

**REPORT OF THE
JOINT SUBCOMMITTEE STUDY OF FINANCIAL INSTITUTIONS**

**TO
THE HOUSE CORPORATIONS, INSURANCE AND BANKING
COMMITTEE
AND
THE SENATE COMMERCE AND LABOR COMMITTEE**



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I. INTRODUCTION

This report is a result of the directive contained in House Joint Resolution No. 271 passed by the 1975 Session of the General Assembly. The resolution directed a joint Subcommittee comprised of members of the House Corporations, Insurance and Banking Committee and the Senate Commerce and Labor Committee to study and report on methods to more effectively monitor, preserve and make secure financial institutions that conduct business in the Commonwealth.

HOUSE JOINT RESOLUTION NO. 271

Requesting a joint subcommittee of the House Corporations, Insurance and Banking Committee and the Senate Commerce and Labor Committee to study and report on ways of better monitoring, preserving and making more financially secure the public utilities and financial institutions doing business in Virginia.

WHEREAS, the economy of Virginia and of the nation is in a serious recession; and

WHEREAS, the protection and preservation of the financial soundness of our public utilities and financial institutions is of utmost importance to the General Assembly and the citizens of the Commonwealth; and

WHEREAS, the General Assembly of Virginia needs to be advised more fully and completely regarding possible procedures for monitoring and protecting such public utilities and financial institutions; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the respective Chairmen of the House Corporations, Insurance and Banking Committee and the Senate Commerce and Labor Committee are requested to appoint five members to the House Corporations, Insurance and Banking Committee and three

members of the Senate Commerce and Labor Committee to a joint subcommittee to study means of better monitoring, preserving and making more financially secure the public utilities and financial institutions doing business in this State, so that the depositors, consumers and public will be better protected during these difficult economic times. The study shall include but not be limited to the problems of removal of officers, merger, appointment of receivers and bonding requirements. The Virginia Bankers Association and the Virginia Savings and Loan League are requested to assist the joint subcommittee in its deliberations. The State Corporation Commission and all agencies of the State shall assist the subcommittee upon request.

The joint subcommittee shall complete its report with any recommended legislation by December one, nineteen hundred seventy-five.

Pursuant to the directive of the Resolution the House Corporations, Insurance and Banking Committee appointed Delegates A. L. Philpott, William T. Wilson, J. Marshall Coleman, C. Hardaway Marks, and Archibald A. Campbell, Jr. to the membership of the Subcommittee.

The Senate Commerce and Labor Committee appointed Senators Edward M. Holland, Coleman B. Yeatts, and William E. Fears to serve on the Joint Subcommittee. L. Willis Robertson, Jr. and Thomas R. Oliver, Jr. were provided by the Division of Legislative Services to serve as staff to the Joint Subcommittee.

The Joint Subcommittee thus formed, was further divided into three Subcommittees to study banks and other financial institutions, the insurance industry, and public utilities.

II. SURVEY

Senator Edward M. Holland was appointed Chairman of the Banking Subcommittee. Senator Coleman B. Yeatts and Delegate C. Hardaway Marks completed the membership. The Subcommittee held several meetings to deliberate the issues and intent of House Joint Resolution No. 271.

At the organizational meeting of the Banking Subcommittee, Senator Holland stated that it was his intent to endeavor to assure the public that due to additional review and audit procedures which were being adopted by the Bureau of Banking to help insure that there would be no repetition of the collapse of the Norfolk Savings and Loan Association. Senator Holland emphasized that it is imperative that citizens have confidence in the financial institutions of the Commonwealth. He noted that there are certain minimal inherent risks which are difficult to avoid when investing and depositing money. However, the Senator emphasized that insurance coverage on deposits is essential.

Also at the organizational and subsequent meetings of the

Subcommittee, the proliferation of Electronic Funds Transfer Systems was a topic of concern and discussion. The Subcommittee heard from representatives of the Virginia Savings and Loan League, the Virginia Bankers Association, and an independent economist concerning EFTS. Senator Holland felt that the Subcommittee did not have sufficient information to make substantive recommendations on a matter with the far-reaching ramifications of EFTS. Many questions remained unanswered about EFTS such as: How will they be regulated? How will they be treated statutorily? What are the safeguards to be taken to prevent fraud, misuse, theft, etc? What impact will they have on small banks and savings and loans associations? It was Senator Holland's opinion, and that of the Subcommittee, that this issue should receive further study and a cautious approach to the matter should be taken in the interim by the General Assembly. According to information obtained during the study, there is already a strong trend occurring in the Commonwealth toward the consolidation of economic power. Will the wholesale introduction of EFTS further consolidate the economic entities in the State and thus lead to the demise of the smaller financial institutions? As stated, these are questions of grave consequence which must be faced and answered immediately if the State is to maintain its proper regulatory function.

In an effort to buttress public confidence in relationship to the solvency of financial institutions, Senator Holland requested the staff to accumulate data concerning the corrective steps which have been taken since the collapse of the Norfolk Savings and Loan Association. The information is as follows:

(1) Industrial loan institutions must have been insured by July 1, 1975. The only exception to this is the People's Industrial Loan of Danville which the SCC gave an extension for cause. The institution has filed the appropriate applications to become a bank.

(2) Savings and loan institutions must be insured by July 1, 1977. Presently, there are five uninsured savings and loan companies doing business in the State. They are as follows: (a) Magic City Savings and Loan (Roanoke) which, will merge with First Federal Savings and Loan in January, 1976; (b) Commercial Savings and Loan (Newport News); (c) Elizabeth Savings and Loan (Portsmouth); (d) Homestead Mutual Building and Loan (Portsmouth); and (e) Augusta County Savings and Loan (Stuart's Draft).

(3) All credit unions subject to State regulation must be insured by July 1, 1976. There are presently forty uninsured credit unions in the State. Credit unions under the auspices of the federal government are already insured.

(4) Savings and loan associations which do not insure their accounts are required by the Code of Virginia (§ 6.1-195.63:1) to state in a prominent place on every advertisement for savings accounts and on every certificate or passbook that their accounts are not insured.

The Subcommittee also communicated with Mr. Ralph Jessee,

Acting Commissioner of Banking, to ascertain his Bureau's current programs and procedures governing banks and savings and loan institutions.

From these communications the Subcommittee determined that the Bureau has established and implemented policies which are designed to insure that financial institutions experiencing difficulty because of capital shortages, internal management problems, etc. are closely supervised and counseled by the Bureau's examiners. Problem areas and deficiencies are pointed out to the management and corrective action is taken.

Institutions which receive less than satisfactory management ratings by an examiner are monitored especially close. Conferences with the Board of Directors and follow-up examinations are utilized to rectify the inadequacies.

The Bureau has adopted stringent standards for employment of new examiners. Additionally, the Bureau avails itself and its employees of all educational opportunities which will enhance an examiner's ability.

Mr. Jessee confers with the officers and directors of a prospective financial institution to advise them of their responsibilities and obligations to the public, the Commonwealth, and the Bureau of Banking. Mr. Jessee assured the Subcommittee that the capital requirements of a prospective financial institution are scrutinized with the utmost care. Under questioning from Senator Holland, he was not prepared to recommend that the capital requirements be increased.

The Bureau has also recently completed its part in a study of itself by an independent firm to examine every facet of the Bureau of Banking. The study is focusing on personnel requirements, recruiting and training practices, the organization for conducting an examination, and other Bureau responsibilities. The results of the study will be taken under advisement by the Bureau, and where deemed appropriate, will result in legislation.

Mr. Jessee stated that his Bureau urgently needs another Review Examiner, additional examiners, additional office space, and escalated salaries to attract qualified personnel.

The Subcommittee charged with reviewing the insurance industry was composed of Senator William E. Fears and Delegate William T. Wilson. This Subcommittee met with the Commissioner of Insurance to review various approaches to the problem which included: (1) a review of existing requirements for the licensing of new companies; (2) means by which to improve and expedite the financial condition examination that the Bureau of Insurance makes of each insurance company licensed to do business in the State; and (3) other alternatives designed to protect the public in the event that an insurance company becomes insolvent.

Senator J. Marshall Coleman was named as Chairman of the Utilities Subcommittee. Delegate Archibald A. Campbell and

Senator Coleman B. Yeatts were also appointed to complete the membership.

Senator Coleman noted that at the March 31, 1975, meeting of the House Corporations, Insurance and Banking Committee that the utility study referred to in House Joint Resolution No. 271 had been assigned to five members of the Committee who would serve with the Senate Subcommittee conducting a comprehensive study of the issue.

After discussing the matter with several persons, including the staff of the Senate-House utility study, Senator Coleman determined that it would constitute an exercise in redundancy to pursue a utility study of his own. The Chairman also noted that the Senate study had been in progress for several months. Consequently they had hired several independent consultants to assist them in this technical area thereby giving them the required expertise to conduct a study of this nature.

Therefore, the Utility Subcommittee did not hold any meetings but will rely on the findings of the Joint Subcommittee Study of Public Utilities.

III. CONCLUSIONS

The Banking Subcommittee will not make any legislative recommendations to the General Assembly. In its study, the Subcommittee was pleased to discover that the Bureau of Banking by its own volition, was initiating additional steps to monitor the managerial and financial situation of Virginia's financial institutions.

The insurance and advertising requirements which are now, or soon will be, in effect governing financial institutions appear to be the best protective measures which can be taken.

As mentioned earlier in the report, the Subcommittee is of the opinion that the question of Electronic Funds Transfer Systems should receive further study by a legislative body designated to deal exclusively with that subject.

The Insurance Subcommittee concluded that Virginia's existing capital requirements for insurance companies appears to be in the median range countrywide and are adequate for their intended purpose. The Subcommittee also believes that existing licensing requirements are reasonably adequate. While there is little question that existing laws could be made more stringent, it is doubtful that such changes would materially strengthen the Bureau of Insurance's present powers. Nor, would such changes guarantee continued future solvency in each and every case—particularly, in today's uncertain economic climate. Equally important is the fact that changes in the existing law would not have much impact upon companies already doing business in Virginia because many of such changes would have to be applied prospectively.

Consideration was also given to possible ways to improve the means by which insurance companies are examined by the Bureau of Insurance. The Commissioner of Insurance reviewed existing procedures with the Subcommittee and reviewed activities presently underway by the National Association of Insurance Commissioners (NAIC) to streamline the examination process. The existing examination procedure has been a subject of much criticism and an indepth review over the last several years. The National Association of Insurance Commissioners has developed a revised Examiner's Handbook, which outlines the examination procedures that are undertaken with respect to each company, and should make final recommendations regarding examination procedures sometime next year. Because of this fact and because it is difficult for any one state to act unilaterally under the present system of state regulation, the Subcommittee felt that it would be appropriate to defer action until the National Association of Insurance Commissioners makes its final recommendations. The Commissioner of Insurance will keep the Subcommittee apprised of developments in this area as they occur.

In summary, the Insurance Subcommittee felt that attempts to change the traditional means of requiring financial solvency would not materially increase the effectiveness of existing regulation. Instead, efforts should be directed more towards the development of procedures designed to protect policyholders in the event of an insolvency in this or other jurisdictions. In this regard, the Subcommittee has examined the steps taken by other jurisdictions and recommends that legislation be enacted to extend to life, accident and health policyholders the same or similar protection presently afforded to Virginia's property and casualty policyholders under Virginia's Insurance Guaranty Association legislation.

While the Subcommittee recognizes that life, accident and health insurance companies are generally more stable than casualty companies, there is also ample evidence that life, accident and health insurance companies have and will continue to experience financial difficulty. For example, between 1963 and 1973 approximately 100 life and health insurance companies were placed in receivership throughout the United States. Since 1973 at least 38 countrywide have experienced severe financial difficulty.

Presently, the Bureau of Insurance's only recourse in the event of an insolvency of a company is to ask Virginia's domestic insurance industry to reinsure Virginia policyholders. While the domestic insurance industry has cooperated in the past, it is not required to do so. In addition, it is possible that under certain extreme circumstances, these companies would either be very reluctant to or would refuse to shoulder this burden. For example, if the assets of the insolvent company were insufficient to pay for the cash value accumulated under policies issued by the insolvent company, insurance companies would naturally not want to assume these obligations without appropriate reimbursement. Nor, would these companies want to assume the business that has been underwritten in an irresponsible manner.

Equally important, is the fact that even if the insurance industry

reinsured or assumed the obligations of the insolvent company, they would not provide money for the payment of existing claims in the event the assets of the insolvent company were insufficient to pay these claims.

Similar problems existed with respect to property and casualty insurance companies. These difficulties prompted the General Assembly in 1970 to enact legislation creating the Property and Casualty Guaranty Association. This association, composed of all property and casualty insurers licensed to do business in the State, will pay outstanding claims against the insolvent company up to the limits of the coverage the policyholder had with the insolvent company. The proposed life and health guaranty legislation would not only pay outstanding claims, but would also provide for the continuation of existing coverage which is particularly important if a policy holder is uninsurable because of age or sickness at the time of insolvency.

Because of these considerations, the Subcommittee believes that the enactment of this type of legislation would provide substantial protection of policyholders without imposing an undue burden upon the insurance industry.

IV. RECOMMENDATIONS

The Insurance Subcommittee is recommending legislation establishing a life and health guaranty fund. This legislation is, with a few minor exceptions, identical to the model bill recently approved by the National Association of Insurance Commissioners. To date, approximately 17 states have enacted such legislation.

More specifically, the proposed legislation will provide for the following:

1. The protection of policyholders holding the following types of insurance: direct life insurance, accident and health insurance, annuity contracts, and supplementary contracts to the above.

2. The creation of an association composed of all companies authorized to sell the type of insurance covered by the proposed legislation. This association would be responsible for paying outstanding claims and assuming outstanding policies in the manner set forth below.

3. The granting of broad powers to the association that either may or under certain circumstances must be exercised subject to the approval of the Commissioner of Insurance. Basically, these powers include the power to guarantee, reinsure or assume the policies of the insolvent company, to provide money necessary to assure payment of the insolvent insurer's obligations and, under certain circumstances, to loan money to the insolvent insurer.

4. The powers that may or must be exercised vary with the type of company involved: With respect to an impaired insurer (that is an

insurer that the Commissioner believes may be potentially unable to fulfill its obligations) the association may reinsure, advance money, etc., provided that the impaired insurer consents to such action. Consent is required because a company is legally authorized to transact business until a formal finding of insolvency is entered by a court of competent jurisdiction. with respect to a domestic or foreign insurer (an insurer domiciled in another state) that is formally declared insolvent, the association must reinsure or advance monies. This is not required, however, when the foreign insurer is domiciled in a state having a guaranty fund similar to that set forth in the proposed legislation since the association in that state will assume these responsibilities.

5. The association would provide protection for all policyholders of domestic companies irrespective of their state of residence. This is because the State of Virginia has the primary regulatory responsibilities with respect to domestic companies. With respect to foreign insurers, it would only protect Virginia residents. In addition, the aggregate liability of the association is limited to \$100,000 in cash values, with respect to any one life.

6. The cost of administering the association and for fulfilling its responsibilities would be assessed against the insurance companies that are required to participate in the association. Assessments would be made against the companies licensed to do business in this state as funds are needed and in accordance with various equitable formulas. More specifically:

a. Assessments for administrative expenses would be assessed equally among participants of the association and would not exceed \$50;

b. Assessments for costs associated with the assumption of obligations of an impaired or insolvent domestic insurer would be computed in the following manner: (1) the cost for protecting policyholders in each state in which the domestic company did business would be determined for each state; and (2) each insurer would then absorb a pro-rata share of the allocated cost in each state based on the relationship that an insurer's premium volume in that state bears to the total premium volume of all members of the association in that state.

c. Assessments for foreign or alien companies would be based on a pro-rata basis equal to the rate that the premium volume of each member of the association in this state bears to the total premium volume of all members of the association in this state.

Assessments may be deferred if the payment of the assessment would endanger the ability of a company to fulfill its obligations to its policyholders. Provision is also made for the return of assessments to the extent the amount collected is not required to fulfill the obligations of the association.

6. The proposed legislation also provides for a premium tax offset for assessments other than those for administrative costs. This tax offset is included in a life and accident health guaranty

association legislation since life and health insurers can only pass this cost onto new policyholders because premium levels are established by a company's existing insurance contract. An auto or fire policy, on the other hand, is renewed each year or every several years at new rates. Accordingly, casualty insurers can spread the cost of such assessments among all existing and new policyholders over a short period of time.

Generally, this offset will not have to be resorted to since the financial structure of life companies will usually provide sufficient funds to cover all or most of the cost of reinsurance and the payment of outstanding claims.

The proposed legislation contains many other provisions that are designed to enable the association to recoup monies advanced and to implement the major provisions outlined above.

Respectfully submitted,

A. L. Philpott, Chairman

Edward M. Holland, Vice Chairman

Archibald A. Campbell

J. Marshall Coleman

William E. Fears

C. Hardaway Marks

William T. Wilson

Coleman B. Yeatts