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PROTECTING CONSUMERS: WHAT CAN CONGRESS DO TO HELP FINANCIAL REGULATORS COORDINATE EFFORTS TO FIGHT FRAUD?

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

AND THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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TUESDAY, MARCH 6, 2001

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE OVERSIGHT AND INVESTIGATIONS, AND
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The joint subcommittees met, pursuant to call, at 2:00 p.m., in room 2128, Rayburn House Office Building, Hon. Sue W. Kelly, [chair of the Subcommittee on Oversight and Investigations], presiding.

Present for the Subcommittee on Oversight and Investigations: Chair Kelly; Representatives Cantor, Gutierrez, Bentsen, Inslee, Capuano and Clay.

Present for the Subcommittee on Financial Institutions and Consumer Credit: Representatives Bachus, Castle, Ryun, Biggert, Toomey, Cantor, Grucci, Hart, Capito, Rogers, Tiberi, Waters, Bentsen, Sherman, Gutierrez, Moore, Gonzalez, Hooley, Hinojosa and Lucas of Kentucky.

Also Present: Representative Oxley.

Chairwoman KELLY. This joint hearing of the Subcommittee on Oversight and Investigations and the Subcommittee on Financial Institutions and Consumer Credit will come to order.

Without objection, all Members' opening statements will be made part of the record. Today we are here to hold the first of many subcommittee hearings on issues of importance to consumers, regulators and the financial services industries.

As this is a joint hearing of the Subcommittee on Oversight and Investigations and my colleague from Birmingham, Mr. Bachus', Subcommittee on Financial Institutions, I want to thank him for allowing me to chair this hearing and for his invaluable thoughts and observations on the issues before us.

In addition, I want to thank the Ranking Member of our Subcommittee on Oversight and Investigations, the gentleman from Chicago, Mr. Gutierrez, and the Ranking Member of the Subcommittee on Financial Institutions, the gentlewoman from Los Angeles, Ms. Waters, for their work on this issue and for agreeing to hold the hearing on this very important issue.

I look forward to continuing to work with you, along with all the Members of our committee, as we consider potential legislation that may result from the information that we gather at this hearing today.

With the recent enactment of the Gramm-Leach-Bliley Act, Congress required "functional regulation" of our financial services industry. In order to make functional regulation work, Congress directed regulators to work together in the policing of their industries. Particularly in the insurance industry, since the enactment of the 1994 Insurance Fraud Prevention Act, the insurance industry has been unable to access the necessary information to enforce this law. This act prohibits anyone who has been convicted of a felony involving dishonesty or a breach of trust from engaging in the business of insurance. However, the law did not provide any means for potential employers or insurance regulators to check for criminal background.

Proper implementation of these acts clearly requires both increased coordination and communication among the regulators and the highest of standards for those who work in the financial services industry. We must ensure that the regulators have all the tools they need to meet these goals. To add to this problem, we have clear cases where criminals, after being banned from one financial industry, have gone to another financial industry to continue their fraud. The best example of this is the case of Martin Frankel, who was just reported to have been extradited back to the United States to face charges for his crimes after his failed escape attempt in Germany last week.

After being permanently banned from the securities industry in August of 1992, Mr. Frankel migrated to the insurance industry, where he is charged with perpetrating an investment scam which stole more than $200 million from insurance companies. Representatives from the General Accounting Office are here with us today who will provide some details of his alleged activities before he fled the country in 1999. Mr. Frankel now faces a 36-count indictment, with 20 counts of wire fraud, 13 counts of money laundering, and one count each of securities fraud, racketeering, and conspiracy.

We have called this hearing to gain a better understanding of these issues from the perspective of regulators and the industry. It is our hope that this can lead to legislation to facilitate communication, which can prevent criminals from exploiting this perceived weakness, as was perpetrated by Mr. Martin Frankel.

At issue before us is the impact these problems have upon consumers and what we can do to further protect consumers by better regulatory oversight.

Before us today we are honored to have two distinguished panels of witnesses to share their thoughts and observations about this problem. I thank all of you for taking time out of your schedules and fighting the snow to get down here to discuss the issues with us.

At this point, I would like to let Members of the Committee and their staff know that it is my intention to enforce the 5-minute rule. I would appreciate their cooperation in this, and I would ask staff to inform their Members of this, should their Member arrive late for the hearing.

Now let me recognize Mr. Sherman, my colleague from California, for his opening statement.

[The prepared statement of Hon. Sue W. Kelly can be found on page 197 in the appendix.]

Mr. SHERMAN. Thank you, Madam Chairwoman.

Consumer fraud is an important issue, and I am glad both subcommittees have come together to hold this hearing. We need better coordination, and the example you gave is a perfect one as to how being banned from one industry should certainly be acknowledged by and usually lead to a ban from the other industries as well. There is more that can be done to coordinate the financial services regulatory scheme.

I think, though, if we are going to fight fraud, there are other areas to look at as well as coordination. One of those is funding.

In the next day or two, the Capital Markets Subcommittee is going to have a hearing on reducing the fees imposed on transactions, I believe with a focus of reducing the fee of 1/300 of 1 percent down to 1/500 of 1 percent.

It may very well be that is an appropriate reduction, but we should not assume that we are doing all that we need to do and accordingly can cut the fees to as low as they possibly could go to keep that continuing effort alive.

I have been in public life for a while at the State and Federal level. No one has ever come to me and complained about a 1/300 of 1 percent fee, or explained that their life would be better if it was only 1/500 of 1 percent.

But not a year goes by when I do not hear several stories of people who are victimized by financial services fraud, usually securities fraud. We need to do more to protect investors from securities fraud. We need to devote the adequate resources to this. We need also to have the resources to increase our efforts. We have to devote the resources necessary to provide parity for those employed by the SEC, and we need to look at new techniques for enforcement.

One thing that troubles me a bit, and I am not ready, without hearing from other experts, to embrace the complete solution to this, is that the SEC is prohibited by its own policies or perhaps by statute from having its people pretend to be investors, which would be the best way, it would seem, to find out what investors are being told, what investments are being marketed. Yet I am told, even if an SEC employee is called by one of these boiler room operations, they have to say, "Oh, by the way, I am with the SEC." Click.

What instead we ought to explore authorizing and directing the SEC to do is to have its people pose as investors, get on the lists, hear the telephone calls, and at least be allowed to search the web the way investors or potential investors do to see what is being offered. That I think is an effective way to make sure that securities that are being offered according to law and the claims being made for them are at least within the realm of reason, and either those claims are legal or at least close to being legal.

I have heard from so many people who have lost so much money by the marketing of securities that are so far outside what is le-

gally allowed that I have to wonder whether we do not need more effort in that area.

I would point out that most crimes take place in private or in the dark. Securities fraud and other investment fraud has to take place openly. The victim does not have a gun to their head, the victim is there in the open, and certainly we should be able to spot crimes that take place in the daylight even more easily than we are able to prevent crimes that take place in the dark of night.

So, Madam Chairwoman, thank you for the hearing, and thanks for the opportunity to make an opening statement.

Chairwoman KELLY. Thank you very much.

We have been joined by a number of other Members. I just simply would like to remind them, if their staff has not told them, that I would like to enforce the 5-minute rule. I would really appreciate their cooperation in this.

Next we turn to the Chairman of the Subcommittee on Financial Institutions, Mr. Bachus.

Mr. BACHUS. Thank you, Madam Chairwoman.

I can think of no better topic which this committee can begin our work with in this Congress than the one that brings us here together today, that is, protecting consumers by making sure our financial watchdog agencies have the necessary tools to combat fraud and that they cooperate and coordinate their efforts in fighting fraud.

We have nearly 200 State and Federal regulators, so it is very important. They each have separate filing systems. They maintain separate records. It only makes good common sense that they would coordinate and cooperate together.

I think, as Chairwoman Kelly has said, with Mr. Frankel being extradited over the weekend back to the United States, he is certainly a high-profile poster boy for why cooperation between Federal and State financial regulators is so critical and what happens when there is not that cooperation and coordination.

I want to thank Madam Chairwoman for convening this joint hearing to consider the issue. This is, as I said, the first hearing of the full committee. I am excited about the new Financial Services Committee. I am excited that Chairman Oxley will be our leader. He is a very exciting person to work with. As a former FBI agent, I know he has a personal interest in this hearing. I know he will be traveling back to Ohio tomorrow because of Governor Rhodes' death for that funeral, and I know we are all saddened by that.

I want to thank my Ranking Member, Ms. Waters. She and I have now been the Chairman and Ranking Member of three separate subcommittees on the Financial Services Committee. We have always had a spirit of collegiality and candor. We work well together. I am sure that is going to continue.

So I look forward, Ms. Waters, to working with you in this Congress. She and I are both very concerned about consumer fraud. Again, this is an appropriate place to start.

I also want to say, we have some staff changes on the Financial Services Committee, and I want to just right up front thank Robert Gordon and Charles Symington in the preparation for this hearing. It was outstanding. If we come into something prepared and well-

briefed, it can be so much more fruitful. I feel like you all have done an excellent job preparing it. It tells me that you already have an expertise in this area, so thank you for that.

The concept of linking together already existing databases maintained by various financial regulators and law enforcement agents to combat fraud ought to be something that we just do, not something that we really have to work hard to do, because it does, as I say, make good common sense. If implemented properly, such an increase can serve as an effective early warning system when con artists like Mr. Frankel attempt to expand the frontiers of their criminal enterprises to new industries and new locations.

As with any effort to promote cooperation between regulators of different industries across jurisdictional lines, achieving that objective is easier said than done. Anyone who has spent a significant time inside the Beltway knows how difficult it is to get different Government bureaucracies to coordinate their activities, each in an area such as this where the benefits of such cooperation are so obvious, but, despite that, turf battles are one of Washington's favorite pastimes. But for the sake of the consumer, we ought to put those aside.

As I mentioned, there are logistical questions related to these different antifraud databases maintained by the agencies, and they should be concerned about confidentiality. We should work very hard to see that, while this kind of information is available, that we protect it and make sure it does not get disseminated where it should not be.

I will close again by just saying, Mrs. Kelly, I look forward to working with you and the staff. We have some new freshman Members on the committee, and I can tell you that they are some of the stars of the freshman class, so we are fortunate that we have got some new Members of this committee that are very sharp. They have come into this Congress with a lot of accomplishments. I think they are going to be of great assistance to us right off the bat.

Some of them are in attendance today. I am looking forward to working with them and Chairman Oxley and the staff as we consider legislative proposals to advance the fight against financial fraud. That fight begins by listening to those who are out there on the front lines combatting it every day, our regulators. So we look forward to this panel and the next panel sharing that information with us and getting us informed enough to make the right decisions on what to do from this day forward.

Thank you, Madam Chairwoman.

[The prepared statement of Hon. Spencer Bachus can be found on page 198 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Bachus.

We will next go in order of appearance for the committee hearing to Mr. Gonzalez.

Mr. GONZALEZ. I do not have an opening statement. Thank you very much, Madam Chairwoman.

Chairwoman KELLY. Thank you very much, Mr. Gonzalez.

Next we will go to Mr. Rogers.

Mr. ROGERS. I will pass. Thank you, Madam Chairwoman.

Chairwoman KELLY. Next we will go to the Ranking Member of the Subcommittee on Oversight and Investigations and someone I look forward to working with, Mr. Gutierrez.

Mr. GUTIERREZ. Thank you very much, Chairwoman Kelly and Ranking Member Waters and Chairman Bachus. I am pleased to be here today. Addressing the importance of sharing information between regulators at different financial services sectors is long overdue, and I want to congratulate you, Chairwoman Kelly, for calling this hearing.

The problem of financial fraud has tremendously affected not only the financial services industry, but also the consumers. Consumers and taxpayers in States around the country ultimately pay the consequences of lacking a centralized network to help prevent fraud.

Clearly, the problem of financial fraud cannot be solved unilaterally by legislators, no more than it can be solved unilaterally by the private sector. If we are to identify and respond to the problem, we have to unite our efforts of industry and legislators at the national level, on the national level, because I don't think any State can do this alone. This really requires the cooperation and, more importantly, the coordination of States alongside the Federal level.

I recognize the importance of providing all Federal and State financial services regulators with a single network where they can obtain necessary disciplinary information regarding a financial services company or individual. However, it is imperative that we maintain and respect confidentiality and privacy of unrelated items or information.

Regulators across America must be able to spot, investigate and halt such actions as Martin Frankel's. Congress must help by providing the necessary legal framework to help achieve this.

I hope with the information gathered here today Congress will be able to take a firm step toward fighting financial fraud. In doing so, we will not only be helping the industry and the public coffer first, but also the consumers.

I look forward to hearing all of the testimony here this afternoon. Thank you very much.

Chairwoman KELLY. Thank you, Mr. Gutierrez.

Next we are going to Ms. Hart.

Ms. HART. I will pass, Madam Chairwoman. Thank you.

Chairwoman KELLY. Next we will go to Mr. Grucci. Mr. Grucci, have you an opening statement?

Mr. GRUCCI. Madam Chairwoman, I don't have an opening statement, but I am interested in hearing what is going to be taking place. I may have some questions. I reserve the ability to ask those questions later.

Chairwoman KELLY. Thank you very much.

Ms. Hooley.

Ms. HOOLEY. I have no opening statement. Thank you.

Chairwoman KELLY. Ms. Waters.

Ms. WATERS. Thank you very much, Madam Chairwoman.

I don't have an opening statement, but I would like to first congratulate you and Chairman Bachus on your new responsibilities and to say to you that I think this is a good start, that we have two subcommittees cooperating. Oftentimes, we kind of run off and

do duplicative work. This is a good sign that we will be able to move forward together.

As you know, Mr. Bachus and I did work very well on the Domestic and International Monetary Policy Subcommittee, where we had the honor of being in the forefront of the debt relief initiative that has been supported by almost everybody in this House and passed.

So I am looking forward to the opportunity not only to serve as Ranking Member on the Subcommittee on Financial Institutions and Consumer Credit with Mr. Bachus, but, again, on working with you and the other chairs of committees.

I would also like to thank Mr. Gutierrez for accepting the responsibility to serve as the Ranking Member on the Subcommittee on Oversight and Investigations.

Let me just say that even though we don't have a detailed proposal before us, that this is an important subject matter. It appears to me that some thought has gone into what we can do to begin to collect information and data and compile it in ways where we can have information on consumers in this country. That may be a good thing, but, of course, you know, as a strong civil libertarian, I have to always be concerned about whether or not we are invading privacy, whether or not we are literally eliminating the opportunity for someone to pursue careers and to pursue their goals in these industries unfairly in ways that will harm them if the information is not correct and complete and well vetted.

So we must be careful when we begin to compile data and information that will eliminate one's ability to work or to perform their duties and their careers.

I also would like to hear as we go forward in this why the Treasury Department has not been included, and maybe this is just the first draft or the first shot at how the Antifraud Subcommittee of the Federal Financial Institutions Examination Council will be created.

So I look forward to hearing from our witnesses here today; and, again, thank you for holding this hearing.

Chairwoman KELLY. Thank you very much, Ms. Waters.

Next we go to Mr. Cantor.

Mr. CANTOR. Madam Chairwoman, I have no opening statement. Thank you.

Chairwoman KELLY. Thank you.

Mrs. Biggert.

Mrs. BIGGERT. Thank you, Madam Chairwoman. I have no opening statement.

Chairwoman KELLY. Thank you.

Mr. Capuano.

Mr. CAPUANO. No, thank you.

Chairwoman KELLY. Mr. Clay.

Mr. CLAY. Madam Chairwoman, I don't have an opening statement. I am just looking forward to hearing the testimony of the two panels. Thank you.

Chairwoman KELLY. Thank you, Mr. Clay.

Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Madam Chairwoman. I have no opening statement, and I look forward to listening to the panelists and asking questions at that time.

Chairwoman KELLY. Thank you.

Mr. Lucas.

Mr. LUCAS. I have no opening statement. Thank you.

Chairwoman KELLY. Mr. Bentsen.

Mr. BENTSEN. No, thank you.

Chairwoman KELLY. Thank you very much.

If there are no more opening statements, let us begin with our first panel.

Before us today we have Julie Williams, First Senior Deputy Controller and Chief Counsel for the Office of the Comptroller of the Currency.

We have Mr. Scott Albinson, the Managing Director for Examination and Supervision in the Office of Thrift Supervision.

We have Terri Vaughan, the Iowa Commissioner of Insurance and the Vice President of the National Association of Insurance Commissioners, who is here on behalf of the National Association of Insurance Commissioners.

We have Mr. Dennis Lormel, the Section Chief for the Financial Crimes Section of the Federal Bureau of Investigation.

Finally, we have Mr. David M. Becker, the General Counsel for the Securities and Exchange Commission.

We thank all of you for joining us here today to share your thoughts on this issue.

Without objection, your written statements will be made part of the record. You will each be recognized for a 5-minute summary of your testimony.

Let us begin with Ms. Williams.

STATEMENT OF HON. JULIE L. WILLIAMS, FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. WILLIAMS. Thank you.

Madam Chairwoman, Mr. Chairman, Ranking Members Gutierrez and Waters and Members of the subcommittees, thank you for inviting the Office of the Comptroller of the Currency to participate in this hearing.

In view of the integration of the financial services industries that is permitted by the Gramm-Leach-Bliley Act and the resulting potential for individuals to move among the banking, securities and insurance industries, it is particularly important for each functional regulator to know whether individuals or entities have been subject to enforcement or disciplinary actions by another functional regulator. On behalf of the Comptroller, I would like to thank you for your efforts to further these objectives.

My written statement describes the most significant ways in which the OCC currently shares information with other Federal and State regulators. I will not repeat all that detail here, but I will just note that we have various arrangements in place to share different types of information with the other Federal banking agencies, with the SEC and with State insurance regulators.

I would also like to especially mention the progress that has occurred in just a few years in cooperative efforts between the banking agencies and the insurance regulatory community.

As you consider the design of a new system for enhanced enforcement-related information sharing among functional regulators, there are two areas that I would like to highlight in my remarks this afternoon.

First is the need to ensure that disclosure of the information is not prohibited or restricted by Federal law; and, if disclosure is authorized, that applicable privileges are properly preserved.

Certain Federal laws, which are discussed in greater detail in my written statement, prohibit or restrict some types of non-public information in the possession of one regulator from being shared with other Federal and State regulators. Even if a statutory exception permits the sharing of information, statutory and common law privileges may still be waived or destroyed by the unprotected disclosure of privileged information. Thus, any new system for enhanced sharing of non-public information among Federal and State regulators needs to take account of and preserve all these different types of privileges.

Second, we need to recognize that expanded information sharing can raise very sensitive issues regarding the nature and reliability of the information collected and how that information is used when it is shared. Disclosure to other regulators of preliminary suspicions, the reliability of which could vary widely, would raise significant privacy issues, including the possibility that dissemination of potentially inaccurate accusations against individuals or institutions could cause unwarranted harm to the reputation of the individual or the entity.

Disclosure of preliminary information also could hamper ongoing investigations by law enforcement agencies or Federal banking agencies and might even expose agencies to some potential liability for falsely accusing individuals.

We respectfully suggest that a balance between addressing these concerns and promoting the benefits of interagency information sharing could be achieved if new legislation first were to focus on establishing a system for ready and convenient access by each functional regulator to information regarding final enforcement and disciplinary actions taken by all the functional regulators.

If Congress chose to include additional types of information in such a system, we would urge that the additional information focus on formally commenced enforcement and disciplinary actions by the participating Federal and State agencies.

Congress could direct the relevant agencies to build on their existing systems to create an automated, linked system accessible to functional regulators that contains public information on enforcement actions taken, potentially with the limited edition of non-public information concerning the initiation of formal actions and with provision for the role of the NAIC on behalf of the State insurance supervisor in that process.

This approach would make it unnecessary to create any new governmental agency to manage information sharing among functional regulators.

In closing, let me again state our appreciation that the subcommittees are addressing these issues. Many of the issues in this area can be quite complex, and we would be happy to work with you and your staffs to provide technical assistance as you develop specific legislative proposals.

Thank you, and I would be happy to try to answer any questions.

[The prepared statement of Hon. Julie L. Williams can be found on page 48 in the appendix.]

Chairwoman KELLY. Thank you so much, Ms. Williams.

Next let us go to Mr. Albinson; and thank you, Mr. Albinson, for being here.

STATEMENT OF SCOTT ALBINSON, MANAGING DIRECTOR, EXAMINATIONS AND SUPERVISION, OFFICE OF THRIFT SUPERVISION

Mr. ALBINSON. Thank you.

Good afternoon, Madam Chairwoman and Members of the subcommittees. Thank you for the opportunity to discuss the information-sharing systems we have in place at OTS.

We support efforts to improve information sharing among the function regulators. Safeguarding thrifts from fraudulent activities and from individuals and entities responsible for financial fraud is of paramount concern to OTS.

We also appreciate the attention that has been directed at the need to protect sensitive information in attempting to craft an interagency database network.

Finally, we support efforts to include confidentiality and liability protections for all shared information so that financial regulators do not compromise existing legal privileges when sharing information with other financial regulators and law enforcement organizations.

Since 1997, 43 insurance groups and 15 securities firms have acquired or affiliated with OTS-regulated thrifts. In each instance, OTS reviewed and evaluated the financial and managerial resources of the applicant in order to identify the extent to which the acquisition or affiliation posed risks to the safety and soundness of the thrift. This often required us to contact numerous State and Federal regulators to obtain information on the applicant and its affiliates.

For an insurance company, for example, that operates on a nationwide basis, this means that relevant information may be available from virtually every State insurance commissioner. Where an applicant has both securities and insurance operations, the information trail extends to the SEC, NASD and State securities commissioners. Thus, our interest in efficiently obtaining access to interagency regulatory information is compelling.

Because of these needs, OTS has been sharing information with various State and Federal regulators for some years. Our cooperative arrangements are both formal and informal. We work closely with our sister banking agencies and State bank regulators. We have a long-standing working relationship with the SEC; and, in 1995, we executed a joint interagency information-sharing agreement with the NASD.

Our most recent agreements were developed as a result of the influx of insurance company applicants for thrift charters during the late 1990's. This prompted us a few years ago to develop a close working relationship with the NAIC, which has led to the development of a model agreement that is the basis for written information-sharing agreements with 41 State Insurance Commissioners. These agreements extend significantly beyond the sharing of consumer complaint data and include the sharing of financial and enforcement information. We hope ultimately to have agreements in place with every State insurance commissioner.

Notwithstanding the relationships we have developed with other financial regulators, the information agreements we have in place and the databases that we currently maintain and access, we share the interests of our fellow regulators in improving our access to information that can help us do our jobs.

In my written statement, we discuss a number of approaches to interagency information sharing. A practical first step is linking or aggregating the existing public databases of financial regulators. This could be accomplished in a variety of ways that would make each regulator's database information accessible simultaneously. Each solution, of course, raises more difficult issues, both logistical and substantive, including security, information integrity, confidentiality and liability protections.

For any type of database-sharing system to be useful in tracking individuals involved in financial fraud, however, the quality and integrity of the information fed into the system must be consistent and sustained.

Currently, the Federal banking agencies are only provided information regarding the addition of new senior officers and directors if the depository institution is in a troubled or undercapitalized condition. A streamlined after-the-fact notice regarding appointments from institutions not otherwise covered by this requirement would address this information void.

OTS will soon issue a regulation that affords thrifts some degree of corporate governance self-defense against perpetrators of financial fraud. This regulation will permit thrifts to adopt a preapproved bylaw that would preclude persons under indictment for or convicted of crimes or subject to a cease and desist order for fiduciary violations from serving on the institution's board of directors.

Financial regulators spend considerable resources tracking down fraudulent activities and the perpetrators of financial fraud. To the extent we can combine and leverage our collective experiences and information, consumers will benefit through a more effective process. We support the committee's efforts to achieve this objective.

Thank you. I will be happy to take any questions.

[The prepared statement of Scott Albinson can be found on page 68 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Albinson.

Next we have Terri Vaughan. Thank you, Ms. Vaughan, for testifying.

STATEMENT OF HON. TERRI M. VAUGHAN, IOWA COMMISSIONER OF INSURANCE, VICE PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, ON BEHALF OF NAIC

Ms. VAUGHAN. Good afternoon. Thank you, Madam Chairwoman, Mr. Chairman, and subcommittee Members. I am pleased to be here on behalf of the NAIC and State insurance regulators to help the Financial Services Committee as you work to establish an effective anti-fraud information network.

Today I would like to make three major points regarding regulatory information sharing.

First, the NAIC and State insurance regulators believe information sharing is the cornerstone for implementing functional regulation under the Gramm-Leach-Bliley Act. As regulators, we exist to protect consumers. To do so, we must have access to criminal history information for routine background checks and to keep tabs on the bad actors in all areas of the financial services industry.

We started the process of sharing information with Federal regulators well before the enactment of the Gramm-Leach-Bliley Act. Our first priority has been to negotiate written cooperation agreements that can be used to open information channels between State insurance departments and Federal banking and securities regulators.

Scott touched on the agreements we have with the Office of Thrift Supervision. In addition to the OTS agreements, we recently completed negotiating agreements with the Federal Reserve Board, the OCC and the FDIC. These agreements cover broad exchanges of information, including information on financial solvency, enforcement matters, routine licensing and consumer complaints; and we expect that most States will sign these agreements during this year.

My second point: As a State-based system, we have considerable experience in information sharing. The NAIC already has sophisticated online systems for sharing information among the States concerning licensing, financial condition, enforcement and consumer complaints.

The NAIC annually spends about $20 million and dedicates roughly 170 staff people to maintaining our databases at the NAIC. As a result of this commitment, we currently have the technical infrastructure in place to share regulatory information with Federal agencies.

As the central database manager and the link to individual State insurance department computer systems, the NAIC is fully capable of receiving and handling both public and confidential regulator information.

We believe effective information sharing must be structured on the following principles:

First, we need to create a national information antifraud network based on information-sharing agreements among functional regulators and law enforcement agencies.

We need to establish a central database authority that would set the policy and technical standards for sharing this regulator and law enforcement information.

We need to link databases, rather than create new ones. Each of us has a significant investment in our current databases, including training and integration. These should be preserved and enhanced by permitting mutual access.

Finally, we need to provide all participants in an antifraud network with legal immunity for good-faith reporting and handling of regulator information.

My third point: While the NAIC supports congressional efforts to create a broad antifraud information-sharing network, we strongly urge you to fix two glaring problems with the current system immediately.

The first relates to our ability to access the FBI's fingerprint identification record system. Madam Chairwoman, I appreciated your opening comments regarding the need for insurance regulators to be able to access this database. As you know, State insurance regulators are the only functional regulators who do not currently have access to this system operated by the FBI.

Permitting States to run national fingerprint background checks on insurance agents and company personnel is the best way to weed out known wrongdoers before they get a chance to commit insurance fraud. It is also critical if Congress expects the States to enforce the Federal insurance fraud laws and to establish a national agents licensing system, as envisioned by Gramm-Leach-Bliley.

Second, we need Congress to help us gain access to the national securities enforcement database maintained by the National Association of Securities Dealers. We have been working with the NASD to try to negotiate access for approximately two years, and to date we have not been successful.

I understand there are potentially some legal issues that they may have that you might be able to help us with. In return, we are willing to share with the NASD the extensive database that the NAIC maintains on insurance agents and companies.

In conclusion, the State insurance regulators and the NAIC fully support a move to create a nationwide network of information sharing among regulators to fight financial fraud. We are ready and able to share the information in our own regulatory databases in exchange for receiving the information held by banking and securities regulators.

The most urgent need, in our opinion, is for Congress to open the doors to the FBI fingerprint and the NASD enforcement databases. These critical tools should not be left waiting while Congress determines how other elements of a national antifraud information program should be implemented.

We pledge our commitment and cooperation, and we appreciate the opportunity to participate in this important initiative. I would be pleased to answer any questions you may have.

[The prepared statement of Hon. Terri M. Vaughan can be found on page 96 in the appendix.]

Chairwoman KELLY. Thank you very much, Ms. Vaughan.

Next we would like to hear from you, Mr. Lormel.

STATEMENT OF DENNIS M. LORMEL, CHIEF, FINANCIAL CRIMES SECTION, FEDERAL BUREAU OF INVESTIGATION

Mr. LORMEL. Thank you, ma'am.

We have a bit of a different perspective. Ours, obviously, is law-enforcement-driven. Yet we are here in support of this initiative, and we appreciate the opportunity to speak with you today and to participate in the forum.

What I would like to do would be to defer most of my comments to questions, but certainly my written statement speaks to two things.

It is to, as my colleague to my right stated, to the information that we have available through our record check capabilities, through our CJIS—Criminal Justice Information Services Division—facility and in other means, and also to the importance of us sharing information, as regulators, as an industry, as a law enforcement community in the opportunity to work together on the crime problems.

The Department of Justice has not yet, with the new Administration, come out with a policy statement, so certainly I am not in a position to talk to policy at this point. But we are here as a sign of cooperation and are interested in working with everybody to further this initiative.

The insurance industry in particular is an industry that is—the enormity of the industry in terms of size, in terms of opportunity for exploitation and control weaknesses is certainly in need of a uniform approach to looking at the crime problems. Lack of uniformity and systemic control weaknesses encourage individuals such as Martin Frankel to enter and fraudulently exploit the insurance industry.

A few of you have spoken about the Frankel case. Unfortunately, the Frankel case is one of a number of cases that speak to the enormity of the crime problem.

We have over 500 investigations ongoing involving the insurance industry. Unfortunately, there have been a few, like the Frankel case, like the Shalom Weiss case out of Tampa, which has been, again, a multi-million dollar case causing multi-million dollar losses; and in that particular case the criminal—I think the convictions in those cases, the sentences were among the most significant sentences given by a judge in financial crimes cases.

Just summing up my position, then, we are here, again, to support this initiative. We look to see that, from our standpoint, anything that the Bureau can support in working with our colleagues—and the essence of the comments that were made by members of the panel and members down here in terms of the necessity for cooperation and coordination, I could not stress that enough.

[The prepared statement of Dennis M. Lormel can be found on page 113 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Lormel.

Mr. Becker.

STATEMENT OF DAVID M. BECKER, GENERAL COUNSEL, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. BECKER. Chairwoman Kelly, Chairman Bachus, Ranking Members Waters and Gutierrez and Members of the subcommittee, we at the Securities and Exchange Commission appreciate very much your efforts in helping us and other regulators coordinate efforts to fight financial fraud. We all share the goal of staying a step ahead of cynical scofflaws who, having been barred from one financial industry sector, move to a different sector in the hope that the regulators there will not know of their taint, or if they do know about it, they won't have the authority to stop them from entering a new industry.

In the securities industry, the Central Registration Depository system supplies useful information on broker dealers and their registered employees. The CRD is maintained by the National Association of Securities Dealers, which is a private organization under the SEC's oversight.

The NASD is also implementing a similar system for investment advisors, so we are familiar with these systems and their benefits and costs.

The Commission also has a long-standing practice of sharing information with other Federal and State law enforcement agencies. Particularly our Enforcement Division, I must say, has worked out modes of rather effective cooperation with other law enforcement agencies.

Of course, in light of the Gramm-Leach-Bliley Act, we are improving, along with banking regulators, our information-sharing arrangements. We are quite enthusiastic in supporting the goal of enhancing information sharing among regulators. We look forward to working with you and your staff in developing an effective system.

We think that any such effort should follow a few general principles, which I will now discuss.

First, any system should provide information that is accurate. We need to develop safeguards to ensure that not only the information that goes in is accurate, but that it stays accurate and does not degrade over time.

Any system should also be secure, with access restricted only to those who need the information to fight fraud. Any system that facilitates sharing among regulators of individuals' personal and nonpublic information increases the risk that private information somehow finds its way into the public.

We should think carefully about where to draw lines on access. I think our view is that there should be multiple lines. That is reflected in the CRD system as now designed where different folks at different levels of access can get different details of information.

Any system, of course, should be cost-efficient and should take into account the extra burden on some entities, particularly nongovernmental entities like the NASD, who have a role in administering the system. These folks may face a liability risk that increases in proportion to the increased access to their system. They also may face increased costs.

The CRD system costs about $50 million a year to maintain and costs about another $50 million to establish. The cost of estab-

lishing and maintaining that system is borne by NASD members who are private citizens who operate in the securities industry.

Any system should be nimble enough to respond to technological changes. We see potential problems with creating a mega-system which could well be obsolete before it is online.

At this point, we think the best approach is to maximize the ability of financial regulators to interact with each other's systems, rather than trying to develop a central omnibus system administered jointly or by some new entity created for that purpose.

Finally, any system of sharing information is only as useful as an agency's ability to make use of the information that it gets. As things now stand, the SEC's statutory authority does not allow it to bar an individual from the securities industry on the basis of, for example, a State insurance regulator's finding of fraud.

We encourage you to consider these kinds of gaps in authority as you address these issues. Let me repeat again that we are enthusiastic supporters of the goal of improving information flow among regulators and that we appreciate the receptiveness of the subcommittees and your openness to our concerns.

Thank you very much.

[The prepared statement of David M. Becker can be found on page 124 in the appendix.]

Chairwoman KELLY. Thank you, Mr. Becker.

The Chair notes that we have been joined by the Chairman of the Committee on Financial Services, my colleague, Mr. Oxley from Ohio.

Mr. Oxley, we would like now to have you make an opening statement and ask any questions, if you would like.

Mr. OXLEY. Thank you very much.

Congratulations to you and your subcommittee on this hearing. It is certainly timely and a good start on oversight.

As you know, Madam Chairwoman, the Frankel case has been much discussed. I won't go into details on that. But, obviously, if we are not willing to invest now to coordinate the antifraud systems of our financial regulators, I guarantee that the next Frankel is waiting to take advantage of us again certainly at a much higher cost.

Overall, the regulators here today have done a good job in protecting consumers and should be commended for upgrading their computer systems and beginning discussions of cross-industry coordination.

But their efforts are not enough, and they can never be enough when done solely on an ad hoc basis. We need a coordinated antifraud computer system that establishes an automated information connection among regulators.

Each regulator keeps a database of individuals and entities that have been censured for wrongful acts. In most cases, these violations are already publicly accessible on each agency's website. There is no way for any regulator to look the information up without manually going to each website.

Yes, the State insurance regulators could have gone to the SEC website and discovered Frankel had been barred from the securities industry, but with literally millions of agents and company licenses being processed each year, I think we can all understand

the difficulty of that endeavor. It is something that every business and international organization is doing, but it is not happening in the Government because there is no entity tasked with coordinating regulators across all financial industries; thus, the need for this hearing.

An anti-fraud coordination mechanism can be put together without requiring any new collection of information, with no additional bureaucracy or regulation, and with long-term cost savings for consumers. The network would only be accessible to regulators and only include data on financial professionals, not individual consumers.

Even if this coordination effort only catches one future Martin Frankel, it would pay for itself many times over.

Madam Chairwoman, two years ago the Members of this committee helped enact historic financial services modernization to integrate the cornerstones of our financial world. Today we are taking the next step forward.

Having begun integration of the industries, we must now turn to integrating financial regulation to create a coordinated and seamless antifraud system to protect consumers.

I want to thank you, Madam Chairwoman, for braving the snowstorms in New York to come down and chair the hearing today, and my friends, Chairman Bachus, Ranking Members Maxine Waters and Luis Gutierrez, for their leadership in putting this hearing together.

I ask that my full statement be made part of the record, and I yield back the balance of my time.

[The prepared statement of Hon. Michael G. Oxley can be found on page 199 in the appendix.]

Chairwoman KELLY. Thank you very much, Chairman Oxley.

With that, I would like to open the questions. I would like to ask the entire panel for a simple yes-or-no answer to a few questions that we have put together here.

I just would like to ask you to hold off any further elaboration until the committee submits written questions to you for further analysis, so this is sort of just off the top of your head, a quick answer yes or no: Won't consumers be better protected if the financial regulators use an automated background check of all agency databases for all financial licenses and applications, as opposed to making specific occasional inquiries?

Let us start with you, Ms. Williams.

Ms. WILLIAMS. Yes.

Mr. ALBINSON. Yes.

Ms. VAUGHAN. Yes.

Mr. LORMEL. Yes.

Mr. BECKER. Yes.

Chairwoman KELLY. Thank you very much. It is unanimous.

Wouldn't consumers be better protected if all background checks for licenses and applications included a check of all financial regulators' databases for comprehensive and seamless coverage and not just those where individual information-sharing agreements exist?

Ms. Williams.

Ms. WILLIAMS. Yes.

Mr. ALBINSON. Yes.

Ms. VAUGHAN. Yes.
Mr. LORMEL. Yes.
Mr. BECKER. Yes.
Chairwoman KELLY. Isn't it cheaper or more effective to create one coordinated antifraud network to exchange information than to rely on numerous individual agreements and computer connections?
Ms. WILLIAMS. Now, this is hard for a lawyer to do, just to answer with one word. Yes.
Chairwoman KELLY. You have done it before.
Mr. ALBINSON. Yes.
Ms. VAUGHAN. Fortunately, I am not a lawyer. Yes.
Mr. LORMEL. Yes.
Mr. BECKER. Yes.
Chairwoman KELLY. Wouldn't regulators be better able to fight fraud if they could share materials without risk of losing critical confidentiality and liability protections?
Ms. Williams.
Ms. WILLIAMS. Yes.
Mr. ALBINSON. Yes.
Ms. VAUGHAN. Yes.
Mr. LORMEL. Yes.
Mr. BECKER. Yes.
Chairwoman KELLY. Thank you all for your cooperation.
I have a few more. Wouldn't it be more efficient for financial institutions to allow the regulators to use a single coordinated entity for sharing information to reduce duplicative examinations and reporting? This is dear to my heart, Ms. Williams. Caution on how you respond.
Ms. WILLIAMS. Not necessarily.
Chairwoman KELLY. That doesn't qualify. It has to be yes or no.
Ms. WILLIAMS. Then I am on the yes side.
Mr. ALBINSON. Yes.
Ms. VAUGHAN. Yes.
Mr. LORMEL. Yes.
Mr. BECKER. I am afraid I just don't know.
Chairwoman KELLY. We will give you a pass on that, Mr. Becker, but we will give you a written question to follow up. Could a coordinated network be used by the regulators as it evolved over time to share other materials and financial data to reduce duplicative filings and examinations?
Ms. Williams.
Ms. WILLIAMS. Yes.
Mr. ALBINSON. Yes.
Ms. VAUGHAN. Yes.
Mr. LORMEL. Yes.
Mr. BECKER. Yes.
Chairwoman KELLY. Would it improve consumer protection in the financial services industry if Congress created an anti-fraud network coordinating limited information among regulators with full confidentiality protections?
Ms. Williams.
Ms. WILLIAMS. Yes.
Mr. LORMEL. Yes.

Ms. VAUGHAN. Yes.

Mr. ALBISON. Yes.

Mr. BECKER. Yes.

Chairwoman KELLY. Thank you. I appreciate you responding to my questions that way.

Let's go to the committee Members and begin with Mr. Sherman. Is he still here? All right.

Mr. Gonzalez, Mr. Gutierrez. No questions?

Ms. Hooley, is she still here?

Ms. Waters.

Ms. WATERS. Well, this agreement and cooperation is too much for me. I have got to find out whether or not we have any concerns whatsoever. We had a little bit of caution that was urged by Mr. Becker, who said we must make sure that the systems are accurate that they're well maintained and that they are cost effective.

Mr. Becker, would you care to elaborate on any of your mild cautions on what the system must do to protect individuals or agencies or companies. Why did you tell us that and what do you mean?

Mr. BECKER. Well, we certainly support the goals of sharing information, and we think it is possible to do that in a way that meets the concerns that I have mentioned. But we do have to be attentive to them and we do not think that the obstacles to doing that are great, but we do need the help of this committee. There are concerns. The NASD, for example, which maintains the securities database, is a private entity and there are concerns about liability. There are concerns about how the data are maintained over time. We do want to make sure that the data are accurate. We want to make sure that what is shared is what is most useful, and at the same time, the least likely to intrude on people's privacy.

I think you heard from Ms. Williams her support for sharing of proceedings, of formal action. Those are the contexts in which people have procedural protections and have opportunities to contest information. That is the type of thing that we are, I think, most enthusiastic about sharing broadly.

Ms. WATERS. I suppose confidentiality is built into this proposed system. Ms. Williams, how do you ensure confidentiality when so many people will have access to this information?

Ms. WILLIAMS. Congresswoman, it obviously becomes more of an issue the more dispersed the information is. There is a balancing test here with the sensitivity of the information that might be included in an expanded database and the extent of access. There is a spectrum of information. The more sensitive the information in the system, the more sensitive we should be to the extent of access.

Ms. WATERS. Should there be penalties of violation of confidentiality?

Ms. WILLIAMS. I think so, yes.

Ms. WATERS. Is it proposed anywhere in the broad proposal that we have here?

Ms. WILLIAMS. I think it is mentioned in the outline that I have seen.

Ms. WATERS. Have any of you given input to what kind of penalties you think would be fair and effective to protect sensitive information?

Ms. WILLIAMS. Not yet specifically, but we've been asked to work with committee staff.

Ms. WATERS. Thank you.

And finally, Mr. Lormel, do you support the performance regulators having access to fingerprint identification record system?

Mr. LORMEL. Yes, ma'am, I do.

Ms. WATERS. Why don't they have it now? Somebody.

Mr. LORMEL. The——

Ms. WATERS. What has stopped them from having access in the past? I guess the other regulators had it. Insurance never had it. Why not?

Mr. LORMEL. I am not exactly sure, ma'am, of the insurance industry regulations.

Ms. VAUGHAN. I can take a stab at that. We do have laws in a handful of States that would permit access to the first database. We do not have laws in all the States. I think there are laws in about 15 or 17 States. So we can get at this one of two ways: We can try to go to all 50 States and enact laws that meet the Department of Justice requirements for protecting the confidentiality of data and so forth, or we can try to do it in one fell swoop in this forum. And we are hoping that we might be able to get it this way—that it would be a more efficient way. We can get it done more quickly than trying to go on a State-by-State basis.

Ms. WATERS. Thank you. I yield back the balance of my time.

Chairwoman KELLY. Thank you so much, Ms. Waters.

Mr. Bachus.

Mr. BACHUS. Thank you, Madam Chairwoman.

Madam Chairwoman, I am going to defer questions. I know it was a pretty traumatic experience having to answer yes or no. In fact, it made me uncomfortable up here. But I appreciate your testimony and your acknowledgment that we all agree that there is an agreement for coordination and cooperation. I am going to defer to Ms. Hart and Mr. Rogers, particularly Mr. Rogers, being a former FBI agent. I think we are all going to look for him for his experiences, but I will pass to him. The two of you are newer and very capable Members.

Chairwoman KELLY. Thank you, Mr. Bachus. All right.

Mr. Rogers.

Mr. ROGERS. Thank you, Madam Chairwoman. We can only go down the hill from him. Thank you, Mr. Chairman, I appreciate it. Although I would encourage Madam Chairwoman that we bring Mr. Greenspan back to the committee and ask the same yes or no questions. And I, also as a former FBI agent, never pass up the opportunity to ask questions of an FBI agent, Mr. Lormel. Thank you for being here. I have waited for this for a very long time.

Mr. LORMEL. I appreciate that, Mr. Rogers.

Mr. ROGERS. Thank you, sir. Do you think there is a need for insurance investigators to obtain any history record checks?

Mr. LORMEL. Yes, sir, I do. We believe that the more we can do in terms of offering information, that will help give us accountable measures in establishing preventative and deterrent type of situations is certainly warranted.

Mr. ROGERS. If the States decide to adopt the statute, who would you recommend be fingerprinted in the industry?

Mr. LORMEL. Anybody in a fiduciary position, sir.

Mr. ROGERS. Is that consistent with the other financial industries?

Mr. LORMEL. Yes, it is.

Mr. ROGERS. Would the guidelines and could the guidelines be the same for every industry?

Mr. LORMEL. I think they can be somewhat consistent. I think we need to certainly look at all of the regulatory considerations among the different industries.

Mr. ROGERS. Is it going to be a problem because we have industries that have different regulatory standards? Do you foresee a problem here when we try to merge this?

Mr. LORMEL. In import sir, I think where at the outset, when I mentioned the need for consistency. I think for instance, when you bring the banking and insurance interests together, we need to have better uniformity.

Mr. ROGERS. Are there any of those industries that do backgrounds checks that don't request criminal history record from the FBI right now?

Mr. LORMEL. Yes, sir. I think, for instance, the banking industry. Banking is voluntary, sir.

Mr. ROGERS. Would you recommend any changes to that as we——

Ms. WILLIAMS. If I could clarify on that, Congressman. We require background checks and fingerprinting in connection with certain situations where we are involved in clearing people for positions at banks. Senior executive officers of institutions that are in troubled condition, for example, or when we charter a newly-established institution, a new bank, and we are looking at the proposed new management and directors. But if a bank is healthy and well managed and it is putting a new person on its board or retaining a new vice president for something or other, there is not a requirement to go through that kind of background check in those situations. The detailed background check applies only in connection with particular situations.

Mr. ROGERS. Given that we are broadening our scope ma'am, would you consider that something we should deal with in this legislation?

Ms. WILLIAMS. I think I would want to have an opportunity to think about it a little bit more. The current approach for us, with the situations that I have described, seems to have worked well. The most extensive clearance process focuses on those situations that are the most sensitive in terms of entry into the banking system of particular individuals.

Mr. ROGERS. Thank you.

Mr. Albison, you talk that you have joint information sharing agreements with 41 commissioners, and that has been in effect how long, sir?

Mr. ALBISON. We began the process early last year. And we are still in the midst of it. So the agreements are relatively new in nature.

Mr. ROGERS. Have you experienced any breach of confidentiality problems in the process of obtaining that information?

Mr. ALBISON. Not to date, no. We have exchanged some information, not a whole lot, because the agreements are relatively new in the preponderance of evidence of the States.

Mr. ROGERS. Thank you, Madam Chairwoman.

Chairwoman KELLY. Next we will go to Mr. Clay.

Mr. CLAY. Madam Chairwoman, I don't have any questions at this time. Thank you.

Chairwoman KELLY. Thank you, Mr. Clay.

Next we will go to Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Madam Chairwoman. I would like to get some clarification, because I have heard most of the presenters say that you want to keep your current database systems and try to share them more efficiently. Is this technologically possible without creating a new system? I will ask Terry if you could answer that.

Ms. VAUGHAN. I am not a systems person. But we have talked to our systems people at the NAIC and they believe very strongly that it is. And I suspect that is true given our experience in the State system. Because we are a State-based system, we have had to network our systems already. And the NAIC serves as that capability for facilitating information sharing among the various States. So we have an internet-based system now that allows us to communicate with the systems in the various States, and we think it is not a big stretch to expand our communication capability to the other Federal regulators.

Mr. HINOJOSA. Would the business computer systems languages be able to speak to one another?

Ms. VAUGHAN. Again, I am not a systems person, but I am told if you agree on the protocols, then you can do that kind of information sharing. That is why we have suggested we need some kind of other coordinating body that would decide on a standard protocol for communication.

Mr. HINOJOSA. How much time would it take to be able to determine that they could without changes of languages of business computer systems?

Ms. VAUGHAN. We don't have an answer for you, but we would be happy to talk to our information people and get back to you about that.

Mr. LORMEL. If I may follow up. We have a suspicious activities reporting mechanism that FinCEN coordinates, and I think that could kind of serve as a parallel model here.

Mr. HINOJOSA. Would you repeat the response for the FBI?

Mr. LORMEL. Yes. Through FinCEN, the Federal Reserve a few years back in the banking industry, to better coordinate what we are talking about doing here today, they established a reporting mechanism known as the Suspicious Activity Reports, and it deals, from the banking standpoint, with the different banking regulators, and we came together in a bank fraud working group, and were able to set up criteria to put in to a database, and it is all run through FinCEN, which is kind of a repository under the direction of the Treasury Department.

Mr. HINOJOSA. Very good. That is the only question I have, Madam Chairwoman.

Chairwoman KELLY. Thank you very much. Next we will go to Ms. Hart.

Ms. HART. I have no questions at this time.

Chairwoman KELLY. Thank you, Ms. Hart.

Mr. Grucci.

Mr. GRUCCI. Thank you, Madam Chairwoman. The question that I have, and first let me thank this panel for being here today and dealing with this critical issue. It is my understanding that we are trying to come up with an anti-fraud network that permits the regulators of each industry to share information on those who have experienced disciplinary actions for misrepresentation, dishonesty, fraudulent and suspicious activities. And I recognize that we have an issue that we face that deals with privacy. But my question is if the intent of this legislation is to inform like industries where an individual with less than upstanding moral character may find themselves, but yet did not commit any kind of act that would lend itself to a criminal act, because then, quite frankly, they would be plucked from the system by the current laws and rules and regulations that are out there.

My question is what happens in the instance when a company would identify one of these individuals through this information network and sharing of information, but it is not a more reputable company. It is a company that may just be starting up, and the earning potential that an individual may have that may be coming to this company is a good one. They have the capabilities of bringing in a lot of money for either the insurance company or the securities or whoever they may be going to work for.

How does the consumer know this? How does the consumer get that information? Is there a way that the consumer with all of the safeguards for confidentiality in place be able to access this information so they can make the determination whether or not they wish to deal with that corporation, that entity that may or may not be hiring that individual? And I will open it up to anyone on the panel that may want to take a stab at that answer.

Mr. BECKER. The NASD has what it refers to as the public disclosure program. And what one can get over the web is information about your individual broker or about the firm, and you can get fairly complete information about the existence, or most importantly, the nonexistence of any sort of disciplinary history. And it is really quite useful and quite effective.

Mr. GRUCCI. Why then isn't that sufficient? Why are we then embarking upon this piece of legislation to be able to share information? If that information is already readily available, it would—and I am not suggesting we shouldn't do this, I am just trying to understand where—we are trying to make sure we do not have dishonest and unreputable people in places where they are going to be making decisions on or for the consumer when it deals with their money. Our concern that the consumer may not know that they are going to be dealing with unreputable or dishonest individuals if indeed their acts lended itself to a criminal act, but maybe one that lends itself to a company of stature no longer wanting that individual in their employ, and they share that information with others. But that may not get that in the hands of a consumer and that consumer may be subject to a dishonest or unreputable individual.

Ms. VAUGHAN. If I can respond from the insurance perspective. I would like to make two points. First, we have public information also available that consumers can access. In most States and perhaps all States, consumers can—certainly regulatory actions are public, and in many cases on websites. But consumer complaints are also public information. In Iowa, a consumer can contact us and ask if any complaints have been filed against an agent and we will give information on what kind of complaints have been seen against that agent. Although we have good information in the insurance sector, we do not have ready access to information in the other sectors.

So the problem we have, for example, when we are considering licensing a new agent, and that agent fills out an application and we ask whether disciplinary actions have ever been taken against that individual in another sector or in another position and they might answer no. Well, unfortunately they are not always answering those questions truthfully. And if we were to do a cross-check against the securities, the NASD CRD we would find they did, in fact, previously have a securities license and regulatory action was taken against them. And that would then affect our decision on whether or not to issue a license to that individual.

So we are looking for—we are trying to build an automated producer licensing system that would give us electronic efficient access to the NASD CRD so we can do those kinds of cross-checks in a very efficient manner recognizing that we have roughly over 3.2 million agents that are currently licensed in this country.

Mr. GRUCCI. Thank you. My last question, Madam Chairwoman.

Chairwoman KELLY. Mr. Grucci, you are over time. If you would submit the question in writing, I would appreciate it. Thank you. Now I will move on to Mr. Cantor.

Mr. CANTOR. Thank you, Madam Chairwoman. I thank the panelists for entertaining our questions. I think generally the way that I read Graham-Leach-Bliley, and wherein, Congress instructed the financial regulators across the country to coordinate their efforts, I think this is a terrific place and I want to salute the two chairpersons here for starting our inquiry into how we were going to coordinate oversight in the area of anti-fraud activities. And I am hearing a lot and reading in your testimony, a lot about information sharing agreements between regulators and just expanding it across the country.

There seems to be a need, if we go that route, for an awful lot of information sharing agreements, and my question, I guess to you, is on the one hand, is it feasible how many information sharing agreements would be necessary, and if not, if you are looking at one central anti-fraud network so to speak, Mr. Becker alluded to the cost of NASD's members, and they are having to support it, and perhaps Ms. Vaughan, your licensees or the licensees in each of the States are impacted with cost of creating this one network, and I have, I guess, a lot of angles to this question. But one of you had mentioned the needs for a central database authority, I think, laying out some policy if we were going to have one network, and how do we see that authority coming into being, empowering, I think, itself?

And as far as requiring licensees to offer information up in a way that would be uniform, so we do not go through duplicative information filing that we are trying to get away from as well. Probably not a coherent question, but I will be glad to restate it if you did not get it.

Ms. VAUGHAN. Well, since I was the one that mentioned the central database authority, I guess I will start. That really stemmed from our recognition that we needed to have some set of technical standards in order to share the information. I don't have strong feelings about how that authority is created. I know there has been some discussion about it being part of the FFIEC. There needs to be some way, however, for those regulators that are going to share information, to agree on the technical specifications for the information sharing.

To answer your question about regulatory cooperation agreements, in the insurance sector, because we are a State-based system, if you say the 50 States plus the District of Columbia, we have 51 agreements that we need to sign with the OCC, the FDIC, the OTS, the Federal Reserve. We have made great progress on the OTS. We have three States that have problems with their State laws that need to be fixed in order to get those information sharing agreements in place. And I believe we have drafted some legislation that at some point proposed to deal with confidentiality issues at the State level that we would be happy to share with you. Again, that would allow us to shortcut that process.

Ms. WILLIAMS. Congressman, I think that regarding the mechanism for determining the protocols for data sharing, Mr. Lormel was referring to the Bank Fraud Working Group, which is an interagency working group that did come up with the protocols for the system that maintains the suspicious activity reports database. That was not a new entity that was created. It was a working group of the affected financial regulators that got together and agreed on how to make the system come about.

Mr. CANTOR. If I could ask Mr. Becker, and I see him going for the microphone. Could you comment on your suggestion that perhaps we benefit and build on the strength of the existing networks among the agencies rather than, and I am just, there is a question of approach rather than creating some new mega network that could perhaps go into obsolescence before it even came online.

Mr. BECKER. On the licensing side, which is really what we are talking about here, I think we are comfortable that it is possible to sit folks down in a room without forming a new entity and arrive at ways to share information. In terms of active investigations, I think we have found that informal mechanisms work extremely well. I know that I came to the SEC a little more than 2½ years ago after representing private clients in the enforcement world, and every time I had a bank client, I think it is safe to say that folks from the SEC and a banking agency showed up, so I think the cooperation has been very effective.

Chairwoman KELLY. Thank you very much, Mr. Cantor.

Mr. CANTOR. Thank you, Madam Chairwoman.

Chairwoman KELLY. Next we go to Mr. Tiberi.

Mr. TIBERI. No questions.

Chairwoman KELLY. No questions. All right then. I think that it appears that some Members may have opening statements or have additional questions for this panel and they may wish to submit those in writing. So without objection, the hearing record will remain open for 30 days for Members to submit written questions to this witness and place their responses in the question.

Oh, Mr. Lucas I am so sorry I didn't see you come in. Do you have any questions?

Mr. LUCAS. No.

Chairwoman KELLY. Thank you.

The first panel is excused. As the second panel will take their seats at the witness table, I will begin the introductions of the second panel. Thank you very much.

For our second panel we are thankful that Richard J. Hillman can join us. He is the Director of Financial Markets and Community Investments Division of the U.S. General Accounting Office. Mr. Hillman, we welcome you today.

Then we have Karen Wuertz, the Senior Vice President of Strategic Planning and Development for the National Futures Association.

We have Thomas Rodell, Executive Vice President and Chief Operating Officer of Aon Risk Services, Incorporated, and the Chairman of the Council of Insurance Agents and Brokers testifying on behalf of the council.

After which we will hear from Mr. Ronald Smith, the President of Smith Sawyer and Smith, Incorporated, who also serves as the State Government Affairs Chairman of the Independent Insurance Agents of America who will be testifying on behalf of Point Association, the National Association of Insurance and Financial Advisors and the National Association of Professional Insurance Agents. We welcome you, Mr. Smith.

And finally, we will hear from Mr. Steve Bartlett, the President of the Financial Services Roundtable. We welcome all of you and thank you very much for joining us today to share your thoughts on this issue.

So, without objection, your written statements will be made a part of record. With one minor exception, you will each be recognized for a 5-minute summary of your testimony so let us begin with you, Mr. Hillman.

STATEMENT OF RICHARD J. HILLMAN, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GENERAL ACCOUNTING OFFICE

Mr. HILLMAN. Thank you very much. I am pleased to be here today to discuss GAO's observations on the sharing of regulatory and criminal history data among financial services regulators. GAO has long held the view that financial regulators can benefit from greater information sharing and with the passage of the Graham-Leach-Bliley Act, the need for information sharing capabilities among financial services regulators becomes even more evident.

My prepared statement released today focuses on: One, an overview of the systems used by financial regulators for tracking regulatory history data; Two, the types of regulatory history data needs of regulators to help them prevent rogue migration and limit fraud;

Three, criminal history data needs among financial regulators; and, four, challenges and considerations for implementing an information sharing system among financial regulators.

Overall, we found substantial agreement among the regulators about the potential benefits of improved information sharing, particularly related to licensing or registration data and adjudicated regulatory actions. Most also concurred that it would be useful to share regulatory and criminal history information in a more automated fashion. However, Congress will need to address concerns raised by regulators related to confidentiality, liability, and privacy issues for greater information sharing to occur.

Regarding the first topic, the systems used by financial regulators for tracking regulatory history data, we found that systems are operated and maintained separately in each of the industries. Systems and databases provide background information on some individuals and entities, consumer complaints and disciplinary records within that industry. Within the insurance, securities, and futures industries, where there are registration and licensing requirements, this information is largely centrally maintained. In contrast, such systems and databases are decentralized among banking regulators. As a result, to find out about an enforcement action in banking, you would have to query databases maintained by each of the five banking regulators.

Regarding the second topic, in discussions with the financial regulators and committee staff, we have found that regulatory history data useful to help prevent rogue migration and limit fraud include information on completed disciplinary and enforcement actions, ongoing investigations, consumer complaints and reports of suspicious activity. Most regulators are in agreement about the sharing of this information, particularly information on registration and licensing status, and closed or completed adjudicated regulatory actions.

Regarding criminal history data needs of regulators, our third topic, we have found insurance regulators are not on equal par with their counterparts in the banking, securities and futures industries, since many cannot obtain such data. As we noted in the previous work, we believe insurance regulators need to have this capability to help prevent criminals from entering the industry and the representatives from NAIC and the FBI have been working on solutions to facilitate insurance regulators' ability to conduct routine criminal backgrounds checks.

Finally, regarding my last topic, we have found that information sharing concerns are more legal than technical. As previously discussed, the financial regulators we contacted did not express concern about sharing basic regulatory history data on closed, disciplinary or enforcement actions. The majority of such information is already publicly available, although not necessarily easily accessible. The threshold of the concern rises as the sensitivity of the regulatory data rises, particularly when unsubstantiated regulatory and ongoing investigation data is involved.

While more work would need to be done to explore the most viable solutions, GAO believes that these issues are addressable. Fraud prevention efforts among financial services regulators can be enhanced, and the benefits are many. This past September, we reported on the activities of just one rogue who had been barred for

life from the securities industry and moved to the insurance industry where he allegedly stole about $200 million over an 8-year period. Our report noted that those losses may have been avoided had more information been shared among regulators.

GAO also believes that the subcommittees' continued endorsement and encouragement in developing and implementing improvements to facilitate the sharing of regulatory and criminal information will provide an important impetus for success.

Madam Chair, this completes my prepared remarks. I would be pleased to respond to any questions you or other Members of the subcommittees may have.

[The prepared statement of Richard J. Hillman can be found on page 139 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Hillman.

Next we go to Ms. Karen Wuertz. Ms. Wuertz, thank you very much for being with us.

STATEMENT OF KAREN K. WUERTZ, SENIOR VICE PRESIDENT, STRATEGIC PLANNING AND DEVELOPMENT, NATIONAL FUTURES ASSOCIATION

Ms. WUERTZ. Thank you. NFA appreciates the opportunity to be here today to present our views on increasing data sharing between financial services industry regulators. NFA has a long history of cooperating with other regulators and welcomes the opportunity to work with this committee to develop an efficient and effective method of systematically sharing information. I would like to take just a minute to describe NFA and its regulatory mission. For close to 20 years, NFA has been the nationwide self-regulatory organization for the futures industry here in the U.S., and the only registered futures association under the Commodity Exchange Act.

NFA's primary mission is to protect the public from unscrupulous, fraudulent, and unethical business practices through efficient and effective regulations of its members. Our regulatory process begins by screening individuals and firms when they seek registration to conduct futures related business and continues with regular examinations throughout their business lives. As a result of our activities, and because we are the sole nationwide SRO in the futures industry, we have a large centralized and comprehensive database containing disciplinary, registration, and background and financial information about the firms and individuals operating in the futures industry. We are all too well aware of the damage that rogue brokers can do when they use their unscrupulous practices to take advantage of unsuspecting investors.

Since our inception, NFA has tracked their migration within the futures industry. Because of our well-designed rules and our effective disciplinary process, the number of rogue brokers in our industry has decreased by over 75 percent. And the number of customer complaints has also decreased by over 70 percent. NFA has always provided futures industry disciplinary information to regulators and to the public at large.

In 1999, NFA became the first financial services industry SRO to make disciplinary information available to the public on the web when it introduced its BASIC system. BASIC contains not only disciplinary information, but also registration status and history infor-

mation about all firms and individuals ever registered in the futures industry. Last month alone, there were over 35,000 BASIC searches, and this trend continues to go upward. We expect that through this year, we will have over 400,000 BASIC searches on the system. We also maintain information in our databases that we do not make public, but that we routinely share with regulators on request. This includes information on customer complaints, open investigations, arbitration matters and other information that individuals and firms have provided in their application forms.

The value of this information to other regulators would be significantly increased if there was an efficient and effective means for sharing this information. NFA agrees with the committee's concern that disreputable individuals could easily move from one financial services industry to another, and this problem will be greater as the various sectors of the financial services industries meld together.

I would like to close by saying that NFA is committed to exploring every avenue that will assist in maintaining the integrity of the financial services industry. We have a strong background in developing our own tracking systems and information databases. We have significant amounts of futures industry data in our databases, and we are the front line regulator in the futures industry. We believe that we would be an extremely helpful participant in developing an anti-fraud network, and we would be willing to help in any effort that is deemed appropriate. Thank you.

[The prepared statement of Karen K. Wuertz can be found on page 160 in the appendix.]

Chairwoman KELLY. I thank you, Ms. Wuertz.

Next we are going to split the time between two witnesses. They will each be recognized for 3 minutes each. That is Mr. Rodell and Mr. Smith, and we are glad to have you have both testify and Mr. Rodell will you please begin.

STATEMENT OF THOMAS J. RODELL, EXECUTIVE VICE PRESIDENT AND CHIEF OPERATING OFFICER, AON RISK SERVICES, INC., CHAIRMAN OF THE COUNCIL OF INSURANCE AGENTS AND BROKERS, ON BEHALF OF THE COUNCIL

Mr. RODELL. Thank you, Madam Chairwoman. The firm that I represent, Aon, is the second largest insurance broker, both globally and in the United States. I am testifying on behalf of the Council of Insurance Agents and Brokers. Madam Chairwoman, on behalf of my firm and the members of our association, I want to express our gratitude to you for the essential role you played in the enactment of NARAB provision of the Graham-Leach-Bliley Act. After decades of effort to improve producer licensing burden, the enactment of NARAB is a guarantee that at last these reforms will occur. Tens of thousands of producers around the country will benefit from the legislation that the Members of this committee and especially you, they have to thank.

Graham-Leach-Bliley tore down the firewalls separating the banking, securities, and insurance industry, creating a brave new world in which banking, securities, and insurance transactions could occur in one place in a seamless manner. Instead of just selling or servicing insurance policies, we are now members of the fi-

nancial services industry, an industry that can provide both its members and its customers with innovative new products and services. We believe the expanded ability to provide consumers with these choices will lead to a more competitive market that can only benefit consumers. However, the market freedom engendered by these reforms comes with a price, the price of increased freedom to offer financial services to consumers is the increased potential for bad actors to move among the banking, securities and insurance sectors without detection. The Council is extremely concerned about this issue. As intermediaries between insurance companies and consumers, our members must be concerned about bad actors entering the market not only as intermediaries, but also as insurance company executives.

One only needs to listen to panel one for some examples of that today. As we move toward a more integrated financial services industry, our paramount concern is for good regulation that will not only provide necessary consumer protections, but also foster growth and prosperity for our industry. In our view, the means of regulation in this case is subsidiary to the end goal of strong and efficient regulation. The approach will assist financial service regulators in detecting patterns of fraud and coordinating their anti-fraud efforts. It will also reduce duplicative requests for information among regulators. In short, it will give Federal and State financial services regulators the tools they need to protect consumers and to preserve our newly found market.

Many State insurance regulators do not currently have the ability to directly access the Federal criminal history records maintained by the FBI. Also, there is no system to share criminal history records between insurance regulators and the National Association of Securities Dealers. Many of our insurance brokers are both licensed insurance agents and licensed securities dealers. There is an additional benefit to the proposal for consumers and financial services as a whole, but one not readily apparent on the face of legislation.

The multiple add-ons to non-resident insurance licensing applications and the State laws that limit the activities on non-resident producers have little to do with enforcing standards of professionalism, and much to do, in our view, with increasing the hassles involved in obtaining non-resident licenses. We believe NARAB enactment, if NARAB does come into existence, will only serve to lift the licensing burden, but also to raise the standards of professionalism involved in producer licensing. The proposal under the committees consideration will contribute much to this goal and strengthen our support. On behalf of Council, I would like to thank you for providing me this opportunity to testify today.

[The prepared statement of Thomas J. Rodell can be found on page 166 in the appendix.]

Chairwoman KELLY. I thank you, Mr. Rodell. Darn it, if I had known you were going to talk about NARAB, I would have given you a little more time.

Mr. Smith.

STATEMENT OF RONALD A. SMITH, PRESIDENT, SMITH, SAWYER & SMITH, INC., STATE GOVERNMENT AFFAIRS CHAIRMAN OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA, ON BEHALF OF IIAA, NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS AND THE NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

Mr. SMITH. We could both do that, talk about that a little bit.

Thank you, Madam Chairwoman, Chairman Bachus. We appreciate being here. We represent the three groups that I am speaking for, represent approximately a million insurance agents and employees across the country. We would be remiss not to mention the good work that we think Chairman Oxley has done on behalf of this entire committee and all of us involved in financial services. I will try and be very brief. Three minutes is moving by rather rapidly. Obviously, I think you have been hearing that we do believe that access to Federal crime databases is an important thing for insurance licensing.

A couple of the areas of concern that we would have as an agents group is number one, many times we have to do different things for different States. So we should be compelled to act only one time in supplying the data information that is needed for our background check. And number two, in conjunction with that and then I will give you a few other specific concerns, but in conjunction with that, you mentioned, Madam Chairwoman, the Violent Crime Control Act of 1994 and the provisions in that, the 1033 provisions have been a problem for insurance agents, and how in the world we are supposed to conform to those. There are no rules, regulations for those.

So our concerns would magnify around these points, really on those two various concerns. Any information that is made available should be limited to information regarding crimes included within the scope of section 1033, and that is part of the Crime Act. Insurance professionals should be required to have a criminal background check performed only once, not have to do it several times.

My agent friend here was saying the same thing essentially. The administrative requirements for performing a check should be minimized as much as possible. The determination of a State insurance regulator that an applicant satisfies the 1033 requirements should be sufficient to satisfy any and all 1033 requirements. Once satisfied, we think we should not have to do that again. I won't elaborate on two or three other points that we think that are important. They are in my formal written testimony to you.

We do think and are in favor, also, of the creation of a functional regulator anti-fraud network. Again, we would want to be careful that we would only supply that information that is needed and that it would be, we think, shared from regulator to regulator, that we could make the systems talk back and forth to each other as was talked about on the first panel.

We do appreciate having this time today. We look forward to working with you closer as we move forward in this project. We think it is a good and worthwhile thing that we are trying to accomplish here. Thank you.

[The prepared statement of Ronald A. Smith can be found on page 173 in the appendix.]

Chairwoman KELLY. I thank you, Mr. Smith, and we go to you Mr. Bartlett.

STATEMENT OF HON. STEVE BARTLETT, PRESIDENT, THE FINANCIAL SERVICES ROUNDTABLE

Mr. BARTLETT. Thank you, Madam Chairwoman. Thank you, Mr. Chair and Ranking Member Waters. I thank you for the opportunity to testify. I commend the two subcommittees for their leadership early in the session on this important issue.

The Financial Services Roundtable membership consists of 100 of the largest financial services companies across the breadth of the industry, banking, insurance, securities, diversified. We are, in a way, the poster child of Graham-Leach-Bliley. The Roundtable and our member companies support the concept of this legislation as you have outlined it. We believe it is important, critical indeed, that there be a uniform standard for sharing of information relating to fraud by regulatory agencies. Legislation is needed to allow that, and such legislation would help to prevent fraud. Fraud within our industry costs our industry and ultimately all consumers, by our estimates anyway, about $100 billion a year.

As an industry we have taken several steps ourselves to identify and prevent that fraud. I will cite two, but I note for the record that both of these steps I will cite support that the appropriate use of information sharing as a key component to combat fraud. One is the Roundtable recently completed a study by Ernst and Young entitled "The Customer Benefits Of Current Information Sharing by Financial Services Companies," and I submitted this, Madam Chairwoman, as a part of my testimony for the record. One of the principal benefits that we identified for appropriate information integration is the reduction of fraud. And in fact, it is that use of information that reduces a great deal of consumer fraud.

Second, our technology affiliate, known as BITS, has established what is called a fraud reduction steering committee. That committee cuts across all sectors in the financial services industry. It is based on the same concept as this legislation, that is, communicating known information about fraudulent activities from company to company and sector to sector will help to prevent fraud. It has helped reduce the growth of check fraud from 17.5 percent a year to 11.7 percent a year.

So in support of this legislation the key points of my written testimony, which I have submitted for the record, are as follows: One, functional regulation as envisioned by Graham-Leach-Bliley is the goal, but it is not yet working entirely smoothly. This legislation would help with functional regulation, but we have a ways to go.

Madam Chairwoman, as it has been alluded to earlier, our industry has over 200 regulatory agencies, and my members tell me that oftentimes each of the 200 chooses to show up at one location on the same day.

Second, the enforcement information exchanged in this legislation should be limited to areas that relate to enforcement activities with no information about customers exchanged per se.

Third, the terms and form of information exchanged should be uniform across all 50 States and within all sectors, banking, securities and insurance.

Fourth, this legislation should establish no new collecting or reporting requirements, but rather should focus on sharing with appropriate agencies the information that is already collected. I will repeat, this legislation should establish no new collecting or reporting requirements, but focus on disseminating or sharing the information that has already been collected.

Fifth, confidentiality and liability protections should migrate with the information. For example, if information is protected under Freedom of Information in its original location where it is collected, that protection should hold to the next agency where it is disseminated.

Sixth, the committee should consider reintroducing or incorporating into this legislation, legislation or proposed legislation known as the Bank Examination Report Privilege Act introduced last session by committee Vice Chair Marge Roukema. This bank examination legislation would be a compelling companion piece to the anti-fraud legislation that is under your consideration today. The Roundtable supports this anti-fraud legislation based on the concepts you have provided, and we look forward to working with you to comment on the details as they develop. Thank you.

[The prepared statement of Hon. Steve Bartlett can be found on page 183 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Bartlett.

At this time, I would like to go to the panel with some questions, and I am going to ask you the same set of questions that I asked the first panel, because I would like to hear your answers. Just answer, please, if you were in the room before a simple yes or no.

Number one, wouldn't consumers be better protected if the financial regulators use an automated background check of all agency databases for all financial licenses and applications as opposed to making specific occasional inquiries? Yes or no.

Mr. Hillman.

Mr. HILLMAN. Yes.

Ms. WUERTZ. Yes.

Mr. RODELL. Yes.

Mr. SMITH. Yes.

Mr. BARTLETT. Yes.

Chairwoman KELLY. Thank you.

Wouldn't consumers be better protected if all background checks for licenses and applications included a check of all financial regulators databases for comprehensive and seamless coverage, not just those where individual information sharing agreements exist?

Mr. HILLMAN. Yes.

Ms. WUERTZ. Yes.

Mr. RODELL. Yes.

Mr. SMITH. Yes.

Mr. BARTLETT. Yes.

Chairwoman KELLY. Isn't it cheaper and more effective to create one coordinated anti-fraud network to exchange information then to rely on numerous individual agreements and computer connections?

Mr. Hillman.

Mr. HILLMAN. Yes.

Ms. WUERTZ. Yes.

Mr. RODELL. Yes.
Mr. SMITH. Yes.
Mr. BARTLETT. Yes.
Chairwoman KELLY. Mr. Bartlett.
Mr. BARTLETT. Yes.
Chairwoman KELLY. Thank you.
Wouldn't regulators be better able to fight fraud if they could share materials without risk of losing critical confidentiality and liability protections?
Mr. HILLMAN. Absolutely, yes.
Ms. WUERTZ. Yes.
Mr. RODELL. Yes.
Mr. SMITH. Yes.
Mr. BARTLETT. Yes.
Chairwoman KELLY. Wouldn't it be more efficient for financial institutions to allow the regulators to use a single coordinated entity for sharing information to reduce duplicative examinations and reporting?
Mr. HILLMAN. Yes.
Ms. WUERTZ. Yes.
Mr. RODELL. Yes.
Mr. SMITH. Yes.
Mr. BARTLETT. Yes.
Chairwoman KELLY. Thank you.
Could a coordinated network be used by the regulators as it evolved over time to share other materials and financial data to reduce duplicative filings and examinations?
Mr. Hillman.
Mr. HILLMAN. Yes, that would be terrific.
Ms. WUERTZ. Yes.
Mr. RODELL. Yes.
Mr. SMITH. Yes.
Mr. BARTLETT. I want to think about that one, and I will submit that one for the record.
Chairwoman KELLY. Well, do you think you want to say yes or no, or do you want to say you don't know? I am giving you three choices. That is all we get on the floor of the House, so yes or no, Mr. Bartlett.
Mr. BARTLETT. I don't know.
Chairwoman KELLY. We will talk to you later.
Mr. BARTLETT. Perhaps, Madam Chairwoman, I didn't understand the question.
Chairwoman KELLY. I will repeat it. Could a coordinated network be used by the regulators as it evolved over time to share other materials and financial data to reduce duplicative filings and examinations?
Mr. BARTLETT. Madam Chairwoman, without straining the point, my testimony was that this should be used only for dissemination of regulatory information and not other data. So I am concerned about the term "other data," to use this system for other data. Again, I would have to see what the other data is.
Chairwoman KELLY. Fair enough. I left you a lot of opening there. Would it improve customer protection in the financial services industry if Congress created an anti-fraud network coordi-

nating limited information among regulators with full confidentiality protections?

Mr. HILLMAN. Yes.

Ms. WUERTZ. Yes.

Mr. RODELL. Yes.

Mr. SMITH. Yes, again, I would refer those 1033 pieces that I mentioned in the Crime Act.

Chairwoman KELLY. Mr. Bartlett.

Mr. BARTLETT. Yes.

Chairwoman KELLY. You can answer that one?

Mr. BARTLETT. Yes.

Chairwoman KELLY. All right. That is good. I appreciate your trying to answer it within the context of your testimony. I really very much appreciate all of you for stepping up to the plate and taking a choice here, because it is important for us to know how you feel about these questions. So I have thank you very, very much.

At this time, I would like to go now to the next Member, Ms. Waters.

Ms. WATERS. Well, you are such wonderful and cooperative, all-agreeing witnesses. I don't have a lot to ask, but I am curious about something. In California, we had the unfortunate and regrettable experience of having an insurance company conspire with the insurance commissioner to set up a fund, a 501C3, or a fund of some kind where they would contribute to nonprofits. And this fund substituted for the reconciling, I believe, of claims of consumers who were harmed during the Northridge earthquake, I believe. Now, would this whole company go into this database? Would the CEO go in the database? How does that work? Did the State regulatory agencies have to do something about them? I don't know exactly what happened, but it was a big scandal, terrible things. Does this database encompass that kind of information?

Mr. SMITH. I will take a stab at it.

Ms. WATERS. Why do not we let Mr. Hillman take a stab at it first.

Mr. HILLMAN. I am not familiar with that particular instance, but the information housed in any system would depend upon who the enforcement action was against. Systems maintain information on both individuals and entities that were considered to be bad actors in an industry.

Ms. WATERS. So it could be a whole company? It could be a company that is on the databases having been fined or reprimanded or something.

Mr. HILLMAN. It could be a company or one of the officers, depending on who the specific action was being taken against.

Ms. WATERS. Now who would make that decision about an insurance company? For example, in the State, would the State regulator make that decision? What if the company is a member of the, what is it, the Roundtable?

Mr. BARTLETT. Financial Services Roundtable.

Ms. WATERS. Yeah, what if a company is a member of Financial Services Roundtable?

Mr. BARTLETT. It would not make any difference, Congresswoman. As I understand the question and the answer, whatever

enforcement action is taken then in the State of California against either individuals or the company would then be transmitted in this database to regulatory agencies in other States or at the Federal level, so that a regulator in Alabama then, if one of the officers that had an enforcement activity in California moves to Alabama and applies to do the same kind of thing, then the regulatory agency, whether it is securities or insurance or banking in Alabama, would know about it, would, in essence, have the same information, no more, no less than the enforcement agent in the State of California had.

Ms. WATERS. How could a consumer in that State access that information?

Mr. BARTLETT. As I understand the legislation, I have testified that the consumer would not be accessing the information unless that information were available to consumers in California. So this is for enforcement agencies or regulatory agencies, as I understand the proposed legislation, and whatever rights the consumers of California have would migrate to the consumers of Alabama, but would not establish new types of information or new types of disclosure.

Ms. WATERS. I will have to take a look at this so that I can understand, because this is about trying to protect the consumer. While the regulatory agencies would be able to make decisions about everything from licensing to other kinds of things, if a consumer was suspicious of or had heard about or thought they knew something about this company that had, in fact, reneged on its obligations to satisfy claims, they would have to try and get this information someplace else because it would not be available to them from this source.

Mr. BARTLETT. It would be available, Congresswoman, in the same way it would be available if they were a consumer of California, no more and no less. So this legislation, it seems to me, is appropriate in that it creates a dissemination of information among regulatory agencies, and then leaves for another day and another forum if that dissemination should be expanded or contracted. This simply allows the regulatory agencies that are regulating the right to look at the legislation that other regulatory agencies have.

Ms. WATERS. My time is up. Thank you.

Chairwoman KELLY. Thank you, Ms. Waters.

Mr. Bachus.

Mr. BACHUS. Thank you.

As I understand it, what we are talking about here is presently collected information, sharing that to enforce present requirements and enforce present laws.

So, Mr. Bartlett, on the question that you were asked, I think maybe we could change the question and it would be clear, and that is, could a coordinated network be used by the regulators as it evolved over time to share existing, as opposed to other—we will just say existing material?

Mr. BARTLETT. I would answer yes to that. This legislation should be used for dissemination of existing information, but not to create new information that needs to be collected.

Our industry seems to have sufficient information collected about us. We do not have a scarcity of that.

Mr. BACHUS. Right. I think the insurance commissioners were saying no new requirements, no new fingerprints, just share what you already have. I think that is what we are all talking about.

I am going to pass, with unanimous consent, to Ms. Hart, and then at the end, with permission, I would like to ask maybe some questions, if they have not been asked.

Chairwoman KELLY. Ms. Hart.

Ms. HART. Thank you, Madam Chairwoman.

Obviously, as a freshman, I am a little new to some of this stuff, but on the State level, one of the things that I worked with quite a bit was this vicious protection of States rights.

I know some of you addressed in your comments that you still support State regulation, but you do also support this proposal for some type of information sharing.

I guess the question I have for you is, and you can all answer this, or a couple of you, if you choose, I don't really have anybody specific in mind, but do you envision this basically as a databank that you would be able to access to determine if this company or individual is clean? Or do you envision it as something beyond simply a databank, or just sort of a repository of information?

Mr. SMITH. I think from our standpoint, the independent insurance agents, professional insurance agents and life agents, we see this as a means of sharing the data. It is a database.

I think the problem Mr. Bartlett had referred to, the problem is, I am from Indiana. We could have an agent that is a rogue in Indiana that decides to move to Arizona, and Arizona does not have access or presently is not accessing Indiana's information. This would do it seamlessly. Indiana could pass that information, and they would have certain guarantees that sharing that information would not incur additional liabilities, things of that nature, so that we could hopefully eliminate a rogue agent from going to 50 different States and doing his damage in 50 different places.

Ms. HART. Just to get a little more specific, would you expect that there would be a physical sharing from Indiana to Arizona, or would you expect that the person in Arizona dealing with this individual would go back to this national bank to which Indiana would be required to submit that information?

Mr. SMITH. I would anticipate that the information would be given to the national database, and then that could be accessed by any other State.

Ms. HART. Do you think it should be mandatory that every State submit that information to the national—I am going to call it the databank, just for my own term?

Mr. SMITH. We are big supporters of State regulation, functional regulation. I always hate the word "mandatory," but certainly we are in favor of protecting consumers from anti-rogue agents. So if we have to go to some extreme to make sure we get that accomplished, we need to do that.

Ms. WUERTZ. I would like to comment on that, as far as it being a databank. One of the things we were envisioning, because I was the one who developed the BASIC system for NFA, and it was a difficult process because the CFTC contributes data, the various futures exchanges contribute data, we were envisioning that if an individual were applying to the futures industry, and we could go to

this network and put in some key information, that it would then say there is a hit on the insurance industry, or there is a hit in the securities industry, and then we could find the means to go get that information.

I think it is just because of the level of information that each industry maintains, to contribute that to a massive database to me seems a little overwhelming. But I think very efficiently, if you would just get hits, and you could follow up on those, I think that would work very efficiently.

Mr. BARTLETT. Congresswoman, if I might elaborate a bit, we would see that the databank concept would be a rather old, antiquated and costly concept. It ought to be much more in the 21st century; it is more a linkage or network in which access is provided.

The last thing we want to do, in my opinion, is to create some new Federal agency to collect data. It ought to be linked, and access to it. Sort of think of it as a giant search engine, with protection so only the appropriate agencies can get to it, but not a place where the data resides.

Ms. HART. One final question. This is also general.

If this is created—and I like Mr. Bartlett's idea of having it be more or less a linkage, since different States have different standards and have different requirements for participation in the agency, and also, I guess, baselines for problems within those industries—how would one who is accessing that information be able to determine the rightness or wrongness of the person's status?

Sometimes if you are going from one State to another, what is a violation in one State would not appear to be a violation of the other, and I appear to be out of time.

Mr. SMITH. Hopefully, the reciprocity that we are striving for right now that the insurance commissioners are working on, if you are licensed and in good standing in Indiana, can be licensed and in good standing in any other State. So it goes back to the individual State to make sure that they keep their licenses straight and up to date. Then they would have to share with the network that information on bad agents.

Ms. HART. Thank you.

Chairwoman KELLY. Thank you very much, Ms. Hart.

Next we will go to Mr. Rogers.

Mr. ROGERS. Thank you, Madam Chairwoman.

You mentioned earlier that there were some 400,000 searches.

Ms. WUERTZ. On our BASIC system.

Mr. ROGERS. Was that by consumer or by regulatory searches?

Ms. WUERTZ. It is a combination of many things. We promoted it very extensively to the consumers. We also promote it to other firms that are thinking of hiring. It helps them determine the supervisory procedures they should be putting in place so they can do their own background checks before making any types of hiring decisions, as well as other regulators use it, but I don't have the breakdown of that.

Mr. ROGERS. I'm sure you are familiar with the 41 agreements with NAIC for their information sharing and the things that were listed by the panel previous to you.

Given those 400,000 searches that you have, and apparently you anticipate that getting larger, and those information-sharing agreements, to any of your knowledge, has there been a breach of confidentiality that has posed a problem serious enough for your attention?

Ms. WUERTZ. First, I will have to say I am not that familiar with the 41 agreements, but as far as we are concerned, the National Futures Association, there have not been any breaches of confidentiality that have caused us any concerns.

Mr. ROGERS. Would that be consistent with the remainder of the panel?

Mr. BARTLETT. Yes.

Mr. SMITH. Yes.

Mr. ROGERS. If you are not familiar with the agreement, that is probably a good standard, because it does involve your industry, and it means there is not a problem with those agreements. Am I assuming that correctly?

Mr. BARTLETT. Congressman, as far as I know, there have been no breaches. There could have been. The companies in this industry are quite sophisticated at building firewalls and developing ways—technology is the answer. But the companies themselves figure out ways to provide this protection, as would these agencies.

So my experience in the industry would tell me that that is not only not a problem, it has probably already been solved, and will be solved on a daily basis as far as the potential breaches.

Mr. RODELL. I would also say that virtually all these disciplinary actions are a matter of public record with the State insurance departments.

Mr. ROGERS. Who do you think should be fingerprinted now that we are getting into the insurance industry? Consistent with the same that is done in the other financial——

Mr. SMITH. I'm sorry, you are asking who should be?

Mr. ROGERS. Who do you think should be fingerprinted under this?

Mr. SMITH. As of now, we think it is consistent with State law, but our feeling would be—for instance, I am an agent in Indiana. I do not have to be fingerprinted. I happen to have a license in the great State of California. I had to be fingerprinted. I have done that.

We believe that once you are fingerprinted, then that should suffice for any jurisdiction that has that requirement. We think that that could stand outside of reciprocity and still not get into conflict with the State regulation of insurance.

Mr. ROGERS. If I can follow up on that question, you mentioned earlier in your testimony, Mr. Smith, that you didn't want to have repeated criminal checks, obviously repeated fingerprintings.

Is there an occasion that is occurring now, and obviously you just mentioned one with fingerprints in California, but not in Indiana. We don't certainly want to impose more burdens on you.

Mr. SMITH. That has been, I think, the most common. I believe there are about 11 or 12 jurisdictions that require fingerprints, and if people operate in all of those States and have to provide those independently, that is a burden.

Mr. ROGERS. Would that also be the same with the criminal history checks? We would have duplicative efforts.

Mr. SMITH. I can't answer that specifically, but if you do the fingerprints, then the criminal background check would flow from that. So, yes, I am sure that would be the case.

Mr. RODELL. Also, I would like to point out that our interest and the Council's interest is that we are working across the financial services industry, so we are licensed as insurance brokers, as securities agents, and we are having to do this a multiple of times across this industry. We feel we should only have to do it once.

Mr. ROGERS. Madam Chairwoman, I am very encouraged by the testimony today. Very rarely will you have a panel of regulators and a panel of those who are regulated in concurrence with something that we need to do in Congress.

I look forward to working with you all as we craft that legislation.

Thank you, and I yield back the remainder of my time.

Chairwoman KELLY. Thank you very much, Mr. Rogers.

Mr. Grucci.

Mr. GRUCCI. Thank you, Madam Chairwoman.

The question that I have really is in line with the question I had asked earlier of the first panel.

The information and the words that I kept hearing, things like unscrupulous individuals, disreputable individuals, rogue individuals, and the need to protect the vulnerable consumer or the vulnerable public, do you see any reason why the public should not also have access to this information? Anyone who wishes to answer.

Mr. BARTLETT. Congressman, let me perhaps start. It depends on which information.

There is a whole body of law and regulations by each of these 200 regulatory agencies I cited in each of the 50 States, and in which there is a well-established pattern of what is available to the public, what is not available to the public.

It is a little bit more complicated than making it all available to the good consumers, because sometimes the good consumers are also the bad competitors or the bad actors or other people who may do harm. So the question is, what within a regulatory activity should be public, and what should be limited to the regulatory agencies.

My sense is that this legislation—there is not a problem there to solve, in my sense. I have not heard of one.

This legislation should focus on a more orderly dissemination of the information that is already being collected. Clearly just simply opening all information that is ever collected for any reason, opening it up and putting it on the Web, is another way to approach it. I don't think that would be a productive way to approach it.

This legislation would say, let us make the information available to one of the regulatory agencies available to the other regulatory agencies, and I think that is the right step, the right approach.

Mr. GRUCCI. How would you then prevent a company that would hire someone with the kind of attributes we have been hearing that were not criminal, that they obviously did not conduct any criminal activity to suffer any criminal punishment for, but yet are not the type of people that some companies would want to represent them,

yet they are still out there, and some companies may hire these types of people?

Why shouldn't the public have that same kind of access so they can make a decision on how to invest their money, whether it is to buy a life insurance product or whether it is to buy an annuity plan for their child's education? Why wouldn't you want them to have that kind of information to determine whether or not the person they are dealing with is reputable?

Mr. BARTLETT. Congressman, I do want the public to have that information. For that purpose we set up 200 regulatory agencies to try to regulate the activities and regulate who can get a license and who cannot. So I think that system, other than the dissemination of the information, is pretty well in place.

The fact is, there is a competitive marketplace that helps to make that decision, so individual consumers decide who they want to do business with. That is sort of the basis of our industry, is to promote the full competition within that industry.

But as far as the licensing of who is allowed to be hired in a particular license, that is pretty well established and we think is working pretty well.

Mr. GRUCCI. Thank you for your answer.

I yield back the remainder of my time.

Chairwoman KELLY. Mr. Hillman, did you want to make a comment?

Mr. HILLMAN. There was one point that I wanted to add. That is that some of the most important information that the public would need would be information on disciplinary actions or enforcement actions that were taken against an individual in any one of these industries that we are talking about.

Right now today that information is currently available to the public, but it is not readily accessible. One of the important things that would be done through this provision would be to make that information more easily available to others.

Mr. GRUCCI. Madam Chairwoman, if I could just follow up?

Chairwoman KELLY. Yes.

Mr. GRUCCI. I just wanted to ask the question, those examples that you just pointed out would be for someone who committed some sort of a criminal act, and there would be some sort of a trail indicating that to the public. Is that my understanding of your answer?

Mr. HILLMAN. It would be a regulatory action that would have been taken by a banking securities or insurance——

Mr. GRUCCI. Is this not designed to cover those people who have yet to commit or are not committing a criminal act, but they are not reputable, they are not acting with the utmost concern for the general public?

Mr. HILLMAN. There is interest in sharing information in addition to enforcement actions and disciplinary actions, to include things like consumer complaints, information on open investigations, and the like. That information also would be very useful to regulators to help them ask more probing questions of applicants in those industries to make sure that they are fit.

Chairwoman KELLY. Thank you very much, Mr. Grucci.

Mr. GRUCCI. Thank you, Madam Chairwoman.

Chairwoman KELLY. Mr. Cantor.

Mr. CANTOR. Thank you, Madam Chairwoman.

Just briefly, throughout the testimony of this panel, as well as the prior panel, my concern has been the risk of duplicative reporting requirements and the creation of new bureaucracy. I am sensing that there really is not much concern for that among this panel. Is it fair to say that the risk of duplicative reporting requirements under the proposed legislation really has been obviated by the uniform licensing requirements inherent in the NARAB provisions of the Gramm-Leach-Bliley bill?

Mr. BARTLETT. Congressman, the reason you do not hear a lot of concern on this side is we have not seen the details of the legislation yet. So the risk is in the way the legislation is drafted.

We have full confidence in both the sponsors and leaders of this committee and Members that that will not happen, but that is always the risk, because it is easy, and I was on your side of the bench for a while, and it is easy to sit on your side of the bench and sort of say, would it not be a neat idea if we just added a few extra requirements here? Well, how about a few more and a few more?

So the risk is the way it is drafted, not in the concepts.

Mr. CANTOR. If I could just follow that up, one of the discussions I was having had to do with, you know, each State has different requirements as far as applications for licensure, and so forth. My question really is, does Gramm-Leach-Bliley speak to that specifically, and the sort of threat of the NARAB provisions hanging over it, does that sort of take care of any duplicative requirement for information under a proposed bill here, because it has already been required under Gramm-Leach-Bliley, and are we going to really be entering an age where there is uniformity among specifically—let's say in the insurance area, is there going to be uniformity in licensing that would automatically be accessible, as Congresswoman Hart said, be accessible through a network search?

Mr. SMITH. As far as the insurance industry is concerned, Gramm-Leach-Bliley has moved the needle precipitously. The insurance commissioners are committed to trying to get to the reciprocity requirements.

I think there are a lot of things taking place as we speak in various State legislatures, and if we can indeed get to reciprocity—I think if we get to 29, because that is the number in the bill, and we stop there, that will not do us a whole lot of good. We are assuming once we get to 29, then we will get to 37, 38, then we will get up to 50 or 51. Then we will make sure we are right where we need to be.

Yes, that would take care of a lot of other requirements.

Mr. CANTOR. Because there are specific sort of offenses, if you will, that an individual may have had on their record that will be there in the databank at the State level that will then be retrieved up to this sort of national linkage?

Mr. SMITH. Absolutely correct. They will be shared from State to State in whatever fashion that would finally take.

Mr. RODELL. Again, I would just like to point out that part of that act really is to look at this as one financial services industry.

So certainly NARAB helps insurance, but it does not help the duplicative issues across the entire sector.

Mr. CANTOR. Thank you. I yield back the balance of my time, Madam Chairwoman.

Chairwoman KELLY. Thank you very much, Mr. Cantor.

Mr. Bachus, you have really not had a chance to ask your questions. Would you like to do that now?

Mr. BACHUS. Thank you. I did reserve my questions.

Mr. Bartlett, you talk about a superagency being created. I think we created—in Gramm-Leach-Bliley we had the Federal Financial Institution Examination Council, which was tasked with coordinating the information-gathering efforts within the financial industry, the banking industry.

It does make sense to have some mechanism for coordinating efforts between the industries. So do you think maybe it makes sense to have that same examination council as the gathering body?

Mr. BARTLETT. Mr. Chairman, I do. I think that the Federal role should be as limited as possible, sort of setting up the ground rules, making sure the information is uniform, establishing uniform standards, and making sure it is accessible.

My caution is to make sure that we don't set up a place where more information is gathered and sort of put into that place. There are warehouses in Washington, as you know, that are the gathering places of all kinds of information that is not accessible. They are just simply gathered.

I just would caution—and I know the committee, from the drafts I have seen, the drafts of the concepts I have seen, is avoiding that. I just want to be sure it is on the record to continue to resist that temptation.

Mr. BACHUS. I think that is why the proposal is to use that examination council so you do not have to set up a new body.

Mr. BARTLETT. We think that is actually the appropriate body to provide the supervision or the oversight on this function.

Mr. BACHUS. Thank you.

You mentioned $100 billion. If we can create an anti-fraud network with a cost of $5 million or $10 million that even eliminates a fraction of this $100 billion price tag, plus—also it could have a savings element there, or could save agencies and individuals money by not having to respond to duplicative requests for information. It could actually be maybe—it could save the States money, the agencies money, and individuals money and at the same time prevent a lot of fraud. So I think it could be a very good bargain for the citizens and the consumers.

I would also use an analogy. This may be a stretch, but we now require repeat sex offenders and child molesters in certain States to register when they go into a neighborhood. I see this as sort of a way of registering some of these not only good agents, but bad agents, and informing people when they do move around from industry to industry or from State to State.

Mr. Hillman, one thing that I have heard time and time again is that in order to implement this information-sharing agreement, these information-sharing agreements, that someone—and I think only Congress would be the one—someone should supply some con-

fidentiality, liability, and corporation requirements; in other words, legal immunity in certain cases.

Do you see any way of doing it without congressional involvement?

Mr. HILLMAN. I believe congressional involvement would be a very critical component. Let me give you one example. Within the securities industry they have this CRD system that maintains information on disciplinary actions, as well as information on open complaints dealing with sales practices against brokers in that industry.

Open complaint information is sometimes unsubstantiated and very sensitive. What they have done in the securities industry is to give Federal immunity to the NASDR, that protects them from any disclosures that have been made in good faith. That would be somewhat of an appropriate model to consider for a system that we are talking about today.

Mr. BACHUS. OK.

Ms. Wuertz, you mentioned that your association has decreased the number of rogue agents by 75 percent by developing a coordinated tracking system. I think that model could be used throughout the industry.

Ms. WUERTZ. It was actually a combination of many things. The rules we have put in place are sales practice rules.

If someone does have something in their history that they are concerned about, we require the firms to have extra supervisory procedures. So we do a lot if we have any information that someone has a questionable background.

Mr. BACHUS. Thank you.

Chairwoman KELLY. Thank you very much, Mr. Bachus.

Ms. Waters, you have been very patient. I think you have a follow-up question, so I would like to call on you at this time.

Ms. WATERS. Thank you very much, Madam Chairwoman.

Instead of doing the follow-up question, I would like to kind of wind it up.

There are a lot of questions that I still have about what it is, a database or linkage, and what the technology is for the linkage, if that is what it is; whether or not it is for regulatory agencies or regulatory agencies and consumers; whether or not someone has taken a look at the various States, and the fact that some States are very, very consumer-oriented and you can have numerous violations, whereas in another State they may not be violations at all, and what you do with that kind of reporting.

All, of course, we have not talked about costs. I don't think it is $5- to $10 million, as Mr. Bachus kind of alluded to. He is hoping, but I think it is a lot more costly than that.

What I am hearing is this, that while we have a concept, it does not appear that those of you in the industries with certain responsibilities, certainly regulatory responsibilities, and so forth, and those of you who are in the industries where you try and form associations so that you can have standards, all of that, it does not appear to me that you have really been deeply involved in writing this or helping to develop this.

So I guess what I want to leave with you and these subcommittees is this, that rather than go down the path of good ideas that

turn out to be nightmares later on, let's make sure that there is enough input and involvement and real critique of the concept so that we can fix it.

Most people are concerned about fraud and rogues and all of that, and others are concerned about fraud and rogues and privacy and confidentiality and effectiveness. So let us make sure you are involved, because you know what you are talking about. You know what you are trying to get at, and know what we are trying to get at and what the owners of the concept are trying to get at. Don't let it run away with the good ideas so that it will not work and will not make good sense.

So I am just going to close by saying, Madam Chairwoman, I think it is very important that we spend the time on this concept to make sure we know what we are doing and how to best do it, rather than move too quickly and create more problems than we ever dreamed we could create.

Thank you. I yield back the balance of my time.

Chairwoman KELLY. Thank you very much for your comments, Ms. Waters.

Mr. Bachus, did you have an additional question?

Mr. BACHUS. Just in closing, I would like to commend both panels. I thought their mood and their demeanor and testimony was one of cooperation. We appreciate that.

What Representative Rogers said I think should encourage us and give us optimism. That is that both panels, both the industry and the regulators—there was agreement between them and a consensus on many things. That ought to assist us in the future.

Chairwoman KELLY. Thank you very much.

Yes, we do appreciate both panels and the fact that you spent as much time as you did. It does give us a strong charge to get this right, but it is good that we have a lot of agreement on where we are going with this.

The Chair notes that some Members may have additional questions for the panel which they may wish to submit in writing, so without objection, the hearing record is going to remain open for 30 days for Members to submit written questions for the witnesses, and for the witnesses to place their responses in the record.

The second panel is excused, with the committee's deep appreciation for your time.

I would like to ask unanimous consent for Members to have 1 week to submit opening statements or handwritten follow-up questions to our witnesses.

I would like to thank the staff, Mr. Robert Gordon, Charlie Symington, and especially my friends and colleagues, Mr. Bachus and Ms. Waters for their work on this hearing.

Thank you very much. This hearing is adjourned.

[Whereupon, at 4:37 p.m., the hearing was adjourned.]

A P P E N D I X

March 6, 2001

TESTIMONY OF

JULIE L. WILLIAMS

FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

and the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES

of the

U.S. HOUSE OF REPRESENTATIVES

March 6, 2001

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

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

Introduction

Madam Chair, Mr. Chairman, and members of the Subcommittees, thank you for inviting the Office of the Comptroller of the Currency (OCC) to participate in this hearing. Effective coordination and information sharing among the regulators of financial services providers -- banks, securities firms, and insurance providers -- are essential in order for the functional regulation framework established by the Gramm-Leach-Bliley Act (GLBA) to work as the Congress intended. In view of the integration of the financial services industries that the GLBA permits, and the possibilities that individuals will migrate between industries and entities will commence new activities, it is particularly important for a functional regulator to have a means to know whether individuals or entities have been subject to enforcement actions by another functional regulator. On behalf of the Comptroller, I would like to thank you for your efforts to further these objectives.

In my testimony today, I will first provide context for your current legislative work by highlighting the most important ways in which the OCC currently shares information with other Federal and with State regulators. I will then offer our perspectives on key confidentiality and liability issues that are raised by proposals to enhance information sharing among financial services regulators.

Coordination and Information Sharing: What the OCC Does Today

The OCC currently shares a variety of types of information with Federal and State regulators, including the other Federal banking agencies, the Securities and Exchange Commission (SEC), and State insurance regulators. I will first review our recent work with State insurance regulators, then turn to efforts involving the SEC and the other Federal banking agencies.

The OCC's Work with State Insurance Regulators

Last year, when I appeared before the Subcommittee on Finance and Hazardous Materials of the Commerce Committee, I described the progress the OCC and the National Association of Insurance Commissioners (NAIC) had made together in developing workable approaches to sharing information about consumer complaints. As I mentioned at that time, the OCC and the NAIC recognized several years ago that the sharing of certain types of information not only benefits consumers through more timely responses to inquiries and complaints, but also serves to identify common cross-industry trends or problems. As the first step in this process, the OCC and the NAIC jointly drafted a model agreement in 1998 to share consumer complaint information involving national bank insurance sales activities. This agreement requires the OCC to send to the appropriate State insurance regulator copies of all complaints that the OCC receives relating to insurance activities in that State by a national bank. Likewise, the State insurance regulator will send to the OCC copies of all complaints it receives involving a national bank insurance activity. To date, the OCC has entered into these agreements with 28 State insurance regulators.

Recently, the OCC and the NAIC have built upon their success with the complaint sharing process and jointly drafted a second, more encompassing model agreement that provides for the sharing of broader insurance-related supervisory and enforcement information, including, but not limited to the sharing of complaint information. Under the agreement, the OCC and State insurance regulators may request from each other, and provide to each other with or without a request, confidential information regarding: (1) material risks to the operations or financial condition of a regulated entity; (2) the insurance activities of a regulated entity; or (3) other confidential information necessary to disclose fully the relations between a regulated entity supervised by the OCC and a regulated entity supervised by the State insurance regulator. The information requested must be in furtherance of the agency's lawful examination or supervision of the regulated entity.

The NAIC adopted this model agreement in December of last year, and just recently transmitted the final version of the model agreement to its members. We expect to begin entering into these new agreements as early as this week.

The OCC also has taken other steps to promote the exchange of information that may be of use to other supervisory entities operating under the functional regulation regime established by GLBA. For example, shortly after GLBA was enacted, we amended our rules relating to national bank corporate activities to ensure that information the OCC receives in connection with bank applications to affiliate with entities engaged in insurance activities is shared with the appropriate State insurance department. Under the revised procedures, a national bank must describe in its notice or application to the OCC to establish a financial subsidiary or an operating subsidiary, or to make a non-controlling investment in an entity that will engage in insurance activities, the type of insurance activities that the bank is engaged in or will engage in and the lines of business for which the company holds or will hold an insurance license. This information is then forwarded to the appropriate State insurance regulator. To date, the OCC has forwarded information contained in almost 70 notices or applications that it has received.

Our information sharing is part of a comprehensive effort to further develop close working relationships with State insurance regulators. With respect to insurance matters, these efforts began in 1996 when the OCC invited State insurance commissioners to the OCC to discuss ways to better coordinate our respective regulatory responsibilities. Since then, the OCC and State insurance regulators have met, separately or through the auspices of the NAIC, on numerous occasions. Our most recent meeting, in fact, was yesterday. To date, regional representatives of the OCC have met individually with insurance regulators in all 50 states and the District of Columbia to learn more about how we each implement our regulatory responsibilities as well as to discuss ways we can assist each other in these responsibilities. Moreover, senior OCC representatives attend NAIC quarterly national meetings on a regular basis to exchange information about their respective regulatory priorities and supervisory approaches and to discuss ongoing regulatory or supervisory projects.

Most importantly, the OCC and the State insurance supervisors are no longer merely observers of each other's regulatory and supervisory activities. We each now actively seek the participation of the other in matters of common supervisory concern, and we recognize that the other offers unique and relevant perspectives to the responsibilities of each respective regulator. Two recent examples illustrate the point.

First, the OCC and other Federal banking regulators consulted with State insurance regulators, through the auspices of the NAIC, during the development of the insurance consumer protection regulations required by section 305 of GLBA. Section 305 required the OCC, the Federal Reserve Board (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) jointly to issue regulations that apply to retail sales practices, solicitations, advertising, or offers of any insurance product by a bank (or other depository institution) or by any person engaged in such activities at an office of the institution or on behalf of the institution. The regulation includes, among other things, specific disclosure requirements that must be made to the consumer before completion of the insurance sale or in connection with an extension of credit. The insurance regulators and the NAIC proved to be a valuable resource providing timely and helpful insights from the experience of State insurance departments.

Second, the Consumer Protection Working Group of the NAIC, chaired by Nat Shapo, Director of the Illinois Department of Insurance, recently invited the OCC and the other Federal banking agencies to comment on proposed revisions to the NAIC's Model Unfair Trade Practices Act, a model statute that each State could use to establish standards for bank and thrift sales of insurance in that State. The revised Model Law is being specifically designed to take account of the preemption standards and safe harbors for State insurance laws contained in section 104 of GLBA, as well as the Federal consumer protection provisions set forth in section 305 and the implementing regulations of the Federal banking agencies. The OCC and the other Federal banking agencies participated in several meetings discussing relevant provisions of the Model Act. We offered suggestions based on our experiences in supervising national banks and found the process initiated by Director Shapo to be open, collegial, and very constructive. As a result, we believe that the draft Model Act will reflect an important and precedential consensus between the State insurance regulators and Federal bank regulators regarding the implementation of GLBA and the protection of consumers.

The OCC's Work with the SEC

The OCC also has developed a number of information sharing arrangements with the Securities and Exchange Commission (SEC). For example, we make referrals to the SEC when the OCC discovers potential violations of the Federal securities laws.[1] We share relevant information on the alleged violation with the SEC, and coordinate with the SEC's investigation and enforcement proceedings. The OCC's participation includes

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[1] The OCC has similar agreements to refer potential violations of law with the Department of Labor for potential violations of ERISA, and the Federal Elections Commission for potential violations of Federal elections law.

making available to the SEC our bank examination reports and other confidential examination information. We also provide bank examiners to assist the SEC in reviewing OCC materials, and to testify for the SEC in its enforcement proceedings.

We make access requests to the SEC for its investigatory and examination information when this information is relevant to the OCC's bank supervision responsibilities. We also request information from the SEC that may be relevant to pending licensing applications under consideration by the OCC, including new bank charter applications and notices of change in bank control.

We have shared information with the SEC on customer complaints received by the OCC when the complaints involve matters that may be subject to the SEC's authority. We have also received information on customer complaints from the SEC related to national banks. For example, we have shared customer complaint information with the SEC in cases involving investment product sales to bank customers, and in cases related to sales of brokered certificates of deposit.

When requested by the SEC, we advise the SEC of the existence of OCC enforcement actions on national bank affiliates of publicly traded bank holding companies, in connection with the SEC's review of securities disclosures made by the holding companies. Staff of the SEC's Division of Corporation Finance have made arrangements to routinely request information on OCC enforcement actions in connection with the SEC staff's review of securities disclosure filings made by publicly traded bank holding companies. The SEC staff uses this information to verify the accuracy and completeness of public disclosures made by these bank holding companies. For example, in the past the SEC staff formed a task force to focus on the accuracy of bank holding company securities disclosure filings related to loan losses, and the SEC staff made requests to the OCC for information on hundreds of national banks as part of this initiative.

Finally, we have been working with the SEC to implement GLBA's new functional regulation provisions as they pertain to national banks' securities activities. We have had several meetings with the SEC's senior staff responsible for examinations of broker-dealers and investment companies to discuss each agency's views of GLBA's functional regulation provisions. Our discussions have covered a review of the scope of examinations conducted by the agencies. We are also in the process of identifying the types of information sharing between the agencies that would serve to facilitate functional regulation.

We also coordinate with the SEC in connection with the OCC's authority over national banks acting as transfer agents, municipal securities brokers and dealers, and government securities brokers and dealers. We routinely share examination information with the SEC on national banks that are registered transfer agents. We also have coordinated enforcement actions in the past related to transfer agents and government securities dealers. We have shared information on municipal securities dealers, including

in cases involving compliance with the rules on political contributions by municipal securities professionals.

Finally, we have entered into an "Agreement in Principle" with the National Association of Securities Dealers covering information sharing on broker-dealers that are involved in selling investment products through banks.

The OCC's Work with the Federal Banking Agencies

We work in close coordination and cooperation with the other three Federal banking agencies -- the Federal Reserve, FDIC and OTS -- in virtually every significant aspect of our regulation and supervision of national banks. Coordination among the agencies has increased in recent years. Over the last 10 years, Congress has increasingly directed the agencies to work together to write implementing regulations for new legislation. Moreover, industry consolidation has resulted, in many instances, in banking organizations containing multiple charters that are supervised by different agencies. Few major supervisory or policy initiatives are today taken by one of the banking agencies without consultation with the others. In many cases, these initiatives are undertaken jointly by the four agencies even when there is no express statutory requirement to do so.

For this reason, it is difficult to catalog all of the ways in which the agencies coordinate and share information. I will, however, highlight a few of the more important areas where we work cooperatively with the other banking agencies on law enforcement matters. As you will note in the description that follows, the methods that the banking agencies use to share information differ depending on the level of sensitivity of the information.

The most widely available type of information is information pertaining to final enforcement actions, that is, actions initiated by one of the banking agencies pursuant to its enforcement authority[2] that result either in an order issued by the head of an agency after the matter has been litigated or in a consent order or agreement entered into by the parties.

Copies of final formal enforcement actions are required by statute to be made public.[3] The banking agencies separately share copies with one another. Moreover, the four banking agencies each maintain a searchable database, available on each agency's Internet website, that enables anyone to enter an individual's or bank's name and obtain information indicating whether that person has been the subject of a final enforcement action. Each banking agency's website is linked to the websites of other financial institutions' regulators, where similar information is available about actions taken by those agencies. For example, by logging on to the OCC's website,[4] the Internet user can

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[2] *See generally* 12 U.S.C. 1818 (enforcement authorities of the four Federal banking agencies).

[3] *See* 12 U.S.C. 1818(u).

[4] The Internet address for this searchable database is http://www.occ.treas.gov/enforce/enf_search.htm.

search the OCC's database of formal enforcement actions by party name or by bank name to find out if we have taken final action against a particular individual or bank. An electronic link is also provided to the sites of the Federal Reserve, the FDIC, the OTS, the National Credit Union Administration (NCUA) and the SEC to enable the user to search for similar enforcement information on each of those sites.

The four banking agencies also share information with each other when formal enforcement actions are initiated, including when an agency issues a notice of charges based on its statutory enforcement authority. Information about the initiation of informal enforcement actions also is shared among the agencies if, for example, the bank that is the subject of the enforcement action is affiliated with an institution directly regulated by one of these agencies. Finally, when appropriate on a case-by-case basis, the OCC provides supervisory and enforcement information to staff at the Federal Reserve, the OTS and the FDIC. This information about the initiation of enforcement proceedings is not publicly available.

Certain information that is not public may, however, be made available to Federal agencies other than the Federal banking agencies and to State agencies under certain circumstances. For example, OCC regulations authorize the sharing of non-public supervisory information to other Federal and State agencies when not otherwise prohibited by law, and the information sought is in furtherance of the performance of the requesting agency's official duties.[5] Utilizing this regulatory mechanism, the OCC regularly provides access to certain confidential supervisory information to other Federal and State law enforcement and regulatory agencies.[6] In addition, under the new model agreement to share information with State insurance regulators that I have previously described, the OCC will notify the State insurance regulator of any enforcement action it takes against a national bank that has a resident insurance license in that state if the action relates to activities the insurance regulator supervises or has the authority to examine, or if the activity at issue poses a material risk to the operations or financial condition of a regulated entity that the insurance regulator supervises. Likewise, the State insurance regulator will notify the OCC of any enforcement action it takes, or that it knows has been taken by another State insurance regulator, against a regulated entity that the OCC supervises or that poses a material risk to the operations or financial condition of a regulated entity that the OCC has the authority to examine.

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[5] *See* 12 C.F.R. 4.37.

[6] Consistent with OCC regulations on the sharing of non-public supervisory information, the OCC has entered into a number of information sharing agreements with other Federal and State agencies. In 1984, the Federal banking agencies entered into a Joint Statement of Policy on the Interagency Exchange of Supervisory Information to share certain confidential or privileged supervisory information, and to make this information available to relevant State supervisory authorities. In 1986, the OCC authorized each of the OCC's district offices to execute separate sharing agreements with State supervisory authorities seeking access to non-public supervisory information. *See* OCC Policies and Procedures Manual, PPM-6100-3 (rev.), January 22, 1986. The Federal banking agencies' most recent interagency sharing arrangement, in 1997, addressed the notification of enforcement actions among the Federal banking agencies. *See* Revised Policy Statement on "Interagency Coordination of Formal Corrective Action by the Federal Bank Regulatory Agencies," 62 Fed. Reg. 7782 (February 20, 1997).

In addition, information reported on the Suspicious Activity Reports (SARs) electronic database is available to Federal law enforcement agencies, the Federal banking agencies, and to State law enforcement and bank supervisory authorities. A SAR is a standardized form for reporting certain illegal or suspicious activities. Depository institutions, including national banks, State-chartered banks, Federal and State-chartered thrifts, and Federal credit unions, are required to file SARs when they detect a known or suspected violation of Federal law, a suspicious transaction related to a money laundering activity, or a violation of the Bank Secrecy Act.[7] Thus, the principal purpose of the SARs database is to catalog for criminal law enforcement authorities any suspicious activity and possible illegal conduct being perpetrated against, or utilizing, financial institutions. SARs are filed with the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) and maintained in an electronic database. FinCEN is a co-owner of the database with the Federal banking agencies, and maintains and manages the SAR database pursuant to an agreement with the OCC, the Federal Reserve, the FDIC, the OTS, and the NCUA. That agreement permits FinCEN to share access to the database with other Federal and State law enforcement agencies and regulators upon securing a written commitment to maintain confidentiality of the information and to safeguard its use. In general, the SAR system is used to provide leads for law enforcement agencies and for banking agencies to identify situations that may warrant initiation of formal enforcement actions to remove and prohibit individuals from banking.

Key Issues in Developing New Legislation

Based on our experience working and sharing information with Federal and State regulators, I would like to highlight two areas which, in our view, present critical issues regarding the design of any new system for enhanced enforcement-related information-sharing among functional regulators. The first is the need to ensure that disclosure is not prohibited or restricted by Federal law and, if authorized, that agency and bank (and other regulated entities') privileges are properly preserved. The second is to recognize that expanded information sharing can raise very sensitive issues regarding the nature and reliability of the information collected and how that information is used, which need to be very carefully considered in the design of an expanded information-sharing system.

1. Authorized Disclosure and Preservation of Privileges

The ability of the OCC and the other Federal banking agencies to disseminate non-public information to other Federal and State agencies currently is limited by the restrictions contained in certain Federal statutes, and also by the necessity of preserving privileges recognized under Federal statutes and State common law. This non-public

[7] *See, e.g.*, 12 C.F.R. 21.11 (OCC regulation prescribing SAR filing requirements). The Bank Secrecy Act authorizes the Secretary of the Treasury to require "any financial institution, and any director, officer, employee, or agent of a financial institution, to report any suspicious transaction relevant to a possible violation of law or regulation." 31 U.S.C. 5318(g). The term "financial institution" is broadly defined in that law to include a wide variety of persons and entities whose business involves monetary transactions. *See* 31 U.S.C. 5312(a) (definition of "financial institution").

information falls into two general categories: privileged and confidential information obtained in the furtherance of the OCC's supervisory and examination authority *from* organizations that the OCC supervises; and privileged and confidential information internally prepared or generated *by* the OCC.

Among the Federal statutes that prohibit or restrict the OCC from transferring non-public information are the Trade Secrets Act, the Right to Financial Privacy Act, and the Privacy Act of 1974.[8] In the absence of an express statutory exception, these laws prohibit or restrict certain types of non-public information from being shared with other Federal and State agencies. Moreover, even if a statutory exception applies, a number of statutory and common law privileges recognized by the courts and available to the OCC may be waived or destroyed by the unprotected disclosure of privileged information. These include the bank examination privilege,[9] the deliberative process privilege, the self-evaluative privilege, and the attorney-client and work product privileges.

Any statutory authorization to share confidential or privileged information with State agencies or other entities needs to appropriately address the foregoing statutory prohibitions as well as ensure protection of all available privileges. Currently, a provision in the Federal Deposit Insurance Act expressly protects transfers of privileged information from, among others, the Federal banking agencies to other Federal government agencies.[10] The provision does not address the sharing of privileged materials with State agencies, such as State banking authorities, however. Although GLBA separately provides that information exchanged pursuant to its section 307(c)[11] by a Federal banking regulator or a State insurance regulator will not constitute a waiver, or otherwise affect, any privilege to which the information is subject, section 307 pertains only to information regarding transactions or relationships between an insured institution and an affiliated company that is engaged in insurance activities and to certain other information that a banking agency believes is necessary or appropriate for a State insurance regulator to administer State insurance laws. It also does not cover information sharing with the NAIC. Thus, under current law, sharing of confidential or privileged information with State agencies and the NAIC runs the risk of resulting in a loss of protected status to the privileged materials.

It is also essential to protect the privileges that banks may assert over their own information that is in the possession of the Federal banking agencies. Since banks have

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[8] The Appendix contains a brief description of these three Federal laws.

[9] *See* 12 U.S.C. 481.

[10] 12 U.S.C. 1821(t). The agencies covered by this protection are the OCC, the Federal Reserve, the FDIC, the OTS, the Farm Credit Administration, the Farm Credit System Insurance Corporation, the NCUA, and the General Accounting Office.

[11] GLBA, sec. 307(c), *to be codified at* 15 U.S.C. 6716(c).

no discretion as to the information they must disclose to supervising agencies,[12] the authority for bank examiners to enter upon bank premises and review all of a bank's books and records is plenary. Thus, self-evaluative, attorney-client and work product communications maintained anywhere in a bank's books and records fall properly within the scope of the banking agencies' examination authority and may be shared with the examining agency by the supervised institution. Such information in the hands of the Federal banking agencies remains privileged because it was obtained through statutory compulsion. Similarly, the sharing of such privileged information among the Federal banking agencies remains protected under 12 U.S.C. Section 1821(t). However, the subsequent sharing of this privileged information with State agencies, without Federal statutory protection, could result in the waiver of a financial institution's privileges. This, in turn, could compromise an institution's legal position and potentially adversely impact its safety and soundness.

2. *Protect Privacy and Confidentiality by Limiting the Types of Information that Can Be Widely Shared*

Information systems obviously create different concerns depending on the level of sensitivity and reliability of the information they contain. In our view, it would be very beneficial to establish a system for sharing and electronic access to information concerning enforcement actions taken by the banking agencies, and comparable enforcement actions taken by other functional regulators. Such a system would enable regulators to identify individuals and entities with records that are relevant when those individuals or entities seek to affiliate with new entities or conduct new types of businesses. In the case of depository institutions, information on final enforcement actions is available to the public pursuant to 12 U.S.C. Section 1818(u), and therefore would not raise confidentiality or privacy concerns.

Sharing non-public information about banks and individuals does raise confidentiality and privacy concerns that are particularly serious, since the information could vary considerably, and may be preliminary or unsubstantiated. All of the Federal banking agencies from time to time receive preliminary information that raises suspicions of illegal activity. Disclosure to other regulators of preliminary suspicions, the reliability of which could vary widely, would raise significant privacy issues, including the dissemination of potentially inaccurate accusations against individuals or institutions that could cause unwarranted harm to the reputation of the individual or the bank. Disclosure of preliminary information also could hamper ongoing investigations by law enforcement agencies or Federal banking agencies and might even expose agencies to potential liability for falsely accusing individuals or institutions.

For example, the SAR system I have described, by definition, contains information about "known or suspected" violations of Federal law and about "suspicious transactions" related to money laundering or violations of the Bank Secrecy Act. By its nature, information reported on a SAR is preliminary or unsubstantiated. We need to be

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[12] For the statutory provisions requiring institutions to provide information to their regulators, *see* 12 U.S.C. 248 (Federal Reserve), 481 (OCC), 1820 (FDIC), 1464(d) (OTS), and 1784(a) (NCUA).

very careful that any new system of information sharing does not taint individuals or entities based upon mere suspicion or allegation.

On the other hand, sharing non-public information *after* an agency has formally determined to initiate an action, has gathered its supporting documentation, and has issued a Notice of Charges, reduces the risks to confidentiality and privacy. If such non-public information were shared only with other Federal and State agencies, this information would remain outside of the public arena. At the same time, since Notices of Charges are fully developed and based on an agency's extensive investigation, they can safely be viewed as relevant by other agencies with a supervisory or law enforcement interest in the individual or institution.

For these reasons, we respectfully urge that legislation focus on enhancing the availability to relevant Federal and State agencies (and the NAIC on behalf of State insurance supervisors) of information regarding final enforcement and disciplinary actions. If information availability were to be expanded beyond those actions, we would urge that it focus on formally commenced enforcement actions by the participating Federal and State agencies. Such a system would be very useful to functional regulators and would not present the information reliability and privacy issues that would arise if broader categories of unsubstantiated information were included.

This approach also would make it unnecessary to create any new governmental entity to manage information sharing among functional regulators. A meaningful level of information exchange already exists among Federal financial institutions regulators and State regulators, though the information is not as complete or as readily accessible as is desirable. In our view, the current systems represent a good starting point, and Congress could direct the relevant agencies to build on what currently exists, to create a linked system containing public information on enforcement actions taken, with the limited addition of non-public information concerning the issuance of Notices of Charges (or comparable actions), as I have described, and with provision for the role of the NAIC on behalf of the State insurance supervisors in that process. That directive, coupled with the necessary protections to preserve privileges and ensure that confidentiality and privacy are protected, would be a significant aid to cooperative law enforcement among Federal and State regulators of financial services providers, and would not require the creation of any new bureaucracy to oversee this activity. This would be more effective, in our view, than creating a new organization, such as a new body within of the Federal Financial Institutions Examination Council, to assume and manage this function.

Conclusion

Madam Chair, Mr. Chairman, and members of the Subcommittees, let me state again the appreciation of the OCC that the Subcommittees are addressing these issues. You have identified an important area, where enhanced information sharing between functional regulators can enhance the integrity of the industries that we regulate. Many of the issues in this area can be quite complex, and we would be happy to work with the Subcommittees and their staff to provide technical assistance as you prepare specific legislative proposals.

I would be happy to answer your questions.

APPENDIX

FEDERAL STATUTES AFFECTING INFORMATION SHARING

The following laws place restrictions on transfers of information made by Federal agencies.

- *The Trade Secrets Act* (18 U.S.C. § 1905). This law prohibits federal agencies and personnel from disclosing specified information unless the disclosures are authorized by law. The information subject to this prohibition "concerns or relates to the trade secrets, processes, operations, style of work, or apparatus, or to the identity, confidential statistical data, amount or source of any income, profits, losses, or expenditures by any person, firm, partnership, corporation, or association." Persons disclosing these types of information without requisite authority may be fined, imprisoned, and removed from federal service.

  It is unsettled whether inter-agency transfers are disclosures subject to the Trade Secrets Act[1]. Department of Justice opinions reflect that, in addition to express statutory authorization, lawful sources of disclosure authority under the Trade Secrets Act may arise from, among other sources, an agency's substantive regulations or necessary statutory implication.[2]

- *The Privacy Act of 1974* (5 U.S.C. § 552a). This law restricts federal agencies' collection and dissemination of information about individuals. Under this law, an agency may collect and maintain information about an individual only if it is relevant and necessary to accomplish a purpose of the agency that is required to be accomplished by statute or executive order. Disclosure of such information may not generally occur without the consent of the information's subject. However, twelve statutory exceptions to the principle of "no disclosure without consent" exist. Of these, two have relevance to and may authorize the transfer of information about an individual to other federal or state agencies. Under the first of these exceptions, disclosure may occur pursuant to a routine use if the use is compatible with the purposes for which records about an individual are maintained. Additionally, if requested in writing by a federal or state agency for an authorized civil or criminal law enforcement purpose, disclosure may also occur.

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[1] *Compare* Shell Oil Co. v. Department of Energy, 447 F. Supp. 413 (1979), affirmed 631 F.2d 231 (3d Cir. 1980) (inter-agency transfer held to constitute disclosure) *with* Emerson v. Schlesinger, 609 F.2d 898 (8th Cir. 1979) (TSA was designed to apply only to public disclosures).

[2] 41 Op. Att'y Gen 106 (1953) (authority to make disclosures implied from statutory mandate to liquidate the RFC); 5 Op. Off. Legal Counsel 255 (1981) (summarization of sources of TSA disclosure authority).

- *The Right to Financial Privacy Act* (12 U.S.C. §§ 3401-3422) (RFPA).While the focus of the Privacy Act is on a broader category of information about individuals, the RFPA applies only to information obtained from a financial institution's records pertaining to an individual customer's relationship with the institution. With respect to this information, federal agencies are generally limited in the means through which this information may be obtained from an institution. However, specific provision is made in the RFPA for examinations conducted by the federal financial regulatory agencies.

  Once information is obtained by a federal agency, it may not generally be transferred to another without notice of the transfer being provided to the customer. However, certain transfers are exempt from this general requirement. Included among these exemptions are transfers: (1) between two designated supervisory agencies having statutory examination authority with respect to the same institution[3]; (2) among and between FFIEC members and the SEC[4]; (3) sought by a federal agency in connection with an investigation or examination of a financial institution[5]; and (4) required by law.[6]

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[3] 12 U.S.C. § 3412(d).

[4] 12 U.S.C. § 3412(e).

[5] 12 U.S.C. § 3413(h)(1).

[6] 12 U.S.C. § 3413(d).

March 29, 2001

Answers Provided by Julie L. Williams,
First Senior Deputy Comptroller and Chief Counsel,
Office of the Comptroller of the Currency
To Questions Submitted by Chair Kelly and Chairman Bachus
Hearing on "Protecting Consumers: What Can Congress Do to Help Financial Regulators Coordinate Efforts to Fight Fraud?"

1. *At a July 20, 2000 hearing of the House Committee on Commerce Subcommittee on Finance and Hazardous Materials, the Office of the Comptroller of the Currency testified that: "The significant changes to the financial services industry effected by the implementation of the Gramm-Leach-Bliley Act make cooperation and coordination between regulators at the Federal and State levels more important than ever before." Could you please expound on this statement?*

The Gramm-Leach-Bliley Act (GLBA) provides new opportunities for banks to become affiliated with companies engaged in securities and insurance activities. At the same time, GLBA limits the authority of bank regulators to obtain information directly from these companies under a program of "functional regulation." In the event that bank regulators need information concerning a functionally regulated entity that is affiliated with a bank, GLBA envisions that this information will primarily be provided by the functional regulator -- rather than the functionally regulated entity. Moreover, as the financial services industry becomes increasingly integrated, we can expect to see not only new affiliations between banks, securities firms, and insurance companies, but also, as companies diversify their activities, increasing movement of individuals between different types of companies. It will therefore become increasingly important for all of the regulators with oversight responsibilities for the activities of integrated companies to coordinate with one another in order to properly implement this system of functional regulation.

As described in my testimony, the OCC has already undertaken a variety of measures to increase coordination with other regulators. For example, the OCC has worked with the National Association of Insurance Commissioners (NAIC) to develop uniform information sharing mechanisms for use with state insurance regulators. The OCC has already entered into agreements to share customer complaint information with many of the state insurance regulators, and we are in the process of expanding these agreements to cover other regulatory information. In addition, the OCC and the Securities and Exchange Commission already have a history of cooperation and coordination in connection with the regulation of bank-related securities activities. We are currently working with the staff of the SEC to develop ways to strengthen and improve this relationship under the new GLBA framework.

2. *In your written testimony for [the March 6] hearing, the OCC opined that it would be "very beneficial" to establish a system for sharing and electronic access to information concerning enforcement actions taken by banking agencies and comparable actions taken by other regulators. If Congress created an Anti-Fraud Network with perfected confidentiality, privilege, and liability protections, what other information should be shared via the Network?*

As I noted in my written testimony before the Subcommittees, the most useful information to be made available through a searchable database would be final enforcement and disciplinary actions. The four Federal banking agencies and the National Credit Union Administration not only share all enforcement and disciplinary actions with each other, they also each maintain a searchable database on linked websites that contain the requisite information about actions taken against institutions and institution-affiliated parties. The availability of electronic access to comparable actions taken by other functional regulators would be beneficial in the OCC's ongoing supervision of the national banking industry, and would assist in identifying and evaluating individuals and entities seeking to gain entry to the banking industry or to affiliate with national banks.

In addition to these final agency enforcement and disciplinary actions, persons found guilty of crimes involving dishonesty or breach of trust, and those who enter into plea agreements and pretrial diversion agreements arising from such criminal behavior are, by operation of law, prohibited from becoming employed, acquiring, controlling or participating in the affairs of insured depository institutions. *See* 12 U.S.C. § 1829. For this reason, the OCC's searchable website also contains the names of individuals formerly associated with national banks who satisfy the criteria for Section 1829 for which the OCC has confirmed the issuance of a final judgment, a court-accepted guilty plea or an approved pretrial diversion. This system provides a ready mechanism for banks, and other regulatory authorities, to search for individuals' names when conducting employment background checks.[1] However, the provisions of Section 1829 are not limited to the violation of criminal law involving financial institutions; it includes crimes of dishonesty and breach of trust committed by persons in any industry. The electronic access to pertinent state and local criminal actions known to exist by other functional regulators would be beneficial in the ongoing supervision of the national banking industry, and would assist each functional regulator and regulated entity when conducting background checks.

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[1] While the OCC does obtain criminal background checks through the FBI for individuals seeking to acquire control of a national bank or senior executives and directors seeking to affiliate with a troubled institution, the routine employment of individuals in the banking industry is not subject to prior agency scrutiny.

Separate and apart from the information described above, the electronic sharing of each agency's formal commencement of an enforcement action or disciplinary matter may also be beneficial in the OCC's ongoing supervision of the national banking industry. While such non-public information is not a final agency action from which supervisory decisions, standing alone, can or should be made, it does provide useful information that may be pertinent to the evaluation of certain safety and soundness issues or in the review of licensing or chartering matters. At the same time, the formal commencement of an enforcement or disciplinary action typically occurs only after the development of an extensive agency record and the necessary deliberation of many important factors. Accordingly, the sharing of this information with other functional regulators can be safely accomplished without hampering the agency's legal position or invading the privacy interests of an affected individual or entity.

The inclusion of other non-public information in the proposed electronic Network presents a number of legal and privacy issues, many of which are discussed in my written testimony to the Committee dated March 6, 2001. Even with Federal statutory protections to the privilege, confidentiality and liability concerns outlined in my testimony, there would remain concerns about whether the various open access laws adopted in many States would be impacted by the legislation.[2]

Providing electronic access to non-public information that is sensitive or unsubstantiated is particularly serious, since the use and reliance upon such information could vary considerably. While the OCC regularly makes available certain non-public information to other Federal and State regulatory agencies through interagency sharing agreements, a separate OCC regulation affords the agency the ability to assess the risks inherent in sharing other confidential information on a case-by-case basis where no information sharing agreement covers the information. In addition, this regulation provides the OCC with the ability to place some legitimate controls on the subsequent use and dissemination of the information. *See* 12 C.F.R. § 4.37. Based upon our experience working and sharing information with other Federal and State regulators and law enforcement authorities, we believe this case-by-case determination provides a better mechanism for evaluating the agency's legal position in each instance, and in gaining a better understanding of how the information will be used and disseminated.

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[2] Some states have enacted laws that provide for the "open access" of public documents maintained by a State agency. These laws vary in the level of public access they require. For example, in Florida, most State government records must be publicly available. Therefore, if a Federal agency requests a Florida agency to assert a privilege or exemption from disclosure, the Florida agency may not be able to do so if the Florida law requires the document to be made public. *See* Fla. Stat. ch. 119.07 (2000). In Texas, information maintained by a Texas State agency is presumed to be public, unless the information is covered by an exception to disclosure contained in the Texas Public Information Act. One such exception covers information made confidential by law. *See* Tex. Gov. Code 552.101 (2000). See also Rev. Code Wash. 42.17.260 (2001) (Washington law similar to that of Texas).

3. *Even in the Gramm-Leach-Bliley Act - - where Congress told the financial regulators to coordinate their oversight activities - - no provision was made to task any specific regulator with overall coordination for the financial services industry. We have read testimony about all sorts of individual information sharing agreements, but has any agency been able to assume the role of ensuring sufficient cross-industry regulatory coordination, particularly with respect to consumer protections and fraud?*

No provision in GLBA tasks any regulator with overall coordination for the financial services industry, including for purposes of information sharing. Current systems provide for meaningful information exchange between Federal and State regulators, however, and we would recommend that these systems be enhanced rather than replaced.

This could be done if Congress directed the relevant agencies to build on what currently exists, to create a linked system containing public information on enforcement actions taken, with the possible, limited addition of non-public information concerning the issuance of Notices of Charges (or comparable enforcement and disciplinary actions), and with provision for the role of the NAIC on behalf of the State insurance supervisors in that process. That directive, coupled with the necessary protections to preserve privileges and ensure that confidentiality and privacy are protected, would be a significant aid to cooperative law enforcement among Federal and State regulators of financial services providers, and would not require the creation of any new bureaucracy to oversee this activity. We would be happy to work with Subcommittee staff to develop the details of such an approach.

4. *Are insurance and securities firms affiliated with banks required to file Suspicious Activity Reports, and if so, who should be reviewing that information?*

Under current OCC regulations, a national bank operating subsidiary generally conducts its activities pursuant to the same authorization, terms, and conditions as apply to the conduct of those activities by the parent bank. 12 C.F.R. 5.34(e)(3). This would include the requirement for the filing of Suspicious Activity Reports (SARs) for known or suspected violations of Federal law, and suspicious transactions related to money laundering or violations of the Bank Secrecy Act. *See* 12 C.F.R. 21.11 and 21.21.

GLBA placed the primary responsibility for ongoing supervision of insurance and securities firms affiliated with banks with the functional regulator and limited the banking agencies' authority to examine such firms. Consequently, the Federal banking agencies generally will no longer examine such firms for

compliance with the applicable SAR regulation.[3] Accordingly, we believe that any review of SARs filed by insurance and securities firms affiliated with banks is now the primary responsibility of the appropriate functional regulator.

5. *At the July 20, 2000 hearing mentioned above, you also expressed the need for congressional legislation granting confidentiality protection to regulators' information. Can you explain to us what different kinds of confidentiality protections the OCC would find useful, both in sharing information with other regulators and entities, and more internally with examined entities?*

As I outlined in my written testimony to the Subcommittees, the ability of the OCC and other Federal banking agencies to disseminate non-public information to other Federal and State agencies is limited by the restrictions contained in certain Federal statutes, and also by the necessity to preserve privileges recognized under Federal statutes and common law. The non-public information in the OCC's possession generally falls into two separate categories: (1) privileged and confidential materials prepared or generated by the agency; and (2) privileged and confidential information obtained from others in the furtherance of the OCC's supervisory and examination authority. Any confidentiality protections provided by statute must, in our view, recognize the legal distinctions that exist between these two types of protected information, and satisfactorily address both the existing restrictions on sharing such information and the preservation of privileges if the information is shared.

With respect to any privileged and confidential materials in the possession of the OCC, the agency may only share this information if it is done so in conformance with certain Federal statutes, such as the Trade Secrets Act, the Right to Financial Privacy Act, and the Privacy Act of 1974.[4] In the absence of an express statutory exception, these laws prohibit or restrict certain types of non-public information from being shared with other Federal and State agencies. We are concerned that the general language proposed in Financial Services Antifraud Network Act of 2001 may not adequately address this issue and urge that consideration be given to the adoption of specific amendments to each of these Acts.

Any statutory authorization to share confidential or privileged information with Federal and State agencies must, in our view, appropriately address the

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[3] For the limitations on the Federal banking agencies' examination authority with respect to functionally regulated subsidiaries, see section 111 of GLBA (amending section 5(c) of the Bank Holding Company Act to limit the circumstances under which the Federal Reserve Board may examine a functionally regulated subsidiary of a bank holding company) and section 112 (applying those same limitations to the other Federal banking agencies with respect to functionally regulated subsidiaries of the entities they supervise).

[4] The Appendix to these answers, which was also provided as an appendix to my written testimony, contains a brief description of these three Federal laws.

protection of agency and bank privileges. While a provision in the Federal Deposit Insurance Act, 12 U.S.C. §1821(t), expressly protects transfers of privileged information from, *inter alia*, banking agencies to other Federal agencies, the provision does not address the sharing of privileged materials with State agencies. In the absence of express statutory language, any sharing of confidential or privileged information with State agencies runs the risk of resulting in a loss of protected status to the privileged materials. While proposed section 1047(h) of the Financial Services Antifraud Network Act of 2001 would provide some protection against the destruction or waiver of privileged information, the provision does not provide all of the necessary protections. Consideration should be given to amending the language of subsection (h) to make clear an agency's "permitted use" of the information, if authorized by the holder of the privilege, does not destroy or waive the privilege. The language also should expressly provide that the holder of the privilege may restrict the further dissemination of the information. These amendments would make the language consistent with 12 U.S.C. §1821(t) and provide at least a colorable argument that a State agency's use of the information does not subject the protected information to disclosure under the open access laws in existence in a number of States.

6. *On our second panel, two insurance agent associations testified in support of allowing criminal background checks to be submitted to the FBI through the NAIC and a coordinated Anti-Fraud Network, so long as the Network filters out the convictions unrelated to dishonesty or financial crimes. How does fingerprinting work in the banking industry, and would a similar filtering system by useful for your industry?*

Banks are permitted by statute to obtain certain information from the FBI. Pursuant to Public Law 92-544 (Oct. 25, 1972), the FBI is authorized to exchange identification records with officials of insured depository institutions to promote and maintain the security of those institutions. These records may be used by the institutions for purposes of employment and licensing and, by regulation, the FBI requires that certain notices and other information must be given to the individuals who are fingerprinted. 28 CFR 50.12. It is our understanding that the banking industry, by and through the American Bankers Association, receives public information from the FBI's criminal action databases relating to the felony arrest and disposition of criminal charges of fingerprinted individuals seeking employment in the banking industry. Banks' ability to receive this information is essential if they are to comply with the prohibition in 12 U.S.C. 1829 against permitting a person convicted of dishonest acts to participate in the affairs of a financial institution.

The OCC also obtains information from the FBI in connection with its licensing processes. As part of the application process for change in bank control or issuance of a new bank charter, all members of an organizing or control group, and any proposed executive officers and directors are required to undergo a

criminal background check. In addition, a criminal background check is required as part of the regulatory approval process of any new senior executive officer or director of a bank that is in a "troubled" condition. *See* 12 U.S.C. §1831i. These background checks are conducted by the FBI following the submission, by the agency, of each individual's completed fingerprint card. The FBI conducts a search of its criminal action databases and provides the Federal banking agencies with all criminal information relating to the fingerprinted individual. As previously noted in response to Question #2, the provisions of 12 U.S.C. Section 1829 barring certain individuals, including those found guilty of crimes involving dishonesty or breach of trust, from involvement with insured depository institutions are not limited to crimes involving financial institutions. Section 1829 includes crimes of dishonesty and breach of trust committed by persons in any industry. Thus, the banking agencies rely upon their experienced licensing personnel to filter out irrelevant or non-substantive criminal information and make informed judgments about other available information.

We defer to the other functional regulators to comment on whether this type of approach would be useful with respect to their industries.

We believe the existing internal filtering system is quite effective and necessary to the supervision of the banking industry. Placing any filtering responsibility in the hands of a third party operating outside the banking agencies would be a significant change from the agencies' long-standing practice, and could have a potentially adverse effect upon the Federal banking agencies' ability to make informed judgments about the criminal behavior of individuals seeking entry into the industry. For these reasons, we would not favor the establishment of any filtering system for information received by the banking agencies.

Statement
of

Scott Albinson, Managing Director
Examinations and Supervision
Office of Thrift Supervision

concerning

Interagency Regulatory Information Sharing

before the

Subcommittee on Oversight and Investigations
and
Subcommittee on Financial Institutions and Consumer Credit
of the
Committee on Financial Services

U.S. House of Representatives

March 6, 2001

Office of Thrift Supervision
Department of the Treasury

1700 G Street N.W.
Washington, D.C. 20552
202-906-6288

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

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

Testimony on Interagency Regulatory Information Sharing
before the
Committee on Financial Services
Subcommittee on Oversight and Investigations
Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives
March 6, 2001

Scott Albinson, Managing Director, Supervision
Office of Thrift Supervision

I. Introduction

Good afternoon, Chairman Oxley, Chairwoman Kelly, Chairman Bachus, Ranking Member LaFalce and Members of the Subcommittees. Thank you for the opportunity to discuss the interagency regulatory information sharing systems we have in place at the Office of Thrift Supervision (OTS). We support the efforts of this Committee to improve information sharing among the financial regulators. Safeguarding thrifts from fraudulent activities and from individuals and entities responsible for financial fraud is of paramount concern to OTS. We have spent considerable time and effort, particularly over the last several years with the increase in insurance and securities affiliations in the thrift industry, to improve our ability to access the most recent and useful information on fraud in all sectors of the financial services industry.

We also appreciate the attention that has been directed at—and urge the Committee to continue to be mindful of—the need to protect sensitive database information in attempting to craft an interagency database network. Finally, we support efforts to include confidentiality and liability protections for all shared information so that financial

regulators do not compromise existing legal privileges when sharing database information with other financial regulators and law enforcement organizations.

II. Recent Thrift Applicants and OTS Regulatory Relationships

Since 1997, 43 insurance groups and 15 securities firms have acquired or affiliated with an OTS-regulated savings association. For all applications, OTS is required by statute to review and evaluate the financial and managerial resources of the applicant. This process is intended to identify, to the extent practicable, the extent to which an acquisition or affiliation poses risks to the safety and soundness of the thrift institution. As you may surmise, this can be a daunting task, particularly if the applicant has financial affiliates throughout the country and in various businesses of the financial services sector.

It is not uncommon for us to consider applications in which an applicant or its affiliates has a significant presence in almost all of the 50 states, as well as U.S. territorial and foreign business operations. Assuming for example that the applicant is engaged in the business of insurance, we may have to contact the state insurance commissioner in each state in which the applicant or its affiliates conduct business. Where an applicant has both securities and insurance operations, the relevant information trail may lead to the Securities and Exchange Commission (SEC), the National Association of Securities Dealers (NASD), and the office of many state securities commissioners.

Pursuant to our statutory standards of review, OTS has been sharing information with various state and federal regulators for some years. Our information sharing arrangements are both formal and informal. We work closely with other federal banking agencies and state bank regulators, both through the Federal Financial Institutions Examination Council (FFIEC) and individually, where appropriate, to identify emerging issues in the financial institutions industry and to coordinate supervisory activities. In some cases, we have written agreements to share information with state banking agencies, and in other instances our relationship is more informal. We have a longstanding working relationship with the SEC and, in 1995, we developed and signed a formal written information sharing agreement with NASD (see attached).

The influx of insurance company applicants for thrift charters during the late 1990s prompted us several years ago to develop a close working relationship with the National Association of Insurance Commissioners (NAIC). This led to development of a model agreement that is the basis for written information sharing agreements between OTS and 41 states, including the District of Columbia (see model agreement and list of states, attached). These joint agreements extend significantly beyond the sharing of consumer complaint data and include the sharing of financial and enforcement information, including prior notification regarding enforcement action taken against a commonly regulated entity. We hope, ultimately, to have agreements in place with every state insurance commissioner, as well as with the insurance commissioner of every U.S. territory. Three states—Rhode Island, Ohio and Oregon—have told us that they need to

change their states' laws to allow for such information sharing, which we understand they plan to do this year.

Our ability to share confidential information with the NAIC itself is limited, since it is not a governmental entity. Because the NAIC plays a significant role in the work that is done by and for the state insurance regulators, it would be beneficial for OTS to be able to exchange information with the NAIC.

III. OTS Information Databases

OTS maintains or contributes to three separate databases that include information on individuals and entities that have participated in illegal conduct. Each database serves a different function.

The first database lists public enforcement actions taken by OTS since 1989. The list, which is updated monthly, gives the name of the individual or entity subject to the enforcement action, the name of the institution, and the type of order issued. We have posted on our website OTS orders removing or prohibiting individuals from insured depository institutions. The list is searchable by the name of the individual, company or savings association. We will be expanding the list to include other types of OTS orders, such as cease and desist orders and civil money penalty assessments, and to post actual copies of the orders to the website.

The second database is our Confidential Individual Information System (CIIS). These records contain information concerning individuals who have filed notices of intent to acquire control of savings associations; individuals who have applied to become senior officers or directors of savings associations (where such review is required); individuals who have a history of professional ethics, licensing, or similar disciplinary problems, or have been the subject of an agency enforcement action; and individuals involved in a significant business transaction with an institution. These records identify the individual involved and his or her relationship to the savings association, service corporation or holding company, and describe the event causing the entry of information into the CIIS database. These records are confidential under the Privacy Act of 1974. Consistent with the limitations under the Privacy Act, OTS shares this information, upon request, with other governmental and self-regulatory organizations, such as the SEC, Commodities Futures Trading Corporation (CFTC), and NASD Regulation (NASDR).

The third database we utilize is the Suspicious Activity Reports (SAR) database, which the OTS contributes to, along with the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB), National Credit Union Administration (NCUA) and the Financial Crimes Enforcement Network (FinCEN). This system contains reports that banks, thrifts and credit unions are required by federal statute to file whenever they have information concerning suspected violations of certain criminal statutes, such as bank fraud, theft and money laundering. An example would be when a depository institution notes that an individual has made

several cash withdrawals from an account, all of which are close to but just below the level at which the bank must file a Currency Transaction Report (CTR).

Because the SAR database contains highly confidential information of known or suspected criminal activities, on-line access to the database is restricted to the banking regulatory agencies, certain other federal agencies, and to law enforcement agencies, such as the Federal Bureau of Investigation (FBI) and the Secret Service. Unauthorized access to this information could substantially jeopardize law enforcement investigations. It could also cause unnecessary harm to individuals whose names are included in SARs as possibly involved in suspicious activities, but where the matter has not been investigated and which may prove to be not true. Banks and thrifts are prohibited from disclosing a SAR or its contents, and bank regulatory agencies do not share SAR information with non-SAR users.

In addition to coordinating on the SAR database, the banking agencies participate with the SEC, Internal Revenue Service (IRS), U.S. Customs Service, and law enforcement agencies, including the FBI and Secret Service, in the national Bank Fraud Working Group. This forum enables these agencies to share information on and cooperate in identifying individuals engaged in fraud and trends involving fraudulent activities. Important interagency information sharing activity also occurs outside of Washington. Many U.S. Attorney offices convene several meetings each year to discuss bank and financial fraud issues and activities. Participating agencies usually include the federal banking agencies and state insurance and bank regulators. NCUA representatives may

also attend. These meetings provide an opportunity for the U.S. Attorney offices to discuss ongoing bank fraud cases, to the extent the information is disclosable, and to alert regulators about recent patterns of criminal activity. The regulators also exchange information about possible criminal activities within their jurisdiction, including information brought to their attention by SAR filings.

IV. Possible Approaches to Interagency Information Sharing

The possible approaches to interagency information sharing vary depending on the type and sensitivity of the information to be shared, the availability and quality of the information on existing agency databases, and the ability to control access to and use of information. Also important are confidentiality and liability protections for shared information, and avoiding over reliance on shared information by users.

Among the range of available options, a practical first step is linking or aggregating the existing public databases of financial regulators. This, of course, assumes that all relevant financial regulators maintain similar types of information and make it publicly available. This option could be accomplished by creating a software link that permits each agency to operate their individual databases separately, but that makes the databases accessible simultaneously via a common search engine or able to be viewed from the same site. This is largely a software solution that improves efficiency by minimizing the number of times a user must search multiple places for the same information. Since the information is public, issues regarding liability and confidentiality should not be

problematic. While access to the linked data could be limited to the financial regulators, it would not have to be, and information that is distributed beyond the linked network should not raise concerns since the information is already public.

While a software link is likely the most efficient approach because it is easiest to implement and poses the fewest potential problems, a centralized coordinator of public database information could also be established. This option is worth considering if there is an overall plan ultimately to expand or modify the system to include non public information.

Expanding the system to include nonpublic information, of course, raises a series of far more difficult issues, and would probably require a more centralized approach. Either a new or existing governmental entity could be charged to coordinate a type of centralized clearinghouse for the collection and dissemination of regulatory database information, and be made responsible for limiting access to the information, defining the parameters for the types and quality of information to be fed into the system, and providing liability and confidentiality protections. This raises obvious, but no less compelling logistical issues, such as how to coordinate the information, who should do so, how to eliminate obstacles about the governmental status of entities that participate in the system (i.e., in order to avoid issues raised about breaches of confidentiality and liability protections), and how to keep the system current. More important are issues involving protecting the integrity of system information—ensuring the information is complete and correct—and ensuring that otherwise non-public information does not fall into the wrong hands.

Variations of this approach include a system in which different levels of "security clearance" are provided to various users for accessing different strata of information. For example, all could access publicly available information, but more sensitive information on current or ongoing agency actions would be made available on a more select basis, with criminal investigatory information carrying the most protections. Also worth considering is whether more than one entity could serve as the aggregator of regulatory information. For example, three separate entities could be charged with collecting information—one each for securities, insurance, and banking information—and could then coordinate in establishing, feeding, and maintaining a centralized system.

A point worth emphasizing that is relevant to all of the variations and permutations described above is that for any type of database sharing system to be useful, particularly with respect to tracking the comings and goings of questionable individuals in the various financial services industries, the quality and integrity of the information fed into the system must be reliable.

Currently, the federal banking agencies are not routinely provided information regarding the addition of new directors and senior officers to a depository institution. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) required a 30-day prior notice to the appropriate banking agency upon the addition of a director or senior officer at a recently chartered depository institution, an institution or holding company that underwent a change in control within the preceding two years, and an

institution or holding company not in compliance with minimum capital requirements or otherwise troubled. As part of the regulatory burden reduction provisions of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, the prior notice requirement was narrowed to cover only troubled institutions and holding companies, capital-impaired institutions, and certain institutions operating under a capital restoration plan.

Although we do not advocate restoring FIRREA's original requirements, it would be beneficial to consider requiring a streamlined, after the fact notice to the appropriate banking agency of all new directors and senior officers of depository institutions. Consideration should also be given to including an appropriate mechanism for the prompt removal of a new director or senior officer where the banking agency determines that the individual has a past history of serious disciplinary problems in the financial industry. This would ensure that, as new directors and senior officers begin to serve at an institution, the agency has the information to conduct a background check and the ability to remove the individual where there is such past history. In addition, the agency would then be able to make the information immediately available to all other financial regulators. Currently, this information is not likely to be obtained until the next regularly scheduled examination of the institution, which could be up to 18 months from the time of the addition.

Another tool worth considering in addressing the problem of identifying and weeding out perpetrators of financial fraud is a corporate governance self-help provision that an institution could include in its bylaws. OTS will soon adopt a regulation that permits, but does not require, federal savings associations to adopt a bylaw amendment precluding persons who are under indictment for, or have been convicted of certain crimes, or are subject to a cease and desist order for fiduciary violations entered by any of the federal banking agencies, from being a member of the institution's board of directors. This affords an institution a certain degree of self defense from perpetrators of financial fraud.

V. Conclusion

Fraud in the financial services industry is not new. What is new are the technological developments and innovations that have dramatically raised the stakes in identifying and weeding out fraudulent activities and bad actors. Each new advance that facilitates the potential for fraud compromises the integrity of our financial system and exposes Americans to greater risks in their financial dealings. The tools that new technologies provide can also be harnessed to help us fight fraud. And it is incumbent upon us to utilize these resources to preserve and maintain control of our financial systems.

All financial regulators spend considerable resources in tracking down fraudulent activities and the perpetrators of financial fraud. To the extent we can combine and leverage our collective experiences and information, our efforts will be that much more effective. As I noted at the outset, there is a delicate balance between effective

information sharing and protecting sensitive database information. No one can refute that access to more, high quality information will improve our ability to fight fraud; but what do we give up to get there? Striking the proper balance is the key.

Thank you. I will be pleased to take any questions.

REGULATORY COOPERATION AGREEMENT BETWEEN THE OFFICE OF THRIFT SUPERVISION AND THE [State Insurance Department]

The Office of Thrift Supervision (OTS), a bureau of the United States Department of the Treasury, is the primary federal regulator of all federal and state-chartered savings associations. The [Name of State Insurance Department] (DOI) regulates the business of insurance in the State of _____ and serves as the primary regulator for all insurance entities domiciled in the State.

The OTS and the DOI each possess financial, consumer complaint, enforcement and other information that may help the other party to more effectively carry out its regulatory responsibilities. To encourage the exchange of such information, the OTS and DOI agree to communicate and cooperate in the manner described below, subject to the conditions, obligations, and responsibilities set forth in this Agreement.

1. Definitions

Agency or Agencies means the OTS and the DOI, individually or together.

Confidential Information: a) *OTS Confidential Information* is information contained in, derived from or related to examination, operating, or condition reports prepared by, on behalf of, or for use by the OTS for the regulation, examination or supervision of a Regulated Entity, complaints received by the OTS, communications between the Agencies or with any other state or federal government entity that the OTS determines to be of a non-public nature, and any other information that the OTS determines to be of a non-public nature and b) *DOI Confidential Information* is information confidential by law or privilege, including examination work papers, analysis of financial condition, draft examination reports, reports of potential fraudulent activity, [_____ _____insert additional categories recognized under specific State laws], and any other information that the DOI determines to be of a non-public nature.

Regulated Entity or Entities means a savings association, a savings and loan holding company, an insurer, or any other related entity that either of the Agencies have the authority to examine and where an affiliation (i.e., any person that controls, is controlled by, or is under common control with a Regulated Entity) exists or is proposed between the savings association and the insurer.

Requesting Agency means the Agency seeking information.

Responding Agency means the Agency responding to a request for information.

2. Information Sharing

a) To the extent required or permitted by applicable law, regulation, or practice, the Requesting Agency may request information regarding: (i) the financial solvency of a Regulated Entity, (ii) the insurance activities of a Regulated Entity, and (iii) the thrift activities of a Regulated Entity, provided that the requested information is material to the Requesting Agency's exercise of its lawful jurisdiction over that Regulated Entity or a subsidiary or an affiliate of that Regulated Entity.

b) Requests for information shall be in writing. In submitting a request, the Requesting Agency shall provide a specific description, indicating the time period and general subject matter, of the information desired. Neither Agency intends that a separate request be filed for each document. The Responding Agency shall reply to the Requesting Agency as soon as practicable upon receipt of the request.

c) The Agencies may exchange other information relating to the activities of Regulated Entities in order to ensure general awareness of the respective positions taken by the Agencies.

d) The Requesting Agency expressly agrees to limit its use of any information it receives under this Agreement to functions directly related to the exercise of its appropriate regulatory authority.

3. Complaints and Consumer Inquiries

a) To the extent required or permitted by applicable law, regulation, or practice, and by the terms of this Agreement, the OTS shall forward to the DOI a copy of any complaint and consumer inquiries that it receives relating to the insurance activities of a Regulated Entity, and the DOI shall forward a copy of any complaint and consumer inquiries that it receives relating to thrift activities of a Regulated Entity to the designated official at the Agencies, as appropriate. Complaints and consumer inquiries shall be forwarded as soon as practicable upon receipt of the complaint and consumer inquiries.

b) With respect to all complaints and consumer inquiries received in writing by either Agency relating to the insurance activities of the Regulated Entities, each Agency will provide copies of such complaints, consumer inquiries and related correspondence to the other Agency and will advise the other Agency of the ultimate resolution of the complaint and consumer inquiries, subject to Section 5 hereof and in accordance with applicable state and federal law.

4. Enforcement Actions

The DOI and the OTS shall notify one another of any enforcement action taken against a Regulated Entity. Whenever practicable, such notification may be given in advance of any enforcement action.

5. Confidentiality

a) The Requesting Agency shall take all actions reasonably necessary to preserve, protect and maintain all privileges and claims of confidentiality related to Confidential Information received pursuant to this Agreement, in accordance with applicable state and federal law. The Requesting Agency shall treat as confidential all information identified as Confidential Information received pursuant to this Agreement.

b) The Requesting Agency shall restrict access to all Confidential Information solely to those persons at the Requesting Agency and their agents under the Requesting Agency's supervision and control (including, but not limited to outside counsel, consultants or experts) actively involved in the matter or proceeding described in the Requesting Agency's request for information. The Requesting Agency shall maintain all Confidential Information in a manner designed to protect the confidentiality and ownership of the material, and shall train all persons given access in the appropriate procedures for maintaining confidentiality.

c) The Requesting Agency acknowledges that all Confidential Information, in whatever form, furnished by the Responding Agency remains the property of the Responding Agency and agrees to take no action the effect of which would be to limit, waive or jeopardize any privilege or claim of confidentiality, including the disclosure of such information to any other state, local, or federal agency, court or legislative body, or any other agency, instrumentality, entity, or person without the express written permission of the Responding Agency. In the event of termination of this Agreement, the Requesting Agency agrees that the Confidential Information received remains confidential and will continue to be protected under the terms of this Agreement.

d) In the event that the Requesting Agency receives from a third party a request for Confidential Information furnished by the Responding Agency, or in the event the Requesting Agency is served with a subpoena, order, or other process requiring production of such Confidential Information or testimony related thereto, the Requesting Agency shall:

(i) immediately notify the Responding Agency that production is being sought, and afford the Responding Agency the opportunity to take whatever action it deems appropriate to protect the confidential and/or privileged nature of the Confidential Information, and cooperate fully in preserving and protecting the full scope of all privileges and claims of confidentiality which may apply to such Confidential Information;

(ii) notify the party seeking production of the Confidential Information that it belongs to the Responding Agency and that requests for release of such information must be made directly to the Responding Agency, pursuant to any applicable laws and regulations (12 C.F.R § 510.5 for OTS Information; _____ for DOI information);
(iii) resist production of the Confidential Information pending written permission of the Responding Agency, subject to subsection 5(e); and
(iv) consent to any application by the Responding Agency to intervene in any action for the purpose of asserting and preserving any privilege(s) and/or claims of confidentiality with respect to the Confidential Information.

e) It is expressly agreed and understood that in the event any court of competent jurisdiction issues an order to compel the Requesting Agency to produce the Confidential Information covered by this Agreement, the Requesting Agency may comply with such order. The Requesting Agency agrees to advise the Responding Agency as promptly as is reasonably possible of such action.

f) No sharing of information under this Agreement or compulsory disclosure to third parties of Confidential Information exchanged under this Agreement shall be deemed a waiver of any privilege or claim of confidentiality, except as expressly found by a court or judicial authority of competent jurisdiction.

g) No waiver by either party of any breach of any provision of this Agreement shall be deemed to be a continuing waiver of similar breaches in the future or a waiver of breach of any other provision hereof.

6. Preservation of Existing Statutory Authority and Obligations

a) This Agreement shall in no way limit the discretion of the Responding Agency to deny requests for information, in whole or part, for any reason consistent with Responding Agency's own supervisory interest and obligations, or where prohibited by state or federal law.

b) Nothing in this Agreement restricts, enlarges, or otherwise modifies the respective jurisdictions of the Agencies. Neither this Agreement, nor its termination, shall affect the rights and obligations of either Agency under applicable statutes or regulations, or be deemed an interpretation of such statutes or regulations.

c) Neither Agency is liable to the other for the accuracy or timeliness of information provided pursuant to this Agreement, nor for obtaining, maintaining, or updating any such information.

7. **Miscellaneous**

a) **Authority to Enter Agreement.** Each of the Agencies hereto gives express assurance that under applicable laws, regulations, and judicial rulings, it has the authority to comply fully with the use and disclosure limitations and conditions of the Agreement and that it will provide written notification to the other Agency within ten (10) days of any material change to this authority or any violation of this Agreement.

b) **Termination.** This Agreement may be terminated by either Agency upon thirty (30) days written notice, *provided, however,* that such termination shall not affect the rights and obligations of either Agency with respect to Confidential Information shared pursuant to this Agreement.

c) **Entire Agreement.** This Agreement supersedes all other agreements or representations either oral or written between the Agencies regarding regulatory cooperation. No waiver, alteration or modification of provisions in this Agreement shall be binding unless subsequently made in writing and signed by duly authorized representatives of the OTS and DOI.

d) **Designation of Official.** As soon as practicable after signing this Agreement, the Agencies will advise one another of the appropriate officials to contact for purposes of notices and exchanges of information covered by this Agreement and will update such information as appropriate.

OFFICE OF THRIFT SUPERVISION	[STATE DEPARTMENT OF INSURANCE]
Name:	Name:
Title:	Title:
Date:	Date:

STATES WITH SIGNED OTS REGULATORY COOPERATION AGREEMENTS
3/1/01

Alabama
Alaska
Arizona
Arkansas
California
Colorado
Connecticut
Delaware
District of Columbia
Idaho
Illinois
Indiana
Iowa
Kansas
Kentucky
Louisiana
Maine
Maryland
Michigan
Mississippi
Montana
Nebraska
New Hampshire
New Jersey
New Mexico
New York
North Carolina
North Dakota
Oklahoma
Pennsylvania
South Carolina
South Dakota
Tennessee
Texas
Utah
Vermont
Virginia
Washington
West Virginia
Wisconsin
Wyoming

Agreement in Principle
Between the
Board of Governors of the Federal Reserve System
Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Office of Thrift Supervision
and the
National Association of Securities Dealers

Background

In recent years, depository institutions have become increasingly involved in selling uninsured nondeposit investment products, such as mutual funds, to retail customers on their premises. In response to this development, on February 15, 1994, four federal financial institutions regulators (the banking agencies) issued an Interagency Statement on the Retail Sale of Nondeposit Investment Products (Interagency Statement). The Interagency Statement contains guidelines for sales of nondeposit investment products on depository institution premises designed to enhance protection and lessen the potential for customers confusing such products with insured deposits.

The Interagency Statement's guidelines apply to recommendations and sales of nondeposit investment products by employees of depository institutions as well employees of affiliated or unaffiliated third parties located on depository premises. When such third parties are broker dealers registered with the Securities Commission and are members of the National Association of Securities Dealers (NASD), the NASD has regulatory and examining authority with respect to requirements adopted under the federal securities laws applicable to sales of nondeposit investment products. Broker dealers that are affiliated with a depository institution also are subject to the supervisory authority of a banking agency.

The banking agencies and the NASD share a common interest in the supervision of broker dealers selling nondeposit investment products on depository institution premises and, in particular, the supervision of broker dealers affiliated with a banking organization or thrift association, i.e., an affiliate, subsidiary or service corporation of a depository institution that is supervised by one or more of the undersigned banking agencies. To ensure that this common interest is addressed with a minimum of duplication of efforts by the respective regulatory organizations and to promote regulatory consistency and reduce unnecessary burdens, the banking agencies and the NASD agree in principle to cooperate in the manner described below in order to facilitate the coordination, and enhance the effectiveness, of examination efforts by the banking agencies and by the NASD.

Sharing of Examination Schedules and Examination Information

1. Sharing of examination schedules between the NASD and the banking agencies for depository institutions with affiliated broker dealers.

   The banking agencies shall share their respective examination schedules for investment product sales programs at depository institutions with affiliated broker dealers with the Director of the appropriate NASD district office as early in the scheduling process as practicable. To the extent practicable, the Director of the appropriate NASD district office also should be contacted when a depository institution, that has a broker dealer affiliate located on bank premises, is given notice of an examination of its investment product sales program by a banking agency. In addition, to the extent practicable, the NASD shall provide the appropriate banking agency with an examination schedule for broker dealers affiliated

with depository institutions subject to the agency's supervision and shall notify the banking agency when it initiates an examination of such a broker dealer.

If a banking agency or the NASD believes, for whatever reason, that it would be appropriate for the two to coordinate their respective examinations of a bank affiliated broker dealer, it shall contact the appropriate NASD or banking agency district office to request such coordination. A banking agency or the NASD may request that one or more of its examiners act as an observer during the other's examination of an affiliated broker dealer. Unless specifically agreed otherwise, the presence of an observer will not be viewed as a joint examination by the banking agency and the NASD, and will not result in the issuance of joint examination findings. In addition, while observers normally will not perform an examination on behalf of their agency or association, the banking agency or the NASD may pursue any observations made by its personnel as a result of such an arrangement.

2. Access to NASD examination findings and workpapers pertaining to the most recent examination of an affiliated broker dealer.

   Banking agencies should have access to the results of the most recent NASD examination pertaining to an affiliated broker dealer from the depository institution or directly from the broker dealer. In instances in which such results, for whatever reason, cannot be obtained from the depository institution or its affiliated broker dealer, a banking agency may obtain information on the examination from the appropriate NASD district office. In instances in which a banking agency has questions about the NASD's findings or the status of any corrective actions taken by the broker dealer, it may contact the NASD district office that initiated the action and obtain the requested information.

   If it is deemed necessary to obtain more detailed examination information concerning the affiliated broker dealer, a banking agency may contact the appropriate NASD official to arrange to review examination work papers at the NASD's district office.

3. Banking agency referrals to the NASD regarding affiliated broker dealer examination findings.

   In the event that a banking agency concludes that apparent violations that fall under the regulatory jurisdiction of the NASD have occurred at a broker dealer selling nondeposit products on the premises of a depository institution, the agency shall promptly notify the NASD and cooperate to the extent permitted under applicable law.

4. NASD communications to banking agencies regarding examination results pertaining to affiliated broker dealers.

   In the event that the NASD concludes that apparent violations that fall within the jurisdiction of a banking agency have occurred at a broker dealer affiliated with a depository institution, it shall promptly notify the appropriate banking agency for the depository institution affiliated with the broker dealer to the extent permitted under applicable law.

   In the event the NASD has determined to initiate a formal disciplinary action against a bank affiliated broker dealer, or an individual associated with the broker dealer, alleging significant violations of NASD requirements or federal securities laws, the NASD shall promptly communicate this information to the appropriate banking agency for the depository institution affiliated with the broker dealer.

5. Communications between the banking agencies and the NASD pertaining to broker dealers not affiliated with a depository institution.

   A banking agency, in connection with its examination of a depository institution, that has reasonable concerns about the activities of a broker dealer selling nondeposit investment products on the premises of an unaffiliated depository institution may request from the NASD information concerning the most recent

examination results pertaining to those activities of the broker dealer if it believes that such information may facilitate the banking agency's supervision of the depository institution. The NASD will provide such information upon confirmation of the existence of an agreement between the depository institution and the broker dealer to make such information available to the institution and the appropriate banking agency and a representation that the institution/agency has been unable to obtain information notwithstanding such agreement. If it is deemed necessary to obtain more detailed examination information concerning the unaffiliated broker dealer, a banking agency may contact the appropriate NASD official to arrange for a review of the relevant examination work papers at the NASD's district office. The banking agency will use information obtained under this paragraph in connection with its oversight of the depository institution and not for the purpose of examining the unaffiliated broker dealer.

In the event the NASD has determined to initiate a formal disciplinary action alleging significant violations of NASD requirements or federal securities laws against a broker dealer, or an associated person of such broker dealer, that sells nondeposit investment products on depository institution premises but is not affiliated with the institution, the NASD shall promptly communicate this information to the appropriate banking agency for the depository institution.

6. Communications pertaining to issues of common interest.

The banking agencies and the NASD will communicate with each other to the fullest extent possible on matters of common interest, such as regulatory and policy initiatives and educational efforts, pertaining to sales of nondeposit investment products on depository institution premises in order to assure a general awareness of the respective interpretative positions taken by the banking agencies, the NASD and by other securities regulators.

7. Confidentiality of Information Exchanged Between the NASD and the Banking Agencies.

Any information exchanged between the NASD and a banking agency must be for a legitimate regulatory or supervisory purpose. The confidentiality of information relating to examination reports or other confidential supervisory information exchanged must be maintained to the fullest extent possible and may not be released to any third party or to the public without the prior written agreement of the furnishing party. Each banking agency and the NASD agree to notify the furnishing party promptly of any requests for information and to assert any applicable legal exemptions or privileges on behalf of the furnishing party as that party may request.

8. Existing Jurisdictions and Interagency Agreements.

Nothing in this Agreement in Principle restricts, enlarges, or otherwise modifies the respective jurisdictions of the banking agencies or the NASD. Moreover, nothing in this Agreement in Principle supersedes or modifies any existing agreement between the banking agencies concerning coordination of examination efforts or the sharing of examination information.

9. Designation of Officials for Purposes of Exchanging Information.

As soon as practicable after signing this Agreement in Principle, the banking agencies and the NASD will advise one another of the appropriate officials to contact for making exchanges of information covered by this Agreement in Principle, and will update such information as appropriate.

BY:

Richard Spillenkothen, Director
Division of Banking Supervision
for: Board of Governors for the
Federal Reserve System

Stephen R. Steinbrink,
Senior Deputy Comptroller
for: Office of the Comptroller of the
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Stanley J. Poling, Director
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Corporation

John F. Downey
Director of Supervision
for: Office of Thrift Supervision

John E. Pinto, Executive Vice President
for: National Association of
Securities Dealers

This Agreement is effective January 3, 1995.

NASD District Directors and Addresses

(as of 3/99)

District No. 1 District Director - Elizabeth Owens
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Follow up questions submitted by Chairwoman Kelly and Chairman Bachus
Hearing on "Protecting Consumers: What Can Congress Do to Help Financial Regulators Coordinate Efforts to Fight Fraud?"

1. What information does OTS currently review to prevent a fraudulent actor from being hired as a high level officer in a thrift, other than self disclosure?

There are two different situations, generally, in which a high level officer will join a thrift. One situation involves individuals seeking a thrift charter; the other situation involves individuals joining and existing institution. Under the former scenario, OTS carefully scrutinizes the background of individuals that are seeking a thrift charter. By granting charters to only those groups and individuals who display a high level of integrity we can reduce the possibly of fraud and insider abuse and lessen potential losses to the insurance fund.

OTS is required by statute to review and evaluate the financial and managerial resources of applicants for thrift charters. This process is intended to identify, to the extent practicable, the extent to which an acquisition or affiliation poses risks to the safety and soundness of the thrift institution. OTS frequently considers applications in which an applicant or its affiliates has a significant presence in almost all of the 50 states, as well as U.S. territorial and foreign business operations. Assuming the applicant is engaged in the business of insurance, we contact the state insurance commissioner in the domiciliary state of the lead insurance unit and the National Association of Insurance Commissioners (NAIC) to obtain information from states in which the applicant or its affiliates conduct business. Where an applicant has both securities and insurance operations, the relevant information trail may lead to the Securities and Exchange Commission (SEC), the National Association of Securities Dealers, and the office of many state securities commissioners.

With respect to existing depository institutions, until 1996, the federal banking agencies were provided 30 days prior notice upon the addition of a director or senior officer at a recently chartered depository institution, an institution or holding company that underwent a change in control within the preceding two years, and an institution or holding company not in compliance with minimum capital requirements or otherwise troubled. As part of the regulatory burden reduction provisions of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, the prior notice requirement was narrowed to cover only troubled institutions and holding companies, capital-impaired institutions, and certain institutions operating under a capital restoration plan.

Although we do not advocate restoring FIRREA's original requirements, as stated in our testimony, it would be beneficial to consider requiring a streamlined, after the fact notice to the appropriate banking agency of all new directors and senior officers of depository institutions. Consideration should also be given to including an appropriate mechanism for the prompt removal of a new director or senior officer where the banking agency determines that the individual has a past history of serious disciplinary problems in the financial industry. This would ensure that, as new directors and senior officers begin to serve at an institution, the agency has the information to conduct a background check and the ability to remove the individual where there is such past history. In addition, the agency would then be able to make the information immediately available to all other financial regulators. Currently, this information is not likely to be obtained until the next regularly scheduled examination of the institution, which could be up to 18 months from the time of the addition.

OTS also maintains or contributes to three separate databases that include information on individuals and entities that have participated in illegal conduct. Each database serves a different function. The first database lists public enforcement actions taken by OTS since 1989. The list, which is updated monthly, gives the name of the individual or entity subject to the enforcement action, the name of the institution, and the type of order issued.

The second database is our Confidential Individual Information System (CIIS). These records contain information concerning individuals who have filed notices of intent to acquire control of savings associations; individuals who have applied to become senior officers or directors of savings associations (where such review is required); individuals who have a history of professional ethics, licensing, or similar disciplinary problems, or have been the subject of an agency enforcement action; and individuals involved in a significant business transaction with an institution. These records identify the individual involved and his or her relationship to the savings association, service corporation or holding company, and describe the event causing the entry of information into the CIIS database.

The third database is the Suspicious Activity Reports (SAR) database, which the OTS contributes to, along with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, Federal Reserve Board, National Credit Union Administration and the Financial Crimes Enforcement Network. This system contains reports that banks, thrifts and credit unions are required by federal statute to file whenever they have information concerning suspected violations of certain criminal statutes, such as bank fraud, theft and money laundering.

In addition to coordinating on the SAR database, the banking agencies participate with the SEC, Internal Revenue Service, U.S. Customs Service, and law enforcement agencies, including the FBI and Secret Service, in the national Bank Fraud Working Group. This forum enables these agencies to share information on and cooperate in identifying individuals engaged in fraud and trends involving fraudulent activities.

OTS continues to maintain a staff of highly trained and experienced examiners who are capable of recognizing behavior and tactics that may be indicative of problems involving fraud and insider abuse. In addition to the training in fraud detection and identifying white collar crime our examiners receive, several new classes are being developed by OTS and the FFIEC that will incorporate the lessons we learned from some of the recent failures.

2. If an Antifraud network were established granting financial regulators the ability to share consumer complaint trend data where they found such information to be relevant or appropriate, along with a general disclaimer that the information could not be used as the sole basis to deny a license or application, could this sort of information help guide regulators for further follow up?

Sharing consumer complaint data currently exists within the scope of the model information sharing agreements. The model agreement jointly adopted by OTS and the NAIC in April 2000 outlines a general framework for sharing consumer complaints as well as financial and examination information and enforcement actions. Because the agreements are still relatively new, we have limited experience in this area. However, many times in recent years, insurance regulators have provided OTS information of the type covered by the written agreements through informal relationships. We expect this type of information to be provided under the agreements as time goes on.

3. In your written testimony, the OTS noted that, "We work closely with other federal banking agencies and state bank regulators, both through the Federal Financial Institutions Examination Council (FFIEC) and individually, where appropriate, to identify emerging issues in the financial services industry and to coordinate supervisory activities." Should FFIEC be limited to solely banking regulators in light of its role in identifying emerging issues in the financial services industry as a whole?

The FFIEC's main purpose is to set uniform principals and standards for federal examinations of banking institutions and to make recommendations to promote uniform supervision and examination. An area of concern is that if the FFIEC is expanded to include non-banking representatives, it may have unanticipated effects on the principal mission of the FFIEC.

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Oversight and Investigations
And the
Subcommittee on Financial Institutions
and Consumer Credit

Committee on Financial Services
United States House of Representatives

Regarding:
Information Sharing Among State and Federal
Financial Regulators

March 6, 2001

Terri M. Vaughan
Commissioner of Insurance
Iowa

Testimony of Terri Vaughan, Vice President
National Association of Insurance Commissioners

Introduction

My name is Terri Vaughan. I am the Commissioner of Insurance for the State of Iowa, and this year, I am serving as Vice President of the National Association of Insurance Commissioners (NAIC), as well as Chair of its Coordinating with Federal Regulators Working Group. This is a particularly challenging time for state insurance regulators as we work to improve our system of supervision and fully implement the requirements of the Gramm-Leach-Bliley Act (GLBA). I am pleased to be here on behalf of the NAIC and its members. We want to work with the Financial Services Committee to identify our respective information needs and perfect the exchange of this information among federal and state regulatory agencies, particularly in the area of fighting fraud.

As insurance issues have just recently been added to the responsibilities of the Financial Services Committee, Attachment A of my testimony includes a brief summary of the role state insurance departments and the NAIC play in supervising the business of insurance in the United States.

Today, I would like to make three points regarding regulatory information sharing in response to financial modernization and legal requirements of the Gramm-Leach-Bliley Act and federal anti-fraud statutes –

- First, the NAIC and state insurance regulators regard information sharing as the cornerstone for implementing the provisions of GLBA as intended by Congress. We are well along the path of putting into place the procedures necessary to make information sharing among state and federal agencies a practical reality. Our efforts include sharing information on fraudulent activities in the marketplace.

- Second, on behalf of the states, the NAIC already has in place sophisticated online systems for sharing regulatory data among the states concerning licensing, financial monitoring, consumer complaints, and enforcement matters. We want to remove existing barriers and expand the reach of these resources so that state insurance departments can readily exchange such critical regulatory information with federal banking and securities regulators.

- Third, the NAIC and the states need help from Congress in gaining access to federal law enforcement records and removing impediments that prevent state insurance departments from easily sharing information with their federal counterparts. In particular, we want to move very quickly on closing the information gaps that prevented state regulators from checking on securities violations committed by Martin Frankel before he got involved in the insurance industry.

Good Financial Regulation Starts with Having Good Information

The Gramm-Leach-Bliley Act establishes a new order of functional financial regulation that depends upon active cooperation and information sharing among several federal and state agencies to be effective. Although this approach is novel at the national level, it is well known among state insurance regulators who have been working together through the NAIC for more than a century. The NAIC serves our need for a national support organization with top quality technical and analytical resources to supplement the in-house resources of each state insurance department.

Like all financial regulators, state insurance departments need easy access to good information in order to be effective. We decided long ago that one of NAIC's core missions should be collecting, managing, and disseminating regulatory information centrally on behalf of its members, who are the chief insurance supervision officials in each of the 50 states, the District of Columbia, and the U.S. territories. Consequently, the NAIC has focused much of its resources on being a leader in developing useful

computer-based systems to help insurance regulators share information produced by themselves, as well as the companies and agents they supervise.

NAIC Maintains Valuable Insurance Databases Needed by Financial Regulators

Today, the NAIC spends almost half of its total resources to maintain a substantial information management division that is a national leader in all respects. To design and operate its numerous databases used by state regulators, businesses, and the public, the NAIC employs 170 people and spends approximately $20 million each year. Moreover, we are using the Internet and other emerging technologies to make NAIC's regulatory databases more easily available to over 10,000 employees of state insurance departments.

The following snapshot of the NAIC's database operations will give you an glimpse of our extensive resources –

- The NAIC operates a newly constructed technology center in Kansas City housing the world's largest insurance regulatory database.

- The NAIC's financial database contains a 15-year history of annual and quarterly filings on 5,200 insurance companies, representing 98% of written premiums in the United States.

- The agent database contains background and licensing information on 2.5 million agents representing 87% of all active producers. This database includes regulatory actions that have been taken to ensure that only qualified professionals are licensed to sell insurance to consumers.

- The consumer complaint database includes information on 1.5 million closed consumer complaints, broken down by type, reason, disposition, count, and trend analysis.

- The formal adjudicated regulatory actions database became operational in the 1960's, and was computerized in 1985. There are more than 120,000 actions in the database regarding insurance companies and agents. This information is publicly available.

- A special database for investigations has been operational since 1989. It tracks suspicious activities, and includes 7,200 entities and 11,800 activities. This information is only available to regulators.

State Insurance Regulators Have Already Begun the Process of Sharing Information with Federal Regulators under GLBA

Establishing sound working relationships with Federal regulators is absolutely essential for state insurance departments under GLBA. In fact, it is so important that NAIC was actively engaged in establishing a sound regulatory dialogue with our federal counterparts before GLBA became law. After enactment of GLBA, the NAIC decided to consolidate its efforts under a new Coordinating with Federal Regulators Working Group, which I chair. Recognizing the importance of this initiative, our members gave the Working Group broad responsibility to stimulate cooperation at all levels.

The basic ingredient for making regulatory cooperation a success is for agencies to jointly agree upon a process that is workable. Thus, NAIC's first priority was to negotiate written cooperation agreements that can be used to open information channels between state insurance departments and federal banking and securities regulators. These model agreements lay out the ground rules for sharing information and keeping it confidential when necessary.

The project to negotiate written information sharing agreements has been a great success. To date, the NAIC has successfully negotiated agreements with the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the Office of Thrift

Supervision (OTS), and the Federal Deposit Insurance Corporation (FDIC). These agreements cover broad exchanges of regulatory information relating to the financial solvency, enforcement matters, routine licensing, and consumer complaints. They are also designed to stand the test of time and inevitable changes in information needs and technologies.

The next step is securing individual agreements by each of the state insurance departments with each of the participating federal agencies. We are farthest along with OTS, which has signed information sharing agreements with 41 states during the past year. Finishing touches on similar model agreements with the Federal Reserve Board, OCC, and FDIC have just been completed. We expect most states to sign individual agreements with these agencies during 2001.

NAIC Has Existing Technical Ability to Share Database Information with Federal Regulators If an Anti-fraud Network Can Be Established

The NAIC has the technical infrastructure in place now to share regulatory database information with federal agencies. Because NAIC is the central database manager and link to individual state insurance department computer systems, we have developed a modern online information exchange system that should have no difficulty in expanding its reach to include federal agencies. Likewise, NAIC is fully capable of receiving and handling both public and confidential regulatory information. In fact, the NAIC may be able to offer guidance in setting up a workable system to agencies having less experience in this area.

We do have strong views on how a multi-agency information exchange system should be structured –

- Create a national anti-fraud network based upon information sharing agreements among functional financial regulators and law enforcement agencies.

- Establish a central database authority to set technical standards for sharing regulatory and law enforcement information. In December 1999, the NAIC attempted to join the Federal Financial Institutions Examination Council (FFIEC) as a means of coordinating on technical matters with federal banking regulators. We were not permitted to join FFIEC, but we still believe there must be a central governing organization where all functional regulators can meet together and set necessary policy and technical standards to make mutual sharing of information a practical reality. For example, the NAIC would like a central governing body to establish the well-known and freely available "XML" language as the common Internet standard to facilitate information exchanges among different regulatory databases.

- A multi-agency information sharing system should link existing databases rather than create new ones. Each regulator has a large investment in its own systems and databases, including training and integration. Functional regulators need to work within their own unique system interface, but will require access to data stored on outside databases in order to be effective.

- Finally, all participants in a multi-agency system should be given legal immunity for good faith reporting of regulatory information and operation of the system.

State Insurance Regulators Need Immediate Access to FBI's Fingerprint Database

While NAIC supports Congressional efforts to create a broad anti-fraud information sharing network, we strongly urge you to fix one glaring weakness in the system immediately. Right now, state insurance regulators are the only functional regulators who do not have access to the Fingerprint Identification Record System (FIRS) operated by the FBI. Congress should close this gaping loophole before doing anything else.

Permitting states to run national fingerprint background checks on insurance agents and company personnel is the best way to weed out known wrongdoers before they get a chance to commit insurance fraud. It is also critical if Congress expects the states to establish a national agent licensing system, as mandated by Subtitle C of Title III of GLBA (National Association of Registered Agents and Brokers).

In addition, the federal criminal law punishing insurance fraud (18 USC 1033) establishes an affirmative duty for state insurance regulators and private employers to check the criminal history of certain persons, yet there is presently no uniform access method for us to conduct such checks with the FBI's fingerprint database.

The General Accounting Office (GAO) specifically recommended that state insurance departments be granted access to Federal criminal history data as part of its report on Martin Frankel's activities (Insurance Regulation: Scandal Highlights Need for Strengthened Regulatory Oversight; GAO/GGD-00-198, September 2000, page 50).

A few state insurance departments are able to use the FIRS system run by the FBI because they qualify separately as "law enforcement" agencies under rules promulgated by the Department of Justice. The NAIC surveyed the states to see where they stand on having access to FBI fingerprint files for background checks. Although 17 insurance departments have access to FIRS, most of them operate under state laws that do not meet Justice Department standards. We found that only three state insurance departments – California, Florida, and Idaho – have consistent access to the FBI database for routine checks of criminal history.

The fastest way to grant state insurance departments access to the FBI's fingerprint database is by federal statute. Beginning in 1999 and most recently last September, NAIC provided specific legislative language to the House Commerce Committee that would accomplish this important goal. Since then, we were able to meet with FBI officials and improve our proposed statutory language to incorporate the FBI's

suggestions. A copy of this updated language has been shared with the Financial Services Committee staff.

NAIC's proposed legislative language simply gives state insurance regulators the same access to FBI fingerprint files that banks, bank regulators, and the American Banking Association currently possess. We ask that you act quickly to put us on a level playing field with federal functional regulators.

State Insurance Regulators Need Access to NASD's Enforcement Database

State regulators need Congress to help us gain access to the national securities enforcement database maintained by the National Association of Securities Dealers (NASD). The NAIC has tried to negotiate appropriate access with NASD for two years, but we have not yet been successful. In return, we are willing to share with NASD the extensive database information NAIC maintains on insurance agents and companies.

The GAO specifically recommended that securities and insurance regulators exchange regulatory information in its Martin Frankel report (pp. 49-50). Enabling such useful exchanges would close one of the unintended gaps in GLBA. We believe closer coordination between securities and insurance regulators is becoming even more important as the products and sales of these products become further intertwined.

Regulatory Confidentiality Must Be Preserved for Information Sharing to Work

Congress should act quickly to guarantee the confidentiality of regulatory information exchanges between state insurance departments and federal agencies, especially in fighting fraudulent activities that have not been fully proven. The system of functional regulation set forth in GLBA requires that regulators communicate freely on all matters

of mutual interest. They cannot do so if they cannot maintain confidentiality for regulatory information.

During our efforts to negotiate regulatory cooperation agreements with the Federal Reserve Board, OCC, OTS, and FDIC, one of the biggest concerns was the protection of sensitive information when it passes from one functional regulator to another. Federal agencies are wary of state freedom of information laws, while states are equally concerned about the level of federal safeguards. In the end, because we could not resolve the confidentiality questions in a manner that could apply to all states, the NAIC's model agreement anticipates that some states will alter it to fit their particular laws. As a result, we are unlikely to achieve a uniform nationwide level of confidentiality on information exchanges.

The NAIC has developed a series of model law amendments that would protect the confidentiality of insurance regulatory information nationwide if all states adopt them. However, that is a distant goal when facing the busy and time-limited schedules of state legislatures. Meanwhile, GLBA has created an immediate Federal interest in opening and protecting the flow of information among functional regulators.

NAIC recommends that Congress act quickly to enact a federal law that protects the confidentiality of regulatory information exchanges.

Conclusion

State insurance regulators and the NAIC fully support Congressional efforts to create a nationwide network of information sharing among regulators to fight financial fraud. We are ready to share the information in our own regulatory databases in exchange for receiving the information held by securities and banking regulators. The NAIC also possesses a high level of technical expertise and resources to implement a national

database system quickly if it is built upon networking our existing facilities instead of building new ones.

The most urgent need, in our opinion, is for Congress to open the doors to the FBI fingerprint and NASD enforcement databases, as well as to protect the confidentiality of regulatory information. In view of its lengthy history and the daily exposure states and unwitting consumers face without such FBI and NASD database access, we urge Congress to act on NAIC's recommended FBI access legislation immediately, and also take whatever steps are needed to grant state insurance departments access to the NASD database. These critical tools should not be left waiting while Congress determines how other elements of a national anti-fraud information program should be implemented.

In all these areas, we pledge our commitment and cooperation, and we appreciate the opportunity to participate in this important regulatory modernization initiative.

ATTACHMENT A

Background on State Insurance Regulation and the NAIC

- All insurance providers doing business in the United States are supervised by State insurance departments operating under legal authority conferred by individual States and the Federal government. These departments work together with other State and Federal agencies to form a national regulatory system strengthened by the checks and balances associated with separate scrutiny.

- To enhance the effectiveness of State regulators, the National Association of Insurance Commissioners (NAIC) was formed in 1871 as a non-profit organization for coordinating the supervision of insurance providers, developing higher standards, and providing expert technical and professional support services to State insurance departments. The NAIC's members are the chief insurance regulatory officials of the 50 States, the District of Columbia, and four U.S. territories. Many regulatory functions which are best done centrally – such as data collection, securities valuation, and liaison with international regulators – are performed through the NAIC.

- State insurance departments, together with the NAIC, have two primary mission goals:

    1. Protect the public interest, promote competitive markets, and facilitate fair treatment of insurance consumers; and

    2. Promote the reliability, solvency, and financial soundness of insurance providers selling products in the United States.

- The record of State regulators in meeting these goals is quite impressive. During the 1980's, many insurers faced severe financial strains similar to those encountered by Federally-insured deposit institutions. However, the level of insolvent insurers under State supervision never approached the crisis level of insolvent deposit institutions that were rescued by the Federal government.

- Congress specifically recognized the strength and expertise of the State regulatory system in the McCarran-Ferguson Act (15 U.S.C. Sec. 1012). That Act states in part: "The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." Through the Gramm-Leach-Bliley Act in 1999 (P.L. 106-102), Congress reaffirmed the McCarran-Ferguson Act and designated States as the functional regulators of all insurance activities by banks, securities firms, and traditional insurance providers.

- The existing State system of insurance solvency and market conduct regulation does not cost the Federal government anything. Unlike the banking and securities

industries, there is no Federal guarantee program to compensate insurance consumers when insolvency occurs. Instead, the costs of insurer failures are handled through State-sponsored guarantee funds. If the States do a poor job of regulating, their taxpayers and citizens directly feel the costs of insolvent companies. State governments thus have a powerful incentive to do the job well.

- Insurance is an enormous industry that generated $898 billion in premiums during 1999. Across the country, State insurance departments employ more than 10,400 people and will spend $910 million on regulation in 2001. These extensive human and financial resources are focused exclusively on the monitoring and enforcement tools needed to supervise thousands of insurers, agents, and brokers participating in the insurance business.

Questions for the Record for Terri M. Vaughan
Submitted by Chair Kelly and Chairman Bachus
Hearing on "Protecting Consumers: What can Congress do to help financial regulators coordinate efforts to fight fraud."
March 6, 2001

1. In the NAIC's written testimony you wrote that you wanted to close the information gaps that prevented State insurance regulators from checking on securities violations committed by Martin Frankel before he got involved in the insurance industry. In the NAIC's view, in what sense were State regulators prevented from checking these prior securities violations?

NAIC Response:

State insurance regulators do not currently have direct access to the Central Registration Depository (CRD) database maintained by the National Association of Securities Dealers (NASD). The CRD database includes information on final enforcement actions taken against broker/dealers in the securities industry. In its September 2000 report on Martin Frankel, the GAO found that State insurance regulators would have found information that could have uncovered the fraud allegedly perpetrated by Martin Frankel much sooner than actually occurred if they had accessed the information in the CRD database.

Although insurance regulators did not have direct access to the CRD, they could have gotten the information through their own State securities department. This indirect access to CRD is less reliable and more time-consuming than directly searching CRD as part of the licensing and change of control reviews routinely conducted by regulators. Through the NAIC, state insurance regulators are continuing their efforts to improve communication and cooperation with state securities administrators.

The NAIC's prepared testimony would more clearly convey the meaning intended by changing the sentence on page 3 to read as follows: "In particular, we want to move very quickly on closing the information gaps that prevented state regulators from directly checking on securities violations committed by Martin Frankel or his business associates before he got involved in the insurance industry."

This is also why NAIC members are asking Congress to address a significant problem identified in GAO's report by granting state insurance regulators direct access to the FBI's fingerprint database. This kind of access is currently enjoyed by state securities regulators, banking regulators, and even commercial banks. Under the regulatory scheme created by GLBA, and as a practical matter, insurance regulators should have the same level of access. We believe insurance consumers and financial institutions are better served when regulators receive this important enforcement information directly, not through an intermediary or third party filter as some have suggested.

2. Does the NAIC think it would be beneficial to expand the focus of the Federal Financial Institutions Examination Council (FFIEC) to include not only efforts to coordinate banking regulatory issues, but also cross-industry regulation issues?

NAIC Response:

The NAIC takes no position on whether FFIEC is the appropriate federal entity to handle the central coordination duties of an anti-fraud information network, which we understand is the current focus of the House Financial Services Committee. We note that NAIC's earlier requests to join FFIEC were not accepted, and that federal banking regulators have told us they still wish to keep FFIEC solely as an entity for dealing with banking matters.

It is important to recognize that the key central requirements for establishing an effective anti-fraud information network are: (1) access by all parties to necessary regulatory and law enforcement databases, and (2) agreement upon the correct technical standards needed to permit different databases to be accessed by outside regulatory agencies. These key requirements for point (2) can be met using bilateral agreements, if necessary, although a central authority could facilitate the process where multiple agencies are involved. However, there is no readily available substitute for Congressional action on point (1) to clear existing legal hurdles that hinder access by state insurance regulators to the FBI's fingerprint database.

The NAIC will gladly cooperate with any appropriate federal entity or agencies to establish effective sharing of anti-fraud information among state and federal financial regulators. Our criteria are simply that the job get done in a manner that is both practical and fair to state insurance departments.

3. In your written testimony, the NAIC expressed its preference that a central governing body such as FFIEC "establish the well-known and freely available 'XML' language as the common Internet standard to facilitate information exchanges among different regulatory databases." How difficult would it be to create a network utilizing the "XML" language as the standard?

NAIC Response:

The network to utilize XML exists today. There are several areas in the financial community where transaction level XML data specifications are already under development. The technology is freely licensed, and permits the automatic exchange and reliable extraction of information across all software formats and technologies. In order to create this specific anti-fraud information network, the participating regulators would need to come together and agree upon one set of definitions for the

data they would be sharing (For example, defining what constitutes a "formal adjudicated action" and how it should be reported). Then each regulator could use these XML standards to exchange the data amongst themselves over the Internet.

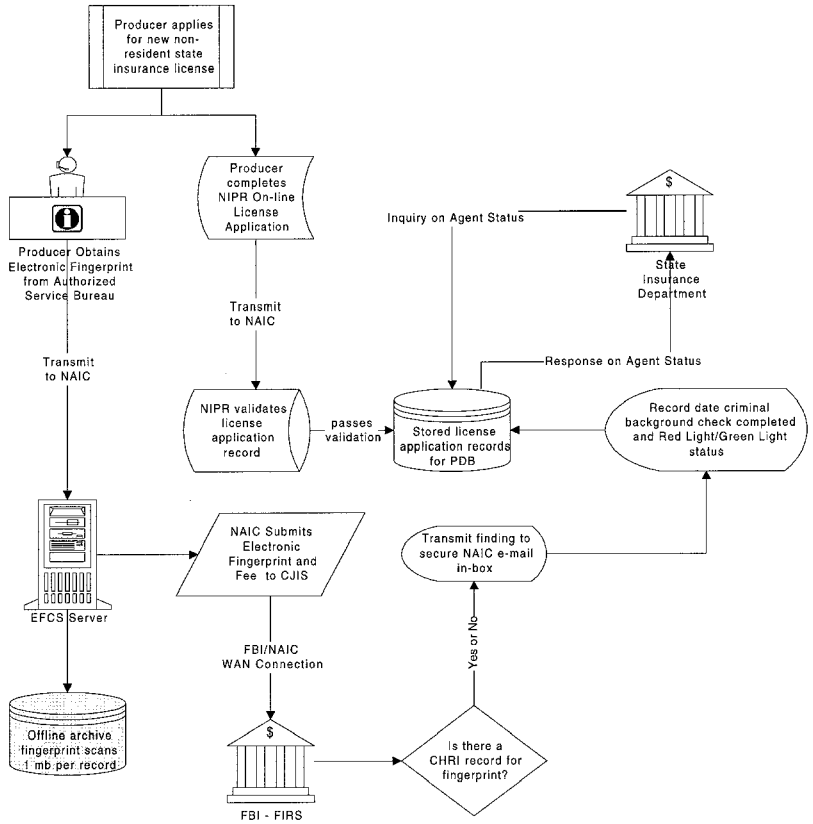
4. If Congress grants State insurance regulators access to relevant portions of the FBI criminal records for doing background checks on agents/brokers and key company employees, can the NAIC store this information in a centralized repository, so that the fingerprinting would only have to be done once, potentially saving agents/brokers both time and money?

NAIC Response:

Yes, this was part of the NAIC's proposal to the Committee. Please see attached chart.

NAIC/NIPR ***Draft - 02/02/2001***

Insurance Producer
FBI Criminal Background Check
Process WorkFlow



TESTIMONY OF

DENNIS M. LORMEL, CHIEF

FINANCIAL CRIMES SECTION

FEDERAL BUREAU OF INVESTIGATION

BEFORE THE

UNITED STATES

HOUSE OF REPRESENTATIVES

JOINT HEARING OF THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

AND THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HOUSE FINANCIAL SERVICES COMMITTEE

WASHINGTON , D.C.

MARCH 6, 2001

MR. CHAIRMAN, I AM PLEASED TO APPEAR TODAY ON BEHALF OF THE FBI AND SHARE WITH YOUR SUBCOMMITTEES THE FBI'S PERSPECTIVE ON CRIMINAL HISTORY RECORD INFORMATION CHECKS ON INDIVIDUALS CONDUCTING BUSINESS IN THE AREA OF INSURANCE. I AM ALSO PLEASED TO HAVE THE OPPORTUNITY TO DISCUSS THE SHARING OF INFORMATION AMONG REGULATORS WITHIN THE VARIOUS FINANCIAL SECTORS AND LAW ENFORCEMENT.

LET ME BEGIN BY EMPHASIZING THAT THE FBI PLACES A HIGH PRIORITY ON INVESTIGATING FINANCIAL CRIMES AND IS COMMITTED TO WORKING WITH THE SUBCOMMITTEES, THE HOUSE FINANCIAL SERVICES COMMITTEE AND ALL OF CONGRESS TO ENSURE THAT LAW ENFORCEMENT AND THE RESPECTIVE FINANCIAL SERVICES INDUSTRIES HAVE THE NECESSARY TOOLS TO COMBAT THESE CRIMES. THE FBI IS AWARE OF THE INTEREST AND EFFORTS TO COMBAT FRAUD THROUGHOUT THE VARIOUS FINANCE-ORIENTED INDUSTRIES. IN THE CYBER ERA, THE SERVICES PROVIDED BY BANKS, SECURITIES FIRMS AND INSURANCE COMPANIES ARE INCREASINGLY SIMILAR. THE ADVANCES IN TECHNOLOGY AND THE DEVELOPMENT OF CYBER FINANCIAL PRODUCTS AND SERVICES IS CONTINUING TO MELD THE OFFERINGS OF BANKS, SECURITIES FIRMS AND INSURANCE COMPANIES. AS A BY PRODUCT THERE IS INCREASED COMMONALITY AMONG REGULATORS. THE GRAMM-LEACH-BLILEY ACT'S (GLBA'S) PURPOSE WAS TO ESTABLISH A COMPREHENSIVE FRAMEWORK TO PERMIT AFFILIATIONS AMONG COMMERCIAL BANKS, SECURITIES FIRMS AND INSURANCE COMPANIES --- ALLOWING A LEVEL PLAYING FIELD WHILE, MAINTAINING THE SAFETY AND SOUNDNESS OF THE FINANCIAL SYSTEM. IT ALSO RECOGNIZED THE NEED FOR GREATER REGULATORY CONSULTATION AND COORDINATION.

I AM THANKFUL TO ALL WHO WERE INVOLVED AND THEIR LEADERSHIP IN WORKING TO ENACT THE GLBA, PARTICULARLY IN THE FACE OF AN EVER-CHANGING GLOBAL ECONOMY, THE CONSOLIDATION OF FINANCIAL SERVICES AND EMERGING NEW TECHNOLOGY.

THE FBI HAS BEEN REQUESTED TO TESTIFY ON TWO DIFFERENT AREAS, ALTHOUGH

SOMEWHAT RELATED: 1.) OUR POSITION ON FBI CRIMINAL HISTORY RECORD INFORMATION (CHRI) CHECKS OF INDIVIDUALS CONDUCTING BUSINESS IN THE AREA OF INSURANCE AND; 2.) OUR POSITION AND SUPPORT ON THE SHARING OF INFORMATION BETWEEN THE VARIOUS FINANCE-ORIENTED BUSINESSES. IN THESE REGARDS, LET ME STATE THAT THE DEPARTMENT OF JUSTICE IS STUDYING THE NEED FOR ANY ADDITIONAL LEGISLATION IN THESE AREAS. WE ARE THEREFORE NOT PREPARED TO SUGGEST OR COMMENT UPON ANY LEGISLATIVE APPROACHES AT THIS TIME. I WILL FIRST PROVIDE A BRIEF DISCUSSION RELATING TO THE INSURANCE INDUSTRY AND FBI CHRI CHECKS.

BACKGROUND

LET ME DISCUSS THE FINANCIAL IMPACT THE INSURANCE INDUSTRY HAS ON THE ECONOMIC SECURITY OF THE UNITED STATES AND ITS CITIZENS. ACCORDING TO THE COALITION AGAINST INSURANCE FRAUD, UNITED STATES (U.S.) PREMIUMS IN 1998 TOTALED $639 BILLION. ACCORDING TO A RECENT REPORT BY THE ALLIANCE OF AMERICAN INSURERS --- A NATIONAL TRADE ASSOCIATION REPRESENTING OVER 300 PROPERTY/CASUALTY INSURANCE COMPANIES --- THE INSURANCE INDUSTRY CONTRIBUTES ALMOST $200 BILLION TO THE U.S. GROSS NATIONAL PRODUCT (GNP) EACH YEAR. THIS IS APPROXIMATELY 2.4 PERCENT OF THE TOTAL GNP. BY COMPARISON, THIS IS ALMOST DOUBLE THE SECURITY INDUSTRY'S CONTRIBUTION OF 1.3 PERCENT AND CLOSER TO THE BANKING INDUSTRY'S 3.3 PERCENT. THE INSURANCE INDUSTRY CURRENTLY EMPLOYS APPROXIMATELY 2.5 MILLION PEOPLE, WITH A TOTAL PAYROLL OF APPROXIMATELY $100 BILLION. FINANCIAL INTERESTS BY THE INSURANCE INDUSTRY ARE ENORMOUS. INSURANCE INDUSTRY HOLDINGS OF STATE AND LOCAL GOVERNMENT BONDS TOTALED $227 BILLION OR 15 PERCENT OF ALL OUTSTANDING MUNICIPAL BONDS. THIS PERCENTAGE IS THE LARGEST OF ANY FINANCIAL SECTOR EXCEPT MUTUAL FUNDS, WHICH HOLD 16 PERCENT. INSURERS ALSO HOLD ALMOST A THIRD OF ALL AVAILABLE CORPORATE BONDS.

INDIVIDUALS ENGAGED IN INSURANCE ACTIVITIES HOLD POSITIONS OF GREAT TRUST. THEY BEAR A TREMENDOUS FIDUCIARY RESPONSIBILITY AND HAVE ACCESS TO AND CONTROL VAST FINANCIAL INVESTMENTS.

RECENT CASES

SOME RECENT FBI INVESTIGATIONS WILL DISCLOSE THE AMOUNT OF TRUST PLACED WITH SOME OF THESE INDIVIDUALS AND THE MAGNITUDE OF FRAUD AS A RESULT OF THIS TRUST. THE NATIONAL HERITAGE LIFE INSURANCE COMPANY WAS THE LARGEST INSURANCE COMPANY FAILURE IN U.S. HISTORY. THE NATIONAL HERITAGE LIFE CASE RESULTED IN OVER $450 MILLION IN LOSSES. SINCE THE MID-1990'S, 16 DEFENDANTS WERE CONVICTED. THE MOST EGREGIOUS CRIMES WERE COMMITTED BY SHOLAM WEISS AND KEITH POUND, WHO WERE RECENTLY SENTENCED TO 845 AND 700 YEARS RESPECTIVELY. THIS IS BELIEVED TO BE THE LONGEST SENTENCE EVER IMPOSED IN NOT ONLY AN INSURANCE FRAUD PROSECUTION BUT FOR ANY WHITE COLLAR CRIME. THIS INVESTIGATION ALSO RESULTED IN A $100 MILLION FORFEITURE VERDICT. IN A RECENT VIATICAL-RELATED INSURANCE FRAUD MATTER, FREDERICK BRANDAU WAS SENTENCED TO 55 YEARS IMPRISONMENT.

CURRENT ENFORCEMENT ACTIVITIES

IN 1994, CONGRESS RECOGNIZED THE FIDUCIARY NATURE OF INSURANCE EMPLOYMENT WHEN IT ENACTED THE VIOLENT CRIME CONTROL AND LAW ENFORCEMENT ACT, WHICH, AMONG OTHER PROVISIONS, INCLUDED NEW FEDERAL CRIMINAL AND CIVIL ENFORCEMENT PROVISIONS AIMED DIRECTLY AT INSURANCE FRAUD, 18 U.S.C. SECTIONS 1033 (1033) AND 1034 (1034). IN PASSING 1033, CONGRESS HELD THAT, AMONG OTHER STATUTORY REGULATIONS, "ANY INDIVIDUAL WHO HAS BEEN CONVICTED OF ANY CRIMINAL FELONY INVOLVING DISHONESTY OR A BREACH OF TRUST, OR WHO HAS BEEN CONVICTED OF AN OFFENSE UNDER THIS SECTION (1033), AND WHO WILLFULLY ENGAGES IN THE BUSINESS OF INSURANCE WHOSE ACTIVITIES AFFECT INTERSTATE COMMERCE OR PARTICIPATE IN SUCH BUSINESS SHALL BE

GUILTY OF A CRIME." CONGRESS FURTHER STATED THAT ANY INDIVIDUAL WHO IS ENGAGED IN THE BUSINESS OF INSURANCE WHOSE ACTIVITIES AFFECT INTERSTATE COMMERCE AND WHO WILLFULLY PERMITS THIS PARTICIPATION OF ANY INDIVIDUAL SO CONVICTED SHALL BE FINED OR IMPRISONED.

IT IMMEDIATELY BECAME ILLEGAL FOR CERTAIN INDIVIDUALS TO EITHER BE EMPLOYED IN THE BUSINESS OF INSURANCE OR CONTINUE TO WORK IN THE BUSINESS OF INSURANCE.

PUBLIC LAW (PUB. L.) 92-544 AUTHORIZES THE FBI TO EXCHANGE CHRI WITH OFFICIALS OF STATE AND LOCAL GOVERNMENTAL AGENCIES FOR LICENSING AND EMPLOYMENT PURPOSES. THIS CAN ONLY BE AUTHORIZED BY A STATE STATUTE WHICH HAS BEEN APPROVED BY THE ATTORNEY GENERAL OF THE UNITED STATES. ONE OF THE PRIMARY PURPOSES FOR ENACTING PUB. L. 92-544 WAS TO ESTABLISH A NATIONAL POLICY WITH ADEQUATE SANCTIONS AND ADMINISTRATIVE SAFEGUARDS REGARDING THE DISSEMINATION OF FBI CHRI TO STATE AND LOCAL GOVERNMENTS FOR NON-CRIMINAL JUSTICE LICENSING AND EMPLOYMENT PURPOSES. FINGERPRINT SUBMISSIONS TO THE FBI UNDER PUB. L. 92-544 MUST BE FORWARDED TO THE FBI THROUGH THE STATE IDENTIFICATION BUREAU WITHIN EACH STATE. FURTHERMORE, A GOVERNMENTAL AGENCY WITHIN THE STATE MUST BE DESIGNATED AS THE RECIPIENT OF THE FBI CHRI, AS SUCH INFORMATION CANNOT BE DISSEMINATED TO A PRIVATE ENTITY WITHOUT SPECIFIC AUTHORIZING FEDERAL LEGISLATION.

A RECENT REVIEW CONDUCTED BY THE FBI CRIMINAL JUSTICE INFORMATIONS SYSTEMS (CJIS) DIVISION DISCLOSED THAT MULTIPLE STATES HAVE STATUTES APPROVED PURSUANT TO PUB. L. 92-544 FOR SUBMISSION OF FINGERPRINTS FOR NON-CRIMINAL JUSTICE LICENSING AND EMPLOYMENT PURPOSES. A REVIEW OF THESE SPECIFIC STATUTES INDICATES A BROAD DIVERSITY OF CRITERIA FOR SELECTING AND SCREENING APPLICANTS. FOR

EXAMPLE, ONE STATE MAY REQUIRE THAT ONLY LICENSED AGENTS BE FINGERPRINTED, WHILE ANOTHER MAY REQUIRE THAT OFFICERS, DIRECTORS, STOCKHOLDERS, MANAGERS, ADJUSTORS, SOLICITORS AND BROKERS BE FINGERPRINTED. ACCORDING TO THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC), ONLY THREE STATES (CALIFORNIA, FLORIDA AND IDAHO) CONSISTENTLY ACCESS THE FBI CRIMINAL DATABASE FOR REGULATORY PURPOSES.

AT PRESENT, ALL STATE INSURANCE DEPARTMENTS DO NOT HAVE CLEAR FEDERAL AUTHORITY TO OBTAIN FBI CHRI CHECKS REGARDING PERSONS WHO SEEK TO HOLD POSITIONS OF TRUST IN COMPANIES PROVIDING FINANCIAL SERVICES TO THE PUBLIC. CONGRESS HAS ENACTED FEDERAL LEGISLATION AUTHORIZING ACCESS TO NATIONAL CHRI FOR THE SCREENING OF PROSPECTIVE EMPLOYEES IN AREAS INVOLVING IMPORTANT NATIONAL INTERESTS, WITHOUT REQUIRING STATES TO SUBSEQUENTLY ENACT STATE LAWS TO ACCESS FBI CHRI. MOST RECENTLY, CONGRESS ENACTED PUB. L. 105-277 TO GIVE ALL STATES THE AUTHORITY TO REQUEST FBI CHRI FOR PERSONS SEEKING EMPLOYMENT AT DIRECT CARE PROVIDERS IN NURSING HOMES. THE FBI REPORTS THAT 10.5 PERCENT OF ALL CIVIL NON-CRIMINAL JUSTICE APPLICANT FINGERPRINT CHECKS IN FISCAL YEAR 2000 DISCLOSED CRIMINAL RECORD INFORMATION. THE INTENT OF 1033'S PROHIBITION IS TO PREVENT CERTAIN PERSONS FROM HAVING THE OPPORTUNITY TO HARM THE PUBLIC OR INSURERS. THERE ARE NO STATISTICS TO DISCLOSE THE AMOUNT OF FRAUDULENT LOSSES ELIMINATED, AS A RESULT OF SCREENING APPLICANTS AND CURRENT EMPLOYEES THROUGH THE FINGERPRINT IDENTIFICATION PROCESS. HOWEVER, BASED ON THE 10.5 PERCENT POSITIVE IDENTIFICATION RATE, ONE CAN ONLY BELIEVE THAT IT IS SUBSTANTIAL. TWO SELECT EXAMPLES ARE NOTED BELOW.

RECENT CASES:

ONE INDIVIDUAL WAS A CONVICTED FELON (STATE FRAUD RELATED CONVICTION) WHO

USED AN ASSUMED NAME IN THE MID 1990'S TO CONDUCT BUSINESS WITHIN THE INSURANCE INDUSTRY. HIS FRAUDULENT ACTIONS RESULTED IN AS MUCH AS $6 MILLION IN LOSSES AND HE WAS CONVICTED ON NUMEROUS COUNTS OF VARIOUS FRAUDULENT ACTS. IN ANOTHER INVESTIGATION, AN INDIVIDUAL WAS RECENTLY INDICTED ON CONSPIRACY, MONEY LAUNDERING AND MAIL FRAUD CHARGES RELATING TO HIS ALLEGED FRAUDULENT ACTIONS, POSSIBLY RESULTING IN AS MUCH AS $50 MILLION IN LOSSES ASSOCIATED WITH THE VIATICAL LIFE INSURANCE SETTLEMENT INDUSTRY. THIS INDIVIDUAL WAS PREVIOUSLY CONVICTED AND SERVED TIME FOR ILLEGAL SALE OF ARMS AND VARIOUS FRAUD CONVICTIONS.

AN INSURANCE AGENT WHO IS LICENSED IN ONE STATE MAY CONDUCT BUSINESS IN ANY NUMBER OF OTHER STATES. THE POLICYHOLDERS ARE PROTECTED TO VARYING DEGREES BY THEIR OWN STATE'S INSURANCE GUARANTY PROGRAM. IF FRAUDULENT ACTIVITY RESULTED IN THE INSOLVENCY OF AN INSURANCE COMPANY, THIS ACTIVITY CAN TRIGGER THE NEED FOR COVERAGE FROM NUMEROUS STATE GUARANTY PROGRAMS TO THE EXTENT THAT POLICYHOLDERS OF THE FAILED INSURER ARE RESIDENTS OF DIFFERENT STATES. ALTHOUGH THE FRAUDULENT ACTIVITY MAY OCCUR IN A STATE THAT LICENSED AN AGENT (BASED ON NOT DOING A CHRI CHECK) WHO WAS IN VIOLATION OF 1033, SHOULD THIS ACTIVITY CAUSE IMMENSE FINANCIAL LOSSES TO AN INSURANCE COMPANY THAT IS HEADQUARTERED IN ANOTHER STATE AND HAS POLICYHOLDERS THROUGHOUT THE NATION, THE GUARANTY FUND OF EACH STATE MAY BE SEVERELY IMPACTED, AFFECTING POLICYHOLDERS AND TAXPAYERS IN VARIOUS STATES. MANY INSURERS DOMICILED IN SOME STATES ARE ELIGIBLE TO OFFSET A PORTION OF THE AMOUNTS ASSESSED BY THE STATE'S GUARANTY FUNDS AGAINST PREMIUM TAXES COLLECTED BY THESE STATES.

IF AN INSURER IS MADE AWARE OF A FELONY CONVICTION, IT MUST THEN MAKE A DETERMINATION IF THAT FELONY INVOLVED DISHONESTY OR BREACH OF TRUST. THE STATUTE DOES NOT IDENTIFY FELONIES THAT INVOLVE DISHONESTY OR BREACH OF TRUST.

IDENTICAL LANGUAGE APPEARS IN SEVERAL FEDERAL STATUTES, INCLUDING PROVISIONS RELATED TO FEDERALLY INSURED BANKS, SAVINGS AND LOANS, CREDIT UNIONS, SMALL BUSINESS INVESTMENT COMPANIES, ETC. THERE DOES NOT APPEAR TO BE ANY COURT DECISIONS OUTLINING STANDARDS FOR DETERMINING WHICH CRIMES INVOLVE DISHONESTY OR BREACH OF TRUST IN THE CONTEXT OF 1033. EACH STATE HAS ITS OWN SET OF STATUTES AND CASE LAW THAT DEFINES WHAT IS, OR IS NOT, DISHONESTY OR BREACH OF TRUST.

AN INDIVIDUAL MAY SEEK RELIEF FROM THE PROHIBITION AGAINST ENGAGING IN THE BUSINESS OF INSURANCE BY OBTAINING THE WRITTEN CONSENT OF THE INSURANCE REGULATORY OFFICIAL (THE APPROPRIATE STATE INSURANCE COMMISSIONER) AUTHORIZED TO REGULATE THE INSURER WHO EMPLOYS THIS INDIVIDUAL. EACH STATE HAS THEIR OWN RULING ON GRANTING WAIVERS ON A CASE BY CASE BASIS.

IN ADDITION TO THE VIOLENT CRIME CONTROL AND LAW ENFORCEMENT ACT OF 1994, THE GLBA PROVIDES THAT STATE INSURANCE REGULATORS SHALL COORDINATE WITH THE FEDERAL REGULATORY AGENCIES AND ACHIEVE A NATIONAL SYSTEM OF AGENCY LICENSING. NEITHER OF THESE SPECIFIC FEDERAL MANDATES CAN BE PROPERLY MET BY STATE OFFICIALS WITHOUT THE ABILITY TO HAVE FBI CHRI CHECKS.

THE NAIC HAS NOTED, THAT WHILE THE INSURANCE INDUSTRY SHOULD REMAIN STATE REGULATED, THERE IS A ROLE FOR THE FEDERAL GOVERNMENT TO PLAY IN THE AREA OF LAW ENFORCEMENT IN CONCERT WITH STATE INSURANCE REGULATORS AND THE NAIC. FEDERAL STATUTES ARE TO BE VIEWED AS ENHANCING, NOT SUPERSEDING, STATE LAW ENFORCEMENT AND WILL HELP TO SERVE AS ADDITIONAL DETERRENCE TO AND PUNISHMENT OF INDIVIDUALS WHO ENGAGE IN ILLEGAL INSURANCE ACTIVITIES.

FOR FIVE YEARS, THE ENERGY AND COMMERCE COMMITTEE'S SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS CONDUCTED INVESTIGATIONS AND HELD OVERSIGHT HEARINGS ON THE INSURANCE INDUSTRY. THESE HEARINGS DEMONSTRATED THAT

ENFORCEMENT OF INSURANCE LAWS AND REGULATIONS IS ONE OF THE WEAKEST LINKS IN THE INSURANCE REGULATORY SYSTEM. IN FEBRUARY, 1990, THE SUBCOMMITTEE FOCUSED ATTENTION ON THE NEED FOR FEDERAL CRIMINAL LEGISLATION IN ITS REPORT "FAILED PROMISES." IN THIS REPORT, THE SUBCOMMITTEE EXAMINED FOUR MAJOR INSURANCE COMPANY FAILURES AND CONCLUDED THAT EXISTING STATE REMEDIES WERE INEFFECTIVE AGAINST THE FRAUDULENT BEHAVIORS THAT DROVE THESE COMPANIES INTO INSOLVENCY. AS A RESULT, CONGRESS ENACTED FEDERAL CRIMINAL STATUTES (1033 AND 1034) TO HELP INSURANCE REGULATORS DEAL WITH INTERSTATE INSURANCE FRAUD SCHEMES.

MANY OF THE STATES HAVE VARYING PROCEDURES/PRACTICES IN PLACE WITH RESPECT TO THE ENFORCEMENT OF 1033. SOME STATES HAVE NO POLICY OR PROCEDURES IN PLACE AND SOME DO NOT BELIEVE THEIR RESPECTIVE INSURANCE DEPARTMENT COULD INTERPRET OR ENFORCE 1033. OTHER STATES BELIEVE THAT COMPANIES/EMPLOYEES MUST DETERMINE FOR THEMSELVES WHETHER THEY MUST SEEK CONSENT. NUMEROUS STATES HAVE POLICY AND PROCEDURES IN PLACE TO ENFORCE 1033 BASED ON THE NAIC GUIDELINES FOR STATE INSURANCE REGULATORS. WE COMMEND THE NAIC FOR THEIR PROACTIVE EFFORTS AND PROGRESS IN SEEKING TO ESTABLISH UNIFORMITY THROUGHOUT THE INDUSTRY.

ALL TOO OFTEN THE PERPETRATORS OF FRAUD AND DECEPTIVE PRACTICES IN THE INSURANCE FIELD NOT ONLY ARE ABLE TO CARRY OUT THEIR SCHEMES WITH IMPUNITY, BUT EQUALLY TROUBLING THEY MOVE ON TO ANOTHER INSURANCE COMPANY TO INFLICT STILL MORE HARM TO THE GOOD NAME OF INSURANCE. EVEN MORE TROUBLING IS THAT CON MEN FROM OTHER INDUSTRIES ARE MIGRATING MORE AND MORE TO THE INSURANCE INDUSTRY BECAUSE OF THE LACK OF UNIFORMITY AND CONTROLS.

I WILL NOW ADDRESS THE INFORMATION SHARING PORTION OF OUR TESTIMONY. THE GLBA FINANCIAL MODERNIZATION LEGISLATION HIGHLIGHTS THE IMPORTANCE OF

CONSULTATION AND INFORMATION SHARING AMONG FEDERAL FINANCIAL REGULATORS AND STATE INSURANCE REGULATORS. ALTHOUGH THE LEGISLATION IS RECENT, REGULATORS IN CERTAIN FINANCE-ORIENTED INDUSTRIES HAVE RECOGNIZED THE NEED TO IMPROVE THEIR COORDINATION AND HAVE TAKEN OR PLAN TO TAKE A NUMBER OF ACTIONS. GENERALLY, THE ACTIONS CONSIST OF ESTABLISHING FORMAL AGREEMENTS FOR SHARING INFORMATION AND CREATING WORKING GROUPS TO DISCUSS MATTERS OF MUTUAL INTEREST. THESE REGULATORY ACTIONS ARE IN THEIR INFANCY.

THE FBI COMMENDS THE GENERAL ACCOUNTING OFFICE (GAO) ON ITS EXCELLENT REPORT: "INSURANCE REGULATION: SCANDAL HIGHLIGHTS NEED FOR STRENGTHENED OVERSIGHT, SEPTEMBER 2000, GAO REPORT TO THE HONORABLE JOHN D. DINGELL." THE REPORT IS A PRIME EXAMPLE OF THE NEED FOR A COORDINATED SHARING OF INFORMATION. HOWEVER, EVEN WITH PRACTICES IN PLACE WITHIN A SINGLE INDUSTRY, VARIOUS STATE REGULATORS WERE NOT SHARING SUSPECTED FRAUDULENT ACTIVITY WITH OTHER STATE REGULATORS. MARTIN FRANKEL, A FORMER SECURITIES BROKER WHO WAS BARRED FROM THE INDUSTRY IN 1992, ALLEGEDLY MIGRATED TO THE INSURANCE INDUSTRY AND CONTINUED TO OPERATE AS A ROGUE BY ENGAGING IN ILLEGAL ACTIVITY. THE INSURANCE COMPANIES NEGATIVELY AFFECTED BY THE SCAM WERE REGULATED BY INDIVIDUAL STATES. ANOTHER ENTITY TIED TO THE SCAM, A BROKER-DEALER, WAS SUBJECT TO REGULATION IN THE SECURITIES INDUSTRY. THE MIGRATION OF UNDESIRABLE PERSONS, OR ROGUES, FROM ONE INDUSTRY TO ANOTHER IS ONE OF MANY ISSUES OF CONCERN FOR FINANCIAL SERVICE REGULATORS THAT ARE ATTEMPTING TO IMPLEMENT THE GLBA AIMED AT MODERNIZING THE FINANCIAL SERVICES INDUSTRY.

A RECENT EXAMPLE ILLUSTRATES THE FAILURE TO COMMUNICATE AND COOPERATE WITHIN A SINGLE FINANCIAL SECTOR BUSINESS. IN FLORIDA, 18 INDIVIDUALS WERE CHARGED PURSUANT TO INDICTMENTS PERTAINING TO A SCHEME INVOLVING THE "PLANTING" OF

MEMBERS OF A SPECIFIC GROUP IN BANKS AS TELLERS. THESE TELLERS IDENTIFIED LARGE ACCOUNTS AND, SUBSEQUENTLY, CO-MEMBERS OF THE GROUP PRESENTED COUNTERFEIT CHECKS TO THEM FOR CASHING. THE LOSSES DUE TO THE ALLEGED FRAUD EXCEEDED $1.6 MILLION. TWO BANKS AND SEVERAL BRANCHES OF THESE BANKS IN VARIOUS JURISDICTIONS FELL VICTIM. THERE WAS NO "BANK-WIDE" COORDINATION OF BACKGROUND CHECKS OF BANK PERSONNEL. EACH BRANCH CONDUCTED THEIR OWN CHECKS AND DID NOT SHARE THE INFORMATION WITH OTHER BRANCHES. AFTER BEING FIRED, THESE TELLERS WOULD SIMPLY BE HIRED BY ANOTHER BRANCH OF THE SAME BANK.

I WANT TO CONCLUDE BY EMPHASIZING THE FBI'S CONTINUED COMMITMENT TO WORK WITH THE SUBCOMMITTEES, THE HOUSE FINANCIAL SERVICES COMMITTEE, CONGRESS, THE REGULATORY AGENCIES, THE FINANCIAL SERVICES INDUSTRIES AND OTHER LAW ENFORCEMENT AGENCIES IN ADDRESSING CONCERNS RELATING TO THE MERGING AND OVER-LAPPING OF THE FINANCIAL SECTORS. THESE ARE EXCITING TIMES IN THE AMERICAN ECONOMY AS TECHNOLOGY CONTINUES TO RAPIDLY CHANGE AMERICA AND THE WORLD.

TESTIMONY OF

DAVID M. BECKER, GENERAL COUNSEL
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING NEW REGULATORY TOOLS TO CONTROL THE ACTIVITIES OF ROGUE INDIVIDUALS IN THE FINANCIAL SERVICE INDUSTRIES

BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS AND THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

MARCH 6, 2001

U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

TESTIMONY OF
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CONCERNING NEW REGULATORY TOOLS TO CONTROL THE ACTIVITIES OF ROGUE INDIVIDUALS IN THE FINANCIAL SERVICES INDUSTRIES

BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS AND THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

U.S. HOUSE OF REPRESENTATIVES

March 6, 2001

Chairwoman Kelly, Chairman Bachus, Ranking Minority Members Gutierrez and Waters, and members of the Subcommittees:

I am pleased to testify today on behalf of the Securities and Exchange Commission ("SEC" or "Commission") about proposals to help give regulators in the securities, banking and insurance areas additional tools to curb the activities of rogue individuals. The Commission strongly supports steps to help regulators act against rogue individuals, such as broadening the Commission's statutory authority to use regulatory information, and improving processes for sharing information among financial regulators. I also would like to highlight implementation issues of particular interest and relevance to the Commission.

At the outset, I would like to note that the Commission welcomes the Subcommittees' attention to this matter, as well as their receptiveness to our concerns, and that the Commission looks forward to working with other regulators and with the Subcommittees to develop a workable approach to these issues. The migration of rogue individuals is a concern that spans regulatory lines. Indeed, the case of Martin Frankel, whom the Commission barred from the securities industry, but who then was able to migrate into the insurance industry and commit a

multi-million dollar fraud, underscores how important it is for regulators to cooperate to protect the public from individuals who have proven to be unscrupulous.

I. Information sharing as a tool against rogue individuals

The Commission recognizes that the sharing of regulatory information can serve as an important tool to help control rogue individuals. The Commission has firsthand knowledge of the benefits of sharing information in a systematized manner. The National Association of Securities Dealers ("NASD"), through its regulatory subsidiary, NASD Regulation ("NASDR"), maintains the Central Registration Depository ("CRD") system. The Commission, self-regulatory organizations ("SROs") and state securities regulators use the CRD system in connection with registering and licensing broker-dealers and their personnel. The CRD system maintains the qualification, employment, and disclosure histories of over 675,000 registered securities employees.

The CRD system contains an extensive range of information filed by broker-dealers, individuals, and securities regulators, as well as information obtained by the NASD during its review of registration filings, such as criminal history record information from the FBI. Data about individuals includes not only information about an individual's registrations and state licenses, but also personal information such as residential history, employment history and education, criminal charges and convictions, regulatory and disciplinary actions, certain civil judicial actions (such as injunctions involving investment-related activity), customer complaints and related arbitration and judicial proceedings, certain terminations (such as for the violation of securities statutes or rules), and certain financial information (such as bankruptcy).

The CRD system permits varying degrees of access to this information, depending on who is requesting the information and for what purposes. For instance, federal regulations

strictly limit the dissemination of criminal history record information provided by the FBI. While securities regulators have the broadest access to the information contained on the CRD system, other parties, including regulated entities, are provided only with specific subsets of that information.

The public is entitled to a subset of the information contained in the CRD database through the NASDR's public disclosure program. Information available through the program includes employment history, other business experience, and disciplinary history. The public disclosure program does not encompass sensitive data such as an individual's social security number, home address, and physical description, judgments and liens originally reported as pending that subsequently have been satisfied, and bankruptcy proceedings filed more than 10 years ago. Also, the NASDR may be directed by a court to remove certain information about a person from the public disclosure program.

The NASDR also has developed, and is in the process of implementing, the Investment Adviser Registration Depository ("IARD") system to collect and maintain registration and disclosure information about investment advisers and their associated persons. Among other things, investment advisers must provide information similar to the information that broker-dealers and associated persons must provide to the CRD. Advisers also must disclose similar disciplinary actions brought against them by state or federal regulators.

The Commission will provide other federal agencies with the same level of IARD access as the Commission has. The general public will be able to obtain information on the IARD other than personal identifying information.

The CRD and IARD systems illustrate that systematized means of sharing information are not cheap. The NASD has spent approximately $50 million to develop and deploy the

internet version of the CRD – "Web CRD" – which it originally deployed in August 1999. The NASD spends about $45 million annually to operate the CRD system and to support Web CRD's regulatory and industry users. Virtually all costs associated with the CRD are paid for by fees assessed on NASD member broker-dealers. The IARD will cost approximately $13 million to construct (despite being able to build upon existing CRD technology), and about $6 million each year to operate.

Moreover, under the Gramm-Leach-Bliley Act, the Commission is required to share information with federal banking regulators about categories of information such as the results of examinations of registered investment companies, and the results of examinations of the investment advisory activities of a bank or bank holding company. The Act also requires federal banking regulators to provide the Commission with information about banks that rely on exceptions from the definitions of "broker" and "dealer" in the Exchange Act, and about the results of examinations of the investment advisory activities of a bank or bank holding company. The Commission will work with banking regulators to develop further mechanisms to exchange this information, as necessary.

Given the presence of existing information sharing mechanisms, the Commission believes that initiatives to share information to curb rogue individuals, or for other purposes, should build upon the arrangements that are already in place, and should be evaluated in light of six key factors.

A. Privacy

Even with the best of intentions, the more people who have access to regulatory information, the more we have to be concerned about the leakage of that information. The states, the self-regulatory organizations and the Commission are keenly aware of the personal privacy

concerns of associated persons of broker-dealers, and therefore seek to collect only the information they need to perform their regulatory responsibilities.

It goes without saying that the government owes a trust to those members of the public who have provided personal information to it. More widespread disclosure of that information raises concerns about core privacy issues such as identity theft. These privacy concerns are accentuated by the fact that a panoply of privacy laws and open record laws apply to regulatory agencies. Some of those laws restrict an agency's ability to disseminate information, and can even lead to civil and criminal liability, while others may require the public disclosure of information used by an agency.

Because privacy safeguards are only as strong as their weakest link, it is incumbent on us to consider carefully what information will be required, how it will be shared, and who will have access to that information.

B. Compromising regulatory actions

Information in the CRD and the IARD includes data about completed enforcement actions against an individual or firm. These systems, however, do not include certain other types of highly sensitive information, such as data about the financial status of brokers. Any approach to sharing information should avoid the premature disclosure of information that could compromise the enforcement mission of a regulatory agency.

C. Reliability of data

Most of the information submitted to the CRD and IARD systems comes from regulators or regulated entities (who may face sanctions for false or incomplete reporting). Examples include information about final actions and findings reached after due process of law. Other

information submitted to these systems comes directly from individuals, such as information on the forms they file when they apply for registration. Securities regulators are mindful of those distinctions when they use information from these systems. Similarly, it is important that the regulators who would use data produced by other regulators be mindful of, and have a means of knowing, the extent to which other regulators' information has been vetted.

D. Fairness

Fairness is a corollary to questions regarding the integrity of data. It is a matter of basic fairness and due process that the data that is placed into regulatory databases and disseminated does not subject individuals to wrongful consequences. The more that regulators share information among themselves, the more this could pose a problem. It would not be consistent with anyone's interest if a person could be barred from practicing his or her livelihood due to a regulatory action that is based on erroneous information placed into a database, without giving the person a fair opportunity to correct the record.

E. Reciprocity and the identification of individuals

The Commission recognizes that different regulators include different types of information in their databases, and that the goal of information sharing may require the staff of each regulator to learn to adjust to the particularities of each individual system. For shared information to be useful, however, it must meet certain minimum standards. In particular, the information would have very little use unless it identifies individuals by name and a unique identifier. Otherwise, information from the originating agency would be useless to the recipient.

F. Scope of access

Any plan for systematically sharing information will raise core questions about who will have access to the information. Given the range of regulatory agencies that may participate, and

the varying administrative and privacy requirements under which they may operate, it is vital for information to be shared in a way that harmonizes all applicable standards.

In the context of the securities laws, the question of access also raises an issue of particular importance – which regulatory organizations will have access to the information. The securities laws encompass the concept of self-regulation. Self-regulatory organizations, such as the NASD and the New York Stock Exchange, play an integral part in enforcing the securities laws. It therefore is important to ensure that SROs be allowed access to the information they need to carry out their regulatory functions.

Indeed, as is discussed above, the CRD already contains multiple levels of data, ranging from publicly available to highly restricted. The SROs have access to the information they need to fulfill their missions. That approach to information sharing – allowing regulatory organizations access to the information they need, but restricting access to more sensitive information – may provide a model for further information sharing initiatives.

II. Weighing the costs and benefits of specific proposals

In general terms, it is important to recognize that deciding how best to share regulatory information may involve a tradeoff between ease of use on the one hand, and the speed and cost of implementation on the other hand. In light of that tradeoff, the Commission feels that a decentralized approach to sharing information would be preferable.

Specifically, a few options for increasing information sharing among regulators are under discussion thus far. One option would be to set up a new system that would provide a centralized means to access existing regulator databases. Another option would be for regulators to exchange reciprocal rights of access to existing databases.

Setting up a new system to access existing regulatory databases may have the potential to provide the fastest and most convenient interface for regulatory staffs to use. That option, however, also would be associated with an unknown cost, and would take an unknown period of time to implement. The history of the CRD and the IARD indicate that the costs and time involved may be considerable.

A process of granting reciprocal regulatory access to existing databases possibly could be implemented more quickly and at less cost. That option may lead to a less convenient result, however, in that it would require the staff of regulators to perform a series of individual searches, instead of a single metasearch.

The decisionmaking process should recognize that tradeoff. Because of the unknown costs and timing associated with creating a new system, and the possible ease of the alternative approach, reciprocal rights of access may be a preferable first step, even if only as an interim measure. Ideally, in the long run, we would welcome a system that is designed to facilitate the interface between various regulatory databases, in a way that would maximize appropriate information sharing, while preserving each agency's autonomy and ability to fulfill its regulatory mandate.

An approach that facilitates the exchange of information among databases that are separately maintained by individual agencies, rather than relying on a single centralized system, may also be more consistent with each agency's specific privacy and administrative responsibilities. With a non-centralized approach, because each agency would be able to continue to employ its established system of internal controls, it would be possible to avoid difficult questions about how a centralized system would substitute for existing individualized control systems.

Finally, it is important to recognize that the value of a new system may depend in part on who is responsible for developing the system, and what their regulatory mission is. Because it may be impossible to develop a mechanism in which a central authority could accommodate equally the different missions of various financial regulators, reciprocal rights of access may be the best way to assure that regulators have access to all relevant information that is available.

III. The need for broader statutory authority

Sharing information is, of course, just a means to an end. It is vitally important that regulators have the tools necessary to act against individuals who have violated a trust, and to keep those persons from migrating among the financial services industries. Access to information by itself is not enough. Information will not lead to a meaningful result unless the Commission, and other regulators, can use that information.

The Commission already has mechanisms in place to look at the backgrounds of individuals when they become associated with a brokerage firm or when they move between brokerage firms. Those mechanisms work well in the context of securities industry activities. We believe, however, that now is the time to refine these mechanisms to address the increasing overlap between the financial services industries. In the Commission's case, for example, statutory changes would be needed before we could effectively put to use any improved access to banking or insurance regulatory information.

Under the current statutory framework, even if the Commission has information showing that a person has been disciplined by banking or insurance regulators, the Commission may not have the authority to use that information to keep that person out of the securities business. That is like giving rotten apples one barrel after another to spoil.

Specifically, Section 15(b) of the Securities Exchange Act ("Exchange Act") and 203(e) of the Investment Advisers Act of 1940 authorize the Commission to censure, limit, suspend or revoke the registration of a broker-dealer or investment adviser under certain enumerated conditions. Those conditions include, among other things, court orders barring the person from associating with a bank or an insurance company, actions by the Commodity Futures Trading Commission, convictions for certain crimes and, of course, violations of the federal securities laws.

Those conditions, however, currently do not encompass orders of state insurance regulators or orders of state or federal depositary institution regulators, meaning that the Commission may lack the legal basis to restrict a person's ability to enter the securities industry even if banking or insurance regulators have barred that individual from those industries.

Other portions of the securities laws are similarly limited. For example, self-regulatory organizations ("SROs") such as exchanges, national securities associations and clearing agencies may limit the ability of a person to associate with a member firm, or to work for the SRO itself, if that person has a "statutory disqualification." Someone with a "statutory disqualification" may work for one of those entities only if the SRO approves that association and demonstrates to the Commission that the association is appropriate and that the person will be adequately supervised. Section 3(a)(39) of the Exchange Act sets forth several categories of findings that constitute a "statutory disqualification," including orders of the Commission, and even orders of foreign securities regulators, but that definition does not encompass orders of insurance or banking authorities.

Accordingly, the Commission believes that the federal securities laws should be amended to give the Commission a basis to exercise its authority against rogues seeking to migrate into the securities industry from the insurance or banking industries.

IV. Liability implications and immunity

Inevitably, there will be disagreements about what information should be disseminated. Some persons may claim to have been harmed by the wrongful disclosure of information, no matter how carefully we tailor these processes. The threat of litigation and liability may discourage some entities from sharing regulatory information. Accordingly, it is advisable to clarify the statutory immunity available to self-regulatory organizations that disseminate information.

V. Conclusion

The Commission appreciates the Subcommittees' efforts to advance these important regulatory goals. We look forward to working with other regulators and with the Subcommittee as the efforts continue.

Responses of David M. Becker to
Questions for the Record Submitted by Chair Kelly and Chairman Bachus
Hearing on "Protecting Consumers: What Can Congress Do
To Help Financial Regulators Coordinate Efforts to Fight Fraud"
March 6, 2001
(Responses Dated March 23, 2001)

1. Can you describe what a name-relationship database is and how it helps regulators identify all of the shell affiliates that a fraud artist might utilize?

As the term is used within the Securities and Exchange Commission (the "Commission"), a name-relationship database is a database that allows a user to search on a specific name and to identify enforcement matters (including investigations) in which that name has arisen because of some relationship to the matter under investigation. A search of the name of a suspected fraud artist, for example, would bring up any enforcement matter with respect to which that person's name had been entered into the database as a related party. Having identified an enforcement matter, a user could then identify from the database all other related names entered for that matter, which might include, for example, shell affiliates related to the suspected fraud artist. The user could, of course, then do a further search on the name of any of the affiliates.

2. When the SEC or NASD is investigating an individual, is there some way for your databases to flag this fact so that different departments in your organization are aware of the ongoing investigation and can coordinate their efforts?

The Commission has a name-relationship database accessible throughout the Commission. Authorized personnel in any division can conduct computerized searches to retrieve information about current and past investigations and enforcement actions regarding an individual or entity. There is no computerized means for the Commission and the NASD to access this type of information about each other's investigations.

3. On our second panel, two insurance agent associations testified in support of allowing criminal background checks to be submitted to the FBI through the NAIC and a coordinated Anti-Fraud Network, so long as the Network filters out the convictions unrelated to dishonesty or financial crimes. How does fingerprinting work in the securities industry, and would a similar filtering be useful for your industry?

The Securities Exchange Act of 1934 ("Exchange Act") provides that persons convicted of any felony (and certain misdemeanors) within the preceding ten years are essentially disqualified from participation in the securities industry.[1] Accordingly, a system that filtered out

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[1] See Exchange Act Section 3(a)(39)(F), subjecting such a person to a "'statutory disqualification' with respect to membership or participation in, or association with a member of, a self-regulatory organization."

convictions unrelated to dishonesty or financial crimes would not be useful for the securities industry and, in fact, would be contrary to the goal of the Exchange Act.

To facilitate compliance with the Exchange Act, securities industry criminal background checks seek to detect virtually any felony or misdemeanor conviction in the preceding ten years. The industry seeks this information in two principal ways: first, by requiring individuals to disclose the information when applying for licensing and registration (typically on a standard form known as a "U-4"), and, second, by conducting a fingerprint check in close cooperation with the FBI.

The fingerprint check has an explicit statutory basis. Section 17(f)(2) of the Exchange Act requires that every member of a national securities exchange, broker, dealer, registered transfer agent, and registered clearing agency have each of its partners, directors, officers and employees fingerprinted. Section 17(f)(2) further requires that those fingerprints be submitted to the Attorney General of the United States. To facilitate compliance, self-regulatory organizations ("SROs") have established "fingerprint plans," which are on file with the Commission. In practice, an individual firm obtains the fingerprints of its own personnel, usually upon hiring, and submits the fingerprints to an SRO. The SRO forwards the fingerprints to the FBI.[2]

Under section 17(f)(2), the Commission and the SRO have access to the results of the FBI's fingerprint check, including complete criminal history record information (known as "rap sheet" information, which includes, for example, arrest records).[3] A firm employing, or seeking to employ, the individual also is given access to the results.

While records generated by the fingerprint check are not made available directly to the public, the process may nevertheless indirectly lead to additional information becoming publicly available. Typically, if a fingerprint check turns up information that an individual should have disclosed, but did not disclose, on a Form U-4, the individual is given an opportunity to amend the U-4. Certain (though not all) information disclosed by the individual on the U-4 may be made publicly available through the NASD's Public Disclosure Program.

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2 The NASD, through its regulatory subsidiary NASD Regulation, Inc., processes approximately 330,000 fingerprint cards per year for industry personnel.

3 The FBI also permits the subject of the fingerprint check to have access to the results. See Attorney General Order 556-73 (September 24, 1973), as amended; 28 CFR Part 16, Production or Disclosure of Material or Information, Subpart C – Production of FBI Identification Records in Response to Written Requests by Subjects Thereof.

4. How many securities firms and broker-dealers have cross-affiliations and activities with the insurance, banking, or futures industry, and is this number increasing or decreasing with the passage of Gramm-Leach-Bliley?

Broker-dealer Banking Industry Affiliations

More than 8,000 broker-dealers are registered with the Commission. Information derived from FOCUS reports (which broker-dealers must file with the Commission), shows that as of the end of 1998, 283 broker-dealers controlled, were controlled by, or were under common control with a U.S. bank. As of the end of 1999, that number had increased to 324 broker-dealers.

While FOCUS report data for year-end 2000 are not yet available, similar – though not identical – information is available from broker-dealer registration materials on file with the Commission. According to those sources, as of March 20, 2001, 414 broker-dealers are directly or indirectly controlled by a bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union or foreign bank,[4] and 184 broker-dealers are involved in networking arrangements or similar arrangements with banks, savings banks or credit unions. Those numbers include sixty-four broker-dealers that are in both a control relationship and a networking arrangement.

The above numbers indicate some increase in cross-affiliations since the passage of Gramm-Leach-Bliley. The vast majority of broker-dealers, however, remain unaffiliated with banking entities.

Broker-dealer Insurance Industry Affiliations

According to FOCUS reports, as of the end of 1998, 327 broker-dealers were insurance companies or were affiliated with insurance companies. As of the end of 1999, that number had increased to 346 broker-dealers.

Again, while FOCUS report data for year-end 2000 are not yet available, certain insurance cross-affiliation information is available from registration materials on file with the Commission. Those materials indicate that, as of March 20, 2001, 87 broker-dealers are involved in networking arrangements or similar arrangements with insurance companies or agencies, and 2,240 broker-dealers sell variable life insurance or annuities.

Broker-dealer Futures Industry Affiliations

According to Commodity Futures Trading Commission data, as of the end of September 1998, there were 210 registered futures commission merchants ("FCMs"), of which 106 were also registered broker-dealers. As of the end of September 1999, there were 203 registered FCMs, of which 101 were registered broker-dealers. As of year-end 2000, there were 190 registered FCMs, of which 94 were registered broker-dealers. In addition, some FCMs that are not registered broker-dealers are affiliated with registered broker-dealers.

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[4] The categories of entities listed here do not correspond precisely to the entities encompassed by the term "U.S. bank" in the preceding paragraph. For FOCUS reporting, "U.S. bank" includes any "bank" as that term is defined in Section 3(a)(6) of the Exchange Act.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Oversight and Investigations and the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services House of Representatives

FINANCIAL SERVICES REGULATORS

Better Information Sharing Could Reduce Fraud

Statement of Richard J. Hillman
Director, Financial Markets and
Community Investment

Summary

Financial Services Regulators: Better Information Sharing Could Reduce Fraud

GAO has long held the view that financial regulators can benefit from greater information sharing. We have previously reported on the potential for rogues, as highlighted by Martin Frankel's alleged activities, to migrate between different financial services industries. In addition, a more integrated financial services industry as envisioned by the passage of the Gramm-Leach-Bliley Act highlights the need for strong information-sharing capabilities among financial services regulators.

This statement focuses on: (1) systems used by financial regulators for tracking regulatory history data, (2) regulatory history data needed to help prevent rogue migration and limit fraud, (3) criminal history data needs among financial regulators, and (4) challenges and considerations for implementing an information-sharing system among financial regulators.

Systems used by financial regulators for tracking regulatory history data are operated and maintained separately in the insurance, securities, futures, and banking industries. Each industry operates systems and databases that provide background information on individuals and entities, consumer complaints, and disciplinary records within that industry. Within the insurance, securities, and futures industries, this information is largely centralized. In contrast, such systems and databases are decentralized among regulators within the banking industry.

Regulatory history data needed to help prevent rogue migration and limit fraud include information on completed disciplinary or enforcement actions, ongoing investigations, consumer complaints, and reports of suspicious activity. Most regulators are in agreement about sharing regulatory information related to an individual's registration or licensing status and closed, or completed, adjudicated regulatory actions. Concerns remain over the sharing of other nonadjudicated regulatory information.

Criminal history data needs of regulators are focused on access to nationwide criminal history data. Currently, insurance regulators are not on equal par with their counterparts in the banking, securities, and futures industries, since many cannot obtain such data.

Challenges and considerations for implementing an information-sharing system among financial regulators are focused more on legal rather than technical issues. We found substantial agreement among the regulators about the benefits of sharing regulatory and criminal data in a more automated fashion. To accomplish this, it is clear that Congress will need to address confidentiality, liability, privacy, and other concerns.

With the Subcommittees' support, we believe that fraud prevention efforts among financial services regulators can be enhanced.

Statement

Financial Services Regulators: Better Information Sharing Could Reduce Fraud

Subcommittee Chairs and Members of the Subcommittees:

We are pleased to be here today to discuss our observations on the sharing of regulatory and criminal history data among financial services regulators. GAO has long held the view that financial regulators can benefit from greater information sharing. Let me point to a couple of examples. In 1994, we recognized the potential for unscrupulous, or rogue, brokers to migrate freely from securities to other financial services industries and related industries, and we recommended expanded information sharing among financial regulators.[1] More recently, we reported on an insurance investment scam allegedly perpetrated by Martin Frankel, who had been barred for life from the securities industry. Mr. Frankel moved to the insurance industry, where he allegedly stole about $200 million over an 8-year period.[2] Our report noted that many of those losses could have been avoided had more information been shared among regulators. Moreover, with the passage of the Gramm-Leach-Bliley (GLB) Act, the opportunity for banking, insurance, and securities products to be sold under the same corporate umbrella highlights the need for strong information-sharing capabilities among the financial services regulators.

In my statement today, I will first provide an overview of the systems currently used by insurance, securities, futures, and banking regulators for tracking disciplinary and other regulatory information. Second, I will discuss the data needs of regulators that would allow them to better prevent the migration of rogues from one industry to another and limit

[1] Securities Markers: Actions Needed to Better Protect Investors Against Unscrupulous Brokers (GAO/GGD-94-208, Sept. 14, 1994).

[2] Insurance Regulation: Scandal Highlights Need for Strengthened Regulatory Oversight (GAO/GGD-00-198, Sept. 19, 2000).

fraud. Next, I will discuss regulators' needs for criminal history information and barriers faced by some financial regulators. Finally, I will discuss some of the regulators' concerns about problems that could arise from sharing regulatory information through a more automated system.

In addition to reviewing our past work on these issues, we have had discussions with and reviewed available documentation from representatives of the National Association of Insurance Commissioners (NAIC), the Securities and Exchange Commission (SEC), the National Association of Securities Dealers Regulation, Inc. (NASDR), the North American Securities Administrators Association (NASAA), the Commodity Futures Trading Commission (CFTC), the National Futures Association (NFA), the Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), the Conference of State Bank Supervisors (CSBS), the Federal Financial Institutions Examination Council (FFIEC), the Federal Bureau of Investigation (FBI), and the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). Each regulator maintains systems for tracking information being discussed here today.

In our discussions we found substantial agreement among the regulators about the potential benefits of improved information sharing, particularly related to licensing or registration data and adjudicated regulatory actions. Most also concurred that it would be useful to share regulatory and criminal history information in a more automated fashion. However, each also raised concerns about various issues including confidentiality, liability, privacy, and the potential negative effects of premature disclosure of unadjudicated actions. As a result, developing and implementing a useful information sharing approach will require the Congress to address

many challenges, including concerns and potential inertia from some regulators about certain types of information sharing.

Overview of Financial Regulatory Information Systems

We found that most financial services regulators kept background and disciplinary-related data on individuals and entities in their particular financial industry.[3] Within the insurance, securities, and futures industries, when regulators have authority to license or register individuals to sell financial products, this information is largely centralized. Each of these industries operates systems and databases that provide background information on individuals and entities, consumer complaints, and disciplinary records within that industry. In the banking industry, where regulators do not license or register individuals, we found that regulators also entered and maintained background, regulatory history, lending practice, and complaint data on entities and some individuals. Within in the banking industry, such systems and databases are decentralized among the separate regulators. Therefore, unlike the "one-stop shopping" search capabilities available in other financial industries, a search on an individual's regulatory history in the banking industry could necessitate separate inquiries of the five regulators' systems.[4]

Insurance

In the insurance industry, NAIC serves as the data administrator for the regulatory information systems and databases that serve each of the state insurance departments. According to NAIC, regulatory information on

[3] Regulatory background information, among other things, would include the licensing or registration status and employment history of an individual.

[4] Federal banking regulators include the FRB, OCC, OTS, FDIC, and the National Credit Union Administration.

over 5,200 insurance companies and nearly 3 million agents throughout the country is available to all state insurance regulators. Some of the key databases administered by NAIC include

- the Producer Database (PDB), a central repository of producer licensing information on agents and brokers that is updated daily with information provided by state insurance departments;
- the Regulatory Information Retrieval System (RIRS), a database of official regulatory actions taken against insurance agents and companies;
- the Directors and Officers (D&O) Database, a collection of company officer data derived from insurers' annual statements that, among other things, allows regulators to track the movement of these individuals from one entity to another (initiated in 1999);
- the Complaints Database System (CDS), a database of closed customer complaints made against individuals or firms; and
- the Special Activities Database (SAD), a database intended to facilitate the exchange of often unsubstantiated information that could be of regulatory interest to insurance regulators, including, in some cases, ongoing investigations.

To simplify queries for information, NAIC has also developed an Internet search application for insurance regulators called I-SITE that can query all of the above databases at the same time and return a combined response. Information from PDB and RIRS are accessible by state insurance regulators and commercial customers; the D&O, CDS, and SAD databases are only accessible to state insurance regulators. Although these databases are maintained by NAIC, much of the information must be supplied by regulators in the individual states, and the extent of such participation varies across the states.

Securities

Within the securities industry, NASDR administers the Central Registration Depository (CRD) system, the primary information system used by securities regulators to search for background information on individuals and firms. CRD can be used to obtain background information on an individual's registration status and employment history.[5] CRD also contains "disclosure" data that includes an individual's criminal history, disciplinary actions taken on the individual by a federal or state securities regulatory authority, and disciplinary actions taken by a self-regulatory organization (SRO). Disclosure items on CRD also include civil judicial actions and open and closed customer complaints tied to the activities of individuals or firms.[6] According to NASDR, approximately 10 percent of CRD records contain disclosure information.

The CRD system is accessible by federal and state securities regulators and SROs as well as by securities firms and broker-dealers; however, the amount of information disclosed varies. NASDR has allowed some other regulatory and law enforcement agencies access to CRD as well. Additionally, NASDR, through its statutory public disclosure program, releases certain disciplinary and other background information to the public on request. To facilitate public access to CRD, NASDR developed Web CRD, offering limited access to CRD through the Internet, although responses are not viewable on NASDR's Internet Web site and must be mailed or e-mailed to the requestor. SEC officials noted that much of the information on CRD is self-reported by broker-dealer firms and unverified.

[5] In addition to registered individuals, CRD also contains records of unlicensed individuals who have been involved in the securities industry.

[6] CRD contains consumer complaints involving sales practice violations that have been settled for more than $10,000 or sales practice or fraudulent practices that contain a claim of $5,000 or more in damages within the past 24 months. Complaints older than 24 months are archived and are subject to more limited disclosure.

Futures

Regulators of futures markets have also developed systems and databases to collect background data on individuals and firms associated with the futures markets. NFA maintains background information on individuals and firms in the futures markets on the Background Affiliation Status Information Center (BASIC) system. The BASIC system includes disciplinary actions taken against firms and individuals by CFTC, NFA, or an SRO. It also includes pending disciplinary actions by CFTC and NFA, but only final actions by SROs. Closed customer complaints can also be found on BASIC. According to NFA officials, nearly 6 percent of individuals in the BASIC system have records of regulatory actions associated with them.

Although the BASIC system is accessible to the public, a number of other databases maintained by NFA are not. The Membership Registration Receiver System (MRRS) is an automated registration processing system that collects registration data on firms, principals, associated persons, and floor brokers. The Financial Analysis Compliance Tracking System (FACTS) is NFA's internal record of all financial and compliance data on registered member firms and individuals. This system also includes information on open investigations, audits, criminal record checks, and consumer complaints. The Fitness Image System is another database that includes scanned-in documents associated with registered firms and individuals.

Banking

Within the banking industry, different bank regulators operate and maintain their own separate systems. Several banking regulatory officials pointed out to us that in contrast to the practice in other financial services industries, individuals who work in the banking industry and deal with the public are not registered or licensed. Consequently, since information

systems and databases used in the banking industry do not have to support such functions, they are not, in some respects, comparable to the systems used by other financial regulators. Although each bank regulator maintains its own databases of completed enforcement actions taken against individuals or institutions, regulators told us that, in general, communication among the banking agencies is good.

Additionally, working together with law enforcement agencies, bank regulatory agencies developed a single form, the Suspicious Activity Report (SAR), for the reporting of known or suspected criminal law violations and transactions that an institution suspects involve money laundering or violate the Bank Secrecy Act. Financial institutions enter these SARs into Treasury's FinCEN system. FinCEN provides support to over 150 federal, state and local law enforcement agencies, as well as to bank regulators and many international financial crimes investigators. FinCEN is a key element in efforts to prosecute money laundering and to "follow the money" to identify and apprehend criminals in this country and around the world.

Most enforcement actions taken by bank regulators have been public since 1989. Banking regulators are generally required to publish these actions and, additionally, have made such information available through their web sites. Recently, in cooperation with the FFIEC, bank regulators have created a set of links between their individual Web sites to facilitate Internet access to disciplinary or enforcement actions taken against individuals and institutions. Although the level of disclosure varies somewhat with each regulator, all disclose information on closed enforcement actions, such as removal and prohibition actions taken against officers and directors of an institution. Other actions posted by regulators include cease and desist orders and civil monetary penalties.

However, it is not always possible to determine from the posted data what specific behaviors or activities resulted in an enforcement action.

Banking officials also told us that each regulator maintains information on open investigations and consumer complaints. Upon request, banking regulators may share information on open investigations with other regulators. They may also contact other regulators including SEC or NAIC to coordinate actions, if appropriate. Most banking regulators are working through NAIC to establish agreements with state insurance regulators. Banking regulators stressed that consumer complaints that they receive usually do not involve bank officials, officers, or illegal acts. Complaints typically involve such areas as fee and service charges, error resolution procedures, interest payment calculations, or issues associated with bank closings or mergers. Regulators monitor trends in consumer complaints and follow up on them during bank examinations.

Improved Regulatory Data Sharing Could Help Prevent the Migration of Rogues and Limit Fraud

In discussions with financial regulators and Committee staff, four types of data, aside from those related to licensing and employment history, used by regulators could be useful in detecting fraud and limiting its spread from one financial industry to another. These data types are 1) completed disciplinary or enforcement actions, 2) ongoing regulatory investigations, 3) consumer complaints, and 4) reports of suspicious or unverified activity that merit regulatory attention, but may not yet rise to the level of a formal investigation. Some of these data types are not sufficient by themselves to support a regulatory action such a disqualification for registration or a license. However, if regulators had the information available, it could prompt them to ask more probing questions or conduct further checks to ensure the fitness of industry applicants. In the Frankel case, although Frankel himself allegedly used aliases and fronts to perpetrate the fraud, one of the individuals who appeared to have provided funds to purchase

the first insurance company, subsequently looted of its assets, had a disclosure item involving complaints and settlements in the securities industry. If regulators had interviewed that individual to discuss past regulatory incidents and probed further, they may have found out that the individual had not actually provided the funds to acquire the insurance company and the scam may have been stopped before the assets were stolen.

Nearly all financial regulators maintain records and databases that include each of the above types of information–some as public information and some for use by only regulators or law enforcement agencies. There is broad agreement that all of this regulatory information has legitimate and beneficial uses. There is much less agreement on how much or, indeed, whether to share some of the information because of concerns about confidentiality, liability, and the potential for inappropriate use of some of the information.

In most cases, completed disciplinary or enforcement actions are public information. Despite their public nature, they may not be easily or conveniently available to all regulators for every person requiring a background check for employment in a financial institution. A network or system for routinely sharing this information would facilitate such checks. Other types of regulatory information would also be useful to other regulators for background checks and for identifying and investigating fraud and other financial crimes. However, regulators' willingness to share this more sensitive information will depend on resolving existing concerns.

Nevertheless, even a system for routinely sharing completed enforcement actions would increase regulatory efficiency and effectiveness in

conducting background investigations that could limit the migration of undesirable people, or rogues, from one financial services industry to another. To improve this process, financial regulators need the ability to readily identify individuals that have had a problematic history within the financial services sector and review the specific circumstances on a case-by-case basis. Currently, financial regulators largely depend on the self-reported information disclosed by applicants during chartering or licensing approval activities to gather information about an individual's participation and background in other financial industry.

Financial regulators should seek to validate the self-reported information on an individual's work history and confirm their reported disciplinary history. If a regulator knows an applicant has worked in another financial industry, it may currently communicate with another regulator depending on the existence of a bilateral information sharing arrangement. However, if individuals with an employment history and involvement in another financial industry do not disclose their backgrounds, it may be difficult for regulators to detect. Without an effective way of routinely checking the regulatory records of multiple industries and agencies throughout the financial services sector, some rogues are undoubtedly able to avoid being detected by regulators.

Our discussions with financial regulators revealed that disciplinary history data would be most useful when evaluating applicants seeking to enter a particular financial services industry or when conducting an investigation. Regulators routinely evaluate new industry applicants when chartering a new institution. During chartering approval activities, the regulatory body assesses the backgrounds of the directors, officers, and owners of the proposed financial institution. Similarly, new industry applicants in insurance, securities, and futures are evaluated as regulators license or

register those that wish to sell financial services products (e.g., agents, brokers, etc.). Financial regulators also mentioned that regulatory history data from other financial industries could be useful during investigative or enforcement activities. An ability to identify associations and linkages among both individuals and institutions would facilitate these investigative functions.

Although regulators generally share information with other regulators when asked, they may not routinely share regulatory data with each other because no convenient method for such sharing exists. Information systems and databases that could be used to conduct regulatory history checks are generally accessible to regulators within a particular financial services industry, such as within the banking or insurance industries, but may not be available or easily accessible across different financial industries. Some regulators, recognizing a need to share regulatory data with other financial regulators, have established bilateral information sharing arrangements to access external regulatory information. Using such arrangements, some regulators already access some systems and databases operated by other financial regulators. For instance, NASDR has provided some banking and futures regulators the ability to access CRD. However, even when such information-sharing agreements exist, obtaining regulatory history data from multiple financial regulators currently requires separate inquiries to each financial regulator from which such information is desired.

Regulators Need Access to Nationwide Criminal History Data

For most financial services regulators, performing routine criminal history background checks is another requirement in carrying out licensing or chartering responsibilities. Currently, financial services regulators do not all have the same ability to access criminal history information on individuals. As noted in our recent report on regulatory weaknesses

associated with a fraud perpetrated in the insurance industry, we found that many state insurance regulators do not have the means to routinely conduct nationwide criminal background checks on applicants who enter the industry. In contrast, the securities, futures, and banking regulators we contacted are authorized to routinely request criminal history checks on industry applicants through the FBI and other law enforcement agencies. As we noted in our earlier work, we believe insurance regulators need to have this capability to help prevent criminals from entering the industry. Representatives from NAIC and the FBI have been working on solutions to facilitate insurance regulators' ability to conduct routine criminal background checks through the FBI utilizing their recently developed automated fingerprint identification system.

FBI and regulatory officials agreed that facilitating information sharing between law enforcement and regulatory agencies was of mutual benefit. FBI officials noted that recent financial modernization efforts will make it increasingly important to assess regulatory information from all financial industries. Likewise, financial regulators may benefit from other law enforcement information beyond that typically supplied through criminal history background checks. Questions remain on the appropriate timing and extent to which information about an ongoing criminal investigation could be shared between law enforcement and regulatory agencies in a more automated fashion.

Challenges and Observations for Implementing a Shared Regulatory Data Network

Generally speaking, the concerns that financial regulators expressed to us about sharing more regulatory information with one another were not technological in nature; rather, they involved issues about the need to protect sensitive regulatory data that may be disseminated to a wider audience. These concerns include questions about what specific

regulatory information may be appropriate to share, the types of entities that would have access to such data, and liability issues surrounding the release of unsubstantiated information. Some of the financial regulators with whom we spoke, including SEC and NAIC, were already considering or recommending legislative remedies to facilitate enhanced information sharing with other regulators or the FBI. Because the views we obtained from regulatory agency officials were preliminary in nature and not official agency positions, we must defer to the financial regulators to convey their specific proposals or positions. Undoubtedly, legislative actions will be needed to address issues related to the sharing of sensitive information. Ultimately, the optimal implementation approach will depend on the extent to which protections are in place to make financial regulators feel comfortable in sharing sensitive regulatory information with one another.

As mentioned earlier, financial regulators possess regulatory data of varying levels of sensitivity. The financial regulators we contacted did not express concern about sharing basic regulatory history data on closed disciplinary or enforcement actions. The majority of such information is already publicly available, although not necessarily easily accessible. Such information could convey whether an individual was registered in a particular financial industry and any closed regulatory actions tied to the individual's activities in that industry. The threshold of concern rises as the sensitivity of the regulatory data rises, particularly when unsubstantiated regulatory and ongoing investigation data is involved. For example, several financial regulators pointed out that the untimely release of information on an open investigation could jeopardize that investigation and existing sources of information.

Another concern was the release of regulatory data to entities or individuals without regulatory authority. Financial regulators in both the

banking and securities industry believed that NAIC's status as a nonregulatory entity was a barrier to releasing regulatory data to it, even though NAIC operates on behalf of state insurance regulators. Also, some financial regulators expressed concern over the varying degrees to which individual states are obligated to protect regulatory information and the different degrees of protection that could result as such information is released among regulators.

Regulators also expressed concern with regard to the potential liability associated with disclosing some of the information maintained in their databases. Financial regulators noted that some of their regulatory data are self-reported or otherwise unsubstantiated. Release of unsubstantiated information, particularly with regard to customer complaints and open investigations, raises liability concerns for some regulators. Those regulators noted that the appropriate sharing and use of this sensitive data must be considered because of its highly prejudicial nature and the potential detriment to the party in question.

Some regulators also questioned whether the proposed system would violate the Privacy Act's prohibition against the nonconsensual disclosure of personal information contained in records maintained by federal agencies. While there are numerous exemptions to this prohibition, including the "routine use" exemption,[7] those regulators cautioned that the Privacy Act, and its goal of safeguarding individual privacy, should be a consideration.

[7] The routine use exemption permits nonconsensual disclosure of personal information when the internal use of the information that is disclosed is compatible with the purpose for which it was originally collected.

Concerning the method for facilitating the sharing of information across financial industries, the regulators we contacted generally agreed that some limited information-sharing capabilities would be useful. Most generally supported an approach whereby regulators would share some basic regulatory information on individuals, such as whether or not they were registered in another financial industry and had a disciplinary related record. However, all of the financial regulators emphasized that maintaining a centralized database containing all of the regulatory data of each financial industry would be costly and difficult to maintain. They pointed out that the vast majority of applicants were not likely to have come with a blemished regulatory history from another financial services industry. Nevertheless, most financial regulators appeared to support the concept of an information-sharing approach that would flag problems disclosed by regulators in connection with an individual's activities in other financial services industries.

A needs assessment would need to be conducted to determine the data elements most useful to each of the financial regulators and the extent to which each regulatory authority is obligated to safeguard the data it collects from its industry. In doing so, a key issue will be balancing one regulator's "need to know" with another's need to safeguard or restrict confidential or sensitive regulatory information. As an information-sharing approach is implemented and the sharing of regulatory data becomes more routine, we believe that regulators will be better positioned to predict, recognize, and reduce the movement of rogues from one industry to another. Moreover, better and more consistent information sharing may facilitate joint efforts to investigate and prosecute fraudulent behavior in the financial services industries.

In conclusion, we have long advocated better information sharing among financial regulators and commend the Subcommittees for moving forward with its efforts to better protect consumers by improving regulators' ability to detect fraud. However, difficult issues must be addressed in order to make this a reality, and regulators will have to overcome some level of inertia and resistance to change. The Subcommittees' continued endorsement and encouragement for improvement in the inter-industry sharing of regulatory and criminal information will provide an important impetus to succeed.

Subcommittee Chairs, this concludes my prepared statement. I would be pleased to respond to any questions you or other Members of the Subcommittees may have.

Contacts and Acknowledgements

For further contacts regarding this testimony, please contact Richard J. Hillman, Director, Financial Markets and Community Investment, (202) 512-8678. Individuals making key contributions to this testimony included Lawrence D. Cluff, Barry A. Kirby, Tamara Cross, Dave Tarosky, James Black, Roger Kolar, Angela Pun, Rosemary Healy, and Shirley Jones.

(250020)

Responses to Questions for the Record
Hearing on "Protecting Consumers: What can Congress Do to Help Financial Regulators Coordinate Efforts to Fight Fraud"
Richard J. Hillman

1. How difficult is it for the financial services regulators to effectively implement information-sharing agreements without congressional legislation for confidentiality, liability, and coordination?

   Confidentiality and liability concerns have been frequently raised by financial services regulators as barriers in sharing regulatory information more broadly and explicit legislation by Congress that addresses these issues and establishes a mechanism for the routine sharing of regulatory information would greatly improve the chances of more effective coordination. In particular, some financial services regulators have expressed concern over the varying degrees to which individual states are obligated to protect regulatory information and the different degrees of protection that could result if such information is released more broadly among regulators.

   Regulators have also expressed concern with regard to the potential liability associated with disclosing some of the information maintained in their databases. Some of their regulatory data is self-reported or otherwise unsubstantiated. Release of unsubstantiated information, particularly with regard to customer complaints and open investigations, raised liability concerns for some. Another concern is the release of regulatory data to entities or individuals without regulatory authority. Financial regulators in both the banking and securities industry believed that NAIC's status as a nonregulatory entity was a barrier to releasing regulatory data to it, even though NAIC operates on behalf of state insurance regulators.

   Developing legislation to deal with these issues would improve the inter-industry sharing of regulatory information and help the financial services regulators overcome some level of inertia about certain types of information sharing.

2. Are the technical requirements of an Anti-Fraud Network exceptionally difficult, or are they fairly similar to the sorts of data networks being established by companies in the private sector all across the nation?

   The technical requirements of an Anti-Fraud Network are not exceptionally difficult. In discussions with financial services regulators, the complicating factors most often mentioned in establishing an Anti-Fraud Network as envisioned by the Subcommittees were associated with data content, not with the technical difficulty of setting up the network.

3. In light of the approximately two hundred financial services regulators at both the Federal and State level, would it not be more efficient to have each regulator coordinate through one central Anti-Fraud Network rather than negotiate separate information-sharing agreements?

   It would be more efficient to have each regulator coordinate through one central Anti-Fraud Network rather than negotiate separate information-sharing agreements. Those regulators who have or are in the process of developing information sharing agreements with some of their counterparts in other financial industries have told us that negotiating these bilateral agreements has been time consuming and has required considerable effort. As discussed in response to question 1, concerns about varying protections over the confidentiality of shared information among the various participants at the Federal and state levels also continues to complicate these negotiations. Even in cases where agreements exist, potential liability issues sometimes restrict communication on sensitive matters.

4. If sufficient protections for information sharing and the ability of agencies to exclude certain extra-sensitive cases were in place, what types of information, other than final disciplinary and formal enforcement actions, would be useful to include in an Anti-Fraud Network?

   Other data that could be useful to regulators in identifying and investigating financial fraud could include information currently available to securities regulators on the Central Registration Depository database (CRD). This includes work history, certain customer complaints, aliases, and in some cases, criminal histories. In addition, information about ongoing investigations could assist other regulators to identify patterns of fraud and to coordinate investigations in different financial industries or geographic areas.

5. Your written testimony states that, "Currently, financial regulators largely depend on the self-reported information disclosed by applicants during chartering or licensing approvals...." Is this self-reporting a sound system for detecting and preventing fraud?

   Without an effective way of routinely checking the regulatory records of multiple industries and agencies, some rogues are undoubtedly able to avoid being detected by regulators. Self-reporting works best when the data is verifiable or publicly disclosed and the existence of a network for routinely sharing regulatory information would provide a powerful incentive for truthful self-reporting.

6. In your written testimony you stated that you found "substantial agreement" among the regulators about the benefits of sharing regulatory and criminal data in a more automated fashion. Could you please expound upon this statement?

Some regulators felt that the systems currently in use worked fairly well. However, almost without exception, regulators with whom we spoke agreed that sharing some types of regulatory information on an inter-industry basis through an automated system or network would save time and could increase their ability to identify persons with unfavorable backgrounds in some other financial sector. For example, while in most cases information on completed disciplinary or enforcement actions is already publicly available, the information may not be easily or conveniently accessible to all regulators. In addition, some regulators believed that it would be useful to share criminal history information in a more automated fashion. Therefore, the development of a network or system to routinely share regulatory and criminal information could increase regulatory efficiency and effectiveness and limit the migration of undesirable people, or rogues, from one financial service industry to another.

TESTIMONY OF KAREN K. WUERTZ
SENIOR VICE PRESIDENT
NATIONAL FUTURES ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
AND THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT

OF THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

MARCH 6, 2001

NATIONAL FUTURES ASSOCIATION

TESTIMONY OF KAREN K. WUERTZ
SENIOR VICE PRESIDENT
NATIONAL FUTURES ASSOCIATION

BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS AND THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT OF THE U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

MARCH 6, 2001

My name is Karen Wuertz, and I am Senior Vice President for Long Range Planning and Development of National Futures Association. NFA appreciates the opportunity to appear here today to present our views on increasing data sharing between financial service industry regulators. NFA fully supports the concept of using technology to facilitate the exchange of information maintained by financial services industry regulatory bodies about the firms and individuals they regulate and discipline. NFA has a long history of cooperating with other regulators and welcomes the opportunity to work with this Committee to develop an efficient and cost effective method of systematically sharing information.

I would like to take just a minute to describe NFA and its regulatory mission. Since 1982, NFA has been the nation-wide self-regulatory organization for the US futures industry and the only registered futures association under the Commodity Exchange Act. NFA's primary mission is to protect the public from unscrupulous, fraudulent and unethical business practices through efficient and effective regulation of its Members. NFA's current membership includes approximately 4,000 firms and 50,000 individuals. NFA's regulatory process begins with screening firms and individuals when they seek registration to conduct futures-related business and continues with regular examinations of them throughout their business lives. NFA also monitors its Members' sales practices. When appropriate, NFA initiates formal disciplinary actions, and these actions can prohibit firms or individuals from conducting futures business ever again. As a result of its activities and because it is the sole nation-wide SRO in the futures industry, NFA maintains a large, centralized and the most comprehensive database containing disciplinary, registration, background and financial information about the firms and individuals operating in the futures industry.

We are all well aware of the damage that "rogue brokers" can do when they use their unscrupulous practices to take advantage of unsuspecting investors. Since its inception, NFA has tracked their migration within the futures industry. As technology has developed over the years, NFA has embraced those changes to create increasingly sophisticated and computerized methods of tracking them. Because of specialized rules that NFA has adopted, since 1988 the number of "rogue brokers" in the futures industry has decreased by 75% and since 1983, customer complaints have deceased by 72%.

Historically, NFA provided futures industry disciplinary information about firms and individuals to regulators and the public at large through a toll-free telephone system. While NFA still offers that service, in 1999, NFA became the first financial services industry SRO to make disciplinary information available to the public on the web when it introduced its BASIC system. BASIC contains not only disciplinary information but also registration status and history information about all firms and individuals ever registered in the futures industry. It is hard to overstate the value of this system and its easy availability. Last month alone, there were over 35,000 BASIC searches conducted, and this number increases monthly. We expect that well over 400,000 BASIC searches will take place this year.

NFA also maintains a variety of information about firms and individuals in its databases that we do not make public but that we routinely share with regulators on request. This includes information on customer complaints that have not resulted in formal disciplinary actions, referrals from other regulators, open investigations, matters arbitrated at NFA and regulatory and criminal information that individuals and firms have disclosed on their application forms. The value of this information to other regulators would be significantly increased if an efficient and cost-effective means for them to access it were developed.

NFA concurs with the Committee's concern that disreputable individuals could easily move from one financial services industry to another. It is possible that this problem will be exacerbated as the various sectors of the financial services industries meld together. The distinctions between the financial services industries are quickly diminishing. For example, in the near future, NFA will expand its regulatory responsibilities by becoming a limited purpose securities association and oversee its Members' activities regarding the sale of securities futures products.

NFA also agrees that being able to easily access information about "rogue brokers" from other financial service industry regulators will allow us to more effectively prevent them from coming into the futures industry. We already do this with the securities industry. When individuals seek registration in the futures industry, we routinely review any information about them in the CRD database, to which we have access under an agreement with the NASDR. Consequently, we are able to identify and screen out disciplined securities brokers who seek to ply

their trade in the futures industry. Frankly, there has not been much migration of brokers from the insurance industry to the futures industry. NFA has not encountered a situation in which we have disciplined a broker for sales fraud only to discover that the broker had a checkered past in the insurance industry that NFA had been unaware of. However, this could become an issue as the financial services industry unifies and NFA would certainly find it helpful to have access to an insurance industry database of background information.

In closing, let me state that NFA is committed to exploring every avenue that will assist in maintaining the integrity of the financial services industry. NFA has a background in developing its own tracking systems and information databases, NFA already has significant amounts of futures industry data in its databases and NFA is the front-line regulator in the futures industry. As a result, NFA believes that it would be an extremely helpful participant in developing an anti-fraud network. NFA stands willing to help in that effort in any way Congress deems appropriate.

NATIONAL FUTURES ASSOCIATION
200 W. MADISON ST. • CHICAGO, IL • 60606-3447 • (312) 781-1300

March 23, 2001

Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515
ATTN: Janice Zanardi

Re: March 6, 2001 Hearing on "Protecting Consumers: What Can Congress Do to Help Financial Regulators Coordinate Efforts to Fight Fraud?"

Dear Ms. Zanardi:

NFA appreciates the opportunity to respond to the Questions for the Record for Karen Wuertz submitted by Chair Kelly and Chairman Bachus regarding the above-referenced hearing. Our answers follow.

1. It is important to note that NFA's tracking system does not operate in a vacuum. It is effective because NFA has adopted a rule that targets brokers who move from firms that are shut down for sales fraud. NFA adopted this rule because it was our experience that the firms that NFA closed for fraudulent sales activity had employed brokers from other firms that NFA had previously shut down for the same reason. To address this situation, NFA's rule requires that a firm must tape-record all of it's brokers' telephone conversations if it employs a specified minimum percentage of brokers who come from previously closed-down firms. NFA uses its information systems to constantly monitor the movement of these brokers and to identify the firms that are subject to the tape-recording requirement.

   This approach has been very valuable to NFA and we believe that it could be valuable in other financial services industries if the industry regulators can establish a connection between brokers' employment histories and fraudulent activities committed by firms they migrate to. In the securities industry, NASDR has adopted a similar rule to apply to the broker-dealer and registered representative community. The efficacy of this approach would have to be judged by each industry based upon its unique circumstances.

2. There are approximately 46,000 registered account executives in the futures industry, most of whom are employed by firms that are also registered as broker dealers or are affiliated with broker dealers. With the passage of Gramm-Leach-

NFA

Ms. Zanardi

March 23, 2001

Bliley, NFA expects that cross-fertilization of our Members with other segments of the financial services industry may well increase.

3. As indicated, NFA routinely shares non-public information, including customer complaints and open investigations, with regulators on request. Provided that technical issues could be resolved, NFA would have no objection to including this type of information in the Anti-Fraud Network.

If we can be of any further assistance or provide any additional information, please do not hesitate to contact me.

Sincerely,

Karen K. Wuertz/pkj

Karen K. Wuertz
Senior Vice President
Strategic Planning and Development

THE COUNCIL
of Insurance Agents + Brokers

Statement of

Thomas J. Rodell

Managing Director

Aon Risk Consultants, Inc.

Testifying On

Protecting Consumers: What can Congress do to help financial regulators coordinate efforts to fight fraud?

Before the

Subcommittee on Oversight and Investigations
and
Subcommittee on Financial Institutions and Consumer Credit

March 6, 2001
Washington, D.C.

Statement of Thomas J. Rodell, CPCU, Chairman, Council of Insurance Agents & Brokers
Before the joint hearing of the Financial Institutions and Consumer Credit and
Oversight and Investigations Subcommittees of the House Financial Services Committee
March 6, 2001

This statement is submitted on behalf of the members of The Council of Insurance Agents + Brokers ("The Council"). The Council is a national trade association founded in 1913 as the National Association of Casualty and Surety Agents. For 88 years, The Council of Insurance Agents + Brokers has provided industry leadership while representing the largest, most productive and most profitable commercial insurance agencies and brokerage firms in the U.S., and around the globe.

The Council's member firms operate in over 3,000 locations and place nearly 80% - well over $100 billion - of the U.S. commercial property/casualty premiums. In addition, The Council's members specialize in a wide range of insurance products and risk management services for business, industry, government and the public. The Council's members operate nationally and internationally and administer billions of dollars in employee benefits.

I am Thomas J. Rodell, Managing Director of Aon Risk Consultants, Inc., of Chicago, IL. I serve as Chairman of The Council, as well as a member of the association's Board of Directors. Aon Corporation is a holding company comprised of a family of insurance brokerage, consulting and insurance underwriting subsidiaries. With locations throughout the United States and in several countries, Aon is one of the largest brokerage firms in the world. Our firm provides risk management services, commercial property/casualty insurance products and employee benefit programs — utilizing both traditional insurance channels and alternative risk-financing options such as captives and self-insurance pools.

Madame Chair, on behalf of my firm and the members of our association, I want to express our sincere gratitude to you for the essential role you played in the enactment of the National Association of Registered Agents and Brokers (NARAB) provisions of the Gramm-Leach-Bliley Act of 1999. Our association began working with the National Association of Insurance Commissioners on the producer licensing uniformity issue in 1939. After decades of effort to improve the producer licensing burden, the enactment of NARAB is the assurance that, at long last, these reforms will occur. Tens of thousands of agents and brokers around the country will benefit from this legislation, and they have the members of this committee – and especially you – to thank.

NARAB's enactment was an essential reform. The purpose of the Gramm-Leach-Bliley Act was to modernize the nation's laws to make our domestic industries more efficient, better able to compete globally and to better serve the needs of consumers. With marketplace convergence occurring throughout the insurance distribution system, it is unacceptable for state licensing laws to serve as barriers to interstate competition. NARAB is a solution to the problem that relies on the existing framework of state insurance regulation. NARAB also represents an important incentive for state insurance regulators to move forward with the modernization of insurance regulation in general. However, we believe that the NARAB provisions are just a starting point for regulatory modernization.

The Gramm-Leach-Bliley Act tore down the firewalls separating the banking, securities and insurance industries, and it created a brave new world in which banking, securities and insurance transactions could occur in one place and in a seamless manner. Instead of just selling and servicing insurance policies, I am now a member of the financial services industry – an industry that can provide both its members and its customers with innovative new products and services. We believe the expanded ability to provide consumers with financial service product choices will lead not only to more innovations but also to a more competitive market. That will only benefit consumers.

There is one area, however, not addressed by the Gramm-Leach-Bliley Act but which we believe is extremely important. Our concerns are expressed both as members of the industry providing financial services products to consumers and, ultimately, as consumers ourselves. It has been said many times that freedom comes with a price. In our situation, the price of the increased freedom to offer financial services to consumers is the increased potential for bad actors to move among the banking, securities and insurance sectors without detection.

The Council is extremely concerned about this issue. As intermediaries between insurance companies and consumers, our members must be concerned not only about bad actors entering the market as intermediaries, but we must also be concerned about bad actors getting involved with the companies with which we do business. One need not look far to find examples of bad actors who were prohibited from doing business in either the banking or securities sectors and then found their way to the insurance sector, only to wreak more financial havoc.

While it is true that Gramm-Leach-Bliley broke down many barriers in the financial services industry, there is one area that The Council feels must not suffer as a result – a sound financial services regulatory system. We firmly believe the different financial services regulators must work together to provide efficient regulation for the financial services industry. As we move toward a more integrated financial services industry, our paramount concern is for good regulation that will not only provide the necessary consumer protections, but also foster growth and prosperity for our industry. In our view, the means of regulation in this case is subsidiary to the end goal of sound but fair regulation.

We also believe it is crucial that financial services regulators work together to present a united front to those who, through fraud and deceptive schemes, would attempt to take advantage of the market freedoms engendered in Gramm-Leach-Bliley. Regulators must always be vigilant to coordinate their fraud-fighting efforts in order to keep bad actors out of the financial services industry.

I understand this committee is considering a proposal to create a means for federal and state financial services regulators and law enforcement agencies to stop bad actors by coordinating and sharing anti-fraud and required criminal background check information. In essence, this proposal envisions the creation of an Anti-Fraud Subcommittee within the Federal Financial Institutions Examination Council (FFIEC), which would administer a computerized network connecting existing anti-fraud databases maintained by federal and state financial regulators and law enforcement agencies. The Council wholeheartedly supports such a proposal for several reasons.

The approach under consideration would not establish a new federal bureaucracy, and would not require any new regulations. It also would not require a new collection of information about individuals in the banking, securities or insurance sectors – rather, it will take advantage of existing databases and Internet technologies to bring fraud-fighting activities into the Information Age. This approach is similar to the approach taken in the NARAB provisions of the Gramm-Leach Bliley Act – the use of existing regulatory frameworks to solve a regulatory problem.

This approach would also have several consumer protection benefits. It will make it easier for financial services regulators to detect patterns of fraud and to protect the public from ongoing fraud. It will make it much easier for regulators to coordinate their anti-fraud efforts, and reduce duplicative requests for information among the regulators. In short, it will give federal and state financial services regulators the tools they need to help protect consumers and to help preserve the market freedom the financial services industry is just beginning to explore.

There is an additional benefit to this proposal for both consumers and the financial services industry as a whole, but one not readily apparent on the face of the legislation. The multiple add-ons to nonresident licensing applications and the state laws that limit the activities of nonresident producers have little to with enforcing standards of professionalism and much to do with increasing the hassles involved in obtaining a nonresident license. We believe that NARAB enactment – even if NARAB ultimately does not come into existence – will serve not only to lift this licensing burden, but also to raise the standards of professionalism involved in the producer licensing process. The proposal under the committee's consideration will contribute much to this goal, and this only strengthens our support.

There is one area of this proposal I want to discuss in more detail. We understand the approach under consideration would permit coordination of criminal conviction reviews currently required for insurance and securities licensing. In addition to the obvious consumer benefits to flow from such coordination, we believe this approach would also provide greater efficiencies both for regulators and for those who must be licensed. I'd like to offer a brief overview of the current insurance producer licensing process to illustrate some immediate benefits.

As I noted at the start of my testimony, The Council's members offer their clients both property and casualty and employee benefits coverage. All Council members hold insurance licenses in multiple states, and many are licensed in all 50 states. Many Council members are also licensed as either insurance agents or brokers (or both) and as securities dealers. They must undergo separate criminal conviction reviews not only for securities licenses and for insurance licenses, but, in many cases, they must also undergo separate reviews for the different insurance licenses that they hold. There are currently 15 states which as yet require some form of criminal conviction review, and several states that still require the submission of one or two sets of fingerprints.

At this time, the state insurance regulators do not have the ability to directly access federal criminal history records maintained by the Federal Bureau of Investigation (FBI). Some states run criminal conviction reviews through their state police, and some state insurance regulators who have specialized anti-fraud units holding law enforcement authority also have some access to some criminal history records. However, the criminal record information gained through these checks is not complete information.

Currently, there is no comprehensive system among state regulators to share information found during criminal conviction reviews performed by individual states, nor is there a system that permits the sharing of information between the state insurance regulators and the National Association of Securities Dealers. When you consider the large number of insurance agents and brokers who are also licensed as securities dealers, it is surprising there is no a formal information sharing process between the two functional regulators. This lack of coordination also leads to the imposition of duplicative requirements on those agents and brokers who hold securities licenses.

Additionally, states that currently perform background checks have varying requirements. As you may recall from our testimony during the hearing held on the NARAB provisions of the Gramm-Leach-Bliley Act, these types of varying requirements create undue expense, administrative headaches and licensing delays for agents and brokers who are licensed in multiple states. Allowing regulators to coordinate the review of criminal convictions will greatly help to alleviate the difficulties caused by wide requirements variances in several ways.

First, coordination of such reviews should decrease the number of separate reviews performed on individuals. Our ideal would be to have an agent or broker go through one criminal conviction review, which would be valid for a specified period of time, and which would be valid for all financial services licenses for which the individual applies. Centralizing the storage of the information from the review and allowing all state and federal financial regulators access to that information would certainly help to decrease the necessity for multiple reviews. Additionally, setting a uniform validation period for a criminal conviction reviews will decrease the necessity for performing additional checks each time an individual wishes to be licensed in a new jurisdiction.

Second, coordination of such reviews will hopefully decrease multiple burdens on licensed individuals to provide to different regulators certain types of information needed in the license decision-making process. Rather, regulators will be able to go to a centralized location to collect necessary information.

Finally, coordination of these reviews will permit regulators to catch bad actors who are attempting to move from sector to sector within the financial services industry before they are licensed and before they can do further harm.

The Council commends the subcommittees for holding this hearing today. As the financial services sectors continue to integrate in the aftermath of Gramm-Leach-Bliley, we believe it is imperative to give federal and state financial service regulators the tools they need to provide necessary consumer protections in an efficient and cost-effective manner. We look forward to working with the committee to reach this goal as formal legislation is drafted.

On behalf of The Council, I'd like to thank you for allowing me to provide this testimony today.

TESTIMONY OF:

Ronald A. Smith, CPCU
Smith, Sawyer & Smith Inc.

On behalf of the
Independent Insurance Agents of America
National Association of Insurance and Financial Advisors
National Association of Professional Insurance Agents

Before the House
Financial Services Subcommittee
on
Oversight and Investigations
and the
Subcommittee on Financial Institutions and
Consumer Credit

March 6, 2001

STATEMENT OF RONALD A. SMITH
PRESIDENT – SMITH, SAWYER & SMITH, INC.
ROCHESTER, INDIANA

STATE GOVERNMENT AFFAIRS CHAIRMAN AND PAST PRESIDENT
INDEPENDENT INSURANCE AGENTS OF AMERICA

TESTIFYING ON BEHALF OF
THE INDEPENDENT INSURANCE AGENTS OF AMERICA,
THE NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS, AND
THE NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

ON THE CREATION OF AN ANTI-FRAUD NETWORK AND
AUTHORIZING STATE INSURANCE REGULATOR ACCESS
TO FEDERAL CRIMES DATABASES

BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
AND THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER
CREDIT OF THE
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

March 6, 2001

Good morning. My name is Ron Smith. I am President of Smith, Sawyer & Smith, Inc., an independent insurance agency located in Rochester, Indiana. I am the current State Government Affairs Chairman and a Past President of the Independent Insurance Agents of America ("IIAA"). I am testifying today on behalf of IIAA and on behalf of the National Association of Insurance and Financial Advisors ("NAIFA") (formerly NALU) and the National Association of Professional Insurance Agents, Inc. ("PIA") (collectively, the "Agents"). IIAA, NAIFA, and PIA represent over 1,000,000 insurance agents and brokers and their employees. Our collective members are large and small businesses that offer consumers a wide array of products, ranging from property, casualty, life, and health insurance to employee benefit plans, retirement programs, and investment advice.

Let me start by saying that the last time I testified before a Congressional committee, Chairman Oxley was chairing a subcommittee in a room across the hall. It was Chairman Oxley who was responsible for a breakthrough on the functional regulation language that ultimately led to passage of the Gramm-Leach-Bliley Act, and I want to thank the Chairman once again for his incredible dedication and hard work to make the functional regulation language reality. The

agent community looks forward to working with this new committee under the very able leadership of Chairman Oxley.

I appreciate the opportunity to testify this afternoon on two inter-related topics of great interest and critical importance to insurance agents and brokers – enabling state insurance regulators to access federal crimes database information concerning insurance professionals and creating a "functional" regulator anti-fraud network. I commend Chairman Oxley for recognizing the importance of these issues, for seeking responsible solutions, and for making them legislative priorities. In many ways, both of these related initiatives grow out of the Gramm-Leach-Bliley Act's "National Association of Registered Agents and Brokers" ("NARAB") provisions and the imperative need to reform our industry's multi-state licensing system. No segment of the industry is affected more by producer licensing laws than our associations' diverse membership of small and large agents and brokers, and no groups will be impacted more by further reforms in this area.

My testimony today is divided into three parts. In Part I, I outline the current licensing system and how that system is being affected by the NARAB licensing reform mandate. In Part II, I explain that authorizing state insurance regulator access to relevant federal crimes database information would enhance the prospects for multi-state licensing reform. I also outline in Part II the practical data collection and administrative concerns that the Agents believe must be addressed to ensure that this access is part of the overall modernization effort begun with the enactment of the GLBA and not an ill-conceived "solution" that is worse than the relatively limited problem it is designed to address. Finally, in Part III, I address the need for the creation of a "functional" regulator data anti-fraud network, and I again outline some of the concerns that the Agents believe must be addressed to ensure that the solution is not worse than the underlying problem.

PART I – THE CURRENT LICENSING SYSTEM AND NARAB

A. The Current Licensing System

I should note at the outset that the Agents have been ardent supporters of state regulation of insurance. The national boards of directors of IIAA, NAIFA, and PIA have repeatedly affirmed their unequivocal support for state regulation of insurance – for all participants and for all activities in the marketplace. Despite this longstanding support for state regulation, we recognize that the current regulatory system does not always operate as efficiently as it should. There are things that can and should be done to improve the current

regulatory regime, and one area of insurance regulation that has drawn warranted criticism is the manner in which the States license insurance agents.

There are some very real problems with the current multi-state licensing process. As agents and brokers obtain growing numbers of nonresident licenses, our members increasingly struggle to stay on top of the required paperwork and clear the logistical and bureaucratic hurdles that are in place today. Staying in compliance with the distinct and often idiosyncratic agent licensing laws of every state is no easy task. It is an expensive, time-consuming, and maddening effort for many agencies, and a dedicated staff person and tremendous financial resources are often required to manage an agency's compliance efforts. These opportunity costs and wasted man-hours could be better spent working on behalf of our customers. We have many members who are frustrated because they are trapped in a regulatory thicket created by a licensing system full of antiquated, duplicative, and unnecessary requirements. Adding to the frustration is the fact that these inefficiencies continue to exist at a time when advances in technology have encouraged society to expect ease, efficiency, and speed –even from government agencies and state insurance departments.

The problems associated with the current system can be divided into three main categories: (1) the disparate treatment that nonresidents receive in some states; (2) the lack of standardization, reciprocity, and uniformity; and (3) the bureaucracy generally associated with agent licensing. The NARAB provisions contained in the Gramm-Leach-Bliley Act ensure that these three problem areas will be addressed soon – either by the automatic implementation of the provisions themselves or by the enactment of preemptory reforms at the state level.

B. Actions Required to Forestall NARAB's Creation

The so-called "NARAB provisions" are contained in Subtitle C of Title III of the Gramm-Leach-Bliley Act. They offer the promise that effective licensing reform may finally be imminent. NARAB, the National Association of Registered Agents and Brokers, is an entity that does not exist today but is one that would be created if the States cannot on their own reach the licensing reform goals outlined by Congress. In essence, the NARAB provisions put the ball in the States' court. The new licensing agency will only be established if the States fail to take the steps necessary to forestall its creation. In this way, the threat of NARAB creates a strong incentive for the States to reinvent and streamline the current multi-state licensing process.

The Gramm-Leach-Bliley Act is clear about what is required to prevent the establishment of NARAB. The creation of the new "agency" will only be averted if a majority of States (which is 29 because the statutory definition of "State" includes both States and territories) do not achieve the specified level of licensing reciprocity or uniformity. The Act is specific about the

reforms that are necessary, and it gives the States two options – licensing uniformity or licensing reciprocity.

Reciprocity is the easier test to satisfy, and it is the initial goal of state policymakers. To achieve reciprocity, the Gramm-Leach-Bliley Act requires that a majority of states license nonresident agents and permit them to operate to the same extent and with the same authority with which they operate and function in the resident state. This sounds simple, but most States will need to make statutory and regulatory changes in order to meet the level of reciprocity required. The reciprocity standard in the NARAB provisions essentially requires 29 States to each satisfy a three-part test:

- First, not impose any unique licensure requirements on nonresidents and only require a nonresident to submit: (1) a license request; (2) proof of licensure and good standing in the home state; (3) the appropriate fees; and (4) an application.
- Second, offer continuing education (CE) reciprocity to any person who satisfies his/her home state requirement.
- Third, not "impose any requirement . . . that has the effect of limiting or conditioning [a] producer's activities because of its residence or place of operations," excluding countersignature requirements.

In short, to satisfy the NARAB test, at least 29 "States" must be prepared to offer full reciprocity to nonresident agents – without imposing any additional obligations or requirements. In order to be "NARAB compliant," a State must thus be willing to accept the licensing process of an agent or broker's home state as adequate and complete. No additional paperwork or requirements may be required – no matter how trivial or important they may seem.

The States collectively have three years to achieve the required level of reciprocity. If 29 States fail to offer full reciprocity to nonresidents by November 12, 2002, the National Association of Insurance Commissioners ("NAIC") will begin the process of establishing NARAB, as provided by the statute. The law requires that the new entity begin operation within two years of the initial deadline. It is unlikely, however, that NARAB will ever come into existence. IIAA, NAIFA, and PIA are optimistic that the States will meet the level of reform required by Congress and implement a licensing system that is in fact better than that offered by the NARAB provisions.

C. Recent Activity / The NAIC Producer Licensing Model Act

Even before the passage of the Gramm-Leach-Bliley Act, efforts were underway to reform the existing licensing system, and some significant strides had already been made. The NAIC, for example, had established the Uniform Treatment Project Initiative, an initial step

toward reciprocity, and developed a national application form. Other early NAIC initiatives include the proactive development of such tools as the Producer Database and Producer Information Network. In addition, many states have recently taken action to eliminate longstanding discriminatory barriers, such as countersignature laws, residency requirements, and solicitation restrictions. Clearly, however, the focus on agent licensing reform has intensified since the enactment of the NARAB provisions, and the pace of reform has quickened as a result.

Most notably, the NAIC has finalized a new agent licensing model law –the "Producer Licensing Model Act." This model law will be the starting point for agent licensing reform in every state and will promote uniformity and reciprocity in the licensing arena. The Producer Licensing Model Act addresses a wide range of issues and will foster uniformity among the states. Most important for this discussion is the fact that the NAIC model contains provisions that allow a State to become "NARAB compliant" by establishing the requisite level of reciprocity. In other words – if a State enacts those sections of the model related to nonresident licensing and reciprocity, then that State will achieve the level of reciprocity required by Gramm-Leach-Bliley.

The NAIC Producer Licensing Model Act makes great strides in the effort to enhance, improve, and streamline the agent licensing process, particularly in the area of nonresident licensing. For this reason, it is an excellent starting point for any state-level reform. I am pleased to report that IIAA, NAIFA, and PIA have been at the forefront of efforts to enact agent licensing reform in the states, and we are happy with the progress that has already been made during this legislative session. Despite the distracting attempts of some insurer representatives to enact broad and unprecedented licensing exemptions into law, state lawmakers are proving that the states can preserve and strengthen state insurance regulation while also protecting consumers and preserving the high standards of licensure. These goals are not mutually exclusive, and we continue to believe the states are up to the challenge.

D. Additional Plans for the Future

The National Insurance Producer Registry (NIPR), a non-profit affiliate of the NAIC, also has plans to further revolutionize the licensing process. NIPR is the private-public partnership and NAIC affiliate responsible for developing the Producer Database (PDB) and the Producer Information Network (PIN).[1] Once the necessary statutory changes are implemented at the

[1] PDB is an electronic database consisting of information about producers and includes information about a producer's licensing status, appointment history, and disciplinary actions. PIN is an electronic communications network that links state insurance regulators with the entities they regulate in order to facilitate the electronic exchange of producer-related information.

state level, NIPR will be able to utilize technology and its existing services to create an administratively simpler and cost-effective licensing environment for agents.

NIPR has developed a detailed plan that will ultimately lead to the establishment of a system through which agents can obtain nonresident licenses in multiple states by using a single on-line point of entry. In the near future, a person licensed and in good standing in their home state will have the ability to obtain licenses in other states by submitting a single license application to NIPR, along with the payment of both state and NIPR fees. Upon receipt, NIPR will perform an automated verification to ensure the producer holds an active resident license and will then issue, at the direction and on behalf of the state(s), the appropriate nonresident licenses.

PART II – ACCESS TO FEDERAL CRIMES DATABASES

There are many challenges that the States face in trying to satisfy the NARAB threshold before the November 12, 2002 deadline. The short timeframe alone is the biggest immediate hurdle. As of today, the States have only 20 more months in which to enact and implement licensing reciprocity or uniformity. Practically, this means that most States have only two legislative sessions to address licensing reform. Many States have very short sessions, and seven will meet only once before the November 2002 deadline. I can assure you, however, that the deadline has certainly generated a sense of urgency, and many States are taking steps to achieve compliance within this short window.

In addition to these logistical issues, the States also have a major substantive hurdle that they have had difficulty resolving within the reciprocity framework – the manner in which they investigate the criminal histories of potential license holders and verify the information submitted on license applications. Today, the States have a variety of different requirements and processes for doing this. Some States simply ask an applicant whether they have a criminal history or if they have committed some act that would preclude them from licensure. Other States require applicants to submit a criminal background report with their application. There are also approximately a dozen States that take a proactive role in this process and independently perform criminal background checks, and several of these States require applicants to submit fingerprint cards so that an individual's record can be checked thoroughly. Whatever the actual process, States that impose individualized background check requirements typically also apply these requirements to nonresident applicants – regardless of whether the applicant's criminal background has already been reviewed by any other State.

There is concern that the wide disparity in requirements and trust among the States in this area could undermine the effort to achieve licensing reciprocity. A State with strong background check requirements is naturally uncomfortable licensing an individual who has not previously gone through the same rigors and background review that the state would otherwise require. Indeed, it appears that each State that requires the performance of a background check will continue to impose that requirement even if it has otherwise taken steps to implement the requisite non-resident licensing reciprocity in an effort to become fully NARAB compliant. Under the NARAB reciprocity standard, however, a State is arguably required to license such an individual – without performing the background check.

In addition to individual state criminal background check requirements, a provision added to the 1994 Violent Crime Control Act (P.L. 103-322) makes it a federal crime for any individual to participate in the business of insurance "who has been convicted of any criminal felony involving dishonesty or breach of trust" or who has been convicted of a crime under Section 320603 of the Act. This provision, codified in Section 1033(e) of Title 18 of the United States Code, also makes it unlawful for any individual who is engaged in the business of insurance to willfully permit the participation of any such individual in the business of insurance. These requirements were created out of the concern that many individuals were working in the insurance industry who have a history of criminal activity that render them unfit to serve in a fiduciary capacity. The creation of these new requirements, however, has created widespread uncertainty within the industry regarding the scope of each insurance company or insurance agency employer's responsibility to verify that their employees are not in violation of these 1033 requirements.

It is our understanding that the Federal Bureau of Investigation ("FBI") maintains a series of databases that are repositories of information on criminal investigations, arrests, and convictions. It is our further understanding that no one – including a state regulator – may access this information without affirmative statutory authorization from Congress. On the whole, we support the NAIC's request for state insurance regulator access to this information so that more complete criminal background checks may be performed on insurance professionals. We are concerned, however, that unfettered access and dissemination rights could lead to unnecessary, unwarranted, and invasive intrusions and become incredibly expensive to exercise. For that reason, we believe it is essential that the extension of any right to the state insurance commissioners to access FBI database information must include the following protections and requirements:

(1) The information that is made available should be limited to information regarding crimes included within the ambit of Section 1033. There is no reason, for example, to disseminate information regarding youth offenses or any other alleged offenses that do not bear on an individual's fitness to act as an insurance professional.

(2) Insurance professionals – like banking and securities professionals – should be required to have a criminal background check performed only once; they should not be required to undergo repeated checks on a state-by-state basis. The statute should dictate that only a single check will be performed and it could leave it to the States to determine how such a check will be completed. This will leave the option of having the resident state regulator perform the background check for all resident insurance professionals or to have a central processing agent perform the checks on behalf of some or all States.

(3) The administrative requirements for performing a check should be minimized to the greatest extent possible. Fingerprinting, for example, can be an incredibly onerous process, particularly when repeated over time. For this reason, if fingerprints are required to access FBI database information, then an individual's fingerprints should be taken one time only and stored electronically if necessary. It also should not be required for a resident of any State unless the State itself imposes that requirement.

(4) The determination of a state insurance regulator that an applicant to be a licensed agent or other insurance professional satisfies the 1033 requirements should be sufficient to satisfy any and all 1033 requirements – for both insurance agency employers and appointing insurers.

(5) A non-employer should not be permitted to receive any of the crimes database information.

(6) Criminal penalties should be imposed on any entity that receives FBI database information to make a 1033 determination or for other expressly authorized purposes if they use that information for any other purpose or if they disseminate that information in any way.

(7) Insurance agents should not be required to incur any additional expense for the performance of the background checks as any such expenses would be viewed as a new tax on their ability to do business.

The Agents would be supportive of a statute that granted state insurance regulators access rights – either directly or through an appointed agent such as the NAIC or one of its subsidiaries – provided that it included the protections and addressed the concerns noted above.

PART III – THE CREATION OF A FUNCTIONAL REGULATOR ANTI-FRAUD NETWORK

The Agents also would be supportive of the statutory creation of a financial services anti-fraud network through which banking, securities and insurance regulators could share information regarding disciplinary actions and investigations among themselves to better enable them to coordinate their anti-fraud efforts. Nothing better illustrates the need for better coordinated regulatory efforts than the recent Martin Frankel debacle, and no one is more interested in insuring that access to the business of insurance is foreclosed to swindlers and scam-artists than the Agents.

Again, however, the Agents believe that any such proposal must be designed to minimize potential costs and to ensure the integrity of the information –much of which will be unverified at the time that it is initially disseminated among regulators. To minimize the cost, we believe that any viable proposal will not create any new bureaucracy, regulations, or collection of information. It would instead simply link the existing facilities of each of the regulators to foster better communication among them. To ensure the integrity of the information, it is essential that access be limited strictly to regulators and information that is not relevant to financial or fraudulent activities should be barred from the network.

CONCLUSION

In closing, I want to thank you for asking me to testify before you today on these important issues. IIAA, NAIFA, and PIA strongly support your efforts to increase access to relevant criminal history information and to enhance the ability of all financial services regulators to better coordinate their anti-fraud efforts. We also believe, however, that such initiatives should be carefully crafted to minimize the potential costs, unwarranted personal intrusions, and other inadvertent side effects that may accompany the implementation of these well-intentioned ideas.

IIAA, NAIFA, and PIA would be pleased to provide any further assistance or information to you as you move forward in your consideration of these issues.

THE FINANCIAL SERVICES ROUNDTABLE

Testimony of

Steve Bartlett

President of

The Financial Services Roundtable

Before the

United States House of Representatives

Financial Services Subcommittees on
Oversight and Investigations and
Financial Institutions and Consumer Credit

on

"Protecting Consumers: What Can Congress Do To Help Financial
Regulators Coordinate Efforts To Fight Fraud?"

March 6, 2001

Good afternoon, Chairmen and Members of the Subcommittees.

My name is Steve Bartlett and I am the President of The Financial Services Roundtable. Thank you for inviting me to testify today on the Financial Services Committee's draft legislation to create an anti-fraud network among the financial services regulators. The Roundtable supports the continuing efforts of the Committee to move towards a seamless, coordinated system of regulating the financial services marketplace. In particular, the Roundtable appreciates the Committee's efforts to protect legitimate financial services companies and their customers from fraudulent actors by facilitating the sharing of relevant anti-fraud information among the agencies. We support the concepts of the proposed legislation as it has been outlined to us and we look forward to working with the Committee towards its enactment.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to American consumers. Member companies participate through their Chief Executive Officer and other senior executives nominated by the CEO.

Roundtable member companies provide fuel for the engine of our nation's economy, accounting directly for $17 trillion in managed assets, $6.6 trillion in assets, and $462 billion in revenue, and providing jobs for 1.6 million employees.

In 1999, Congress passed the Gramm-Leach-Bliley Act ("the GLB Act"), historic legislation that allowed banks, insurance companies, and securities firms to affiliate under one corporate structure so that financial services companies can more readily anticipate

and meet their customers' financial needs on a comprehensive basis. The GLB Act also established a system of functional regulation and requires greater coordination among the various agencies.

Now, the financial services community is faced with the complex task of making functional regulation work. Collectively, there are almost 200 different financial services regulators, including the various state banking, insurance, and securities regulators and all of the federal banking, thrift, and securities agencies. As integrated financial services companies increase the scope of their business activities and the products and services they offer, they face a substantial compliance burden by having to file duplicative reports to multiple regulators. In addition, new regulations are being issued much faster than anyone could have imagined. In the past three months, the Roundtable alone has reviewed for formal comment over twenty-five proposed regulations.

Functional regulation can work, and I believe it will be efficient and effective at some point in the future. But today, in 2001, functional regulation still has some significant overlap and duplication. This issue is for a different hearing, but as the Oversight Subcommittee, you may wish to further examine the state of functional regulation.

The legislation under discussion today proposes increased communication among the regulators for the purposes of fraud reduction, which is an important step towards fully implementing functional regulation. In particular, identifying the fraudulent activities of a few bad actors, who can cause great harm to American consumers and, potentially, to the entire financial services system, is a significant improvement. Financial services providers lose significant amounts of money from fraud, some or all of which will ultimately be borne by customers. It is estimated that the financial services

industry loses more than $100 billion a year in fraud, which includes $85 billion to $120 billion in insurance fraud, $24 billion of which comes from property/casualty fraud[1]; $13 billion in check fraud; $3 billion in identity fraud; and $600 million in credit card fraud.[2] If financial services regulators had a consistent and coordinated system of sharing information on fraud, they would be better equipped to expose fraud sooner and limit the damage to the American public.

The integrated management of information is the single most powerful weapon in combating fraud. As evidence of this, Ernst & Young released a study at the end of last year on the benefits that customers of Roundtable member companies receive as a result of our companies' ability to integrate information.[3] The study found that information integration among financial services companies helps prevent fraud and reduces the incidence of identity theft. Moreover, the sharing of information makes it easier for companies to resolve problems and limit damage after fraud has been detected. We would be happy to provide a copy of the study and a briefing of its results to any interested member of this committee.

The financial services industry is deeply committed to deterring and detecting financial fraud. As evidence of this, the Roundtable's affiliate organization specializing in emerging technology issues, BITS, has established a Fraud Reduction Steering Committee to lessen the effect of fraud in financial services organizations. Representatives from the Roundtable's member companies who serve on the Steering Committee work together with financial services regulators to develop ways to combat fraud, particularly with regard to the electronification of the industry. For example,

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1 *The Insurance Information Institute Fact Book, 2001.*
2 *Customer Benefits from Current Information Sharing by Financial Services Companies*, conducted for The Financial Services Roundtable by Ernst & Young, December 2000.
3 Id.

through their efforts, the growth of check fraud in large institutions was reduced from 17.5 percent to 11.7 percent annually.

The Roundtable strongly supports the Financial Services Committee's efforts to safeguard the public from ongoing fraud by streamlining the anti-fraud coordination efforts of the financial services regulators. As we understand it, the draft legislation would create a computerized network linking existing anti-fraud databases of federal and state financial regulators through the Federal Financial Institutions Examination Council ("FFIEC"). If crafted carefully and implemented effectively, the proposed anti-fraud network could have tremendous long-term advantages by assisting regulators in detecting patterns of fraud, reducing duplicative information requests by regulators, and allowing the agencies to take advantage of emerging technologies to modernize fraud fighting.

The Roundtable is pleased to hear that the legislation will clearly state that no information that is unrelated to fraudulent activities would be shared. We believe that the legislation should be as specific as possible about the type of information that is involved.

The Roundtable is especially pleased that the Committee will seek to ensure that no information on customers would be shared under the new anti-fraud network. Financial services companies rely on the trust and confidence of their customers and are undertaking extraordinary efforts to protect the privacy of their customer's information. Any new anti-fraud regulatory network must assure the continued protection of customer privacy.

The Roundtable is also appreciative of the Committee's efforts to ensure that in creating an anti-fraud network, Congress would not create any new bureaucracy, new regulators, or new regulations, and would not require the collection of any new

information. The benefits of the anti-fraud streamlining could be counterbalanced if the proposal imposed additional regulatory burdens on the industry.

In addition, the Roundtable is pleased that the Committee intends to ensure that confidentiality and liability protections would be provided for all networked information to allow regulators to share information without losing existing legal privileges. Towards this end, the Roundtable would support a national uniform standard of confidentiality for all financial regulators.

Critical to the Roundtable's support for this initiative is the Committee's assurance that the shared information will only be available to financial regulators. Allowing public access to the regulatory databases could increase the liability risk for companies and undermine the bill's primary goal of preventing fraud.

As the Committee continues to explore ways to improve information sharing among regulatory agencies, the Roundtable urges the Committee to again consider the "Bank Examination Report Privilege Act," or "BERPA," as it is commonly called. This draft legislation would protect the integrity and effectiveness of the bank examination process by preserving the cooperative, non-adversarial exchange of information between supervised financial institutions and their examiners. First, BERPA would clarify that a supervised institution may voluntarily disclose to the examining agencies information that is protected by the institution's own privileges without waiving the privileges as to third parties. Second, BERPA would codify and strengthen the bank supervisory privilege by defining confidential supervisory information, affirming that such information is the property of the agency that created or requested it, and protecting this information from unwarranted disclosure to third parties, subject to appropriate judicial review. Finally,

BERPA would reaffirm the agencies' power to establish procedures governing the production of confidential supervisory information to third parties.

A version of BERPA passed the House by voice vote in the 105th Congress as part of H.R. 4364, the "Depository Institution Regulatory Streamlining Act of 1998," and was included in similar legislation, H.R. 1585, introduced in the 106th Congress by Congresswoman Marge Roukema (R-NJ). The Roundtable appreciates Mrs. Roukema's leadership and encourages the new Financial Services Committee to reintroduce and pass this important legislation, either in connection with the anti-fraud network legislation or as a stand-alone bill. Additionally, to reflect the recent integration of the financial services industry, the Roundtable urges the Committee to expand the bill to extend its security protection provisions to examination information shared by insurance and securities companies and their regulators.

In conclusion, The Financial Services Roundtable supports congressional efforts to promote greater coordination among the financial services regulators to share relevant anti-fraud information. Such an anti-fraud network would greatly benefit the financial services industry and its customers, as well as the regulatory agencies. We look forward to working with the Committee to draft balanced legislation that achieves this laudable goal.

I will be glad to try to answer any questions that Members of the Committee might have.

STATEMENT OF
THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES
(NAMIC)
ON THE ESTABLISHMENT OF A FINANCIAL SERVICES ANTI-FRAUD NETWORK

BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS AND
THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
OF THE COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES
MARCH 6, 2001

The **National Association of Mutual Insurance Companies (NAMIC)** is a full-service trade association with more than 1,200 member companies that underwrite 40 percent ($123 billion) of the property/casualty insurance premium in the United States. NAMIC's membership includes five of the ten largest p/c carriers, every size regional and national p/c insurer and hundreds of farm mutual insurance companies. NAMIC benefits member companies through government relations, public affairs, education and arbitration services, and insurance and employee benefit programs.

NAMIC supports the objective of establishing a mechanism through which criminal background checks can be conducted on prospective employees and believes that the committee is moving in the right direction by addressing this issue. There are important reasons to grant this access. Individuals in the insurance business are exposed to and have access to tremendous amounts of money. Those in charge of insurance operations have an obligation to their policyholders, customers and stockholders to ensure that company assets are handled legally and responsibly. Congress recognized this in 1994 with the passage of the Insurance Fraud Prevention Act, which makes it a crime to employ persons who have been convicted of fraud or financial crimes. To date, there has not been a mechanism for insurers to conduct background checks. Others in the financial industry, including banks and securities firms, have had systems for conducting background checks for many years.

Under the outline being considered by the committee, an insurer would submit a request for a criminal background check on an individual to their state insurance department. The state regulator would then send the request through a clearinghouse administered by the National Association of Insurance Commissioners (NAIC). The necessary information would be filtered and sent back to the state regulator. The NAIC clearinghouse would keep the information on file and serve as a repository for future background checks by other states.

NAMIC believes it is important to make sure that the NAIC simply serves as a clearinghouse and is not granted any new authority under the legislation. NAMIC recognizes the importance of having a centralized system for processing background checks. Having a central clearinghouse for the information is the most efficient approach if it is administered appropriately. A central system will reduce the number of requests that insurance regulators must submit. It will also make it easier to coordinate efforts between all of the different segments of the financial industry and enhance fraud prevention. The staff-provided outline for the legislation suggests administration of the network would be coordinated through the Federal

Financial Institutions Examination Council (FFIEC). It is strongly recommended that the FFIEC be expanded to include representation by one or more state insurance regulators.

It is important that the criminal background check mechanism for insurers have equal standing with that used by the banking and securities industries. In addition, it is important that individuals have the right to verify and correct the information provided about them through the appropriate venue. Finally, liability protections should be included for the users of the information.

While NAMIC supports the concept for a legislative proposal to accomplish the goal of permitting a streamlined, cost efficient data sharing system for insurance personnel background investigations, it reserves its endorsement of specific legislation until such time as a bill is available for review in its entirety.

The members of the Committee on Financial Services are to be commended for seeking a solution for the problem currently experienced by insurance operations in complying with the law.

WRITTEN STATEMENT OF
THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

To Be Included in the Hearing Record of

The Subcommittee on Oversight and Investigations And The Subcommittee on Financial Institutions and Consumer Credit Hearing

Committee on Financial Services

"Protecting Consumers: What Can Congress Do To Help Financial Regulators Coordinate Efforts To Fight Fraud?"

March 6, 2001

The North American Securities Administrators Association[1] is pleased to present its views on efforts to coordinate federal and state programs to fight financial fraud against consumers. State and federal securities regulators have developed an efficient and cost-effective mechanism for centralizing the licensing and disciplinary histories of broker-dealers, broker-dealer agents, investment advisers and investment adviser representatives. NASAA supports Congressional efforts to create a network amongst federal and state functional regulators to coordinate certain enforcement information.

The complementary structure of state, federal and industry regulation of the securities markets has a proven record of serving investors well over the past 60-plus years. State securities regulators play a unique role in protecting investors through enforcement programs, investment adviser and broker-dealer regulation, review of financial offerings of small companies, and investor education initiatives. State securities regulators work on the front lines, recognizing potentially fraudulent activity and alerting the public to beware of scams. Because they are closest to the investing public, state securities regulators identify new investment scams quickly and bring enforcement actions covering a wide variety of investment-related violations. They also work closely with criminal prosecutors at the federal, state and local levels to punish securities law violators.

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

NASAA's members handle the majority of individual investor complaints and are often in a more advantageous position to observe the impact of regulatory policies on investors. The role of state securities regulators has become increasingly important as Americans have turned to the financial markets to prepare for their financial futures. We are today indeed a "nation of investors." Over half of all American households -- and 70 percent of voters -- are now investing in the securities market.

Since 1998, state securities enforcement activity has focused on several areas including:

Day Trading - After uncovering questionable practices at day trading firms beginning in 1998, Colorado, Massachusetts, Wisconsin, Indiana, Maryland and Texas took actions and imposed restrictions on firms in their states. Since then, the National Association of Securities Dealers Regulation (NASDR) proposed rules to the SEC relating to the opening of day trading accounts.

Boiler Room Scams – Long before the movie *Boiler Room*, NASAA published a 1997 Investor Alert warning the public about investment fraud promoted over the telephone. In 1998, NASAA coordinated a nationwide enforcement "sweep" that included 106 actions against 75 firms in 29 states.

Joint Promissory Note Enforcement Sweep – Last year, state securities regulators and the Securities and Exchange Commission (SEC) announced a joint effort to combat the fraudulent sale of promissory notes to investors. Although they can be legitimate investment vehicles, promissory notes have increasingly been used as a vehicle to defraud investors. Securities regulators in 28 states filed scores of actions against hundreds of individuals and entities for selling bogus promissory notes. The SEC filed 13 enforcement actions against 38 individuals and 22 entities involved in the fraudulent sale of promissory notes.

Viatical Scams – Viatical contracts are interests in the death benefits of terminally ill patients. Because of uncertainties in predicting when a terminally ill person is going to die, these investments are extremely speculative and often inappropriate for small investors. State securities regulators and law enforcement officials recently observed a disturbing increase in the number of scam artists who have entered the viatical industry with the intent of fleecing investors. As a result, they have heightened regulatory scrutiny over and filed numerous enforcement actions against parties selling investments in viatical settlement contracts.

Payphones – Securities regulators in 17 states are concluding a sweep targeting questionable payphone investments. So far, investigators have identified over 4,200 individuals that stand to lose $75 million; total losses are likely to be in the hundreds of millions of dollars. In a typical scheme, a company, through a middleman, sells pay phones to investors for between $5,000 and $7,000. As part of the sale, the company agrees to lease back and service the phones. Investors are promised annual returns of up to 15 percent. Of particular concern to state regulators is the role of insurance agents in the sale and distribution of risky, questionable or fraudulent securities. In addition to

payphones, a variety of other high-risk investments, such as ATMs, viaticals, and promissory notes, are being sold by independent insurance agents.

Callable CDs – Some stockbrokers are pushing elderly investors to buy higher yielding "callable" certificates of deposit with 10- to 20 -year maturities. Rising interest rates and the falling stock market have made CDs more attractive, especially to investors who rely on interest income. But what many investors don't realize – and some stockbrokers apparently aren't adequately disclosing – is that with "callable" CDs only the issuer, and not the investor, can "call" or redeem the CD. Investors who want their money before a "callable" CD matures risk a substantial loss.

As you can see from the above examples, fraudsters are creative and resourceful, and often move from one vulnerable set of victims to another and even from one industry to another. NASAA supports the effort to create an anti-fraud network to assist regulators in detecting patterns of fraud and coordinating efforts amongst functional regulators.

To coordinate enforcement actions, state securities regulators meet with their SEC and NASDR counterparts at an annual NASAA-sponsored enforcement conference, at its Spring Public Policy Conference and during many informal meetings throughout the year. Perhaps NASAA's and NASDR's most important collaborative effort was their joint development of the Central Registration Depository (CRD): the electronic filing and tracking system for all entities that regulate broker-dealers and their representatives.

CRD Background

State securities regulators, NASD and the SEC realized that it was inefficient for each regulator to have their own filing systems to license broker-dealers and their agents. Not only was it burdensome for the regulated community, but the information was hidden away in one regulator's filing system; other regulators had little or no access to the often-important information. In 1980, the NASD and the states through NASAA, agreed to jointly develop a system that would collect information to be stored in a single place, the CRD, and be available to all securities regulators. **State securities regulators also make CRD reports available to the general public and other regulators upon request.** After NASAA and the NASD launched the CRD in 1981, a "rogue" stockbroker could no longer go from state to state and hope that the jurisdictions did not communicate with one another -- all the disciplinary information on that individual is stored in a central place and easily accessible to state regulators, the NASD and the SEC. Perhaps more importantly, by using the CRD, a state securities agency protects investors from fraudulent activity by refusing to grant a securities license to a fraudster who is trying to sell securities to residents of that state. Making the CRD information available to the public and urging customers to check the CRD before investing with a broker is a cornerstone of NASAA's investor education program.

NASAA and the NASD have worked diligently to take advantage of technological advances to improve CRD as a licensing and enforcement tool. In 1999, for instance, NASAA and the NASD as joint owners, launched Web CRD, a thoroughly redesigned

system that gives regulators the ability to keep even closer track of problematic firms and individuals. Thanks to Web CRD, a regulator can access this licensing and disciplinary information from anywhere in real time. For example, a state securities regulator performing an exam on a broker-dealer in Kansas can use a laptop to log onto Web CRD and discover an action taken against that broker-dealer by the NASD that same morning.

Web CRD also allows regulators to proactively search the database and generate reports highlighting bad brokers and troubling trends. The CRD system contains records on more than 650,000 individuals and over 6,000 firms. Disciplinary information is captured from a number of sources, including state securities regulators, the SEC, the NASD, the NYSE and AMEX, from FBI rap sheets returned from fingerprint submissions, as well as from individual registrants and the brokerage firms.

IARD Background

Another successful cooperative effort between state and federal regulators is the Investment Adviser Registration Depository (IARD). The National Securities Markets Improvement Act of 1996 (NSMIA) divided regulation of investment advisers between the states and the SEC depending on the amount of the firm's assets under management. The number of investment advisers has grown exponentially over the last ten years and now approaches 25,000 firms and approximately 125,000 investment adviser representatives.

The SEC and NASAA chose NASD Regulation as the vendor to build and operate IARD and to integrate it to the extent possible with Web CRD. IARD is modeled on Web CRD and provides for the centralized electronic filing of registration applications, amendments and renewals. Like Web CRD, IARD will allow securities regulators nationwide access to disciplinary information and utilize similar functionality.

Antifraud Database Across Regulator Lines

As detailed above, NASAA has used and developed Web CRD and IARD to license registrants and to combat fraud. These systems were designed for and have been effective in allowing securities regulators to share information about individuals and entities they regulate.

Now, with the advent of the Gramm-Leach-Bliley Act and the ingenuity of those who commit fraud, NASAA believes it is critical that information among financial regulators be shared in order that those who migrate from industry to industry can be effectively tracked.

NASAA has extensive experience developing a comprehensive electronic system to deliver enhanced regulatory oversight and enforcement with the ultimate goal of protecting investors. Our members look forward to working closely with you as your proposal takes shape. There are many questions to be asked and answered during the

development phase of a network to be accessed by a number of different entities. They include:

- What regulatory enforcement databases currently exist?
- What information is captured in each database?
- Who has access to this information? Is it regulators only? Does the public have access to databases that currently exist?
- How can confidential regulatory information be protected?
- What information should be accessible and what types of information should not be released?

The vast majority of brokers and investment adviser representatives are honest, ethical professionals. It is the duty of state securities administrators to ensure that investors are doing business with reputable professionals. There are a relative handful of bad apples in the securities and investment adviser business but they can do a lot of harm to individual investors. These "rogue" operators often move from firm to firm, and from one industry to another, as complaints and disciplinary actions pile up against them.

State and federal securities regulators have developed an efficient and cost-effective mechanism for centralizing the licensing and disciplinary histories of broker-dealers, broker-dealer agents, investment advisers and investment adviser representatives. We support Congressional efforts to create a national information-sharing network among regulators to fight financial fraud. State securities regulators have a wealth of technical expertise and resources and welcome the opportunity to work with the Financial Services Committee as a system is developed to share enforcement information with state and federal regulators from the banking and insurance sectors.

Statement of Chairwoman Sue Kelly

**House Committee on Financial Services
Subcommittees on Oversight & Investigations
and Financial Institutions -
Joint Hearing entitled "Protecting Consumers:
What can Congress do to help financial regulators
coordinate efforts to fight fraud?"**

Tuesday, March 6, 2001 at 2:00 p.m. in 2128 Rayburn

Today, we are here to hold the first of many subcommittee hearings on issues of importance to consumers, regulators and the financial services industries. As this is a joint hearing of the Oversight and Investigations Subcommittee and my colleague from Birmingham, Mr. Baucus', Subcommittee on Financial Institutions. I want to thank him for allowing me to Chair this hearing and for his invaluable thoughts and observations on the issues before us. In addition, I want to thank the Ranking Member of our Subcommittee on Oversight and Investigations, the gentleman from Chicago, Mr. Gutierrez and the Ranking Member of the Financial Institutions Subcommittee, the gentlewoman from Los Angeles, Ms. Waters, for their work on this issue and for agreeing to hold this hearing on this very important issue. I look forward to continuing to work with you along with all the members of our committee as we consider potential legislation that may result from the information we gather at this hearing.

With the recent enactment of the Gramm-Leach-Bliley Act, Congress required 'functional regulation' of our financial services industry. In order to make functional regulation work, Congress directed regulators to work together in the policing of their industries. Particularly in the insurance industry since the enactment of the 1994 Insurance Fraud Prevention Act, the insurance industry has been unable to access the necessary information enforce this law. This act prohibits anyone who has been convicted of a felony involving dishonesty or a breach of trust from engaging in the business of insurance. However, the law did not provide any means for potential employers or insurance regulators to check for a criminal background.

Proper implementation of these acts clearly requires both increased coordination and communication among the regulators and the highest of standards for those who work in the financial services industry. We must ensure that the regulators have all the tools they need to meet these goals. To add to this problem we have clear cases where criminals after being banned from one financial industry have gone to another financial industry to continue their fraud. The best example of this is the case of Martin Frankel who was just reported to have been extradited back to the U.S. to face charges for his crimes after his failed escape attempt last week. After being permanently banned from the securities industry in August, 1992, Mr. Frankel migrated to the insurance industry, where he is charged with perpetrating an investment scam which stole more than $200 million from insurance companies. Representatives from the General Accounting Office are here with us today who will provide some details of his alleged activities before he fled the country in 1999. Mr. Frankel faces a thirty-six-count indictment with twenty counts of wire fraud, thirteen counts of money laundering, and one count each of securities fraud, racketeering and conspiracy.

We have called this hearing to gain a better understanding of these issues from the perspective of regulators and the industry. It is our hope that this can lead to legislation to facilitate communication, which can prevent criminals from exploiting this perceived weakness as was perpetrated by Mr. Martin Frankel. At issue before us is the impact these problems have upon consumers and what we can do to further protect consumers by better regulatory oversight.

Before us today we are honored to have two distinguished panels of witnesses to share their thoughts and observations about this problem. I thank all of you for taking time out of your busy schedules to discuss these issues with us.

Chairman Spencer Bachus

OPENING STATEMENT FOR MARCH 6, 2001
HEARING ON ANTIFRAUD NETWORK PROPOSAL

Thank you, Madam Chair, for convening this joint hearing of our two Subcommittees to consider the issue of antifraud coordination by Federal and State financial regulators. As this is the first formal hearing in this Congress that involves the Financial Institutions Subcommittee, let me just say how excited I am to be chairing the Subcommittee, and how much I look forward to working with my Ranking Minority Member, Mrs. Waters, and all of the other Members of the Subcommittee over the next two years. Mrs. Waters and I have now served together as the chairman and ranking member of **three** different subcommittees of this Committee, and while we certainly do not see eye-to-eye on every issue, we have always dealt with each other in a spirit of collegiality and candor. I hope that will continue.

I can think of no better topic with which to begin our work in this Congress than the one that brings us here today - protecting consumers by making sure that our financial watchdog agencies have the necessary tools to fight fraud and that they cooperate and coordinate their efforts in fighting fraud.

[As Mrs. Kelly mentioned in her opening statement], today's hearing is particularly timely, given the extradition back to the U.S. over the weekend of Martin Frankel. Mr. Frankel is a high-profile "poster boy" for why coordination between Federal and State financial regulators is so critical.

The concept of linking together already existing databases maintained by various financial regulatory and law enforcement agencies to combat fraud against consumers makes good common sense. If implemented properly, such a network could serve as an effective early warning system when con artists like Mr. Frankel attempt to expand the frontiers of their criminal enterprises to new industries and new locales.

As with any effort to promote cooperation between regulators of different industries across multiple jurisdictional lines, achieving that objective is easier said than done. Anyone who has spent significant time inside the Beltway knows how difficult it can be to get different government bureaucracies to coordinate their activities, even in an area such as this where the benefits of such cooperation are so obvious. Turf battles are one of Washington's favorite pastimes.

In addition, logistical questions relating to access to the anti-fraud database and the kinds of information that will be available there will need to be addressed.

I am confident that today's hearing will help the Committee begin to answer these questions, and I look forward to hearing from all of our distinguished witnesses. Finally, let me commend Chairman Oxley for moving so quickly in this Congress to place this important matter on the Committee's agenda. I look forward to working with him, Mrs. Kelly, and my other colleagues as we consider legislative proposals to advance the fight against financial fraud.

CURRENCY

Committee on Financial Services

Michael G. Oxley, Chairman

For Immediate Release: **Contact: Peggy Peterson at 226-0471**
Tuesday, March 6, 2001

Opening Statement
The Honorable Michael G. Oxley
Chairman, House Financial Services Committee
March 6, 2001
Joint Hearing
Subcommittee on Oversight and Investigations and
Subcommittee on Financial Institutions and Consumer Credit
"Protecting Consumers: What Can Congress Do To Help Financial Regulators Coordinate Efforts To Fight Fraud?"

Last Sunday, the United States extradited international fugitive Martin Frankel from Germany to face a 36 count indictment for insurance fraud, money laundering, and racketeering. Before he committed these crimes, Frankel had been banned for life from the securities industry for fraudulent activities. But the State insurance regulators had no knowledge of this ban, and Frankel easily switched from the securities to the insurance industry, where he proceeded to defraud State regulators out of hundreds of millions of dollars in lost assets.

Unfortunately, Martin Frankel is but one of thousands of fraudulent actors that are undermining our financial system every day. Modern technology and the Internet have created wonderful new opportunities to begin reshaping our financial services industry to better serve consumers, but they are also fraught with the potential for fraud. Consumers and regulators can no longer rely on face-to-face contact and communication to determine trustworthiness. Instead, the technology of the future demands an evolution in our regulatory oversight to protect consumers. If we're not willing to invest now to coordinate the anti-fraud systems of our financial regulators, I guarantee that the next Martin Frankel is waiting to take advantage of us again, at a much higher cost.

Overall, the financial regulators here before us today have done a good job of protecting consumers, and should be commended for upgrading their computer systems and beginning discussions of cross-industry coordination. But these efforts are not enough. And they can never be enough when done solely on an ad-hoc basis.

We need a coordinated anti-fraud computer system that establishes an automated information connection among regulators. Each regulator keeps a database of individuals and entities that have been censured for wrongful acts. In most cases, these violations are already publicly accessible on each agency's website. But there's no way for any regulator to look the information up without manually going to each website. Yes, the State insurance regulators could have gone to the SEC website and discovered Frankel had been barred from the securities industry. But with literally millions of agents and company licenses being processed each year, that search will never happen unless Congress steps in and creates a simple

computer search engine networking the systems of the financial regulators

This sounds simple, and it's something that every national and international business is doing today. But it's not happening in the government because there is no entity tasked with coordinating regulations across all financial industries. And there is no mechanism now for regulators to share information without losing critical legal privileges and confidentiality protections for the material, as well as potentially being subjected to unlimited liability. The regulators can not set up this system by themselves without congressional legislation and coordination.

An anti-fraud coordination mechanism can be put together without requiring any new collection of information, with no additional bureaucracy or regulation, and with long-term cost savings for consumers. The network would be only accessible to regulators and only include data on financial professionals, not individual consumers. Even if this coordination effort only catches one future Martin Frankel, it will have paid for itself many times over.

Three years ago, the Members of this Committee helped enact historic financial services modernization legislation to integrate the cornerstones of our financial world. Today, we are taking the next step forward. Having begun integration of the industries, we must now turn to integrating financial regulation, to create a coordinated and seamless anti-fraud system to protect consumers.

I thank Chairwoman Sue Kelly for braving the snowstorms in New York to Chair this hearing today and my friends Chairman Bachus, and ranking Members Maxine Waters and Luis Gutierrez for their leadership in putting this hearing together.

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