools for the institutions to attract new deposits because consumers are able to earn market rates of interest on their savings.

On the lending side, deregulation has taken the form of new consumer loan products. One example is the variable rate loan which has been proposed and is pending before this Legislature. Another example is the resoundingly successful revolving home equity loan extended to consumers who own homes, for home improvements, further education, and other personal projects. Given their increasing

popularity with lenders and borrowers alike, it is easy to see why home equity loans are touted as the consumer loans of the future.

A further deregulatory measure was the introduction of adjustable rate mortgages which has helped many achieve that perennial American dream of home ownership. Adjustable rate mortgages last year accounted for about two-thirds of all new mortgages issued nationwide, and they are credited as well with having sheltered the housing market from higher market interest rates.

Where are we going? What does the future hold? I know these are questions you have asked yourselves as legislators and as consumers. These are questions which the Governor has also asked me.

In the coming year, some of the difficult banking issues we will face involve -- as your Chairman has just pointed out -- interstate banking, and the related question of non-bank banks. The major banking trends evident this past year related to deregulation will be stronger this year and will probably provide more challenges for New Jersey's financial institutions.

I see one major trend emerging in 1985. I believe that market pressure for expanded interstate mergers and acquisitions of banks, thrifts, and other financial institutions will continue in this region, as elsewhere around the country. As you know, one trade association is preparing a legislative proposal which would allow interstate banking on a restricted basis among several central Atlantic states. This regional approach is a cautious one aimed at ensuring that New Jersey will retain control over the growth and development of its commercial banks, the same banks that respond to the State's economic needs, until such time as national interstate banking becomes a reality.

I think it is important to note to the members of this Subcommittee that New York and the other large money center states are not included in the proposed region, but would be included in the eventual nationwide reciprocity which is envisioned in the banker's proposal. The exclusion of those states from the initial region is designed to give our institutions, and others in the proposed region, time to grow in size and strength so that they will be better able to

meet the competitive and takeover initiatives which will predictably occur when the money center bank holding companies are permitted to enter our marketplace in the future.

While contemplating the interstate question, one must remember that banking does not function in a vacuum. It is not independent of domestic and international economic trends, inter-industry trends, nor is it independent of the needs of the American public. New Jerseyans are on the move. Americans are on the move. Our economy is blooming due to lower interest rates, increased credit availability, and low unemployment. These factors are expected to continue throughout 1985 and the financial community must be ready to respond. That is why I believe that interstate banking is an undeniable part of the banking future, and we must therefore take a careful look at this concept to see how it may best suit all of our financial institutions and our consumers. Thus, without being unduly provincial, we must seek to preserve some measure of State control over the shape of interstate banking to come.

If we do not arrive at a consensus on the State level with regard to the future of interstate banking, it is certain that financial entities which already have the ability to compete interstate will continue to make inroads into the New Jersey banking marketplace through numerous avenues. Moreover, given enough of a head start, they could preempt much of the market for a wide variety of financial services delivered without geographic restrictions, and the issue of geographic deregulation of banks could become moot.

One immediately pressing example of this trend is the series of so-called non-bank bank applications which have been filed with the Comptroller of the Currency and the Federal Reserve Board by out-of-state money center bank holding companies. I have personally traveled to Washington on two occasions to meet with both of these regulators to specifically request that those applications be denied, or at least tabled while our Legislature considers such a development.

I object to granting out-of-state bank holding companies a charter to operate these near-bank entities in New Jersey at this time because they are banking competitors whose size dwarfs even our largest

banks. To emphasize this fact, permit me to share some figures with you. The largest bank holding company in this State has assets of approximately \$10 billion, compared to Citicorp -- the nation's largest bank holding company -- at \$135 billion. In point of fact, the New York-based Citicorp asset size is greater than all of our New Jersey commercial and savings banks combined at approximately \$80 billion. Some of the other brethren out-of-state bank holding companies are at similar size disparity with our New Jersey-grown institutions.

If the vision of interstate banking indeed becomes a fact, then I submit that it should be introduced through legislative action, and not through loopholes in existing law. For this reason, our Banking Department supported the non-bank bank moratorium bill, recently passed by this Legislature and signed by Governor Kean, which prohibits new non-banks from being established in New Jersey for one year. It is clear that the Legislature, and the New Jersey public needs time to determine how, and who, will be affected by the seemingly unpluggable non-bank loophole in the regulatory dike. I have alerted the Federal Reserve Board in Washington of your actions in Trenton, and have asked that they, without hesitation, either deny or hold the applications before them until the expiration of this moratorium legislation.

It is clear that the time has come for State-level decision-makers to participate in resolving the complex issues involved in the ongoing process of deregulating the United States banking system. We can no longer wait for action by our Federal counterparts to come up with answers that we must live by. Historically, the Federal government has accorded tremendous latitude and power to individual states when it comes to determining the ultimate shape of their respective banking systems. In effect, State-level decision-makers have the power to do something about this situation. The market pressures and immediate circumstances confronting us, coupled perhaps with a reluctance to trust the matter entirely to Federal regulators or legislators, have compelled you to act.

The dual banking system -- the system of State and Federal charters -- is unique in financial institution history and has been

widely acclaimed for fostering innovation and experimentation in banking and for keeping bank regulation from becoming unduly oppressive. You all know the virtues of this system, and I believe that its concept has continuing validity in the modern day of banking. Therefore, I would caution you that in your deliberations in this Subcommittee you keep in mind that regulations you may seek to enact should not unduly prejudice State-chartered institutions.

My philosophy in governing our State banking system is simple and straightforward. I believe that the State Department of Banking has the responsibility to provide leadership, guidance, and new opportunities to all members of the industry. I believe that the industry must be given greater ability to compete and that the Department, simultaneously, has in hand the supervisory tools necessary to ensure that our institutions are "playing by the rules" established by your legislation and by our Department. And finally, I believe that the structure of banking must change at all levels in order to meet the social, financial, and economic challenges of the future.

When I took office in July, I was entrusted with the responsibility to ensure that the safety and soundness, the health, and the stability of our financial institutions were safeguarded. I am happy to report that New Jersey's banking industry is booming and is being encouraged to pursue new opportunities rising in the future through industry initiatives and Department efforts. It is through the strength of our banking institutions and their customers -- the businesses and consumers of this State -- that all of them will attain their economic goals.

I am pleased that I will be joined by you, the legislators, industry officials, and representatives of the public in this effort to stimulate future industry growth at all levels, to enhance new product development and new investment opportunities, and to guarantee that New Jersey consumers will continue to enjoy a constant and viable financial services network. The financial industry will continue to be deregulated, and we should, therefore, take special note of a deft observation reported in a recent Time Magazine:

"A bank's most important asset is not the cash in its vaults, but its customers' confidence. In the past few hectic months, some bankers have made heavy withdrawals from their confidence accounts. Financial leaders must now show that they can use their freedom from regulation to rebuild a strong and stable banking system."

I thank you for this opportunity to appear before you today. I want you to know that my entire staff and I are available to answer any questions or concerns arising from these hearings, and we will be eager to help design the legislative blueprints which will be the product of this Subcommittee. Please do not hesitate, as well, to call upon my Legislative Liaison Officer, Miss Najnigier, whom I have asked to remain present throughout the hearing for your convenience. We are all here ready to serve your efforts in this Subcommittee. We look forward to dynamic and constructive progress through your work. Thank you.

ASSEMBLYMAN LaROCCA: Commissioner, I am very happy that you appeared before us to give us your viewpoints. On behalf of this Subcommittee and the Legislature, I can say that we are all on the same wavelength. We are very much interested in the same things that the Department is interested in, and that you are interested in. I assure you that this Subcommittee will take serious note of what you have said.

I also want to comment about your trips to Washington to urge them that these pending applications either be denied or tabled. As you said, this should not depend on loopholes. This is such an important item, it should not be regulated through the method of a loophole in the law. As you know, there has been cooperation between the Legislature, your Department, and the Executive Branch on this particular point. Through the Legislature and the Governor's office the moratorium was signed, with quick action. That ties in with these hearings and with the same thinking that the Executive Branch has, as well as the Legislative Branch. At least it will give us some time to see what the effects are. It should be done by legislation or regulation, not by loopholes.

I agree with your comment that the State should also be vigilant as to the problem with the two-tiered regulations. I am very happy to report that we have rapport between the two departments.

Members of the Subcommittee, do you have any questions?

ASSEMBLYMAN KOSCO: Yes, I would like to ask some questions.

ASSEMBLYMAN LaROCCA: Assemblyman Kosco.

ASSEMBLYMAN KOSCO: I have a report here, which you also have, from the American Banker. It is a report on interstate banking and Florida public interest. One of the arguments contained therein is against certain things that have to do with state banking and geographical restrictions. I'm wondering if you might have an answer. It says, "Regional reciprocity and regional reciprocity not coupled with a trigger: Permitted nationwide reciprocity on a subsequent date may be illegal." Do you think that is a true statement?

COMMISSIONER PARELL: Assemblyman, that very issue is now pending before the United States Supreme Court, in a case testing the New England Regional Interstate Banking Compact, which does not contain a trigger. Last week I conversed with the general counsel to the Federal Reserve about this point. I pointed out to him that the proposed legislation for New Jersey does contain a national trigger. I said that if New England had such a trigger, wouldn't the case pending before the Supreme Court be moot, and he said he thought so, yes.

So, the proposal which the New Jersey bankers have agreed upon, and seek to air before this Subcommittee before the year is out, will not, in my opinion, suffer from those constitutional deficiencies.

ASSEMBLYMAN KOSCO: It doesn't really matter what the time would be? It could be three years, five years, or ten years, as long as there is a trigger.

COMMISSIONER PARELL: I would say it should be reasonable, yes.

ASSEMBLYMAN KOSCO: Do you think it is fair to say that if interstate banking does take place, whether it be on a regional basis or whatever, the consumer would stand to benefit because of the open competition it would provide?

COMMISSIONER PARELL: I think that this Subcommittee should address itself to that question throughout its deliberations. I do not claim to have the last word on that. No one can really predict with assurance how these developments will affect the consumer. However, the experience, at least in the regions which have developed across state lines in banking, is that the consumer in a deregulated marketplace talks with his dollar. If the service is not being provided to him at his bank, he now has a range of options to choose from. He can take his business elsewhere. So, even though perhaps banks will be becoming larger and control will be more centralized in the banking industry, the bankers themselves recognize, very clearly, that service and competitive prices must be provided in the marketplace or they are not going to succeed, big or small.

ASSEMBLYMAN KOSCO: I think one of the biggest fears is that the small bank will go away. Most of the people we discuss it with back in our legislative districts are concerned that the small banks will go away. The report I read in the bankers magazine claims that that is not true, that the small banks are not on the verge of going away; they will not have a trend of going away, because the costs seem to stay stabilized, according to the percentage of business they are doing. The banks which are properly managed will not have a negative effect on interstate banking, even though a larger bank may come in and buy out some of the smaller banks. The survival of small banks is still possible. Do you think that is a true statement?

COMMISSIONER PARELL: That is a very good question, and I think one that this Subcommittee should also focus on throughout its hearings, that is, with larger and larger geographical scope for banks, will the small banks go away? I agree that it appears the answer is "no." I think New Jersey needs both big banks and small banks in order to serve the vast variety of banking customers which we are fortunate to have in this State. You need a small local personal bank for some uses, and you need great big banks to finance great big achievements in this State. You need both.

The dual system of banking offers a great opportunity for small banks to spring into existence, to become stable, and to serve

their communities. We are seeing an increasing trend toward a desire to start up new banks, and so as some of the, perhaps, weaker sisters are merged out of existence, stronger new banks are coming into existence.

ASSEMBLYMAN KOSCO: From the standpoint of the consumer, again, a smaller bank with "X" amount of dollars available would usually set aside -- and I'm guessing because I am not a banker -- a certain percentage of that money which it would earmark for high risk loans. If a bank had a larger amount of dollars available, wouldn't that number become higher, thereby allowing for more high risk loans in a certain area? Maybe the consumer would be helped a little bit that way, where someone who really didn't have topnotch, number one credit would have an opportunity to get a loan to get his credit back on track.

COMMISSIONER PARELL: Certainly one of the best aspects about a community-managed bank is that it looks beyond just the black and white numbers on the page of someone's financial statement. They can tell through their knowledge of the person's existence in the community whether this is a good loan risk or not. That would be something the community bank should continue to address and serve. On the other hand, the major challenge facing banks, large and small, these days is to make sure that their assets and their liabilities are properly matched, so that they remain sound and strong.

ASSEMBLYMAN KOSCO: Thank you.

COMMISSIONER PARELL: Thank you.

ASSEMBLYMAN LOVEYS: Commissioner, I have a series of questions to ask, but I think what I would rather do is wait until I hear some of the testimony from the experts in the audience today before I ask those questions. However, I would like to personally thank you for your appearance here today, and I thank you for the input you have given us on the subject matter.

COMMISSIONER PARELL: Thank you, Assemblyman Loveys. As the work of this Subcommittee develops, I would hope to be invited back. Mr. Chairman?

ASSEMBLYMAN LaROCCA: A few facts have come to my mind. In your opinion, how has deregulation boosted some of the total assets?

COMMISSIONER PARELL: Well, the main problem which brought about the movement toward deregulation of interest rates was that the money market account was invented, not within the banking industry, but without the banking industry, and people, realizing that they could now get market rates of interest on their savings, were not putting their money in the banks in such great numbers. Banks simply had to become competitive to reattract the deposits which, after all, are their stock in trade. So, but for deregulation of interest rates, you would have seen a further erosion of the banks' ability to serve their customers.

ASSEMBLYMAN LaROCCA: This reminds me of occasional trips to the city with my wife. I have seen elderly people, little old ladies with a shopping bag, going to one bank and taking their money out, getting a \$20.00 certificate or a fan, and jumping from one bank to another. I have wound up at the Port Authority Bus Terminal where everyone had a full shopping bag. I think I succumbed to something like that too, because my wife said-- All right, I think that is what you are driving at.

COMMISSIONER PARELL: Well, it is a facetious point, Mr. Chairman, but it is also a very, very strong point. Banks are the only ones which insure depositors' money through the Federal deposit insurance system. So, I believe there is a long-term future for banks. There is a great need for people to understand that if they want to be sure their money is safe and sound, that money should be put in a bank.

ASSEMBLYMAN LaROCCA: I don't mean to go into the nitty-gritty of it, but I wonder if you have some offhand conclusions as to how New Jersey can preserve control over the shape of interstate banking. As you said, it is here. We see it. It is in a loophole condition and all that, but I am just wondering if you have any projections as to how the State -- between the Legislature and your Department -- can do something about that.

COMMISSIONER PARELL: Yes, I have conclusions in several areas. Regional interstate banking would be a major accomplishment by the State in terms of shaping the future of its own banking industry. If legislation were passed, New Jersey would be saying to the rest of

the country, "We recognize that interstate banking as a market force is coming, and in many forms is here. We are not isolationists, but we are going to guide when and how this is going to come." That is one example.

Another example is, within this admittedly complex Federal and State regulatory scheme, the states do have a certain amount of latitude to determine which powers their financial institutions will be permitted to exercise. So, as this Subcommittee gets further into the question of new powers, or expanded powers for the financial institutions, then we guide, or you guide, the development of our institutions as competitive forces in the market.

ASSEMBLYMAN KOSCO: One more thought just came to me. About three or four years ago -- I'm not sure when it was -- when it started, I was Vice Chairman of a commission which was established to study banking rules and regulations. We tried -- from that time up until the present -- to consolidate and maybe provide a little parity between the different types of lending institutions in the State. Do you see this happening? Suppose we go into a regional type of banking and we join with other states, wouldn't that lead to the states having to get together to set up some type of regional banking plan, as far as rules and regulations are concerned, because right now each state has its own regulations? If we recognize a bank from another state, it may not meet the same standards and the same regulations that we require, and vice versa.

COMMISSIONER PARELL: That is another very telling point, Assemblyman Kosco. The kind of interstate banking we are talking about today will not require that. The kind of interstate banking that we get tomorrow might require some effort. The today issue in interstate banking is not the branching of Pennsylvania or Maryland banks into New Jersey. It is the acquisition or merger of banks which are located in one state to be owned by holding companies in other states. In other words, under the regional interstate banking proposal, a New Jersey-based bank holding company could acquire a Pennsylvania bank. Now, that bank in Pennsylvania would continue to be regulated in Pennsylvania.

ASSEMBLYMAN KOSCO: But, if we went on to the next stage?

COMMISSIONER PARELL: Branching would raise the question of matching regulations across state lines.

ASSEMBLYMAN KOSCO: Thank you.

ASSEMBLYMAN LOVEYS: I don't have a question, but as long as this dialogue is continuing, I feel that if we achieve maybe a goal of interstate banking and we have consolidation regionally, you are going to find, very definitely, that the larger banks -- and, I'm happy to hear that New York is not even being considered in this regional setup--

COMMISSIONER PARELL: (interrupting) Not in the first phase.

ASSEMBLYMAN LOVEYS: Yes, the first phase, but I feel that the larger banks will definitely control the prices, and maybe to the detriment of the consumer. I would like to hear someone prove, or try to prove, that this would not take place. I feel, also, that with consolidation it might lead to an excessive concentration of economic power in one political hand, if you will, or one banking hand. These are avenues that I am much concerned about.

There is one other aspect of this whole interstate banking thing. I know a lot of communities are really satisfied and happy with the service attitudes and activities that the local banks give to the communities. I would hope, because of interstate banking, that the communities would not lose this flavor. I think that is very important to our small municipalities where we have lending institutions which take very active roles in municipal activities. Again, I am cautious.

COMMISSIONER PARELL: They are a great treasure to the State.

ASSEMBLYMAN LOVEYS: That is something I would never like to see the State lose. I have some questions in this area. Again, the questions are not for you, Commissioner. They are just some thoughts I have on interstate banking itself.

ASSEMBLYMAN LaROCCA: Are there any further questions? (negative response) Thank you, Commissioner. The cooperation between both departments will continue.

COMMISSIONER PARELL: Thank you very much.

ASSEMBLYMAN LaROCCA: The next witness is from the Department of Insurance, the designee of the Commissioner of Insurance, Verice Mason.

VERICE M. MASON: Good morning, Assemblyman LaRocca, Assemblyman Kosco, and Assemblyman Loveys. My name is Verice Mason; I am Director of the Division of Legislative and Regulatory Affairs. At my left is Thomas Hooper, Special Assistant to the Commissioner. We are both appearing today on behalf of Jasper J. Jackson, Acting Commissioner of Insurance.

Unfortunately, we have very little to report to you today because we are studying the issues currently under study by this Subcommittee. We have established our own task force on banking and insurance matters. This task force was established late last year; it met early in January; and, we are expecting recommendations to be made on similar issues as are under study by this Subcommittee, on or before May 1 of this year. At that time, our Department will take those recommendations, study them, and issue a final report on what our recommendations are concerning the issues under study at this time.

As I said, they have just begun working. They have broken down into subcommittees, and we do expect a report. Mr. Hooper is our liaison within the Department who is working with this particular task force. The task force consists of 13 members, industry individuals, who are very knowledgeable in this area and who are expected to give us good recommendations. We might say that our timetable, as I have stated, should permit us to get some information back to you, possibly in June. At this time, we are offering our expertise and any help that we may provide to this Subcommittee during your ongoing studies of these issues.

I have nothing more to say at this time. If you have any particular questions about the current work of our task force, Mr. Hooper stands ready to answer those questions.

ASSEMBLYMAN LaROCCA: I am pleased to hear that we will have a good rapport with the Department of Insurance, and we will continue along those lines. You understand that this is the first hearing and everyone is getting his or her feet wet, so to speak, by listening to all of the issues. Are there any questions from my colleagues?

ASSEMBLYMAN KOSCO: Do we have one person in the Department of Insurance who is a contact person for us? If this Subcommittee wants to contact your task force, whom do we speak to?

MS. MASON: It could either be me, Assemblyman Kosco, or Mr. Hooper.

ASSEMBLYMAN KOSCO: Why don't we have one person so that we can--

MS. MASON: (interrupting) It can be Mr. Hooper because he is our Departmental liaison with the task force.

ASSEMBLYMAN KOSCO: If we can have direct contact with Mr. Hooper, we will know whom we have to speak to, and vice versa.

You have established your task force. You have 13 people from the industry, but which industry, the insurance industry?

MS. MASON: Yes, that is my understanding.

ASSEMBLYMAN KOSCO: And, you are going to be studying insurance companies being in the banking business, and banks being in the insurance business?

MS. MASON: Yes. We have given them a listing of 16 areas we would like them to study. Mr. Hooper might want to elaborate on that, or you might like a copy of a letter we sent them asking them to study certain issues.

ASSEMBLYMAN KOSCO: I would like a copy of that letter, and I also wonder, do you have any members of the banking industry, or a liaison from the Banking Department on your task force? If you only have insurance people on the task force, you are certainly going to get a one-sided report. I could probably write that report for you right now, and could probably parallel the one you are going to get from your committee.

THOMAS J. HOOPER: Well, I think the thrust of the task force's study is to view the problem of banks versus insurance in the perspective of the insurance industry. The task force--

ASSEMBLYMAN KOSCO: (interrupting) Excuse me. Is it to review the problems, or is it to review the possibility of it? It may not be a problem, or it may be a problem. If we start now with the understanding that it is a problem, we are going to end up with that I'm sure. I am just trying to put it into the same perspective as we have put this Subcommittee. We are trying to get pros and cons; we want to get both sides of the story so we can sit down and make a real

judgment based on the real needs of the consumers of the State of New Jersey. That's first. Secondly, we want to make a judgment based on the needs of the industry. But, how it is going to affect the consumer is a very important part of our hearings. I think it should be an important part to you, also. If you only have 13 members of the industry, and no one from the Public Advocate's office, no one to represent the consumer, and no one to present the facts, you might get a little bit of a one-sided answer.

MR. HOOPER: Well, the task force was given a great deal of autonomy when it was formed by Commissioner Merin last November. He told the task force that it was free to solicit statements from the Public Advocate, from consumers' groups, from banks, and from any area it found it might receive useful information.

Admittedly, though, the perspective is that of the insurance industry, and I don't--

ASSEMBLYMAN KOSCO: (interrupting) See, that report would be beneficial to us, but only if we had another report that came from just the banking industry, and if we had another report that came from just the Public Advocate's office. Then we could take the three of them and--

MR. HOOPER: (interrupting) I understand that Commissioner Parell has a similar committee working on the same problem, viewing it from the banks' perspective. So, hopefully you will get two views, one from the perspective of each industry.

ASSEMBLYMAN KOSCO: Okay. I would suspect that--

MR. HOOPER: (interrupting) And, that would put the burden on you of--

ASSEMBLYMAN KOSCO: (interrupting) Yes. I am just trying to look for all the information I can get from as many people as I can get it. Then, I will have to sit down, sift it, and decide on a piece of legislation. I say I, but we have to approve of that legislation. This is a very, very important thing. It is going to set the foundations for what is going to happen in the State. As the Commissioner said before, we are dealing with laws and rules right now that were not written for the electronic age, and we have to be very

concerned about that. We need all the information we can get from every department.

MR. HOOPER: Assemblyman Kosco, are you familiar with the DeWind Commission Report, the legislative study that was made in New York?

ASSEMBLYMAN KOSCO: No, I am not.

MR. HOOPER: All right, I will be happy to send you a copy of it. I think it will prove useful to you.

ASSEMBLYMAN KOSCO: That would be good. Maybe you could send it to all of us.

MR. HOOPER: Yes, I'll do that.

ASSEMBLYMAN KOSCO: Okay, thank you.

ASSEMBLYMAN LaROCCA: I just have one question. I wonder if your Department has any feeling about banks selling insurance.

MS. MASON: Well, quite frankly, Assemblyman LaRocca, we feel uncomfortable about making any determinations at this time without--

ASSEMBLYMAN LaROCCA: (interrupting) That is one of the big things. Later on, after more testimony and after more hearings, I hope there will be some input along the lines of whether banks should sell insurance. That would be your Department. Maybe it's good; maybe it's bad. I realize this may be a little snowball which occurred, but I didn't mean it that way.

MS. MASON: Well, we will be cognizant of the need to provide some input to you on that issue. As I said, please contact Mr. Hooper at any time and we will try to provide you with whatever information you need.

ASSEMBLYMAN KOSCO: On the issue that Assemblyman LaRocca just brought up about banks selling insurance, do you think we may get two feelings from the industry, one feeling from the companies which say, "We do not particularly care who sells our product, as long as our product is sold," and another one from the agent, who says, "I am the agent and I want to be the one who sells the product." For example, you know I own an automobile dealership, and I don't really care who sells my cars, whether a mechanic sells my cars, whether my salesmen sell my cars, or whether my office manager sells my cars. But, my

salesmen care who sells my cars. So, if I have a mechanic doing the job of a salesman, I am going to hear a different story. But, from a company standpoint, I don't really care who sells them.

MS. MASON: We have agents who sit on this particular task force.

ASSEMBLYMAN KOSCO: You have agents and company people?

MS. MASON: Yes, we do.

ASSEMBLYMAN KOSCO: Great.

MS. MASON: So, we will try to balance that out.

ASSEMBLYMAN KOSCO: Okay.

MS. MASON: All right? Thank you very much.

ASSEMBLYMAN LaROCCA: I am going to try to accommodate everyone time-wise. The next witness will be Mr. Richard Jones from the National Conference of State Legislatures. Mr. Jones has come all the way from Denver, and I hope he will give us an overview of what is happening nationally on this little parochial problem, which is now a national problem. Mr. Jones?

RICHARD JONES: Thank you. Mr. Chairman, Assemblyman Kosco, Assemblyman Loveys: Thank you very much for inviting me and for giving me an opportunity to come here with the National Conference of State Legislatures. One of the areas and issues I happen to deal with there is the banking question. Over the course of the last several years, this has been a very hot topic in a lot of states, including New Jersey. We have held several sessions at our annual meeting, and at other meetings on the topic. In October, we held a conference in the Midwestern states, specifically looking at regional banking in those states. We are planning a seminar this May -- most likely in Washington -- for the Eastern and Mid-Atlantic states, as well as some others, to look at the issue of interstate banking. So, this is something we have been interested in. We have talked to a lot of the legislators about it.

Mr. Chairman, I have a couple of reports I will leave with your staff. One is a summary of what the states have done on interstate banking. This was done in June of last year. The other is a transcript of the meeting we held in October on regional interstate

banking. This was held in conjunction with the Wisconsin Legislature, and there are a lot of different viewpoints from independent bankers, as well as larger banks, on the topic.

In my presentation here, I am just going to try to concentrate on bringing you up to date, and letting you know what the Legislatures have done around the country relative to interstate banking. In 1983, there were approximately 81 bills dealing with geographic expansion within the state Legislatures. In 1984, 33 Legislatures looked at interstate banking. A number of them passed legislation. Right now, there are approximately 20 states -- as of the end of 1984 -- that provide for some form of interstate banking. I will go through some of the approaches we have looked at and have been able to identify.

One is full open interstate banking -- a bank from any state, no reciprocity. Another is reciprocal interstate banking, generally based on a region. The third is to set up a limited purpose office to allow banks to come into your state to do a specific thing. Generally, certain requirements are placed on the bank before it can come into a state to do that. The fourth is emergency acquisitions, and the fifth would provide for some grandfather provisions for banks which had interstate operations prior to the amendments. These banks would be allowed to continue to operate their interstate banks.

Let me go through these in a little more detail and point out the states. Full open interstate banking: Two states, Alaska and Maine, allow for full open interstate banking right now. Generally, those states passed this legislation as a means of trying to attract capital into their states. Maine is a relatively small state; Alaska is bigger but, also, I think they are a bit off the beaten path and they want to get capital into their state. Maine initially enacted legislation that provided for reciprocity. In 1984, they removed that reciprocity requirement. One of the reasons was that they had a difficult time determining whether their law and Massachusetts' law were, in fact, reciprocal, whether, in fact, they were the same. Maine also established a provision called a "net new funds provision," which required, before the banking regulators could approve an acquisition or

the operation of a new bank in the state, that the bank had to demonstrate that it would result in new net funds coming into Maine, and they would have to report that annually to the banking regulators. The equivalent of their banking commissioner made a presentation at the Midwestern Conference that they had been able to attract \$30 million to \$40 million in new capital in 1984, as a result of a change in their law. They feel there that the banking industry is very competitive now in the State of Maine.

The second approach is reciprocal banking. Clearly, this is the most popular approach that the states are looking at, the one that is getting most of the attention. Principally, it is on a regional basis. States in the same region will allow banks from other states in that region to either set up new offices or to acquire banks in their state, providing their banks can do the same in the other states. Ten states allow reciprocity. New York allows reciprocity with all 50 states. Florida, Georgia, North Carolina, and South Carolina allow reciprocity with the other Southeastern states, and they extend as far north as the District of Columbia.

Kentucky allows reciprocity with contiguous states. Some of those would be similar states to those involved in the Southeastern region, but it would also mean some states in the Midwest, such as Indiana and Illinois. Massachusetts, Rhode Island, and Connecticut, the region in New England, allow reciprocity between their states. Utah will allow reciprocity with 11 Western states. Noticeably absent from the Utah bill is the State of California.

Clearly, the states have approached regional reciprocal laws with the idea of excluding some of the states which have large money center banks. In the New England approach, they did not want New York as part of their region. I think Utah and some of the Western states would be concerned about not having California as part of their region. The Midwest had some initial concern about the Chicago banks; however, the legislation I have seen, and from talking to people in the Midwest, Illinois is now included as part of that region. Apparently Continental Illinois' problems have resulted in the other states in that region becoming less fearful of the Illinois banks.

The next approach was one that was aimed at setting up, again, limited-purpose offices. The states have done this with the idea that it will stimulate economic development and provide jobs. They allow banks to come into their states for a special purpose; for example, to set up a credit card operation. They have done this by providing them with various incentives, either removing usury limits, for example, on what the banks could charge on the credit cards, or providing other tax incentives. I see this, probably, as a trend that will not continue too much further. The states that have passed legislation that would provide for this would be Delaware, South Dakota -- the two most notable -- Nebraska, Maryland, and Nevada. Nevada passed legislation in 1984 to allow Citicorp to set up a credit card operation outside of Las Vegas.

The next approach was an emergency acquisitions policy to deal with potential failures in the financial services area, in terms of dealing with bank failures, as well as S&L failures. There, they have generally set out a hierarchy for laying out who is to acquire what type of institution and who has preference. Then they have also dealt with the branching after acquisition. Oregon, Virginia, Washington, and Utah are examples of states which have passed that type of legislation recently.

Again, the last part would be the grandfather states, where they allow the banks to continue their interstate activities which were underway prior to the Bank Holding Company Act and its amendments.

What is pending now and where? Again, regional reciprocal continues to be the hottest thing the states are looking at. Indiana has a bill pending that would allow regional reciprocal banking with contiguous states. Ohio -- contiguous states as well. They would go to full interstate. They have a national trigger. The banking commissioner was talking about this trigger. Ohio would allow it two years after enactment. It is my understanding that this is similar to the Kentucky statute. Maryland is also looking at regional reciprocal. Wisconsin has a bill before its Legislative Council which is likely to be introduced. They have had a special committee studying the issues this last year, also regional reciprocal. Oregon is looking at regional reciprocal.

Two states are looking at legislation that would provide for full interstate banking. Washington has two bills. One would allow reciprocity with all of the states, much like New York. The other would provide interstate banking without reciprocity, much like the Alaska and Maine provisions. Arizona has legislation that is looking at, again, wide-open full interstate banking. Other states where I do not have as many details are Virginia and Tennessee. I understand they are looking at legislation, again I think, on a regional basis.

In Michigan they had legislation that was enacted at the end of last year which would provide for intrastate branching, as well as regional interstate branching, which was vetoed by the Governor in December. After contacts with the Michigan Legislature last week, I understand they do not have legislation introduced as yet, but it is pretty likely they will introduce another bill.

Illinois' regional reciprocal bill is likely to be introduced. The big banks and little banks apparently have been meeting and discussing legislation that they both can live with. It is expected that that will be introduced there.

Pennsylvania, because of its being a neighboring state-- We have talked to some people there, and they do not have any bills which have been introduced as yet. However, more than likely, the issue is alive there and will be discussed.

I will mention some other issues concerning interstate banking, and then I will stop. Most of what I have said here is included in the report which I have provided to the Committee. Assemblyman Kosco, you mentioned a question about the constitutionality of the regional approach. As the Commissioner stated, it is now pending before the United States Supreme Court. The Second Circuit Court of Appeals, in August, ruled that the Massachusetts and Connecticut laws-- There are basically two major points: One, they did violate the commerce clause of the Constitution by prohibiting banks from outside of the New England region to acquire; and two, it was not a violation of the compact clause of the Constitution. The banks said that the only way the states could override, essentially, the commerce clause was to enter into an interstate compact. An

interstate compact has to be ratified by the Congress; this was not ratified by the Congress. The courts decided this was not an interstate compact, but basically paralleled legislation, and they found that it was perfectly legal. It is my understanding -- and it comes just from the press -- that the court is expected to hear arguments on that case in April, and will render a decision sometime this year.

The second major area of activity is in the Congress. The last Congress had two pieces of legislation, one in the Senate that was passed in the Senate, and a House measure that was not passed in the House. They were kind of different approaches, but essentially would look at product deregulation -- principally on the Senate side -- and would also talk about some geographic expansion. I think the major factors in the legislation from the last Congress likely to be involved in the legislation, and this Congress, which will affect the states principally are: One, a closure of the non-bank bank loophole; two, a specific approval, or a specific statement in the legislation that Congress would approve and allow the regional reciprocal approach that the states have enacted; and, three, a move to prohibit the export of certain products. One of the things that South Dakota did in 1984 was allow banks to set up insurance operations where they could sell insurance, but they could only sell it outside the State of South Dakota. The Congress, at least in the legislation last year, would have prohibited them from just exporting that. It wouldn't be able to allow the banks to sell it outside of South Dakota. The major question with the Congress is when, and will they act. If so, what will the final result be?

I guess the third major issue that I will leave you with is the question of non-bank banks, which apparently you folks have already dealt with in your moratorium. As I understand it, four states have enacted legislation aimed specifically at preventing bank holding companies and other banking institutions from setting up non-bank banks. The Colorado Legislature, for instance, acted already this year, and the act was signed by the Governor about a week ago. This was acting very quickly for them, since they have only been in session,

roughly, for about a month. Connecticut, North Carolina, and Florida reportedly also have adopted similar legislation.

In closing, I would again like to thank the Subcommittee for affording me the opportunity to speak to you. I have some reports for you. I have copies of many of the statutes I have referred to, and I can provide them to your staff. We are more than willing to work with you as best we can throughout your study period. Thank you.

ASSEMBLYMAN LOVEYS: Mr. Jones, just one minor point. Would you please repeat the scenario in South Dakota regarding selling insurance?

MR. JONES: Sure. Basically what they did was, they allowed state-chartered banks to set up an operation to sell insurance, but they prohibited them from selling that insurance within the State of South Dakota.

ASSEMBLYMAN LOVEYS: So, conversely, North Dakota could sell insurance in South Dakota.

MR. JONES: Well, if North Dakota acted.

ASSEMBLYMAN LOVEYS: If they acted?

MR. JONES: Yes, but North Dakota did not act yet. It was not a reciprocal kind of a deal.

ASSEMBLYMAN LOVEYS: Again, what was the main reasoning behind that?

MR. JONES: I think the main reason was that it would provide a benefit to the banking institution which would set up the insurance subsidiary to sell it.

ASSEMBLYMAN LOVEYS: Who were they protecting?

MR. JONES: I think Citicorp was one of the banks which got a state charter and did set up a subsidiary to sell insurance. They would just sell it by mail into some other states. But, specifically the Legislature said they would not be able to do it within the State of South Dakota.

ASSEMBLYMAN KOSCO: Did that happen?

MR. JONES: Yes, the legislation was enacted. In terms of the status of the operation, I am not sure whether they are actually selling the insurance or whether they backed off on it. The provision,

as I understand it in the Congressional legislation last year, would have prohibited states from allowing that to occur.

ASSEMBLYMAN LaROCCA: I gather that this subject matter is a national one. Does your organization have any model bill, or model act, that you recommend or suggest?

MR. JONES: Mr. Chairman, we have worked very hard at not getting into the model legislation business, and I think for good reason. What I would suggest you do -- and there are citations provided to the other states' legislation in this report, and as I said, I can provide copies of it to you -- is look at what the other states have done. For the most part, it has been relatively very similar. You know, you read one of the bills and it is pretty much the same as another. There have been some variations. Obviously, a major question would be: Do you want to do some sort of trigger mechanism to open it up to full interstate down the road? Another option would be to allow banks to come into the State, or just limit it to acquiring a couple of states, extending the privilege out to other types of institutions beyond banks.

ASSEMBLYMAN LaROCCA: Professor Nadler, do you have a question you would like to ask?

DR. NADLER: I was just wondering if the various states looking into interstate banking are talking about full branching, letting a bank actually set up a branch, or is it strictly a holding company operation?

MR. JONES: For the most part, what they have done is allow the acquiring institution, when it has come into a state, the same privileges as an existing institution within the state. So, as I understand it, if the New Jersey banks could branch statewide and a Pennsylvania bank bought one of your banks, then they would have the same privilege.

DR. NADLER: Have there been any cases yet where a state has allowed another state to come in and actually branch, instead of going in as a holding company operation?

MR. JONES: I'm not sure. I wouldn't be able to answer that.

ASSEMBLYMAN LaROCCA: All right. Are there any other comments from the Subcommittee?

ASSEMBLYMAN KOSCO: I have a comment. For the people in the audience here, the organization that this gentleman represents is a very, very well-respected organization. New Jersey happens to be very fortunate, because although it is one of the smallest states in the Union, we have two representatives in an official capacity. We have Assemblyman Willie Brown and Assemblyman Chuck Hardwick serving as officers of that organization. So, New Jersey is very well represented.

MR. JONES: We appreciate your participation in the organization, and the services of those gentlemen to it.

ASSEMBLYMAN LOVEYS: Mr. Jones, are you staying in New York City or Atlantic City?

MR. JONES: Actually, neither. I am staying out of state. You are not getting much of a tax benefit out of me. I grew up in Philadelphia, and my parents still live down there. So, not only is it a good opportunity to speak to you about banking, but it is a good opportunity to get home as well.

ASSEMBLYMAN KOSCO: Do you know of any reason why everyone wants to stay away from New York?

MR. JONES: I think it is pretty much as the Commissioner explained to you. I think many of the arguments that have been made for the regional approach are to allow the banks within the states -- the smaller banks -- to combine, to merge, and to grow in assets. I think everyone who has talked about this issue or written about this issue expects full open interstate at some point, so that those banks could be large enough to take on the money center banks. One of your questions earlier was, "Will the small banks be able to compete?" Some of the evidence that people point to is New York, where they moved, in approximately 1974, to intrastate banking. A lot of the money center banks, the big New York banks, went upstate. As the Assembly Banking Chairman from the State of New York indicated, they got their heads handed to them. The smaller banks in that region were able to compete with them, and compete very well.

I think it is clearly that the banks in some of these other regions are concerned about having to take on a Citicorp or Manufacturers Hanover, or some of the other money center banks.

ASSEMBLYMAN LOVEYS: But, Citicorp itself has not expanded beyond New York State, has it?

MR. JONES: I am not sure whether they have or not. I think they tried.

ASSEMBLYMAN LOVEYS: I'm not so sure they even tried.

ASSEMBLYMAN LaROCCA: All right, thank you.

MR. JONES: Thank you, Mr. Chairman.

ASSEMBLYMAN LaROCCA: For a change in pace and a change in philosophy, we will now hear from a former Commissioner of Banking who was on the inside during two previous administrations. I am happy to have as our next speaker, Mr. Richard Schaub. We welcome you here, Mr. Schaub. Please let us know what you have to say on this big subject matter, which is a national one.

RICHARD F. SCHAUB: Thank you, Chairman LaRocca and members of the Subcommittee. It is a pleasure to be back in Trenton again today. I do miss it from time to time; there are other times when I don't. I am pleased to have the opportunity to speak to you today.

I am Richard F. Schaub, Chairman and Chief Executive Officer of the First Fidelity Bank in West Jersey, a \$420 million affiliate of the \$10.6 billion-asset First National State Bank Corporation Holding Company, New Jersey's largest banking organization.

I have held my present position since 1976; prior to that I served first as Deputy Commissioner and then as Commissioner of the New Jersey Department of Banking. I was a Cabinet member in Governor William Cahill's and Governor Brendan Byrne's administrations.

In 1983 and 1984, I held the office of Chairman of the New Jersey Bankers Association, and I presently serve as a member of that organization's executive committee, and as Chairman of its Interstate Banking Task Force.

My remarks today will deal, generally, with the evolution of New Jersey's banking structure, one of the most modern and efficient in the nation, as well as the competitive factors that have helped to build that structure.

Prior to 1968, New Jersey's financial institutions only operated within county lines; that was a few short years ago. By that

I mean that banks could not branch outside of their home counties. In addition, banks could not branch into municipalities within their counties in which the home office of another bank was located, or where a branch office of another bank was located, unless the population of that municipality exceeded 7,500.

County line barriers, home office protection, and branch office protection, stifled competition and inhibited the growth of our financial industry. We were a second-class industry, unable to compete with the New York and Philadelphia giants to our east and west.

In 1968, two major pieces of banking legislation became law and signaled the beginning of the end of an era which, if allowed to continue, would have guaranteed the perpetuation of a second-class status for not only our banks, but for our State and our people as well.

The first and most important was the Bank Holding Company Act; and, the second was the creation of three banking districts within which banks could branch. However, the anti-competitive home office protection and branch office protection provisions of the amended banking law still prevailed in the three districts.

It wasn't until 1973, when Governor Cahill signed the statewide branching bill into law, that the banking industry in New Jersey began to come of age.

I would remind the Subcommittee that prior to 1970, there was no billion dollar bank in New Jersey; nor was that notable milestone first achieved by First National State Bank or the National Newark and Essex, the predecessor of Midlantic Banks. The Howard Savings Bank was the first billion dollar bank in New Jersey.

During the first few years after the introduction of statewide branching, we experienced a period of bank expansion that was unprecedented in our history. Not only were new branches being established all over the State, but new banks were being established as well.

Local entrepreneurs eagerly seized the opportunity to seek new charters in order to establish banks in developing areas neglected by existing banks. Never before were banking services more

conveniently available to the people of our State. More importantly, never before had we seen such a high degree of competition among financial institutions, competition that drove banks to provide longer hours of service, develop new products, reduce loan rates and service charges, and raise rates on savings deposits.

The public interest was truly served by the competition generated through the elimination of barriers to the free movement of financial institutions into all areas of our State.

One valuable lesson learned during this period was that well-managed, large, medium-sized, and small holding companies, and independent banks as well, can operate profitably in the same markets, in spite of that competition.

This period of rapid expansion was followed by one of consolidation. Mergers and holding company acquisitions continue at a fairly rapid pace, as we have learned that too many units represent an inefficient use of precious capital. For competitive purposes, however, we still have an ample number of units, ensuring that the public interest will continue to be served.

In the past few years, as New Jersey has been completing its structural deregulation, Congress and Federal regulatory authorities have begun the deregulation of banks' balance sheets as well. Beginning with the liability side of the balance sheet, the interest rate ceilings on deposit accounts have virtually been eliminated. Bank customers now expect, and get, market rates of interest on their savings and other forms of time deposits, such as NOW accounts. In order to be able to pay these higher rates, banks have been forced to charge somewhat higher rates on the loans they make with these deposits.

In addition, charges for bank services have been increased to reflect their true cost. Some services, which were at one time free, are now charged for. Gone are the days when customers who kept large free balances in their checking and three or four percent savings accounts subsidized customers who maintained lower balances.

The composition of bank deposits has shifted dramatically. It is not unusual for banks to have 70 to 90 percent of their deposits in interest-bearing accounts of some kind.

Banks, unlike the post office or a public utility, cannot petition a regulatory body for higher rates when profits decline because of increased costs. We are shareholder-owned companies, operating in a highly-competitive marketplace which requires skillful managers who can provide quality service to customers of every economic level, while generating sufficient profits in order to capitalize future growth and pay a dividend to our shareholder/owners.

Granted, we operate under charters, awarded by either the State or the Federal government, to serve the public interest. There is no question about that. But, let there be no mistake, we are profit-oriented and profit-driven; without profit, we cannot exist and we cannot serve the public interest.

Further balance sheet deregulation is required if we are to survive. Banks must be allowed to enter other financial service industries. Insurance companies can own and operate banks, brokerages, and investment banking companies. Wall Street investment firms own and operate banks, and they sell insurance. Banks can do neither.

As our traditional markets are eroded by this invasion of non-banking entities, profits and, thus, quality of service must decline as well. The 14 thousand, plus, commercial banks in this country, along with their branch network, represent, from the public's point of view, the most convenient method of distributing financial services of all types.

Real estate brokerage and investment, insurance of all types, the sale of securities, and the underwriting of certain issues, are products and powers that banks must have if they are to compete in this new financial services arena.

Interstate banking is the last subject I will comment on today. You are all aware of the regional interstate compacts -- I am sure the Commissioner has mentioned this already, and perhaps other speakers have as well -- that have either already been established, or are in the process of being established throughout the country. Despite challenges to the constitutionality of such arrangements between states, one of which is to be heard by the United States Supreme Court in April or May, I submit that interstate banking on, first, a regional and, ultimately, a nationwide basis will prevail.

Interstate banking legislation will merely formalize and expand the powers of banks that already operate a vast network of mortgage banking companies: loan production offices, Edge Act subsidiaries, second-mortgage loan companies, credit card operations, consumer banks, and savings and loan associations, acquired under distress circumstances on an interstate basis. We already have interstate banking.

The New Jersey Bankers Association has drafted a regional reciprocal interstate banking bill. I expect that it will be introduced in the very near future. I would urge your immediate bipartisan attention and support of this measure.

It will grant those bank holding companies that want to, an opportunity to achieve the size necessary to compete, first, on a regional and then on a nationwide basis. The alternative, ladies and gentlemen, is to do nothing. Let me assure you that this course of action would make every bank and every bank holding company in New Jersey, including the very largest, take-over candidates, as soon as the Congress passes nationwide banking legislation. New Jersey could then conceivably end up without a major banking organization headquartered within our boundaries.

Revisit with me, for a moment, that period in the early 1970s, when we were trying to finance the Meadowlands Sports Complex without any help from the large New York City banks or the Wall Street community, because we were stealing their Giants. It was a New Jersey banker who rallied the New Jersey financial community to take the risk and buy the bonds in order to build that Complex, in which we all take such great pride. What chance would we have had in gaining that support if that bank had been headquartered in San Francisco or Chicago, or, worse yet, New York? Virtually none.

To ignore the momentum that is leading us to full nationwide interstate banking would be to return to those earlier days of stifling laws that raised artificial barriers to freedom of movement and healthy growth. We would again become a second-class banking industry, unable to compete, and, therefore, unable to serve the best interest of the people of our great State.

Mr. Chairman, I appreciate having had the opportunity to speak to you and to the the members of your Subcommittee. I would be happy to answer any questions you may have.

ASSEMBLYMAN LaROCCA: Thank you, Mr. Schaub. I am going to excuse myself for a minute. The Vice Chairman will carry on for a few minutes.

ASSEMBLYMAN KOSCO: Yes. I have a question, Mr. Schaub. You indicated that you feel that down the road -- or maybe sooner -- you will have a regional compact-type arrangement for interstate banking. Did you also say it is inevitable that we will have nationwide banking?

MR. SCHAUB: I honestly feel that way, yes.

ASSEMBLYMAN KOSCO: You feel that if this were a ten-, fifteen-, or twenty-year program, that the banks in New Jersey, if they were in a regional compact -- excluding New York City -- could in that period of time build up assets so that they would not be in a position for a takeover once we went nationwide?

MR. SCHAUB: Within the boundaries of New Jersey alone?

ASSEMBLYMAN KOSCO: Yes. I am just talking about New Jersey.

MR. SCHAUB: Not a chance. While other states have made compacts and established regions, and they are building, growing, and expanding within those regions, there is absolutely no way that New Jersey banks could achieve the size necessary, if they were operating only in New Jersey without a regional compact, to be able to compete with those other larger units once the nationwide barriers go down.

ASSEMBLYMAN KOSCO: When the nationwide barriers went down, will not the larger lending institutions, or banks, in New Jersey be gobbled up by the New York City banks?

MR. SCHAUB: Well, that may be the case if nothing happens in-between. You must understand that there are five-- Perhaps someone has already pointed this out today: Any one of the five largest banks in New York City have assets, right now, that exceed all the banking assets in the State of New Jersey. So, obviously, that is the reason New York was not included in our bill initially.

ASSEMBLYMAN KOSCO: So, what you are saying to us is, you need time to get a little larger so they can't, in fact, buy you out.

MR. SCHAUB: That's right. That may happen yet. That could happen. I mean, shareholders make the final determination as to what happens to their shares of stock.

ASSEMBLYMAN KOSCO: But, do you think the stockholders of the lending institutions in New Jersey -- whether they be large or small -- would like to be purchased?

MR. SCHAUB: Yes, some would. Obviously, some would not like to be purchased because they haven't sold yet. We do not have one bank in New Jersey; we have a healthy mix of large, medium-sized, and very small community banks in New Jersey.

ASSEMBLYMAN KOSCO: I gather from what you are saying that you are in favor of a regional compact, excluding New York City, or New York State?

MR. SCHAUB: New York State.

ASSEMBLYMAN KOSCO: But, eventually, you see nationwide action taking place, so New Jersey banks should be given the latitude and the time to become stronger, is that correct?

MR. SCHAUB: As other states are doing, yes; that is a fair assessment of my position.

ASSEMBLYMAN KOSCO: Again, I have a statement here from a report that I have been looking at. It says: "The evidence clearly indicates" -- and, again, this is out of Florida -- "that large banks have no scale or cost advantages vis-a-vis small banks. In fact, small banks have out-performed large banks in recent years, in terms of standard financial measures. Acquisition of large banks within the market has resulted in declining market shares in entered markets, rather than their dominance."

Do you think that same trend would happen in our State?

MR. SCHAUB: I am not familiar with that report, Assemblyman. Is that a--

ASSEMBLYMAN KOSCO: (interrupting) This is a report from Florida.

MR. SCHAUB: But, does it speak only to Florida?

ASSEMBLYMAN KOSCO: Yes, this speaks to Florida.

MR. SCHAUB: As I pointed out earlier, New Jersey has perhaps the most modern banking structure of any state in the country. It has evolved from county lines -- two or three districts -- to statewide branching and holding company acquisitions, statewide. We have operated in this very highly-competitive market since the beginning of 1978, and statewide since 1973. So, we have a mature banking market in New Jersey. Our little banks, our medium-sized banks, and our large holding companies all compete. They are all competing fairly and profitably, side by side, in the same marketplace.

My own market area is a microcosm, perhaps, of what is going on in the State of New Jersey. We have my own affiliate, which is a part of the very largest in the State; we have the Town and Country Bank, which is part of the Summit Bank Corporation Holding Company, a medium-sized holding company; and, we have the Flemington National Bank, which is a small home-town bank, operating in the Hunterdon County marketplace. Flemington National, the smallest bank in the market, just had their most profitable year. They earned a million dollars for the first time in their history.

Now, I make that point only to differentiate New Jersey from Florida. Florida has been a non-branching state. They have developed their banking system through the establishment of new banks by holding companies and their affiliates. So, really, for the most part, they are all pretty large banking organizations down there.

I don't think you can make just a blanket comparison between Florida and New Jersey, and talk about allocations, market shares, and things of that sort. I think it is a different market here.

ASSEMBLYMAN KOSCO: The point I am making is that one of the biggest concerns we have -- and I do not believe you were here before when we were speaking to the Commissioner -- is that the small bank would be negatively affected. I am just trying to establish in my mind that this would not happen, provided, of course, the small bank was properly managed and operated.

MR. SCHAUB: Those were the same fears that were expressed, first in 1968, and then in 1973, when statewide branching came through. You may recall that we phased in statewide branching by

population levels. Again, by giving those banks that wanted it the time to do whatever they wanted to do -- to hire new management, to become more competitive, to merge, to join a holding company, or to do "whatever" -- those worst fears were never realized in New Jersey. The big banks didn't come in and cut loan rates or raise rates on savings and drive small banks out of business. That just didn't happen.

We have found, as I pointed out in my remarks, that the big, the medium-sized, and the small can all compete in the same marketplace. Small banks have found their niche. They provide good service to a sector of the community, and they will survive. There will always be room for small community banks, as there has been in New Jersey. We have had 12 years of statewide branching. We have had 12 years of statewide banking in New Jersey. As a matter of fact, the community bankers of New Jersey were all for allowing New York into our region immediately, because they have learned there is nothing to fear from size; they can operate and operate profitably.

ASSEMBLYMAN KOSCO: How far do you recommend we go on product deregulation?

MR. SCHAUB: As far as you want to, as far as I am concerned.

ASSEMBLYMAN KOSCO: No, I am saying what would your recommendation be -- basically?

MR. SCHAUB: Well, it is a tired expression, but for a change I would like to see a level playing field. I would like to be able to do the same things that companies which are coming into New Jersey -- charter loophole banks, consumer banks, or whatever you want to call them -- are doing; they are also able to sell and underwrite securities. We would like to have the same privileges and abilities to deliver financial services as those folks have.

We don't kid ourselves. We don't feel -- and I am speaking, I think, for the entire New Jersey Bankers Association -- that there are any instant profits or magic in the insurance business, investment banking, brokerage, the underwriting business, real estate investment, or joint venturing. We don't think they are a panacea to vast profits. We know that they are very complicated and very technical businesses, in and of themselves, and it is going to take a long time

for them to get good at what we do, and for us to get good at what they do. So, it will be a slow process of evolution.

I think we have seen a blending of financial institutions in New Jersey; people seldom make a differentiation anymore between a savings bank, a savings and loan, and a commercial bank. They are all banks in the eyes of the public. We have seen that distinction blurred. We will see a blurring of distinction between the traditional deliverers of financial services also, but that will be an evolutionary process; it is not going to happen overnight.

ASSEMBLYMAN LOVEYS: You don't envision that in the long run -- this is a statement I made earlier -- we are going to see an excessive amount of concentrated power in the banking industry?

MR. SCHAUB: In the banking industry? That's a good question. That troubles me too. I hope we have built-in safeguards to prevent that. We have a Justice Department that, I would hope, could prevent that on a national level.

I think the best thing we could do would be to pass legislation that would ensure we maintain a healthy spirit of competition among financial institutions of all kinds in the State. That competitive spirit is what has best served New Jersey.

There is another key. We operate in this country, and we have for a long, long time, under what is called a dual banking system. Banks that are chartered in Washington are national banks; and, banks that are commissioned by our Commissioner of Banking are State banks. As long as we have freedom of entry, that is, as long as there is an option to either charter-- If we don't like what the Commissioner in New Jersey is doing, if he is allowing too heavy a consolidation and communities aren't being served, as long as we have freedom of entry and groups of local entrepreneurs who can get together, raise capital, and start a bank, the public interest will be served. The public will not put up with poor or shoddy service. If the large units foul it up, new small units -- as long as we have freedom of entry -- will spring up to provide that service.

ASSEMBLYMAN LOVEYS: May I have a copy of your statement?

MR. SCHAUB: Sure.

ASSEMBLYMAN LaROCCA: Are there any other questions? (no response) Thank you, Mr. Schaub.

In the interest of time and fairness, because I see it is just a little after 12:00, we will adjourn at 12:30. We will resume at 1:30. In the meantime, I think we can hear from two more witnesses, and the rest can be guided accordingly.

For a change, we are going to listen to a representative from the New Jersey Council of Savings Institutions. I have then projected that we will hear from Al Griffith, from the New Jersey Bankers Association. Does that fit in time-wise? I know a lot of you personally, and I am trying to accommodate everyone. We will take those two witnesses and then there will be an adjournment. We will then resume at 1:30.

Mr. Kevin Crowe, New Jersey Council of Savings Institutions.

KEVIN CROWE: Mr. Chairman, I thank you and the members of the Subcommittee for the opportunity to be here today. I have a brief verbal statement that I would like to present. I would also like to leave you with a copy of my written statement. I will answer any questions you might have after my presentation.

As has already been stated, financial institutions are undergoing a tremendous period of change. This is also true for the savings banks I represent here today on behalf of the New Jersey Council of Savings Institutions, whose membership consists of 15 State-chartered savings banks and three Federally-chartered savings banks.

This process of change is best described by the term "deregulation," which we have heard a lot about today. I would like to briefly mention three aspects of deregulation and how savings banks have been affected by those aspects.

The first is interest rate deregulation, which is primarily the lifting of interest ceilings on rates paid to depositors and charged to borrowers. There is regulation on the Federal level and there used to be ceilings on the State level. Savings banks and other institutions have found the lifting of these interest rate ceilings to be necessary for them to remain competitive with out-of-state lending institutions and non-bank competitors, such as the money market funds

the Commissioner of Banking referred to earlier. Essentially, the result of this is that the rates charged and given to bank customers are established by market conditions, competition, and the general economic situation. Again, we found this to be helpful to our competitive posture.

The second form of deregulation is product deregulation. This is essentially the offering of new products by financial institutions, other than the traditional banking services. For thrift savings banks this means an addition to their home mortgage lending; consumer loans; auto loans; commercial loans; real estate development; and other such products. We found these products to be very necessary in order to stay competitive and to remain profitable, particularly in the last few years of high interest rates, such as 1981 and 1982. We needed additional powers in order to add to our balance sheet profits.

The third form of deregulation is geographic deregulation, otherwise known as interstate banking. Of late, I guess the most notorious of this type of banking is the non-bank bank, or loophole bank. As you know, the State of New Jersey has recently passed a bill imposing a moratorium on non-bank banks in order to give the State and Congress time to formulate a coherent policy on this topic. This is something that we approve of, and we support you in this effort.

In closing, I would just like to say, on behalf of the New Jersey Council of Savings Institutions, that we are eager to assist you in any way we can. I would be happy to answer any questions you may have for me today.

ASSEMBLYMAN LaROCCA: Do any of the members of the Subcommittee have any questions?

ASSEMBLYMAN KOSCO: Do you have any situations that might be unique to your institutions, but which may not apply to a regular bank?

MR. CROWE: I guess, primarily, that would be in the product deregulation area. Thrift institutions have historically been concentrated in the home lending market and, as a consequence, they have long-term fixed assets on their books, and it is necessary for the thrift industry to branch out by offering different products, such as commercial lending, etc. This has been recognized by the Congress, as

was mentioned earlier, through the Garn-St. Germain Act and other regulatory initiatives by the Federal thrift regulators. So our main area of concern would be product deregulation, in order to allow us to engage in services other than traditional banking services.

ASSEMBLYMAN KOSCO: So you eventually see no significant difference between what we call a bank, a thrift, or an S & L? You see just one bank, where everyone has the same duties and responsibilities because there will be no need for individual designations?

MR. CROWE: Well, as was mentioned, in the eyes of the public, they are all just banks right now. In terms of legality or business, we feel it should be left up to the individual institutions to choose how they want to gear their shop. So, if an institution wants to stay in the role of a thrift lender and deal primarily with mortgage lending, that will be up to them. If they want to gear more towards commercial lending, that will be up to them. I guess what I am saying is, it may not necessarily be a homogeneous playing field, but it should be up to the institutions to choose where they want to go. It may not result in homogenization, but it might. It is hard to predict that type of thing.

ASSEMBLYMAN LaROCCA: Have the savings banks been hurt by deregulation? I remember a time when they were one of the most protected banks. In fact, if you were a savings institution, you were a stock holding. Have your banks been hurt by deregulation?

MR. CROWE: Not at all. In fact, to the contrary; it has been very helpful. We have recaptured deposits, as the Commissioner of Banking mentioned earlier, of money market funds, located primarily out of state, in New York and in the investment companies.

We have engaged in profitable real estate activities, and other such activities, which have enabled us to survive the problems of 1981 and 1982, when there were serious and very high, short-term interest rates which impacted on the bottom line of savings institutions in general. So, deregulation has been very helpful to us, very definitely.

ASSEMBLYMAN LaROCCA: Are there any other questions?

DR. NADLER: I have a question. Do you worry about interstate competition due to the New York savings banks coming in and competing? Or, do you agree with Mr. Schaub, that in a couple of years you will be able to hold your own?

MR. CROWE: Our position in the past has been that we are not in favor of interstate banking, primarily because of the threat of the New York and Philadelphia money center banks.

ASSEMBLYMAN LaROCCA: I want to thank you, Mr. Crowe.

Our next witness will be Al Griffith, New Jersey Bankers Association.

ALFRED H. GRIFFITH: Good morning, Mr. Chairman, members of the Subcommittee, and Dr. Nadler. It is a pleasure to be here on behalf of the New Jersey Bankers' Association to present our views on the subjects before this Subcommittee, which are very, very appropriate at this particular time and juncture in the banking industry.

Prior to moving to some of my comments, I would like to say collaterally that I am working as a student at the Stonier Graduate School of Banking. I am in my last year, and my thesis dissertation is the deregulation of the banking industry. The general feeling is that banking is deregulated, and it is not -- not entirely. What I would like to try to do is point to four areas of banking deregulation, and perhaps this might serve as a focal point throughout the Subcommittee's consideration of this issue.

There are four ways of looking at banking deregulation:

Number one is price deregulation. In the past, we were limited as to what we could offer to depositors and what we could charge on loans. That is an important aspect of our operation.

The second area of deregulation is product deregulation, the types of services and products we can offer to our institutions and to our customers. We have not had as much deregulation in that area as we have had in the price area. We are behind, in fact, on that particular point, from a deregulatory point of view, and I don't think we can say we are truly deregulated in the product and service area. Hopefully, we are moving toward it.

The third area of deregulation is geographic deregulation, which has been talked about this morning -- the ability of banks to branch not only within their own states but outside of their states, and vice versa. We have not yet had full deregulation in that area; however, there have been numerous back-door approaches. From what has been mentioned this morning, a non-bank bank is one approach. Regional developments in various states is another approach. However, there have been, over the years, a number of ways by which banks have been able to enter into other states through various means, whether they be electronic, whether they be through Edge Act corporations, or whether it be through a decision, made in 1982, to allow an out-of-state entity to acquire a failing entity in another state under certain circumstances.

Of the three areas, this is one of the areas where the State has had the greatest voice and say over the years. The Douglas Amendment, in 1956, was designed to permit states, if they so desired, to allow the banks in their state to merge with the required banks in another state, if the state was desirous of doing so. In doing that, Congress told the states that they had authority in that area, and much of what we heard this morning from Mr. Jones indicates that the initiatives in the regional area are state initiatives.

The fourth area is what I would call a procedural area: safety and soundness; consumer protection; and capital adequacy kinds of requirements that the State and Federal regulatory bodies look at as they look at the banks they charter. We have not seen too much deregulation in that area, and I am guessing that the more freedom we get in price, product, and geographic area, the more regulation we are going to see in the procedural phase. The more occasion for sin, and perhaps the more undue risk may cause regulators to look even harder at the day-to-day operations of the banks that they oversee.

So, in looking at deregulation, perhaps one way one would look at it would be to look at it through those four faces, and in looking at it, the deregulation of each of those varies with speed. Projecting into the future may vary as well, as far as speed is concerned.

I would like to say at the outset that the comments I make may not be truly representative of every single commercial bank in New Jersey. We represent every single bank in New Jersey; however, our banks look at things differently. They look at these four areas of deregulation differently. They look at them perhaps because they have a national charter versus a State charter; or they may look at them because they are a North Jersey bank as opposed to a South Jersey bank; or they may look at them because they are a Fed member or they are not a Fed member; or they may look at them because they are part of a holding company, as opposed to being an independently-operated bank, free of a holding company; or they may look at them because their perspective is such that they have assets of over \$1 billion. Another bank may look at these four areas, and deregulation, differently because they may have assets of under \$100 million. So, there is some diversity of thinking about these four areas in the commercial banking community because of the differing features of the banks, as we have them in New Jersey.

Most importantly, at the outset, I want to say that our Association deeply appreciates the consideration this Legislature has given to the concerns we have. We were almost up against the wall when Congress decided -- rightfully so -- to deregulate the ceilings on savings deposits. We faced the serious difficulty of being able to take that expensive money and lay it off in a way that would be profitable for our stockholders, if the traditional ceilings on mortgage loans and consumer loans had remained in place at the State level.

Fortunately, as was mentioned earlier, and in tribute to the Legislature, around the same time there was a willingness -- in the early part of 1980 -- on the part of the Legislature to more or less deregulate the loan ceilings in New Jersey, so we were able to put the increasingly expensive money to work.

The financial services industry has changed dramatically since the early '70s. Banks and thrift institutions were subject then, and continue today to be somewhat subject to depression period Federal limitations governing the cost of our products, the types of products

we can offer our customers, the locations in which we can offer them, and our internal procedures.

At that time, and continuing to a lesser degree today, banks were limited in the way they could serve consumers and operate internally. Limitations, placed on the interest rates banks could pay depositors, put banks at a competitive disadvantage in the 1970s and the early 1980s, and depositors, trying to cope with high inflation and very volatile interest rates, sought the maximum return on their funds.

New money market tools, attractive to even the smallest saver, with check-type writing privileges, were established by lesser regulated non-banks during the period, and created serious disintermediation in banks and thrifts which were limited by Regulation Q. Money market mutual funds, run by brokerages, gained substantially at the expense of banks at that particular time.

Our Association, at the time, tried to decide how we could cope with the particular issue of having another industry, lesser regulated than us, and without Regulation Q limitations, stealing our customers away. In evaluating it, the majority of the bankers who were represented on our policy-making committee decided at that time, and they tend today to continue to believe, that we don't have a problem with our competitors being able to offer customer services. We did not object then, even though we were unhappy about it. We went back to Congress and said, "If it is good for the money market mutual funds, then it should be good for us." We continue to take that position anytime we look at competitors who have an edge on us when we are dealing in the same marketplace.

Again, I might say there are some bankers -- I would say they are in the minority -- who would disagree with that. If they had their druthers, they would prefer to have regulators and legislators pull our competition back to the level we were at, and they were at, at the time. That is very difficult to do legislatively when, in effect, you are taking benefits the consumers now have away from them, even if they weren't offered by a bank.

A new significant related trend in the financial services industry developed when insurance companies, travel and entertainment

companies, retail stores, and others, acquired or established not only securities entities, but also real estate companies, banks, thrifts, and non-banks. Such combinations increasingly expanded their banking-type services, and established one-stop financial centers. As an example, a customer can now enter Sears and have banking, insurance, securities, and real estate needs met in one place, the ultimate consumer convenience.

While securities, insurance, and retail companies have entered banking and presently expand their customer and service base, banks cannot do the same. The longer this disparity takes place, the longer the threat to the future existence of banks will remain, as future customers are lost.

Some have suggested that financial conglomerates in diverse fields should divest, but consumers will not allow the benefits they offer to be eliminated.

Fortunately, Congress has finally allowed banks to compete for depositor funds. Bank costs have substantially increased as a result. Depositors are no longer subsidizing borrowers. Fortunately, the New Jersey Legislature deregulated most loan rates in order to allow us to be competitive.

Unfortunately, loan demand may slack during tight money situations, as rates reach a point where borrowers cannot lock themselves in. As a result, it is imperative that banks have other ways to use the more costly depositor funds to remain sound and maintain their stockholder confidence, since they are privately owned.

What can banks do when there is insufficient loan demand to offset the cost of increased funds?

One, the banks could reprice the services they offer so they are not economic losers. Services, once free because the banks' funds funds-costs were cheaper, must be repriced or eliminated, and banks are encouraged to seek increased fee and charge income. There has been opposition to bank repricing for a number of reasons. We have heard these reasons, we have discussed them, and perhaps we will again.

Two, they can reduce staff, service, and/or expand the use of computer technology to offset costs.

Three, they can close unprofitable branches or substitute them with electronic technology as a way of saving money to offset the increased cost of funds.

Or, four -- which is perhaps the best alternative -- they can diversify their line of consumer services to bring in the funds that will offset costs. Services, such as securities and insurance sales and, possibly, underwriting and brokerage could be offered to consumers. The new services would help to retain bank employees and offices, and it would perhaps reduce fees and charges, as well as loan rates, if they were properly run.

Obviously, banks would have to be subject to consumer protection limitations when offering services, if they were statutorily permitted.

I would like to move on because I know time is of the essence, and I have pretty well heard testimony on some of the other subjects I have in my written statement. Perhaps I will approach the near end of my comments.

At this point, Federal regulators have been, and are, petitioning Congress, along with the banking community, to allow banks to diversify the activities they may engage in, in order to offset the costs.

Some of the Federal regulators have been advocates of national banks and are pressing to allow banks to have asset deregulation in order to offset the liability deregulation imposed in the early 1980s. At the same time, they are also expanding capital requirements for banks and public exposure, along with their normal supervisory procedures, to ensure that the public is protected.

The state banks have also sought similar relief from state banking departments and state legislatures, with varying success nationwide. Some comments were made this morning regarding that. In states such as Delaware, South Dakota, and several others they have liberalized not only their interest rate ceilings but the types of products that can be offered as a means of bringing financial institutions into those states.

The state banking department regulation has been successful in most states, including New Jersey. Our banks are healthy, as is our State's economy.

Regarding the banking structure, our Association would very much prefer the maintenance of a dual banking system. We feel it allows for increased innovation, the maintenance of the State's desire to see at least what its State banks can do, and it avoids the possibility of a central regulatory authority that might not care about New Jersey's needs.

In looking at it, however -- and this is getting away from my written comments -- by supporting the dual banking system, we are also concerned that at times a competitive disadvantage can be granted either to state chartered banks or to national banks, in the absence of authority by the legislature of the institution that is disadvantaged in that competitive posture.

As an example, a bill has moved through the Assembly and is over in the Senate now, which would severely restrict service charging by banks on savings accounts. Should it be enacted, it would only apply to state chartered banks, since the Comptroller of Currency has indicated that national banks can reasonably service-charge various accounts.

Not looking at, nor discussing the merit or the lack of merit of the bill, the key is that this action, and perhaps any similar action on the Federal level, could create a disadvantage to a particular segment of banks.

We feel, in summary, that a decision has to be made soon at the State and/or Federal level regarding what banks and their direct competitors can do. Right now, the rules are not fair. Either banks should be allowed to offer consumers, including their own depositors, the same wide range of services their competitors have, subject to rules and regulations that are equitable, competitively; or, their competitors should be forced to return to the specific authority, or product line, they offered before they entered the bankers' tent, with everyone playing by the same rules.

Again, I indicate that our Association has generally taken the attitude that the latter position is probably not necessarily the public interest position, because consumers would be denied the additional opportunity of having a greater degree of competition for particular services.

The ultimate decision belongs to elected officials. The decision isn't easy because each side brings reams of self-serving arguments to justify why their competitor shouldn't be in the tent. The challenge is to sort out what is true, and, more importantly, how the residents of the State can best benefit. It is not easy, but the prime goal is one offered frequently by Chairman Adubato, and that is one of equity.

In conclusion, clearly the legislative mandate is to, within the aura of safety, soundness, and fairness, allow consumers the maximum benefit they can enjoy. The feeling of our Association is that at this particular point our organizations are not able to do that. As an example, we feel that when product deregulation, and then the less geographic deregulation become a reality, we will be able to better serve customers. Hopefull, there will be more competition, lower prices, and, the best public interest will be served in the end.

I would like to thank you very much for your consideration of my comments this morning.

ASSEMBLYMAN LaROCCA: Mr. Griffith, I note from the many comments that have been made, and from what I have read, that there is a model bill. Do you know what that is?

MR. GRIFFITH: A model bill on interstate?

ASSEMBLYMAN LaROCCA: Right.

MR. GRIFFITH: Our Association has been working for about a year and a half on a bill draft. I hate to use the word model; I am not sure it is.

ASSEMBLYMAN LaROCCA: Maybe it is the wrong word.

MR. GRIFFITH: But, I know what you mean. We have a bill draft, a regional interstate banking bill draft, that we have been working on internally. There has been about a year and a half of discussion and compromise within our community on this draft. The bill

draft is designed to permit, if it is legislatively approved, banks in New Jersey to acquire, or to be acquired by banks in what we have termed the Central Atlantic States. The states that have been considered as possibilities in our draft would be neighboring Pennsylvania, Delaware, Ohio, Maryland, Virginia, West Virginia, and the District of Columbia. Obviously, as mentioned before, New York City is not included.

The thought was that we would be able to branch into those states, and banks in those states would be able to branch into New Jersey, unless, or until, a so-called trigger took place, and the bill draft trigger is either one of two things: If two other states, other than New Jersey, in this region agree to have a regional reciprocal arrangement with New Jersey, then three years after that an additional state -- or, in effect, a third state -- entered, New Jersey would then be eligible to engage in full nationwide interstate banking.

Another trigger in the proposed bill would be that if a quarter of the states -- in effect, 13 states -- were to pass legislation providing for full interstate banking, when that 13th state signed on, then New Jersey would also be in a position to compete on a nationwide basis.

There was a lot of disagreement, at least initially, in our organization about the so-called trigger. The feeling was that regional reciprocal legislation is designed to allow banks to gear up in a given area in order to become large enough to be competitive. This is not seen as the final answer in any way, shape, or form. It is done with the understanding that interstate banking is inevitable. The question is when? That is a question nobody really seems to know the answer to for sure. Perhaps the decision may be somewhat affected by the Supreme Court's decision on the Massachusetts bill, which is now before the Court. Or, perhaps it may become moot. If non-banks continue to go into other states -- non-bank banks -- without states protecting themselves, as New Jersey has, we may have back-door interstate banking that might make the McFadden-Douglas Act virtually meaningless.

So, at this point we are kind of in a real state of transition and confusion. The regional approach we have talked about was done previous to the Supreme Court decision to hear the case, and it was also done previous to the decision of the Comptroller to allow non-banks into other states.

We are, and have been, discussing the bill draft with the Banking Department and the Governor's office. We have tried to take the position that we want a bill to be in a position to be signed by the Governor before we decide to try to move the bill on a legislative basis. So, we don't have anything yet. We don't have a final decision by the Administration as to whether or not that is the way they would like to go. But, that is essentially where that stands, Assemblyman.

ASSEMBLYMAN LaROCCA: You mentioned some of the other states, New Jersey, Pennsylvania, Delaware, etc., and one thought that goes through my mind is, I am wondering what position you take and whether this particular type of operation has hurt the New Jersey banks. I am talking about the growth of these loan production offices that the New York banks have established and are trying to push quite seriously. They are called loan production offices.

MR. GRIFFITH: That is a perfect example, Assemblyman, of why, in a way, we have a whole lot more interstate banking than anybody thinks. We do have loan production offices by out-of-state banks in New Jersey, competing with us, head on, day in and day out.

For some reason, the presence of these loan production offices has not reached the point where anybody is pinching the staff members at NJBA to do something legislatively. My assumption is that at this particular point most of our banks don't have a problem competing with these loan production offices -- at least not at this particular time.

I think probably the bigger pinch, and the biggest pinch in the whole interstate scheme, is when we engage in deposit-taking. It is not so much the loan making that seems to pinch; it is the deposit-taking that really is, and has been, the bottom line. Deposit-taking has been the one thing, when you talk about interstate banking, that really is "it".

ASSEMBLYMAN LaROCCA: Isn't a lot of this done through the credit card system? All you need for a loan production office is to get a credit card and you are in the banking business.

MR. GRIFFITH: Even though you are not supposed to take deposits in a given state, a serious question is raised when a credit card comes into New Jersey from Delaware by way of an institution from another state that moved to Delaware. As to whether or not the transaction that takes place with that card is, in effect, taking a deposit-- I guess we really start getting into splitting hairs with terminology, but effectively a loan is made in New Jersey with the credit card. Perhaps, more specifically, it is not necessarily the credit card but the shared ATM card which might be even more appropriate, where you can use your ATM card across state lines. That has become an accepted practice and a convenience that seems to satisfy consumers and even bankers who weren't particularly happy about shared ATM's a couple of years ago. They are now beginning to come around because, in a way, it helps them to hold onto their customers when they cross state lines.

As far as I understand it, at this point the ATM card cannot be used for deposit-taking purposes either. But, one has to raise this question: When there is a transfer of funds between checking and savings, as an example, and a card is used, are you or are you not engaging in the deposit-taking area?

Some people have said that deposit-taking is not, and may not be, a significant issue in the future, and they base that on the claim that deposits were once cheap. When you had three percent passbooks, large dollars, and checking that bore no interest, you had cheap money and a deposit in that area was pretty good. But, we now have more of a national money market. If a bank needs money, it can buy it nationally. We have also seen a tremendous increase in the cost of deposits as we have deregulated that area, to the point that there is a question as to whether deposits in other states are going to be as attractive now as they were before the deregulation of pricing because those deposits aren't cheap anymore.

ASSEMBLYMAN LaROCCA: My colleagues in the legal profession will have a lot of fun with that.

Colleagues on the Subcommittee, do you have any questions?

ASSEMBLYMAN KOSCO: State-chartered banks, right now -- since 1975 -- under the Leeway powers can sell insurance and get involved in real estate, correct?

MR. GRIFFITH: The banks can't. Savings banks and savings and loans cannot. They can't. The 1975 Leeway Bill was for savings banks only, and savings and loans can invest in anything savings banks can invest in, so they are able to engage in that as well.

That authority, in 1975, as I understand it, has been principally used for real estate-equity participation activities. Involvement by the thrift institutions in the securities and insurance area is an authority they were granted by the Federal Home Loan Bank Board as an allowable authority.

ASSEMBLYMAN KOSCO: Have they exercised that right? Have they used it? Have they sold insurance?

MR. GRIFFITH: I understand they have, but I can't really say, specifically, the degree to which they have, or anything of that sort, because we don't represent them.

ASSEMBLYMAN KOSCO: Do we have an indication of any problems or any situations that have come up?

MR. GRIFFITH: Our Association has never been aware of any particular problems with the thrift institutions utilizing that authority through their service core mechanism. Again, we have been hopeful, but we have not been successful in being able to move legislation at the Federal level which would allow our bank subsidiaries to have the same type of authority the service cores have.

ASSEMBLYMAN KOSCO: It seems that one-stop-shopping for financial services appears to be the "in" thing, whether one goes to K Mart or Sears, or wherever. Do you think that every depository institution should have to serve every customer and provide every need, and if they do, don't you think this would be stretching their resources a little bit?

MR. GRIFFITH: Well, there are two different schools of thought on that, Assemblyman. One school of thought is, the only way a bank is going to be successful in the future is to be a full-service

supermarket, offering all services, such as Sears is offering, nationwide, as Sears is doing. When you really look at the practical reality of this, very few banks are large enough to be able to do that on a nationwide basis.

From all my reading, and from hearing what I am hearing, I think banks may do any one of perhaps three things:

Some of the largest banks, perhaps the Citicorps of the world may get into something like Sears and K Mart, where they have such diversity they can expand nationwide in order to do it where it makes sense, financially, to provide all those services directly.

The other extreme is the community bank, which I know you are concerned about, and we are too. We feel that the community bank has, and will continue to have, an important role to play in this country. Our community bankers were more uptight four years ago about interstate banking than they are now. As Dick Sharp said before, we have had a number of smaller banks recommend that New York be put in our regional reciprocal bill.

The smaller banks kind of parallel the big shopping malls that come in. The feeling is that the big shopping mall is going to knock out every specialty store around. We have come to find that is not the case. Yes, the mall has been built, and, yes, some stores have gone by the wayside; but, there have also been a number of retail stores -- individual stores -- both in the mall and outside the mall in downtown areas, that have continued to operate successfully and profitably because, as a community store, they were able to meet a community need on a personal, up-front basis. So, using the idea of having a mall, on the one hand, and being in that business, and, on the other hand, perhaps being a boutique -- I hate to use that word, but maybe that is the right "in" word -- perhaps the community bank will be the boutique, it will be the 7 Eleven of the future, and perhaps it will still provide those services, but it will probably do so in conjunction with some other institution. In other words, you will be able to go into a community bank and have your financial needs, or your securities needs, or your insurance needs met, but perhaps that local institution will be a funnel. Those services will not be offered

directly in that local institution, but if it doesn't offer those services, and if they are services the customers want, it may have a hard time retaining their customers.

So, yes, even the smaller banks will have to do it, but they won't do it directly. Just as you have the shared use of the treasurer with the ATM card, which comes out of First Fidelity, you have a number of banks that want to make that service available. However, they are not big enough to offer the treasurer, so they agree to become part of the treasurer network in order for their customers to continue to enjoy that benefit. That is probably what the community bank will do in order to provide these other kinds of needs and services if their customers want them.

Then there are the regional banks, in the middle of the two extremes, that will probably be doing a little bit of everything. Maybe they will be doing what they do best, whether that best be trust services, or whatever, and perhaps they will franchise out other activities. So, it appears as though -- and who knows -- the one-stop-shopping thing is going to be necessary, but doing it directly as opposed to doing it through someone else will probably vary by bank size and community needs.

ASSEMBLYMAN LaROCCA: I have just one more comment. In your experience on behalf of the Bankers Association, how do you feel -- or what is your opinion -- about banks complying with the Federal Community Reinvestment Law?

MR. GRIFFITH: Well, the banks have had a very good record, as I understand it, with the CRA Act. We are not aware of any major problems with our institutions in New Jersey where there has been non-compliance with that particular act. Probably the Community Reinvestment Act will be the same type of act that legislatures will need to ensure -- as an example, when and if interstate banking takes place -- that the communities' interests are protected. The CRA will probably have an additional value at that particular time.

Interestingly enough, we have come to find in some of the research we have done, that while the consumer groups came forward and wanted the Community Reinvestment Act enacted at the Federal level,

most of the time it is being used against a bank, it is being used by another bank that desires to move into its territory. In perhaps 70 percent of the cases it is used that way.

ASSEMBLYMAN LaROCCA: I am looking at the clock.

ASSEMBLYMAN KOSCO: I have just one more question. I don't really know how to phrase this, but it seems to me that you now have smaller banks and there is a possibility of larger banks coming in someday. Couldn't we set up some kind of a contingency liability for these smaller banks that enter into contracts which says, yes, they will sell out to a larger bank if and when something takes place? I am concerned about the "if and when" contracts that will probably take place, and that have already taken place.

MR. GRIFFITH: There are probably some already, Assemblyman, where you have out-of-state banks buying 4.9 percent of the stock.

ASSEMBLYMAN KOSCO: Doesn't that sort of dilute the resources that are available and set up a contingency liability for a bank that might be coming in?

MR. GRIFFITH: Yes. I guess as long as the Federal statutes permit 4.9 percent of the stock to be purchased by a bank from out-of-state you will have that. Yes, it is the out-of-state bank desiring to come in and gain a foothold.

I guess one key thing a legislator has to bear in mind in this whole picture is, "whether or not," "who comes in," and "how much stock they buy." Capital adequacy standards are probably going to continue to be essential in situations like that. That is why I don't think procedural deregulation, or regulatory regulation is going to go away. I think we will probably see more of it as we see more freedom for banks to operate, and it is probably in the public interest if that is the case, although not all bankers would agree with the comment I just made.

ASSEMBLYMAN KOSCO: The gentleman who was here before made a comment about the main banks that set up a program, where they have new funds which would have to be put into a bank that comes into the State of Maine. They would then have to provide a yearly report as to what they were doing with those funds. Does that make sense?

MR. GRIFFITH: Well, a major question is -- and I know this is a concern the Banking Department has as we have talked about a regional reciprocal bill -- the ability of the State and the Banking Department of the State to have some influence over an out-of-state entity if it is here, in order to make sure it is not taking an undue amount of deposits out of our State. We have to be sure that any out-of-state bank which comes in here complies with the community reinvestment needs that exist in our statutes, and so forth.

So, I would say, as we really begin to see interstate banking and out-of-state entities coming in, that, clearly, the Legislature will have to be mindful of various limitations in order to make sure that depositor needs, loan needs, and so forth, are being met by that institution, no matter where it is from. Not to do that would really be a default situation, which is something I do not think any legislature wants to see happen.

ASSEMBLYMAN LaROCCA: In the interest of procedure, as I have said before, we will adjourn until 1:30.

(LUNCH RECESS)

AFTER RECESS

ASSEMBLYMAN LaROCCA: The hearing will now come to order. Our Vice Chairman, Assemblyman Kosco, will be here shortly; however, in the meantime, we will proceed.

The next witness will be John Lee.

JOHN LEE: Thank you. Mr. Chairman, Assemblyman Loveys, and Dr. Nadler: My name is John Lee, and I am representing the Deposit Taking and Lending Division of the Dean Witter Financial Services Group, a Sears, Roebuck and Co. affiliate.

Sears is proud of its continuing commitment to the State of New Jersey. Some of the highlights of Sears' role in New Jersey economy in 1983 are as follows: Sears' employees, 14,126; State and

local taxes paid by Sears, over \$51 million; Sears' investments in State and local municipal bonds, approximately \$168 million; Sears' purchases from merchandise sources, \$571 million; merchandise sources in the State, total about 500; Sears' facilities, including Sears stores and other sites, over 200; Sears' shares owned by residents, approximately \$6 million; and, residents who own Sears shares, 22,622.

I was honored when Lois Dinsmore, President of the New Jersey Retail Merchants Association, asked me to present testimony respecting Sears' plans for consumer banks.

We have always competed on price and quality, winning the confidence of consumers by offering them new choices. That is the way competition works. It gives customers a choice, and it assures that the company that finds a better way to serve its customers will prosper. Competition is good for consumers, for companies, and for our country. I think we can all agree on that, even though we know that the competitive marketplace is difficult and challenging. There are losers in the game. The marketplace is not a gentle playing field, but it should be level, nevertheless, for banks and other types of financial service providers. Those who ignore change and play by yesterday's rules will lose. Companies that will not respond to customer needs can disappear. But, the price of thwarting competition is even greater. Over-regulation creates inefficiencies, reduces choice, and often reduces the quality of products and services.

Financial service is a consumer business. Sometimes we forget that. Creating capital, lending money, and providing investment opportunity are not restricted to big business. Small business people and consumers must be well-served by our financial system, but traditionally, the financial services industry has tended to ignore some basic consumer needs.

One thing is certain: The financial services marketplace has been invigorated by competition. It is responding to the consumer as never before, offering choices and options never before available. Any opportunity driven by changes in consumer needs appeals to Sears. That is how we built our business, and that is how we will improve our business.

Many people are interested in learning about what Sears plans to do in the field of banking services. In general terms, Sears plans to continue, and to expand the same kinds of consumer financial services that it has been providing for a very long time.

Before I elaborate on this general answer, I want to note that I welcome the opportunity to address this topic in terms of Sears' plans and intentions, because it will permit me, I hope, to dispel some misconceptions about Sears that have resulted from stories in the financial and general media. There is great fear and concern expressed in some quarters about Sears entering what is supposedly a "new" field. In a very important sense, it is not new to Sears at all. Sears' recent commitment to expand into consumer financial services is actually a continuation and broadening of services it has provided to the American mass consumer for a very long time.

A brief review of Sears' experience in this field should demonstrate that no lawmaker or regulator should be concerned about Sears' intentions or seek to restrict its plans. Sears' involvement in this field started as early as 1911, when it began offering credit arrangements to its merchandise customers. Many of these customers would have been unable to receive credit from the traditional source of credit in those days, the banking industry. At that time, the banking industry was primarily catering to farms and businesses, and had little interest in the mass consumer who was, and is, the basic Sears customer.

Sears expanded further into financial services in 1931, when it started the Allstate Insurance Company to provide lower-cost automobile insurance for its customers than was otherwise available to consumers at that time.

Sears' next major expansion into financial services came in 1958, when it acquired a California savings and loan. After mergers and growth, that institution -- now called the Sears Savings Bank -- has assets of \$5.5 billion. So, Sears has been in the deposit side of the banking business for over 25 years.

For more than 10 years, Sears has operated other consumer lending companies, including Allstate Enterprises, which has a \$1

billion portfolio of auto and other consumer loans, and Allstate Enterprises Mortgage Corporation, a residential mortgage banker.

Finally, three years ago, Sears acquired Dean Witter and Coldwell Banker, to round out its product offerings of consumer financial services.

Looking forward, Sears is committed to expansion of these services, but everyone should be clear about what Sears does and does not intend to do. Sears does intend to become a major provider of consumer loans, consumer deposit services, and consumer transaction services. Transaction services include such things as checking, bill paying, and credit card and debit card operations. The target market of Sears is the so-called "middle market," that is, households with incomes in the \$20,000 to \$70,000 range. We believe this is our principal market for two reasons: First, Sears already has an important relationship with the customer base. These are the people most likely to seek the services of Sears. Second, we believe the middle-income group represents a rich market that can be better served by the non-traditional means of delivery that Sears intends to explore. And, it is a group that the traditional providers have not served particularly well.

Sears intends to seek new and better ways of bringing these products to the mass consumer. An example of this is the establishment of the Sears Financial Network Centers that I am sure you are familiar with. The information coming to us from the operation of these Centers so far, shows that this approach is reaching a group of consumers not adequately serviced by existing financial institutions. Sears is offering banking, insurance, and real estate and investment services at places and during hours that are convenient for the consumer, and the consumer is responding to this. For example, Dean Witter has discovered that 60% of its new clients in the Center offices are first-time brokerage accounts, almost all of which are from the middle-income group.

An important point to note is that Sears does not plan to go into commercial banking. We are seeking to expand only in consumer banking services. Sears believes that the Federal and state regulatory

restrictions imposed on the ownership of banks, and the activity of deposit taking, are based on policy concerns that should have no applicability to consumer banks. Take, for example, the Federal Glass-Steagall Act, which enforces a separation of banking and securities underwriting. If you examine carefully the history of that act and the dangers that it sought to address, you will see that the real concern was the involvement of commercial lending by banks affiliated with securities underwriters.

Similarly, the Federal Bank Holding Company Act prohibits diversified companies, such as Sears, from owning banks that both accept demand deposits and make commercial loans. Under present Federal law, diversified companies can own banks that make only consumer loans. We think that is good policy, and that is why Sears acquired a consumer bank in Greenwood, Delaware. But, there are efforts in Congress and in the states to stop companies like Sears from owning consumer banks, and we see no sound policy basis for that position. Such legislation would simply restrict free competition in providing services to the consumer.

The Greenwood Bank will not engage in commercial lending, and thus is what has been called a "non-bank bank." This term has led to the misunderstanding that these consumer banks -- to use a better term -- are not regulated as normal banks are, and thus may be unsafe. This is completely untrue. Non-bank banks, or consumer banks, are chartered, regulated, and supervised exactly like all other banks, and their deposits are insured by the FDIC. They can be chartered as either national banks or state banks. The only difference between consumer banks and other commercial banks is that consumer banks do not make commercial loans, or, if the banks so elect, do not take demand deposits. There is nothing unsafe about them.

Sears is advocating limited deregulation of banking because of our belief in and commitment to the free enterprise system. But, the term "deregulation" has become a fuzzy and emotional term. Sears is not advocating that banks be allowed to engage directly in activities unrelated to banking, nor to lessen the degree of examination and supervision of banks themselves. What we are

advocating is a degree of deregulation that will allow diversified companies such as Sears to own deposit-taking institutions. We believe there is no sound basis for artificially restricting the universe of companies that can own deposit takers.

To facilitate the ability of Sears and other companies to continue to provide more choice and service to the American consumer, we advocate that New Jersey support this movement. You can do this by repealing the laws that preclude ownership of consumer banks by diversified companies.

The question is, why restrain the competitive spirit emerging in this industry? Why deny consumers the advantages of new technology, new convenience, and new access to financial markets? Why continue legislation that does not protect the consumer, but protects the limited interests of some members of the industry?

Innovation does not threaten well-managed banks and other financial institutions. There is room for all of us.

This concludes my testimony, and I will be happy to answer any questions that members of the Subcommittee may have.

ASSEMBLYMAN LaROCCA: Do I understand your position is that organizations like yours should be opened wide on a free competitive basis, even going so far as to knock out existing regulations and existing laws which regulate you?

MR. LEE: No, we wish to compete under those laws and under that supervision. We believe that a well-managed institution under the system of regulation can compete and can offer consumers a better choice.

ASSEMBLYMAN LaROCCA: But, who would regulate you? Who would protect the public? In my opinion -- and I am just playing the role of the devil's advocate here -- you have indicated that the marketplace will take care of all of those things. Competition -- they will take care of it. Don't worry about the regulators. They are the bad guys in Washington, and they are the bad guys in Trenton. I would like you to elaborate a little bit more on that particular point. It appears to be quite an extreme point. That is my gut reaction to what you said.

MR. LEE: On the contrary, in the area of consumer banks, we wish to accept the regulations regarding charter, the regulations and the supervision. We do not advocate doing away with any of that. If you are talking about the expanded powers of brokerage activities, or real estate activities that are offered in our Sears financial networks, we are under supervision, regulation, and licensing.

ASSEMBLYMAN LaROCCA: By whom?

MR. LEE: By State regulatory agencies at the present time, or Federal, in the case of broker activities. Those industries are regulated. We comply with those regulations.

ASSEMBLYMAN LaROCCA: Ralph, do you have any questions?

ASSEMBLYMAN LOVEYS: No. I heard Mr. Lee say what he had to say quite distinctly. I thought it was very precise. I do not have any questions at this time.

DR. NADLER: May I question Mr. Lee?

ASSEMBLYMAN LaROCCA: Sure.

DR. NADLER: I just wonder how you avoid the problem of conflict of interest, with your banks saying they will only lend money to people who are going to buy items in Sears. There are Federal laws against tie-in relationships when you are referring to antitrust matters. I am wondering, just what is the philosophy of the bank?

MR. LEE: The philosophy of the bank is to respond to the consumer market. I don't think consumers would long stand for any suggested tie-in with any products.

DR. NADLER: Then may I ask, when Sears takes over a bank, is it with the idea that this is another service to bring people into Sears, or is it as an independent profit-making organization?

MR. LEE: We intend it to be as an independent profit-making organization, assuming that the good management of the bank can conform to Sears' expectations.

DR. NADLER: But, I just wonder why Sears went out and bought a bank instead of buying something else. Do you feel you are providing a full service to the customer, which will then bring him into a Sears store, where otherwise-- Is it a full service banking approach?

MR. LEE: No, we do not want a full service banking approach, because traditionally that has meant commercial banking business also. So, we do not want to be a full service bank.

DR. NADLER: May I ask the percentage of accounts in your Delaware bank of people who do not live in Delaware?

MR. LEE: At present, I do not know that because we bought the Delaware bank as recently as two weeks ago. I don't think those figures have been worked up yet.

DR. NADLER: What I am trying to get at is, what is Sears' motive for wanting to have a bank? Banks certainly do not earn as much as a department store does, you know, just through the use of capital. I just wonder what their feeling is. How does this tie in with the whole picture of Sears as a financial service?

MR. LEE: In my remarks, I referred to various financial services we intend to explore, including transactions services or credit card/debit card operations. Those are still in the planning stages, if that is responsive to your question. That is exactly the line we intend to pursue.

DR. NADLER: I am just trying to see why Sears would be different as an bank from anyone else. Is there any way that the public would be sort of forced to give more of its business to one company because of that? I mean, it is such an unusual thing for a retail store to want to own a bank.

MR. LEE: I don't think there is any compunction about bringing people in. We believe that the consumers are requesting these services, and we believe that by owning a bank we can respond with these services. We believe that the future activities of companies like Sears -- and, there are others which own banks; it is nothing new -- will bear this out. Sears is certainly not the first retailer. There are other companies -- as I am sure you are aware -- which have followed and which have laid the groundword for it.

ASSEMBLYMAN LaROCCA: I made the statement earlier that this is one of the problems that at least should be considered. All these decisions will soon be made by three geographical locations, Wall Street, Chicago, and San Francisco, California. For Sears, or any

other group -- I do not mean to single out Sears -- this is just going to be an adjunct to selling their products. I don't know whether this would be good for the public or for the banking industry as a whole. I say the banking industry, and you say, "Well, there isn't such a thing as the banking industry." Now we are going to have the Sears Roebuck industry -- and, I do not mean that in a derogative way, I am using that as a concept -- the same way, traditionally, you have always gone to a bank for your mortgage. Now you go to K-Mart. I don't know whether the public likes that or not. I think that is what the Professor was trying to bring out, whether that is putting the horse before the cart, or vice versa. I don't know whether the people really want that. I think people like to go to a bank to borrow their money or get their mortgage, and when they want good tools, they will go to Sears. I don't know; I am perplexed by all this. I want to hear more discussion along those lines.

DR. NADLER: May I ask-- You indicated that Sears has an opportunity to fill a void with things that customers want. Could you indicate -- and I know that two weeks isn't very much experience -- where Sears saw this void in financial service? What type of account did the public want that it wasn't able to get?

MR. LEE: The banking services which we feel can be met may relate to the availability of hours and services in a Sears store. Whether or not that is, in fact, the case is not known; we need more history on it.

DR. NADLER: Well, talking about hours, let's say you have a Delaware bank, and I come into a New Jersey store, will I be able to do my banking in the Sears store in New Jersey?

MR. LEE: With that Delaware bank?

DR. NADLER: Yes.

MR. LEE: That hasn't been decided.

DR. NADLER: I know you can't make deposits because that is against the law, but other than that, will I be able to cash checks, get a consumer loan, or avail myself of other services from this Delaware bank?

ASSEMBLYMAN LOVEYS: Not for a year.

MR. LEE: Not under present law. I would like to respond, Mr. Chairman, to your concerns about whether or not there would be three or four centers where decisions were made or policy was dictated. Even with the phenomenon of regional banking coming to the forefront, we believe states still have a very important role in the dual banking system. We do not see that as being overcome by coalescing in certain geographic centers. We don't think there is a reduction in that important responsibility.

ASSEMBLYMAN LaROCCA: Now, this is a Subcommittee of the Assembly Banking and Insurance Committee here, and I recall a couple of months ago when an insurance bill was being discussed. We had one of your counsels here -- I think he came from Chicago -- and the same idea was thrown out to him. When cars get fixed after an accident and Allstate is the insurer, what is the hook-in with parts? Where do they buy the parts? The Committee had received a lot of complaints at that time, that if you wanted to have Sears insure -- if Sears was the carrier -- you had to get your parts from Allstate. That is one of the things that has been brought out. It is really an adjunct to the original concept of the Sears merchandising store. I am not saying that is good or bad; I don't know. But, I recall that that was the same idea which was thrown out at that time. I think he was a brother attorney. He sat in your chair and he squirmed a little bit. But, don't take that attitude. I'm playing the devil's advocate here. I just wanted to bring the point home so we could evaluate it.

MR. LEE: I think that retailers generally feel -- and I think Lois Dinsmore would agree with us -- that consumers are requesting certain services. They are expecting certain services. They will not put up with tie-in techniques. They will let their dollars speak for them, as was mentioned earlier this morning. We are in favor of that opportunity, and we would be willing to work with this Subcommittee and other staff members to develop legislation to that effect.

DR. NADLER: Mr. Chairman, may I ask another question?

ASSEMBLYMAN LaROCCA: Sure.

DR. NADLER: Let's say New Jersey now has a moratorium that restricts your bank for a year. Let's say I were to walk into a Pennsylvania Sears store, say within a month. Would there be any way that I could do my banking business through your Delaware bank?

MR. LEE: Within a month, no.

DR. NADLER: Well then, let's say within six months. In other words, how do you envision this Delaware bank serving Sears customers throughout the nation?

MR. LEE: We are moving very carefully and slowly on that because of the Federal legislative climate. As you know, Congressman St. Germain has proposed a specific bill that would cause serious problems and serious reconsiderations. Until the time that we definitely know what is happening at the Federal level, we will consider our business plans very carefully.

On the other hand, if Congress does not act on this measure, as they have not acted for the past two years, I believe retailers, from what I understand, can consider that a choice also. Non-action is a choice. The states then, in their efforts toward regionalism and their very valid concern over regulation of the banking industry, have a very important role to play.

DR. NADLER: Will the day come when I can walk into a Sears store and it will be my full service banker?

MR. LEE: Full service, no, because that includes commercial loans.

DR. NADLER: Other than commercial loans?

MR. LEE: Other than commercial loans, that is a possibility. Will the day come? I can't sit here and say that it will.

ASSEMBLYMAN LaROCCA: Supposing the Garn-St. Germain team makes it retroactive to June 30, will you have some problems?

MR. LEE: If you mean 1983, yes.

ASSEMBLYMAN LaROCCA: If there are others who have not spoken as yet who have comments on this, I would gladly welcome those comments. Don't get me wrong, Counselor, it is part of my job to play the devil's advocate, as I said earlier, all in the interest of trying to get the best possible information.

Do you have any questions, Ralph?

ASSEMBLYMAN LOVEYS: No questions.

MR. LEE: Again, I enjoyed appearing before the Subcommittee. We look forward to working with the members on new legislation for 1986.

ASSEMBLYMAN LaROCCA: We will keep in touch with you, and you keep in touch with us about any further ideas you would like us to have. We will try to work together and see what the end product is.

MR. LEE: Thank you very much.

ASSEMBLYMAN LaROCCA: Our next witness will be Mr. Tom Hart from the New Jersey Savings League.

THOMAS HART: Mr. Chairman, Assemblyman Loveys: My name is Tom Hart; I am Executive Vice President of the New Jersey Savings League, which represents virtually all of the 165 savings and loans in the State. We have submitted a statement for the record which includes how financial institutions before deregulation -- back in 1960 -- went through a period of what then became very popular, a new term, "disintermediation." At that time, the Federal government imposed interstate controls on savings accounts, restrictions as to what could be paid as a maximum. That, in turn, led John and Mary Doe, the consumers, to withdraw their funds from financial institutions and place those funds in other places where they could get a higher return. Again, this is before deregulation. What this caused, Mr. Chairman and Assemblyman Loveys, was a cutback in mortgage lending because of a lack of loanable funds. The funds simply weren't there. This had a severe impact, not only on housing in New Jersey, but on housing nationwide.

In the late 1970s, Congress began removing those interest rate restrictions and regulations as to what could be paid on savings accounts; the most recent action was another change in the deregulation as of January 1 of this year. Also, at that time in the late 1970s and early 1980s, we all know we were going through a high interest rate period with record inflation, and we -- the savings and loan industry, the thrift industry, not only in New Jersey, but nationwide -- were caught in an earning squeeze. We were able to attract savings because

we could pay a higher rate, but at that time we had limited opportunities to invest those moneys to earn income for profitability.

What it came down to, Mr. Chairman and Assemblyman Loveys, was the fact that for a period of time in 1981 and 1982, we were paying depositors a rate of interest on their savings accounts which exceeded the income derived, obtained, or received on the major asset of a savings and loan, a mortgage loan. Typically, this exceeded the return from the mortgage loan portfolios. In 1981 and 1982, we know the thrifts had a serious earnings problem with the 4% and 5% long-term fixed mortgage loans. I had one of them as a matter of fact. But, the deregulation of the financial institutions brought about by -- as Chairman LaRocca just mentioned -- Garn-St. Germain back in 1982, gave the business a means, a vehicle, a way to weather future periods of high interest rates, while continuing to support housing through a wider range of primarily housing-related lending services to the consumer here in New Jersey and nationwide -- as Commissioner Parell mentioned this morning -- adjustable mortgage loans.

The savings and loan business is still dedicated to housing. In 1984, mortgage lending achieved a new record here in New Jersey, through the savings and loans, of close to \$9 billion, exceeding 1983, which had been a record year of a little over \$7 billion. We are concerned, however, that if deregulation goes back to re-regulation, it will impair the industry's ability to withstand the economic shocks we went through, as I described before, and will harm the housing-related financial services made available to the citizens of New Jersey.

Presently, the New Jersey law under which the State-chartered savings and loans operate -- the New Jersey Savings and Loan Act -- gives State-chartered associations parity with Federally-chartered savings institutions contained within that statute. If that was curtailed, eliminated, or restricted, it would certainly put State-chartered New Jersey savings and loans at a competitive disadvantage with the Federally-chartered depositories.

We believe the issue related to interstate banking which has been discussed this morning should be resolved by Congress as a first step, before State action is taken. We support the recent action

related to the non-bank bank statute taken by you and your colleagues in the Assembly and in the Senate, which was recently signed into law by Governor Kean. We believe the New Jersey savings institutions now have the power necessary to serve and provide the mortgage finance needs of the citizens of New Jersey, and we are meeting those mortgage finance needs, as demonstrated by the record mortgage lending shown in 1984.

What the savings and loan industry needs now, Mr. Chairman and Assemblyman Loveys, is time to recover from the effects of that long-standing policy of investing in fixed-rate, long-term, low-yield mortgage loans, which many are still holding, so that the industry can be competitive, can meet the needs of the consumer, and can serve the public in all phases of this economic cycle here in New Jersey.

In conclusion, we are concerned that deregulation does not become re-regulation.

ASSEMBLYMAN LOVEYS: Tom, if I may, I found what you had to say interesting, but I also found there was a little bit of defensiveness on your part, or at least that was what I heard. Do you feel for one minute that the reason we are having this hearing is to maybe institute new regulations in the savings and loans institutions in this State?

MR. HART: Absolutely not, Assemblyman Loveys. Basically, what we wanted to present to the Subcommittee was that deregulation has not only helped savings and loans and other financial institutions, but just as important, if not more important, it has helped to serve the consumers' needs. If I gave that impression, I apologize.

ASSEMBLYMAN LOVEYS: I thought there was a little bit of defensiveness going on, and quite frankly, I would be very disappointed if anyone on this particular Committee ever started to talk about usury laws again, or if they didn't realize what good has taken place in this State because of deregulation. I know I wouldn't even consider that area you are concerned with.

MR. HART: I appreciate that very much.

ASSEMBLYMAN LaROCCA: How does your industry feel and react to the comments made by the previous speaker? Just to carry something on, I would like to hear all sides.

MR. HART: Are you referring to Mr. Lee's testimony?

ASSEMBLYMAN LaROCCA: Yes.

MR. HART: I took note, and my response to that, Mr. Chairman, would be that when the New Jersey Bankers Association initiated the non-bank bank loophole legislation, we immediately joined with them in supporting that legislation.

ASSEMBLYMAN LaROCCA: Do you want to ask anything else, Ralph?

ASSEMBLYMAN LOVEYS: No, thank you.

ASSEMBLYMAN LaROCCA: All right, Tom, thank you very much.

MR. HART: Thank you, Mr. Chairman.

ASSEMBLYMAN LaROCCA: Our next witness will be Mr. Russell Bent, New Jersey Association of Life Underwriters.

RUSSELL F. BENT: Thank you, Mr. Chairman. My name is Russ Bent. My testimony this afternoon is being made on behalf of the New Jersey Association of Life Underwriters, which represents 3,000 life and health insurance agents throughout the State.

It is our understanding that this is the first in a series of hearings that your Subcommittee will be holding, and that one of the purposes of this hearing will be to determine the direction that subsequent hearings will take. We would like, Mr. Chairman, to reserve the right to appear at those subsequent hearings to offer additional testimony depending upon the subject matter of any particular hearing.

Mr. Chairman, the position of the life and health insurance agents on the entrance of depository institutions into the marketplace of insurance is well known to most in this room, but for the record let me state it again. We are totally opposed to any depository institution or financial institution engaging in the sale of insurance either directly or through a wholly-owned subsidiary. Also, for the record, we are just as opposed to any insurance company owning a depository or financial institution either directly or through a wholly-owned subsidiary.

It can be argued that banking is different -- possibly on a higher plain -- than some other industries. Many feel it is potentially dangerous, not just for the financial institutions

themselves, but for the State as well, to allow banks to perhaps blunder into the cold winds and onto the playing fields, level or not, of marketplace competition.

It is well said that the ultimate discipline of a deregulated world is bankruptcy. But, depository institutions are the circulatory system of the economy. They are too important to be allowed to collapse. Thus, for decades, public policy has kept banks from going too far afield into other businesses, where the risk of failure may be high. And, public policy has been to prop banks up when they did get into trouble. Economist Henry Kaufmann of Solomon Brothers argues that when you encourage the entrepreneurial drive of banks, the only way that drive can be disciplined is by allowing banks that have behaved improperly to fail.

This is a key issue. Are we willing to allow major institutions that hold savings and temporary funds to place themselves in a position to fail when the discipline of the marketplace is exerted upon them?

We believe, Mr. Chairman, that the public has a special wisdom in matters of broad social change. Members of the New Jersey legislature -- like all legislators -- must be responsive to this wisdom. This Subcommittee would be unwise, indeed, should it fail to determine public sentiment on the questions posed in the resolution before us today. In attempting to discern those answers for ourselves, and reluctant to act without public opinion, we looked for and found significant public support.

First, labor: In March, 1984, testifying before the Senate Finance Committee in Washington, the AFL-CIO stated that: "Banks are safekeepers of other people's money," and further stated that there is a correlation between deregulation and bank failures. They went on to say that the authority for banks to engage in more activities would intensify the scramble for funds and the pressure to place funds in high risk investment. As to insurance, the AFL-CIO said there would be at least "subtle pressure" exerted by loan officers to give bank insurance affiliates an unfair advantage over competitors. They added that expansion into insurance would further the concentration of

economic power and reduce the bargaining position of the consumer. The union said it was "strongly opposed" to banks involvement in insurance.

Second, the opinion of small business: The National Federation of Independent Business, speaking on behalf of its members nationwide, expressed the fear that small business will be at a disadvantage when asking for a loan from a bank that has a competing subsidiary. Small business said it is opposed to banks engaging in insurance, real estate, and securities brokerage.

Third, the opinion of insurance regulators: Citing long-standing solvency safeguards and the dangers of tie-in sales, the National Association of Insurance Commissioners acknowledged that the commissioners' obligation to the public is very high. They said that legislators and regulators must ask whether deregulation and the integration of financial service institutions is truly desirable.

Fourth, the position of the State insurance legislators: In February, 1984, the Conference of Insurance Legislators opposed legislation that would let insurers, banks, and securities houses get into each other's businesses. They stated: "It serves all of us well to remember that it is the nest eggs of our constituents that may be broken if we let deregulation move too far, or at too fast a pace." They also added a telling point, that not one of the financial services industries has managed its own risks well enough to justify the expansion contemplated by deregulation.

All of these groups have specialized points of view. But, what of the feelings of the most important segment of society to be sustained or failed by the vital circulatory system of financial institutions, the consumer, the poor figure depicted in one magazine cringing on the 50-yard line of some presumably level playing field, as the competing teams run roughshod over him; or the man caricatured in a New York Times cartoon, as squeezed and struggling between the two opposing hands of an apparently titanic arm-wrestling contest.

What is the hapless consumer's view of financial deregulation? The Consumer Federation of America, representing 30 million people, stated that the most apparent fact of the deregulation movement is distinct categories of winners and losers, and among the

losers are small business, home-buyers, consumer borrowers, and small depositors. As for banks entering another business, such as insurance, the Consumer Federation expressed concern about the excessive economic power of banks combined with insurance, and also with the potential for harmful tying arrangements.

Finally, what do senior citizens say about deregulation? The American Association of Retired Persons, representing 15 million people, has stated that the aging population has a keen interest in the safety of financial institutions. The senior citizen group said commercial banks, and financial institutions by any other name, have special powers given to them by State and Federal authorities and that their activities have been carefully circumscribed by every government. The senior citizens did not see why advanced computer technology and communications should be allowed to somehow dictate that commercial banking should be free to engage in financial and business activities previously prohibited. They went on to state that they did not see how technology could be construed as obviating the safety issues presented by mixing banking with commerce. In fact, citing computer fraud, they said technology seems to be creating more safety problems than it is solving.

So, we have taken a good measure of public opinion. Does the public embrace the supermarket school of financial services? Labor says "no." Small business says "no." State insurance regulators say "no." Consumers young and old say "no."

In much of the nineteenth century, when banking regulation was virtually nonexistent, financial panic and bank failures were commonplace. People seem afraid of a return to something akin to that. Considering that bank failures are on the rise, their concern seems well placed.

Lastly, Mr. Chairman, we submit that the financial institutions have not shown that they have the consumers interest in mind, at least when it comes to insurance. We would ask that you include, at some point in your hearings, a discussion on credit life and health insurance. It has been our experience that the premiums charged for this coverage are vastly excessive in terms of the true

economic value of the insurance coverage being provided. Moreover, it is our belief that these rates return to the financial institutions, profits that are unconscionable.

So, to the voices of the union, small business, insurance regulators, insurance legislators, and senior citizens, we add our "no" to the deregulation of financial institutions. The Life Underwriters Association stands ready to assist this Subcommittee in any way it deems appropriate, and it is grateful for the opportunity to testify before you here today.

I will be happy to answer any questions you may have.

ASSEMBLYMAN LaROCCA: As we say in the law, issue has been joined. You have been very clear-cut as to the position of your organization. Banks should not sell insurance, and you should not have a supermarket approach. At least we know where you stand, and that there is that feeling. That is something we will have to evaluate. That is the only comment I have right now. What flashes across my mind along the lines of insurance is, if there is more competition, do you think the rates would go down?

MR. BENT: No. As far as insurance rates are concerned, I do not, because they are set, of course, by--

ASSEMBLYMAN LaROCCA: (interrupting) The process.

MR. BENT: By the process which includes investments, expenses, and mortality rates. They are set, as you know, by actuaries. How they go about determining those figures is way above me. But, we do not believe there will be increased competition. Our feeling is that once an individual goes into that financial institution and the door closes behind him, so closes competition.

DR. NADLER: If you say there is no way rates can go down, how come savings bank life insurance, which is illegal in New Jersey, is so much cheaper than regular life insurance?

MR. BENT: Well, I answered the question in the context of additional competition. The rates can go down. I don't know that competition would drive them down, but I am not an actuary, so I don't know. They should come down in many areas; for example, in credit life insurance, certainly there is an area where they should come down substantially.

DR. NADLER: I was thinking of agents' commissions, which can be over 100% in the first year's premium. If a bank does it on a non-commission basis, that should cut rates, shouldn't it?

MR. BENT: Well, it should, but I don't know that it will. It very well might. By the way, there are very few companies that offer 100% commission. We would oppose that. As an agents' group, we believe that is excessive. Not too long ago, there were situations where companies were apparently interested in buying business. We saw commission rates up to 220%. We made complaints to the Department of Insurance that those rates were outrageous. We do not believe in that kind of a commission structure.

If the rates can come down because of competition, by letting the banks in, we certainly wouldn't be opposed to that. It might make us work a little harder, but that's all right, that is what the marketplace dictates.

DR. NADLER: How could you find that out without having legislation allowing a tryout?

MR. BENT: Well, it has been evident through credit life that the banks -- because agents do not sell credit life -- have not brought rates down. From what we can determine, they have gone to the highest rates possible. There is no competition in credit life. When you go in to make a loan, you are before that loan officer and you are given the opportunity to take out credit life or not, as you choose, but there is no competition. Because there is no competition, there is no lowering of the rates for credit life.

DR. NADLER: So, you're saying the banks have given a poor example of what they might do in the insurance field?

MR. BENT: Absolutely. We can document that.

ASSEMBLYMAN LOVEYS: I think your request is a fair request. I think the request the agents have made should be part of our ongoing studies. We will have some sort of an investigation, if you will, regarding banks selling insurance.

DR. NADLER: May I ask you also to look at savings bank life insurance in the states where it is legal?

ASSEMBLYMAN LOVEYS: I hope we will look at everything that is available to us.

MR. BENT: We would certainly not oppose that either. You understand that savings bank insurance is sold only by savings banks, and only in three states.

ASSEMBLYMAN LOVEYS: You said at the beginning of your testimony that you don't want to see insurance companies go into banking any more than you want to see banks go into insurance. What is your feeling then, as a trade organization, when you see a company like Prudential buy a non-bank bank?

MR. BENT: We have made our position clear to Prudential that we object to that. Now, I understand, in fact I have even read, where the chairman of Prudential has gone public and said that Prudential would sell its bank if banks would stay out of the insurance business. I am only repeating what I saw publicly stated.

ASSEMBLYMAN LOVEYS: They are buying non-banks, and they are buying undercover.

MR. BENT: Well, they have one bank in Georgia, to the best of my knowledge. As far as I know, that is basically a shell. I don't even think they are working it. Again, I don't know.

ASSEMBLYMAN LOVEYS: Joe will tell us.

ASSEMBLYMAN LaROCCA: All right, thank you, Russ. Our next witness will be Mr. Jeff Klein, American Insurance Association.

JEFFREY M. KLEIN: Before I start, I would just like to say if I knew there were going to be so many bankers here, I might not have worn a pin stripe suit today, so you wouldn't confuse us.

My name is Jeff Klein; I am an Associate Counsel for Government Affairs for the American Insurance Association. We are a national trade organization representing 174 property and casualty companies, including many domesticated here in New Jersey -- Selected Risks, Crumb and Foster, and the Chub Corporation. We have a significant interest in this issue, as you can imagine, and are pleased that you invited us here to testify today. I want to emphasize that our statement is rather lengthy, and I ask only that it be included in full in the record. I will just summarize it so as not to take up too much of the Subcommittee's time.

Several years ago, we testified before the Department of Banking on the credit leverage issue that Russ Bent spoke about. At that time, we urged the Governor to conduct a wide-ranging study of the financial services issue here in New Jersey, because things were moving so quickly on all fronts. We are pleased that he has working groups in both the Banking Department and the Insurance Department, and we are also pleased that the Assembly saw fit, by resolution, to establish this Subcommittee for a similar study.

I am going to echo many of the things that Mr. Bent said. Our Association's national position is very steadfast, and that is, there are many problems associated with merging the two industries, the so-called financial services integration. If we oppose it, at best and at least, we urge everyone to take a very close look at the issue to make sure that you are all apprised of the many problems which may take place.

There are about six major items that I highlight in our testimony about why we think the banks request that they get into the insurance industry is fraught with danger. One of them is the traditional separation of banks from commerce issue, which you heard about today under the Glass-Steagall Act, enacted in the depression days under the Bank Holding Company Act. More recently, there are substantial concerns that because of the nature of the banks' credit-lending authority, because of their peculiar role in the Federal system of helping to shape monetary policy through the Federal Reserve System, and so forth, that banks having affiliates, actually making loans, and so forth, in business with commerce-type companies, could only be fraught with danger, be they securities or other types of entities.

Congress has explicitly reaffirmed, in the Garn-St. Germain Act of 1982, that insurance is not closely related to banking, nor is it in a similar vein. We think that traditional separation is well justified and should continue, not only in New Jersey, but in the country as a whole.

As I said, banks serve as a stand-by source of liquidity. It is a nationwide service that they provide in terms of monetary policy

and, as my statement indicates, there are a number of considerations that should be looked into by that committee.

By the way, I don't know if you folks have copies of the DeWind Commission Report from New York, but if you don't, feel free, despite our difference of opinion on the recommendation of that majority report-- We have all of the materials in-house, and today I brought some of them for you.

Another big issue we have raised, and we think we are justified in this, is the question of bank solvency. Statistics show that in 1983 and 1984, there were more bank failures than at any time since the depression of the 1930s and 1940s. The basic question must be raised whether these institutions should be allowed to enter what I like to call "a new line of work," without having gotten their own house in order.

Commercial banks' present overexposure in foreign loans, particularly in the Third World and the Eastern Block nations, is staggering. The Wall Street Journal itself criticizes the overextension of loans, saying that in the past they escaped the hard work of banking, that is to say assessing individual risks, by merely dumping large loads of money on governments for them to use and misuse as they saw fit. The situation is one that was taken note of in New York during the DeWind Commission hearings. Alfred S. Howes, who is a member of that temporary state commission, described some of the testimony of the banking representatives up in Albany, New York, and said: "The alarm warnings should have gone off when every witness for the banks indicated the need for insurance underwriting authority to help recoup some of the revenue being lost to other financial institutions." We are currently witnessing the tragic consequences of activities in the Baldwin-United bankruptcy. No corporation in that conglomerate is escaping the impact of mismanagement and insolvency.

It has been our position that the Baldwin-United problem, and more recently the problem of Continental Illinois in Chicago, raises very serious questions for legislators, people on this Subcommittee, and people all around the country, to take a look at the dangers which may result from allowing these institutions to enter into a new line of

business. Some people have asked me, "Well, what about the insurance industry?" I know this question will be asked, so I might as well hit on it now. We have had very, very bad underwriting results. The year 1984 was a very bad year for the industry. We feel that that is just another argument why both industries have to get their own houses in order before there is any consideration whatsoever of a merger. The consequences for the consumer, and the people of the State of New Jersey in particular, are just too staggering to mention.

Several people here today have mentioned the next topic I have highlighted, that is, excessive market concentration. Statistics have shown that the banking industry is much more concentrated than the insurance industry is. A large percentage of deposits in most major cities is held by a very small number of banks. In Los Angeles, the top three banks have 62% of the deposits; Detroit has 59%; the top three banks in San Francisco have 79% of the deposits; and, Boston has 57%. This increased concentration has led to higher prices and fewer policy alternatives and options for consumers. I think the situation is even being exacerbated in New Jersey where, unfortunately, now we have Heritage Bank merging into Midlantic. You are getting a few big financial giants here as well.

So, that problem exists. We think the insurance industry, although we are having problems, is much more competitive. There are thousands of insurance agents in the State of New Jersey who compete with each other. Unfortunately, competition has gotten a little too much into the commercial area for my companies, where rates have dropped because of the competition. That has created some financial problems, but the fact remains that there is sufficient competition. We fear that if you get a few large money center banks entering the insurance area, buying up agencies outright, or buying up companies, you are going to have a sharp reduction in alternatives for consumers. So, we hope that this answers that argument.

The credit leverage argument is a very, very good one, and I think the agents associations in this State -- and Russ Bent's association -- have been in the forefront of trying to educate everyone about how much of a problem that is. It is more a problem of

perception than anything else. We mentioned the Department of Banking before. Although there have been attempts to regulate explicit tie-in sales, as the Department did in a regulation which was adopted -- I will hand that out to the Subcommittee in case you have not seen it -- November 18, 1983, there is a far more serious problem of implicit tie-in sales. When a consumer goes into a bank and takes out a loan on his property, he may be under the impression -- and it may be only a subtle impression -- from signals sent to him by the person sitting across the desk, that he has to buy the insurance in order to get the loan. This has been documented. There was a Federal Reserve study in February, 1979 -- which I have mentioned on Page 12 of my testimony -- by Eisenbeis and Schweitzer, which indicated that roughly 25% of the people surveyed by the Federal Reserve said that they bought the insurance because they believed it was required, or it may have been, in fact, recommended by the banking institution.

The same study indicated that nearly two-thirds of the bank borrowers who were surveyed actually purchased the credit life or credit health insurance, so the actual purchase was in the 66% range. The actual impression was much less, but still at a high level at the 25% range.

We urge this Subcommittee, in the study you are doing of this whole issue, to take a new look at credit leverage. As I said, it was last addressed in 1983, and we think it was inadequately resolved by the Banking Department in the regulation. There were very few safeguards put in and, once again, it dealt only with explicit tie-in sales. We think that issue should be raised once more.

There is another problem -- Item 7 in my testimony -- which you, Mr. Chairman, have raised, and that is the question of regulatory conflicts. We see a severe problem arising with attempts either to create a super agency on the Federal level, or a similar one on the State level, to attempt to regulate both banks and insurance companies. Right now, banks are regulated by the FDIC, the Federal Reserve, the Federal Home Loan Bank Board, the Comptroller of the Currency, and some other agencies. The insurance industry continues to be regulated by State government, and thank God for that because I have

a job, as opposed to working in Washington. But, the question is, exactly how would you deal with this issue if you merged the two agencies? We don't know the answer to that. We can say that some recent bank failures, including Penn Square in Oklahoma City and the Butcher Banks in Tennessee, have shown that bank regulators have their own hands full trying to detect fraud and unsound financial conditions. They have, in fact, stated that they have insufficient information right now to accurately assess current banking operations. We think this task would be considerably complicated if they were expected to regulate bank activities in the insurance industry. Some people have questioned, "Well, would the Banking Department regulate what is, in effect, an insurance company that is owned by a bank? Would the Insurance Department in New Jersey continue to regulate the new insurance units of the larger banks? We just don't know, and God knows both industries, as I said, are under severe financial strain and tight regulation now. We just think that will exacerbate it even more.

There is nothing I can say more strongly on this issue than that we think a piecemeal approach by the states will not do the job. There is no level playing field right now, by the way. Insurance companies can be purchased by a bank under some loopholes, the bank can immediately take over the agency structure, and with certain restrictions, can write insurance. In that sense, the State problem is not as much of an obstacle to a bank as the other way around. An insurance company, because of the restrictions on purchases of non-banks right now, and because of the predominance of the Federal Bank Holding Company, cannot similarly attempt to purchase a bank and then operate all around the country as well. There are certain roadblocks. That is one of the things we think regulators should take a look at.

We think that Congress has to look at this situation because it goes across state boundaries. South Dakota attempted to do this in their own state. The Federal Reserve Board subsequently denied some of the applications for operations of non-bank banks in that state, as my testimony will indicate. We do not think it will be to the consumers' interest in any given state if each state attempts to write a different

set of rules for this issue. We are pleased, by the way, that Governor Kean has signed the bill for a moratorium to give a Subcommittee such as this the opportunity to study this issue. We hope that Congress will resolve it in 1985. We are not alone in advocating this. In testimony before the United States Senate Banking Committee in April, 1983, then Treasury Secretary, Donald Reagan, had the following quote, which is on Page 18 of my testimony: "I think that as long as banks are going to come under the Federal deposit framework, and as long as the Federal government is going to be responsible as the bank of last resort in order to help these banks if they get into trouble through the FDIC, the Federal government has a right to state what activities that bank may and may not perform."

Similarly, Paul Voker, the Federal Reserve Board Chairman, responded to a letter from the Delaware Insurance Commissioner in April, 1983, and stated that he was, "seriously concerned about the possibility of widely divergent and inconsistent laws governing both bank and thrift powers, with deposit-taking organizations shopping for the most permissive rules, and states competing to pass such laws." Similar statements have been made by FDIC Chairman, William Isaac. So, we are not alone by any means in a concern that a state-by-state approach is not the way to go.

Finally, probably the most obvious thing we can say in the insurance industry about banks getting into insurance is the problem of individual service. I think that has been touched on here a bit today, but I want to get a little more into it. We don't know what the commercial banks' plans are for consumer services. I can tell you now that many of my companies, if not a large majority of them, work through the independent agency system. There are some companies that are members of other trades, and others that are direct writers in this industry, but by and large we are an independent agency set of companies in an association. We don't know what the banks have to offer. We can say that the vice chairman of Citibank, who testified at the DeWind Commission, admitted before that Commission that consumers might benefit in lower prices for insurance products through the use of automatic teller machines. We really want to know whether the

consumers of the State of New Jersey would prefer to purchase insurance policies through an automatic teller machine or a computer than through their independent agency system. It is not perfect; it has been changed over time, even by bills through this Committee, but by God, local agencies provide personal service. Many of them are your neighbors around the State. They are someone you can go to when you have an insurance problem and it is a technical problem. I know I would feel more comfortable consulting with an agent than going to a teller machine after hours. Sometimes it doesn't even return your money as properly as you would wish.

So, that is a consumer issue. That is probably the key consumer issue, whether the level of service you are going to get from these large banks is going to be sufficient to provide the service you need in insurance, which is a very complex field, and which involves risk assessment. It is not just a question of taking deposits and loans.

That basically summarizes the major points in my testimony. Once again, I would ask that the full statement be included in the record. I am willing to answer any questions you have. The AIA has tons of material on this from our Washington office and our regional office, and we will provide you with anything that you request.

ASSEMBLYMAN LaROCCA: You touched on one subject that I am sure the Subcommittee will consider at future hearings, and that is the problem of bank failures, for example, Continental Illinois. I have read articles which said there were 70 or 80 banks that failed throughout the United States. Not many people know that. Does that shake them up? The FDIC has come in to bail them out. I don't see anyone paying higher premiums on the FDIC because of the bailout. Should that premium be spread out? Maybe it is good that some agency comes in and prevents these banks from failing, but then there is another underlying question. Why are these banks failing? A lot of the articles I have read say that it may be because of mismanagement, or Third World loans going too far. I think that is a subject that I am going to suggest to the other members of the Subcommittee and the staff that we look into at future hearings.

Are there any comments or questions from the members of the Subcommittee? Lou?

ASSEMBLYMAN KOSCO: It seems that in the report you refer often to the potential abuse of powers to grant loans and the use of this as some type of leverage. The potential for abuse of power is always prevalent, no matter what we do. That is the purpose of passing regulations. Do you have any ideas along the lines of how we could prevent this, other than abstinence? How could we probably prevent that from happening?

MR. KLEIN: This question has been raised. Some have suggested that one way to go about doing it is to "wall off the subsidiary to make sure that the insurance sales are not being conducted on the premises of the bank." That has been one of the most commonly suggested means. Others have suggested that prominent notices inform the consumer of his rights, or that the banks be prohibited from having their same name on the insurance sales function that their subsidiary is performing. But, every time this has been kicked around by experts in our industry, and folks like the agents who have heard complaints about this, barring any real complete prohibition, we have not been able to come up with any way to prevent it. And, in studies conducted of it, as I said, there doesn't seem to be any adequate method to prevent it, because the problem is one of appearance, as much as reality, which turns into reality the minute someone feels he or she has to purchase the insurance on the loan.

So, to date, those have been a few of the suggestions made, but no one looking at it from the consumer point of view is yet convinced that those methods will be sufficient. I can only say that it continues to be kicked around, but it hasn't been resolved yet.

Someone here today raised a question about whether insurance companies would be willing-- What would they be willing to do under an act that was imposed retroactively? I can speak for the chief executive officers of some of our members. They said they would divest themselves of these non-bank banks. The reason the industry has, in some instances -- very few companies of mine, but there have been some instances -- gotten into the non-bank bank business is to stay

competitive now under existing loopholes, or laws if you will. Everyone else is doing it, Sears and the banks, but that is mainly a marketing strategy for now. They want to remain in the insurance business, primarily and only in the insurance business, and they would be willing to divest themselves of these non-bank banks. I challenge any Bankers Association representative to say the same. I am not speaking for the Association as a whole, but I am speaking for several major insurance companies that I represent.

As far as competitive rates are concerned, if banks get into insurance, as I said, there is going to be a more concentrated market, so I fail to see how that is going to lower insurance rates. On the subject of tie-in sales, as Mr. Bent indicated, a bank may compete on a loan itself, but once an individual is in there purchasing insurance, the rates have been very, very high, very expensive, and not very competitive at all. We have heard the remark that banks buying insurance companies will lower the price for consumers and make this a real streamlined direct effort. So far, experience has not borne that out.

ASSEMBLYMAN KOSCO: Don't you think it will work the opposite way, because if an insurance company owns a bank and is selling insurance, as a by-product of selling insurance it may be given the mortgage?

MR. KLEIN: As I said, since most if not all of my companies--

ASSEMBLYMAN KOSCO: (interrupting) Wouldn't you tend to do the same thing?

MR. KLEIN: I probably would, and that may be another good reason for divestiture, but they do not want to remain in the banking business. As I said, this is being done as a temporary measure because of an uncertainty in the law now and the need to remain competitive and protect their own shareholders. But, you are probably right. It could not be done on an efficient basis where the companies do not have any expertise in banking.

ASSEMBLYMAN LaROCCA: Are there any other questions?

DR. NADLER: Mr. Chairman?

ASSEMBLYMAN LaROCCA: Yes, Dr. Nadler.

DR. NADLER: I don't understand how you can say that, Mr. Klein. Letting banks into insurance would lead to more concentration. I thought there would be more competitors in the field.

MR. KLEIN: It might look like there would be more competitors in terms of the fact that you are having another industry present, but if the financial institutions on Wall Street, and so forth, start gobbling up insurance agencies, as I said, and if present practice is any indication, there will be an attempt to skim profits from some aspects of the business to make up for the lower price that may be imposed on another aspect of the business, like the credit life and health. The expense has been very, very high.

DR. NADLER: You have drawn the assumption that bigness always means higher prices to the consumer. You said that three banks own three-quarters of the market in California. They are crazy numbers you have, because you are throwing in the whole statewide operation. You have assumed that the bigger they get, the higher the prices are. I mean, hasn't every study shown that we have giants fighting against each other? For example, take airline competition, where you have three or four giants fighting each other. There was a case where the price to California was \$119.00. Yet, when you don't have the giants, and you just have the little guy, if you go to Little Rock it's \$300.00.

There is no evidence which says size means that the consumer pays more. Usually, big people fighting each other brings competition and lower prices, as we have seen in bank service.

MR. KLEIN: But, the attempt to get lower prices only further concentrates the market. You see, once the foot is in the door, there will be a "sale on services" in order to get into the business. But, once they have established a market presence, we contend that this Subcommittee should seriously consider-- I am not saying that this will happen; I'm saying there is a good possibility it may happen.

DR. NADLER: But, are you saying that if the banks get in, it is going to so weaken the traditional life insurance companies that some of them may go out of business, and there will be higher prices? If they are that weak, why do you want to protect them? You're talking about the banks being weak.

MR. KLEIN: I am not saying that banks entering into the insurance field are going to make any insurance company -- weak or otherwise -- go under, etc. I am just saying that the insurance industry, for better or worse -- and we have had problems in auto insurance and other things in this State-- When there are a lot more players in the field, the market share is a lot more equally divided among all of the companies, from the first company to the twentieth. That is not the case in the banking industry, and I, for one, fail to see how a consumer is going to be served by having to deal with just three or four big financial institutions. I do not subscribe to the view that big is necessarily better.

DR. NADLER: But, you're saying that if the banks are allowed in insurance, the traditional insurance companies are going to go out of business.

MR. KLEIN: We hope that will not happen. We fear it might happen in some instances, but it is more a question of both industries getting their own houses in order at the present time. I am not going to contend that if Citibank comes into the State of New Jersey and purchases some insurance sales that it is going to make any one of my members go down the tubes. But, what we are saying is, there are too many dangers from the consumer viewpoint, both on the banking and insurance sides, to permit that to happen. An adequate study has to be made. You cannot move headlong into it. This thing is happening around the country, but it is more a question of events going faster than Legislatures can respond to them. That is why this Subcommittee is here today.

ASSEMBLYMAN LaROCCA: Are there any questions from the members of the Subcommittee? (negative response) Thank you, Mr. Klein. Is there anyone else who would like to speak before we adjourn? (no response)

I would just like to announce that, toward the end of March, we will be holding another hearing somewhere in North Jersey. Keep in touch with the Subcommittee. I know there are two other public interest members here. I have discussed this with them, and they will wait until the next hearing. That hearing will be relative to the

excessive holding periods and the effects of that on the public, particularly the senior citizens. I hope that some other insurance companies will appear before the Subcommittee. We will also take under consideration bank failures and other matters allied thereto.

Since there is nothing else to come before us today, the hearing is adjourned.

(HEARING CONCLUDED)

APPENDIX

STATEMENT

OF

AMERICAN INSURANCE ASSOCIATION

ON

THE EXPANSION OF DEPOSIT-TAKING INSTITUTIONS
INTO THE BUSINESS OF INSURANCE

BEFORE

SUBCOMMITTEE ON THE STUDY OF DEPOSITORY
INSTITUTIONS REGULATION AND DEREGULATION
OF THE ASSEMBLY BANKING AND INSURANCE COMMITTEE

State House Annex
Trenton, New Jersey
February 13, 1985

Good afternoon. I'm Jeffrey M. Klein, Associate Counsel for Government Affairs in the New York/New Jersey Region of the American Insurance Association. Our Association represents 174 insurers that write over one-third of the total property and casualty premiums written in New Jersey. As such, our members have a keen interest in the subject of financial services integration and the deliberations of this Subcommittee. We appreciate the opportunity to be here today and to discuss issues which are of critical importance to financial services institutions and to consumers alike.

(I)

Introduction

In recent years, there has been growing pressure from deposit-taking financial institutions, principally large bank holding companies, to enhance their ability to compete with other financial institutions. In addition to their efforts to obtain greater bank marketing flexibility, banks are seeking to engage in nonbanking enterprises, which are denied them by federal law and many state laws. Among the increased powers sought by these bank holding companies is the authority to underwrite and sell insurance, including property and casualty lines. These banking efforts to acquire insurance authority have been improperly included in the term "deregulation of financial services."

Our Association and its members are opposed to the granting of new property-casualty insurance authority to deposit-taking institutions. This statement will outline the reasons why banks have a special role in our

economic system and the rationale for the separation of banking from commerce. We believe there are sound reasons for keeping the barriers between banking and commerce intact, especially as they apply to banking and insurance. There are inherent problems in allowing banks to enter the business of insurance. In particular, there are clear dangers of credit leverage abuse, multiple regulatory conflicts, and excessive economic concentration. These dangers can and should be avoided by continuing the current national policy of not permitting deposit-taking institutions to underwrite or sell insurance. This policy was most recently reaffirmed by Congress in Title VI of the Garn-St. Germain Depository Institutions Act of 1982.

Congress is the appropriate legislative body to determine whether financial deregulation is necessary and, if so, how it shall be effected. This important task cannot be left to unilateral state action. Finally, any deregulation of the financial services industry should be equitable to all industry participants.

The members of the American Insurance Association have no fear of fair competition in insurance services. Indeed, the public will benefit if all participants play by the same rules with proper safeguards imposed without unfair advantage. On the other hand, if one type of institution is considered special, as deposit-taking institutions are, and receives special advantages such as federal deposit insurance, those institutions must expect to be regulated in a manner befitting their special responsibility to the public and the national economy. The public responsibilities of deposit-taking institutions should not be sacrificed merely to further the goal of financial deregulation. We believe these considerations preclude the granting of new property-casualty insurance authority to deposit-taking institutions.

(II)

The Separation of Banking and Commerce

The grant of insurance authority to deposit-taking institutions calls into question a fundamental tenet underlying the regulation of banks: the separation of banking and commerce. The doctrine of the separation of banking from commerce arose out of the need to ensure safety and soundness in the banking system, while guarding against undue concentration of financial power, minimizing conflicts of interest, and prohibiting activities not in keeping with the special trusteeship incumbent upon institutions that engage in the lending of their depositors' money. The doctrine was established by the Banking Act of 1933, often referred to as the "Glass-Steagall Act." In the Glass-Steagall Act, Congress sought to prevent the type of abuses that led to the massive bank failures of the early 1900's. Not only does the Glass-Steagall Act prohibit banks from involvement in securities underwriting, it also sets forth the public policy that member banks of the Federal Reserve System should not risk their depositors' funds by investing in equity securities of a commercial enterprise.

The separation of banking and commerce was extended in the Bank Holding Company Act of 1956, which restricts bank affiliation with a parent company that engages in commerce directly or indirectly. Section 4 of the Bank Holding Company Act prohibits a bank holding company from engaging in nonbanking activities or from owning or controlling shares of any company that is not a bank. In enacting Section 4 of the Bank Holding Company Act, Congress was concerned that a bank holding company might use its banks to

allocate available credit on bases other than the credit-worthiness of the borrower--for example, by preferring customers of the banks' affiliates in the holding company or by denying credit to competitors of the banks' affiliates. There was further concern that a holding company might impair the soundness of its subsidiary bank by causing the bank to make funds available to nonbanking affiliates or to their customers. Congress recognized in Section 4 of the Bank Holding Company Act that the public interest is best protected by generally prohibiting combinations of banking and commerce. Traditionally, this prohibition has extended to insurance activities.

Exceptions to the separation of banking and commerce are narrowly drawn. Section 4(c) of the Bank Holding Company Act specifically enumerates situations to which the general prohibition against combining banking and nonbanking activities does not apply. Principal among them is the exception that permits bank holding companies to engage in activities that are so "closely-related" to banking as to be in the public interest. In October 1982, in Title VI of the Garn-St. Germain Depository Institutions Act, Congress explicitly reaffirmed the longstanding policy that insurance is not "closely related" to banking. Section 4(c) of the Bank Holding Company Act was amended expressly to prohibit bank holding companies from engaging as an insurance underwriter, agent or broker in all but a few carefully enumerated exceptions.

(III)

The Special Role and Responsibilities of Banks

Although it may appear that banks are being singled out unfairly by these statutory restrictions, in fact the restrictions are based on a recognition that banks fulfill a special role in our economy and have a special responsibility to the public. As was noted in a recent essay by the President of the Federal Reserve Bank of Minneapolis, banks perform several important and unique functions in our economy. First, they issue transaction accounts, which are liabilities that are payable on demand at par and are readily transferrable to third parties. It is such transaction accounts that supply the day-to-day flexibility that keeps our economic and financial system running smoothly. Second, banks provide a backup source of liquidity and credit for all other classes and sizes of institutions, both financial and nonfinancial. This role of banks as a standby source of liquidity is especially important in periods of financial stress when other sources of liquidity may dry up. Third, the nationwide network of banks functions as a transmission belt for monetary policy as set by the central bank. By adjusting discount rates and reserve requirements, the Federal Reserve System uses its member banks to control national monetary policy.

To carry out successfully the special functions noted above, banks require public confidence to minimize the likelihood of large, sudden drains of bank deposits. Two tools enabling banks to retain public confidence are their ability to offer deposit insurance as provided by the Federal Deposit Insurance Corporation and their access to the lender of last resort in the

form of the Federal Reserve's discount window. These two devices constitute a public safety net generally available only to banks. Although the presence of this public safety net reflects a longstanding consensus that banking functions are essential to a healthy economy, it also implies that these institutions have unique responsibilities and should be regulated accordingly.

For example, in order for banks to fulfill their role as standby sources of liquidity and credit, they must have ready access to a variety of domestic and foreign market sources in addition to deposits. This access depends, in turn, on market judgments as to the quality of banks' assets and overall financial strength. To maintain asset quality, banks must be able to make rigorous, impartial and objective credit decisions, particularly in times of economic stress. Rigorous impartiality in credit decisions might be difficult if a bank were approached for credit by an affiliated company. The bank might come under intense pressure from a troubled affiliated to provide it with credit that it might not be able to repay. If the bank made the loan notwithstanding the risk involved, there would be a negative impact on the bank's asset quality. As the bank's asset quality deteriorated, its access to funds from market and deposit sources would be correspondingly diminished and the bank would be unable to fulfill its role as ultimate source of liquidity and credit to borrowers in our economy. This scenario exemplifies a major reason for the existence of laws regulating the commingling of banking and other interests and the ownership and control of banks. Laws such as the Bank Holding Company Act help ensure not only that banks remain solvent but that they maintain their special role in our economy.

Our Association does not object to the reexamination of the policies and regulations that make banks special or to analysis of whether the unique role of banks in our society needs to be changed. We believe, however, that any

reexamination should take into account the ability of banks to continue to play their unique role in our economy, as well as the effect of any changes in this role on other participants in the financial services industry and on the American public. Moreover, we believe there are a number of considerations that require continuation of the traditional separation between banking and commerce and of that doctrine's derivative restrictions on banks and other deposit-taking institutions engaging in the sale or underwriting of insurance.

(IV)

Bank Solvency

A significant reason for the separation of banking from commerce was and is concern for the solvency of banks. The number of recent bank failures is unprecedented since the Depression of the 1930's and early 1940's (in 1983 there were 44 bank failures, at that time the worst year for U.S. banking since 1943 when 43 banks failed) and raises the question of whether new and potentially risky activities should be authorized for the banking industry when obvious problems exist in the current banking system. The business of insurance has a history of cyclical underwriting returns and is faced with changing public attitudes about risk and with new concepts of legal liability, the combination of which results in significant new and emerging exposures. The entry of banks into insurance, therefore, would involve new risks and uncertainties for banks at a time when there are numerous indications-- including the rising number of failed and troubled banks and the well-known default potential of large portfolios of shaky international loans to developing nations--that banks may have problems meeting their present banking obligations.

Commercial banks' present overexposure in foreign loans, primarily to third world and Eastern bloc nations, is evidence of their vulnerability to speculative errors which have threatened small investors in the past. The danger in today's economy is not a widow losing her life savings, thanks to the F.D.I.C., but there is a continuing danger that a series of banking collapses would lead to severe financial dislocations. These foreign loans do not paint a picture of prudent banking, but a profile of financial insecurity. The Wall Street Journal has criticized the overextension of commercial bank loans to third world nations stating, "In the past they escaped the hard work of banking, that is to say assessing individual risks, by merely dumping big loads of money on governments for them to use and misuse as they saw fit" (Wall Street Journal, March 29, 1984, p. 28).

Some proponents of deregulation of financial services assert that creating a system of discreet subsidiary operations would sufficiently insulate a healthy banking operation from other business activities that may be experiencing financial difficulties and vice-versa. Most bank regulators, however, admit doubt that in time of financial peril a bank can be insulated from the problems of its sister organizations. The U.S. General Accounting Office in a June 1982 report on the extent and nature of nonbanking activities of depository institutions noted that "ancillary activities may adversely affect the safety and soundness of the depository institutions and their related holding companies." In particular, the GAO said that "bank holding companies with nonbank subsidiaries had a higher incidence of problems than companies without subsidiaries." The issue of solvency should remain a paramount concern in any consideration of expanded bank activities,

particularly in light of the fiduciary duty deposit-taking institutions owe to their depositors. It should also be recognized that, because of federal deposit insurance, the ultimate cost of bank insolvency falls on the American public.

As Alfred S. Howes, a member of New York State's Temporary State Commission on Banking, Insurance and Financial Services in describing the testimony of some banking representatives at the Commission's hearings, stated:

"The alarm warnings should have gone off when every witness for the banks indicated the need for insurance underwriting authority to help recoup some of the revenue being lost to other financial institutions.

"The pattern of a financially unhealthy member of a corporate family draining the assets of a healthy one is too familiar to be ignored. We are currently witnessing the tragic consequences of such activities in the Baldwin-United bankruptcy. No corporation in that conglomerate is escaping the impact of mismanagement and insolvency." (Dissent of Alfred S. Howes, Commissioner, to the Majority Report of the Temporary State Commission on Banking, Insurance and Financial Services, February 15, 1984, at p. 48).

The Baldwin-United failure demonstrates that a parent's use of a subsidiary invites conflicts of interest problems in transactions between affiliates. Banks simply could not be insulated from the problems of an insurance affiliate.

The more recent problems suffered by Continental Illinois in Chicago is the latest evidence of severe underlying problems affecting the banking industry which warrant attention by legislative and regulatory officials. The banking industry must demonstrate that it can get its own house in order before attempting to enter other lines of work.

(V)

Excessive Market Concentration

Broad questions of concentration within the financial services industry emerge in connection with the expansion of bank powers. Historically, one concern of Congress in establishing the separation of banking from commerce was preventing the accumulation of too much economic power in the hands of the nation's banks. This concern is still relevant today. Deregulation raises the possibility that banks, using the various advantages they possess as a result of their special status, may make such substantial inroads into other parts of the financial services industry that concentration in the industry will be increased to a harmful degree.

The banking industry is typically far more concentrated than the insurance industry. For example, data available on banking concentration in standard metropolitan statistical areas, an accurate measure of the market of most banks, indicates that the top three banks have 62 percent of deposits in Los Angeles, 59 percent in Detroit, 79 percent in San Francisco-Oakland, and 57 percent in Boston. The relatively higher level of concentration in the

banking industry suggests that the entry of banks in a concentrated banking market into a relatively unconcentrated insurance market would result in the insurance market becoming more concentrated. This increased concentration could in turn lead ultimately to higher prices and fewer policy alternatives for insurance consumers. Moreover, banks would amass even greater economic power than they currently possess.

On the other hand, the insurance industry is not the protected anti-competitive industry that the banks portray it as. The insurance industry is a more competitive industry with few barriers to entry. Thousands of insurance agents, who perform individual service to the consumer, compete with each other in New Jersey as well.

(VI)

Credit Leverage

With respect to the sale of insurance by banks, there exists a significant potential for abuses of banks' power to grant credit by tying loan transactions to the sale of insurance. The ability of banks to use the power to grant or deny credit to compel the purchase of another product or service--such as insurance--is known as "credit leverage." The opportunity to exploit credit leverage exists because banks are the principal providers of credit services and have, or are perceived by consumers to have, a superior bargaining position in loan transaction.

Although Congress saw the potential for the tie-in sale problem and prohibited the tying of loans to the purchase of insurance in the Bank Holding Company Act amendments of 1970, that law reaches only explicit tie-ins. Just as damaging as explicit tie-ins, but by far more difficult to detect, are subtle coercive methods through which a bank might imply that prospects for receiving a loan would be improved if the customer filled his insurance needs through the bank. It would not be realistic to expect that a small businessman or consumer without the bargaining power or access to alternative sources of credit of a large corporation could ignore subtle pressures to purchase insurance when his sole source of credit was at stake. For all practical purposes, a person seeking a loan will do all that he can to motivate the lender to grant him credit, including "voluntarily" purchasing the lender's insurance on a basis other than its price or service.

Credit leverage is not an illusory problem. The Federal Reserve Board has noted in a study¹ of the issue that nearly two-thirds of bank borrowers surveyed purchased credit life or credit health insurance from the lending institution even though such insurance is not typically required as a condition for a loan. Over 25 percent of those surveyed did so because they believed it was "required" or "strongly recommended." In addition, there is clear evidence that where lenders engage in marketing of credit insurance,

¹ "Tie-Ins Between the Granting of Credit and Sale of Insurance by Bank Holding Companies and other Lenders," Robert A. Eisenbeis & Paul R. Schweitzer, Board of Governors, February, 1979.

premium rates are not reduced by competition, but instead are held at artificially high levels so as to produce higher commissions for lenders acting as agents in the sale of such insurance. This "reverse competition" stems largely from banks' superior bargaining position in the lending transaction. Similarly, in the area of real estate title insurance, it is well documented that the lender can control the selection of the title insurer by a mortgage borrower.

Credit leverage in the sale of insurance by banks has damaging ramifications, not only for the insurance industry, but for the consumer. The ability to tie in the sale of insurance to the granting of credit gives banks an unfair competitive marketing advantage over existing insurers. To the benefit of the consumer, the insurance industry is currently very competitive. Tie-in sales, however, could deprive consumers of the benefits of this competition because their insurance choices would in reality be limited to policies offered by banks at the prices the banks set. In addition, the banks' anti-competitive tactics could lead to more concentration in the insurance industry as traditional insurers unaffiliated with deposit-taking institutions are unable to compete with banks. As noted above, such concentration almost inevitably will lead to higher prices and fewer options for consumers.

In 1983, the New Jersey Department of Banking conducted a hearing on insurance sales and credit leverage (PRN 1113-264) at which we and many representatives of both the banking and insurance industries testified. We testified concerning the dangers inherent in implicit tie-in sales and urged the Banking Department not to promulgate the regulation, which it did in substantially similar form, because it was too narrow and did not address the problem of implicit tie-ins. A copy of our testimony in that earlier hearing

as well as a copy of the adopted regulation is attached as part of an appendix to our testimony here. We believe that this Committee should be aware of the nature of the problem and the fact that, to date, it has not been sufficiently addressed in New Jersey.

(VII)

Regulatory Conflicts

Combining banking with other commercial activities, such as insurance, will lead to regulatory problems because different financial services activities have traditionally been related by diverse regulatory agencies with differing regulatory philosophies and procedures. For example, banks are regulated by a number of federal and state agencies, including the FDIC, the Federal Reserve, the Federal Home Loan Bank Board, the Comptroller of the Currency and others. Insurance regulation has been and is primarily the responsibility of state government. In enacting the McCarran-Ferguson Act in 1945, Congress declared that the business of insurance should continue to be subject to state jurisdiction.

For a number of reasons, including differing accounting procedures, reserve requirements, and overall approach to business, the banking and insurance industries are very different. Therefore, regulatory techniques and requirements are different. Regulation across industry lines of banking and insurance by different agencies invites regulatory turf battles. The answer to the difficult question of whether divergent regulatory goals and procedures can be reconciled is not merely to combine all the regulators into one super regulatory agency at the federal level, or for that matter, at the state

level. Such a solution would create a bureaucracy so monstrously complex that it would undoubtedly cause more problems than it would solve, besides disrupting an effective and smoothly functioning state insurance regulatory system. A super agency is not the answer. However, allowing regulators of one industry to regulate another is a certain invitation to confusion and inefficiency.

As recent bank failures involving, among others, Penn Square Bank of Oklahoma City and United American Bank of Knoxville have shown, the numerous bank regulators have their hands full trying to detect fraud and unsound financial conditions in the banking system with respect to banking activities. In fact, federal bank regulators have publicly stated that they have insufficient information to accurately assess current operations. Their task would be considerably complicated if they were expected to regulate bank activities in the insurance industry, which is subject to different business practices, investment policies, guaranty fund requirements and consumer protection mechanisms. Similarly, insurance regulators would have to reorient completely their regulatory procedures to be able to regulate banking activities adequately.

Notwithstanding how difficult it would be for regulators to readjust to regulating a new industry, it is neither practical nor wise to expect regulators of one aspect of the financial services industry, such as insurance, to ignore the potential impact of a regulated entity's operations in another area, such as banking, when there is such a high likelihood of crossover problems. However, it is exactly this large potential for the spread of financial difficulties across corporate lines that would undoubtedly lead to conflicts among regulators. In short, to allow banks into other regulated industries invites regulatory chaos.

(VIII)

Piecemeal Deregulation by States

Although most of the debate concerning financial services deregulation has focused on Congress, on federal statutes such as the Bank Holding Company Act, and on federal regulators such as the Federal Reserve Board, certain proponents of expanded bank powers have contrived to have legislation introduced at the state level in an attempt to circumvent federal law and policy regarding permissible bank activities. South Dakota has already enacted a law that, in giving state chartered banks the power to engage in all facets of the insurance business and blatantly inviting out of state bank holding companies to acquire such banks, directly undercuts Section 4(c)(8) of the Bank Holding Company Act and thus attempts to usurp the ability of the federal government to regulate the nation's banking system.

The South Dakota law was passed with the avowed purpose of attracting large money center bank holding companies to the state so that they can conduct insurance activities through South Dakota state banks, despite the fact that bank holding companies are explicitly prohibited from engaging in insurance activities under federal law. Promoted as a revenue producing jobs bill that would benefit South Dakota, the statute is structured to encourage banks to offer their insurance products and services only outside the state. The South Dakota legislation was passed in totally self-interested fashion without concern for its impact on other states or on the national banking system. Similar legislation was recently discussed but not introduced in Delaware. Other states, including New Jersey, are currently coming under

pressure from banking interests to consider legislation expanding the power of state-chartered banks to offer insurance services. Bills have been introduced at Governor Cuomo's behest in New York to directly permit the sales and underwriting of insurance services by banks; these bills are outgrowths of the DeWind Commission's report which recommended adoption of such proposals. In New Jersey, bills are still under consideration by the Governor's office which would authorize the sale and underwriting of insurance by lenders. The proposal would provide a complete wish list of new and expanded powers sought by lenders coupled with provisions that would subject bank holding companies to state regulation by New Jersey, for the first time. We believe that consideration of these issues properly resides with Congress.

The issue involved here should not be confused with, or disguised as, a question of the authority of states to regulate their state chartered banks. It is clear that the intent of the South Dakota legislature was not internal regulation of South Dakota state banks, but rather the creation of a vehicle for out of state bank holding companies to offer insurance products and services outside South Dakota in contravention of the federal Bank Holding Company Act. The real issue is whether New York and other states should attempt to deregulate the financial services industry for the rest of the country on a unilateral and piecemeal basis. Clearly, the actions of individual states should not be allowed to threaten the stability of the national banking system. The determination of public policy with respect to the expansion of the powers of bank holding companies and federally chartered banks and thrift institutions should reside with Congress.

Deregulation of financial institutions, integration of financial services, and expansion of bank powers are issues with national implications that should

be decided on a national level. Congressional authority in this area should not be thwarted by state laws that are designed merely to short-circuit federal law and create loopholes in longstanding federal restrictions on bank activities.

We are not alone in advocating such an approach. In testimony before the United States Senate Banking Committee on April 6, 1983, then Treasury Secretary Donald Regan, presently White House Chief of Staff, stated:

"I think that as long as banks are going to come under the federal deposit framework and as long as the Federal government is going to be responsible as the bank of last resort in order to help these banks if they get into trouble through the Federal Deposit Insurance Corporation, that the Federal government has a right to state what activities that bank may or may not perform."

During the debates in Delaware concerning the bill to permit Delaware state banks to engage in insurance activities, Paul Volcker, Federal Reserve Board Chairman, responding to a letter from the Delaware Insurance Commissioner requesting his views as a federal official, indicated on April 12, 1983, that he was:

"...seriously concerned about the possibility of widely divergent and inconsistent laws governing both bank and thrift powers, with deposit-taking organizations shopping for the most permissive rules, and states competing to pass such laws.... The Secretary of

the Treasury has stated that 'this kind of deregulation--haphazard and without consistency or an underlying concept of what is appropriate for an insured institution--is obviously unsatisfactory,' and I agree with him fully. In such a process the public interest may well be lost in assuring that the structure of banking legislation appropriately reflects continuing concern about the safety and soundness of our depository institutions and the appropriate borderline between banking and other activities."

These concerns may have contributed to a decision by the Delaware Governor not to introduce the legislation.

FDIC Chairman William Issac considered overlapping and contradictory federal and state regulations as a contributing factor in the collapse of the United American Bank owned by the Butcher brothers in Tennessee and elsewhere in the South. He stated:

"This made identification and assessment of the problems extraordinarily difficult. The present system with its overlapping

lines of authority is not conducive to effective supervisory coordination of affiliated banking enterprises in a deregulated, rapidly changing environment. (Cited in Howes' dissent before New York Temporary State Commission, supra p. 50).

(IX)

Individual Service

A final point which must be made is one which is perhaps the most obvious and cogent reason why banks' entry into insurance must be examined closely: personal service. What are the commercial banks' plans for consumer services? Hans Angermueller, Vice-Chairman of Citibank admitted before the New York DeWind Commission that consumers might benefit in lower prices for insurance products through sales of insurance by banks, through the use of automatic teller machines. Will consumers really prefer to purchase insurance policies through automatic teller machines than through the independent insurance agency system in place now? By contrast, local agents provide personal services to all communities of each state. People look to agents as advisers as well as sellers of insurance; they are in many instances neighbors as well as friends of the insured who can be called upon at any time for assistance. If banks enter into the insurance field, not only will many of the jobs associated with these agencies be lost but the consumer would lose the personal service that simply cannot be accomplished by a computer or automatic machine.

(X)

Conclusion

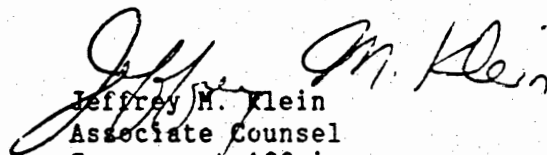
In our testimony before the New Jersey Banking Department at the hearing on credit leverage in August, 1983 and since that time, we have urged the Governor to guide State agencies and financial services institutions toward a comprehensive solution to the many problems that have arisen in recent years from the blurring of distinctions in the financial services industry. We have called for a broad, multifaceted study of financial services deregulation in the State. This is all the more important as we await resolution of this issue at the level at which it should be resolved: the federal level. We are pleased that under the Governor's direction, both the Insurance Department and the Banking Department have convened working groups to examine the scope of the issue and to recommend possible solutions. We are also pleased that the State Assembly has, through Resolution 89 of 1984, authorized the creation of this Subcommittee which has undertaken to solicit views and make its own determination concerning financial services integration in this State. The Legislature once before has attempted to address the question of whether lending institutions should be permitted to sell insurance (P.L. 1975, c. 346, see N.J.S.A. 17:22-6.6(a)) when it responded 'no', but the law was invalidated by the courts due to constitutional infirmities. See ADA Financial Services Corporation et al. v. State of New Jersey et al., 174 N.J. Super. 337 (Appellate Division, 1979). The subject warrants further attention and we believe that the current study process undertaken in both the executive and

legislative branches will prove valuable and provide a wide-ranging forum for examination of the issues. We also believe that the many risks which are associated with banks' entry into insurance which have been addressed in our statement here today should give sufficient pause to those advocating financial services "integration" or "deregulation."

On behalf of our Association and its members, I thank you for the opportunity to be present here today to convey our views. I would be pleased to answer any questions you may have. Our Association stands ready to provide you with any additional information you might request.

Respectfully submitted,

AMERICAN INSURANCE ASSOCIATION


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JMK:mav