NATIONAL CONFERENCE OF INSURANCE LEGISLATORS
FINANCIAL SERVICES & INVESTMENT PRODUCTS COMMITTEE
SAN DIEGO, CALIFORNIA
NOVEMBER 17, 2005
3:00 – 4:30 P.M.
DRAFT MINUTES

The National Conference of Insurance Legislators (NCOIL) Financial Services & Investment Products Committee met at the Hilton San Diego Resort in San Diego, California, on Thursday, November 17, 2005, at 3:00 p.m.

Rep. Joe Hune of Michigan, Chair of the Committee, presided.

Other members of the Committee present were:

Rep. Bill Brady, IL
Sen. Tom Buford, KY
Sen. Joe Crisco, CT
Sen. Steven Geller, FL
Sen. William Haine, IL
Rep. David Hildenbrand, MI
Rep. Morris Hood III, MI
Rep. George Keiser, ND
Rep. Brian Kennedy, RI
Sen. William Larkin, Jr., NY
Rep. Gabe Leland, MI
Del. Harvey Morgan, VA
Rep. Leslie Mortimer, MI
Rep. Terry Parke, IL
Rep. Gene Seaman, TX
Rep. Fulton Sheen, MI
Rep. Geoff Smith, OH
Rep. Frank Wald, ND

Other legislators present were:

Rep. Glenn Anderson, MI
Assem. Nancy Calhoun, NY
Sen. Ann Cummings, VT
Rep. Robert Damron, KY
Rep. Craig Eiland, TX
Rep. Don Flanders, NH
Rep. Robert Godshall, PA
Assem. Ivan Lafayette, NY
Sen. Carroll Leavell, NM
Rep. Virginia Milkey, VT
Sen. Pam Redfield, NE
Rep. Mike Ripley, IN

Sen. James Seward, NY
Sen. Ruth Teichman, KS

Others present were:
Susan Nolan, Nolan Associates, NCOIL Executive Director
Paul Donohue, NCOIL Director of State-Federal Affairs

MINUTES
Upon a motion duly made and seconded, the Committee voted unanimously to approve the minutes of it July 7 meeting in Newport, Rhode Island.

FINANCIAL INSTITUTIONS' RESPONSE TO KATRINA
Mr. Donohue reported that after Hurricane Katrina six federal agencies including the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration asked, but did not require, financial institutions to be lenient on people affected by Katrina. He reported that the agencies recommended, among other things, that financial institutions waive ATM fees, increase daily ATM cash withdrawal limits, and ease restrictions on cashing out of state and non-consumer checks. He reported that a number of institutions including Washington Mutual, Citigroup, Daimler-Chrysler, Ford Motor Credit, Sallie Mae, and MBNA responded to the government's call. He said the IRS was also helping by extending tax filing deadlines, allowing hurricane survivors to borrow from their retirement plans to repair or replace a home, and relaxing administrative rules regarding hardship loans and distributions from certain retirement plans.

Mr. Donohue, addressing ATM issues, reported that many people who tried to get out of New Orleans were unable to do so because they could not get sufficient funds from their bank's ATMs. He reported that the National Federation of Community Development Credit Unions, Inc. followed the FDIC recommendations but experienced problems as a result. He explained that, after the credit union's announcement, a rumor quickly spread that the bank was giving away $300 free to all depositors. A great number of depositors, many of whom did not have sufficient funds in the credit union, withdrew money causing a financial loss for the bank, he said.

STATE/FEDERAL FINANCIAL SERVICES ACTIVITY
Mr. Donohue updated the Committee on Social Security legislation on Capitol Hill and reported that there was one new Social Security bill since the last NCOIL meeting, HR 3304, introduced on July 14 by Representative Jim McCrery (R-LA) and 46 Republican cosponsors. The bill, *Growing Real Ownership for Workers Act of 2005*, is not a comprehensive Social Security reform bill but rather a stopgap measure that would keep Social Security surpluses from going into the general fund, he said. In the Senate, Mr. Donohue reported, Senate Majority Leader Bill Frist (R-TN) agreed to allow supporters of Social Security reform to bring future bills directly to the floor for a vote. Mr.

Donohue said the move would come under an expedited procedure that bypasses committee action. However, Mr. Donohue surmised that chances for passage of any Social Security bill appear very slim as there is near unanimous opposition from congressional Democrats.

J. Kevin McKechnie of the American Bankers Insurance Association (ABIA) reported on HR 111, the *Community Choice in Real Estate Act,* and explained that the issue pitted banks against realtors. He said the banking industry is attempting to expand its financial authority into the real estate industry. By way of background, he explained that in 1999 Gramm-Leach-Bliley (GLB) changed the standard by which the Federal Reserve Board chooses what financial activities are appropriate for banks. He said, prior to 1999, there were bank holding companies, and financial activity had to be banking in nature. After 1999 and the passage of GLB, he said, banks were reclassified as financial holding companies and their permissible scope of activities was broadened to be simply financial in nature. The Federal Reserve declared that real estate brokerage was financial in nature, said Mr. McKechnie.

Mr. McKechnie reported that neither HR 111, which has 251 cosponsors, nor the Senate version, SB 98, has passed. He said that while the House bill has many cosponsors, none is among the most powerful members of the House Financial Services Committee, and those Committee members have blocked the bill. He said while neither bill is moving forward, the Treasury appropriations process is preceding. He explained that both the House and Senate have agreed to a one-year ban on real estate brokerage by banks as part of the appropriations process. Mr. McKechnie predicted that this fight would return next year.

PAYDAY LENDING MODEL ACT

Rep. Hune explained that prior to the Summer Meeting he submitted an American Legislative Exchange Council (ALEC) *Payday Lending Model Bill* as a starting point for NCOIL discussions regarding drafting a payday lending model act. He said that as part of those discussions the Committee heard from industry representatives on why payday lending is necessary. He explained that at the November meeting the Committee would examine Illinois' newly enacted HB 1100, the *Payday Loan Reform Act*.

Mr. Donohue said that the Illinois bill was notable because of its wide acceptance by both industry and consumer groups. He explained that 46 consumer groups as well as the Community Financial Services Association (CFSA), which represents more than 200 payday loan establishments in Illinois, took part in drafting the bill. He pointed out that while numerous consumer groups are behind responsible payday loan legislation, the Consumer Federation of America (CFA) is against all legislation that does not classify payday loans as small loans, thereby subjecting them to small loan protections and interest-rate caps.

Rep. Parke said that to understand payday loans one must look through the eyes of that segment of society that operates on a cash basis. He explained that most of those people do not have checking accounts or other affiliations with banks and therefore live

paycheck to paycheck. He confessed that he initially had a very negative impression of payday lending but because of the persistence of industry lobbyists, he agreed to take a tour of one of the facilities. He said he learned there truly is a need for responsible payday loans. Rep. Parke said he worked for a number of years with interested parties on the bill and finally got it passed, although he noted that some in the payday loan industry thought the bill's interest rate caps were too low.

Mr. Donohue stated that the Illinois bill includes a number of provisions not present in the ALEC bill, including those limiting the minimum and maximum loan terms; requiring a loan cap of $1000, or 25 percent of a consumer's monthly income; requiring a cost cap of $15.50 per $100 loaned; requiring lenders to use a state-certified reporting service to verify the income of consumers; allowing consumers to make loan payments in increments as small as $5; requiring lenders to establish repayment plans, without additional finance charges or interest fees, for consumers with loans older than 35 days; requiring lenders to adhere to strict reporting requirements on all aspects of their business; and prohibiting payday loans facilities from locating within one mile of military bases and gambling establishments.

Del. Morgan stated that the only safeguard against multiple loans in the ALEC model was the consumer's attestation that they had no other loans. He questioned whether the Illinois bill has provisions different from the ALEC model on safeguarding against multiple loans. Mr. Donohue replied that the Illinois bill requires the lender, upon loan origination, to report to a central state-approved reporting service as a safeguard against consumers securing multiple loans. Mr. Donohue stated that many payday loan companies would prefer the use of a private reporting service. Del. Morgan said he worked three years in Virginia to pass a payday loan bill. He explained that the Virginia bill allows payday lenders to use a private reporting service. He reported that, as a result, some consumers were obtaining multiple loans, a fact known only to the payday lenders.

Rep. Smith questioned the effect of the administrative reporting requirement, if any, on loan cost in Illinois. Rep. Parke responded that he did not believe the reporting cost increased the consumer's cost in any significant way. He said that consumer groups questioned the bill's sponsor over those details and were ultimately satisfied that cost escalation would not occur. He added that since Illinois has seven states surrounding it, the state's laws pertaining to businesses must be competitive.

Rep. Keiser stated that North Dakota passed a bill similar to the Illinois bill three years ago but that they amended it a year ago to require lenders, prior to initiating a new loan, to go to the Department of Financial Institutions and document that there is not an existing loan in effect. He observed that the new provision has not had a chilling effect on payday loan operations in his state.

Mike Waters of CFSA stated that he worked on the Illinois bill and that the final product was a compromise. He said that the bill's 15.5% interest rate was as low as industry could go and was much less than industry charged prior to the bill's passage. He reported that the CFSA has just released new model bill provisions suggesting an interest cap of

17 percent. He indicated that payday lenders are not happy with having to use approved databases such as those specified in the Illinois bill because of the extra work and cost involved. He said many state bills require payday lenders to enter data into the database going back two or three years, but that the Illinois bill did not.

Sen. Buford asked Mr. Waters if he had concerns with any of the provisions of the ALEC model. Mr. Waters said the CFSA no longer endorses models without caps on interest rates. Mr. Waters also reported that the current model endorsed by the CFSA no longer permits loan rollovers and provides for a repayment plan for overdue loans.

APPLICATION OF SARBANES-OXLEY TO PRIVATELY HELD COMPANIES

California Deputy Insurance Commissioner Ramon Calderon, member of the NAIC/AICPA Working Group, reported that the group had withdrawn its original proposed plan that included Sarbanes-Oxley (SOX) Section 404-like requirements and a proposed $25 million small-company exemption. He said interested parties had submitted an alternative proposal. Their plan differed in that it did not include an independent auditor attestation requirement and called for increasing the small-company exemption to a $500 million premium threshold, he said.

Deputy Commissioner Calderon stated that there was consensus in the Working Group on accepting those two changes. He explained that there would be 90 percent coverage on all active policies at the $500 million premium level threshold. He also said that figure would encompass 40 percent of existing insurance companies, many of which are already Security and Exchange Commission (SEC) registrants and therefore already complying with SOX. However, he explained, only 6 percent of the nonpublic companies would have to comply, and many of those are already voluntarily complying because of good governance practices. He said two jobs remained: creation of an implementation guide and establishment of a starting date.

Deputy Commissioner Calderon explained that the interested parties would make suggestions for minor refinements and that those suggestions were due by November 30, 2005. He predicted that the Working Group would vote at the NAIC fall meeting to recommend the revisions to the full NAIC/AICPA Committee. He said that the full NAIC/AICPA Committee would then reopen the recommendations for comment as proposed revisions to the Model Audit Rule.

Rep. Hune asked how the subgroup arrived at the $500 million premium threshold level. Deputy Commissioner Calderon explained that industry suggested the figure and that the Working Group reviewed it and found it to be a workable compromise. Deputy Commissioner Calderon said that there were discussions underway about putting an index on the $500 million number so that it would increase in response to economic factors. Sen. Seward asked whom these current provisions were trying to protect since SOX is for public companies and mutual companies are not public. Deputy Commissioner Calderon responded that it was for the protection of consumers and would allow for early intervention in troubled companies. Sen. Seward responded that the

NAIC already has numerous tools at its disposal and that it does not need SOX.

Bruce Ferguson of the American Council of Life Insurers (ACLI) commented that Deputy Commissioner Calderon did an excellent job of summarizing the work completed by the parties. He said that ACLI had not taken a formal position on the proposal but would before the December NAIC meeting. He stated that he expects that ACLI will support the proposal.

Bob Zeman of the Property Casualty Insurers Association of America (PCI) reported that there had been significant progress since the last NCOIL meeting as a result of discussions at the NCOIL conference regarding alternative proposals. He explained that PCI met with Doug Stolte, Chair of NAIC/AICPA Working Group, and that together they sowed the seeds for what was to become the interested party proposal. He said he told Mr. Stolte what he believed to be the two key points: that there should be no specific framework required for compliance, and that the nature of documentation testing should be at the discretion of management. In particular, he said, there should be no outside auditor requirement, which was one of the main cost drivers of the original proposal. Mr. Zeman stated that another significant agreement with the Working Group was that specified changes occur through the NAIC Accreditation Program. He said the result would be a seasoning period, which means states would have time before having to implement the changes. He added that he was pleased that the Working Group had formally withdrawn its original proposal.

Ed Stevenson of Barnert and Associates, representing the National Alliance of Life Companies (NALC), reported that the interested parties believe that SOX has a place in corporate governance, but only in those large, complex companies with multilayered management. He explained that for small companies with direct lines of communication among management, SOX is of less benefit. He said that the Working Group divided its SOX plan into three areas: auditor independence, corporate governance, and internal controls. He said that up to this point speakers had only addressed NCOIL about the internal controls section of the NAIC proposal. He explained that the interested parties still have significant disagreement with corporate governance proposals that would require privately held corporations and mutual companies to appoint independent directors to their board of directors. He questioned the effectiveness of appointing independent board members, noting that many of the biggest corporate disasters, including Enron, WorldCom, and Disney, occurred despite the fact that independent members were on their boards.

Rep. Keiser asked if the $500 million limit applied to all three parts of SOX, as defined by the NAIC. Mr. Stevenson said that, at this point, it only applies to the internal controls section of the proposal.

Neil Alldredge of the National Association of Mutual Insurance Companies (NAMIC) stated that NAMIC was not a member of the interested party group and was firmly opposed to all SOX proposals. Mr. Alldredge explained that the benefits of the proposal did not justify its cost. Even when applying it only to companies at the $500 million-

level, he said, the program's cost would be three times its benefit. He pointed out that Congressman Michael Oxley (R-OH), in a letter to the NAIC, stated that he could have included nonpublic companies in the original SOX legislation, but declined. Mr. Alldredge said that the NAMIC Board of Directors would meet in December and would review the interested parties' proposal for comment. He pointed out that some of NAMIC's companies most opposed to the proposal are under the $500 million-premium level. He concluded that while there was room for improved solvency regulation, the SOX proposal was not the solution.

Deputy Commissioner Ramon Calderon responded that the letter from Representative Oxley to the NAIC did not instruct the NAIC to stop work on its SOX proposal. He explained that NAIC President Commissioner Diane Koken (PA) responded to Representative Oxley that the NAIC was conscious of the cost effects of its proposal, and that regulators were proceeding in a cautious manner. He also pointed out that not all parts of a business are subject to cost-benefit analysis. He explained that areas such as executive compensation are typically not subject to such an analysis.

OTHER BUSINESS

REVIEW OF NCOIL MODEL LAWS, AS PER BYLAWS

Mr. Donohue explained that NCOIL adopted the *Identity Theft Protection Model Act* in 2003 and that NCOIL Bylaws required legislators to review the Act to see if changes might be appropriate. Mr. Donohue pointed out that the proposed *Data Security Act* in Congress might preempt parts of the *Identity Theft Protection Model Act*. He suggested tabling discussions on review of the NCOIL model until he could study the Data Security Act in its final form. Rep. Hune agreed. Upon a motion made and seconded, the Committee deferred review of the bill until the Spring Meeting.

PROPOSED 2006 COMMITTEE CHARGES

Rep. Hune referred the Committee to the tab in their binders containing the proposed 2006 Financial Services and Investment Products Committee charges. Upon a motion made and seconded, the Committee adopted the 2006 Committee charges as follows:

- Further consideration of proposed model legislation regarding payday loans
- Investigate issues and take a position on the proposed entry of the banking industry into real estate
- Establish a position on issues regarding Social Security reform
- Monitor problems and conflicts associated with the merging of banking and insurance products
- Examine jurisdictional issues and tax incentives regarding annuities
- Monitor NAIC attempts to introduce elements of Sarbanes-Oxley into the Model Audit Rule

ADJOURNMENT

There being no further business, the meeting adjourned at 4:30 p.m.

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