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FY '07 Budget Testimony
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New Jersey Department of Banking and Insurance
before
Senate Budget Committee
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Mr. Chairman: The Department of Banking and Insurance regulates the State's banking, real estate and insurance industries with the goal of promoting financial stability, efficiency, competition and compliance with the highest standards of consumer protection.

I am honored to have been nominated and confirmed as Commissioner, and I look forward to the very different set of challenges I face as a result of my transition from the private sector to government. But one thing I do not plan to change is my businessperson's approach to achieving efficiency and results.

I've been impressed during my short tenure at the Department by the knowledge and sincerity of the employees who serve in it. While there have been modest upgrades of the workings of many of its systems, I *know* it can do more.

A decade after they were merged into one department, I am not convinced that Banking and Insurance functions are as integrated as they might be, in order to make efficient use of staff and be more productive on regulatory matters involving both industries.

Therefore, one of my first acts as Commissioner was to direct a top-to-bottom review of the Department's organizational structure. I have instructed that this review be conducted with an eye on cost savings, as well as an analysis of the effectiveness of the Department's many functions.

The analysis is being conducted unit by unit, employee by employee and policy by policy. In line with Governor Corzine's directives, this evaluation will include a determination of how cross-training and technology can be applied to maximize both the human and financial resources of the Department.

Following any initial restructuring or realignment of the department, I have asked the staff to develop an ongoing Internal Organizational Audit function to track the implementation and success of the effort.

I share the Governor's view that, as public officials, we are accountable to those we serve. As Commissioner, I have placed a high ethical bar at DOBI. The Department will continuously scrutinize the actions of its staff and endeavor to insure that sound judgment is applied to issues having ethical implications.

During the course of my testimony I'll discuss, among other things, the implementation of dedicated funding at the Division of Banking. With this change, the Department is now funded entirely by the industries it regulates.

That being said, I want to make it perfectly clear that I, in no way believe that the self-funded nature of the Department absolves it in *any way* from the obligation to excise waste and be a meaningful part of budget reform.

The budget for Fiscal Year 2007 proposes the elimination of 30 positions, 6 unclassified, 11 classified and 13 through attrition for a savings of approximately 1.5 million dollars.

Recently, I implemented a plan that consolidates unclassified positions at the highest level of the Department. The Chief of Staff, Assistant Commissioner for Public Affairs, Assistant Commissioner for Legislative and Regulatory Affairs and Legislative Counsel have been merged into two positions: the Director of Operations and Communications and the Director of Legislation and Policy. This consolidation saves the Department both money and salaried positions.

In response to the Governor's budget recommendations the Department has also reduced its non-salary operating expenses by \$318,000. These reductions, along with the reductions in staff, allowed us to absorb the Managed Care Unit transferred from the Department of Health with a modest decrease to our budget.

I've mentioned that the need to streamline the organization goes beyond the need to better control costs. That is because the Department plays a significant role in economic development in New Jersey.

Regulatory activities impact the health of the banking, real estate and insurance industries which generate \$80 billion dollars in annual economic activity in our State.

The Department's role in maintaining competitive marketplaces that benefit consumers is about more than the relationship of insured to insurer, or depositor to depository.

It is about the job market, the tax base, the climate for new investment not only in these fields but in any field that relies on services from insurers or bankers or real estate professionals.

The following statistics give a general overview of the scope of these activities.

The Division of Insurance is responsible for the regulation of 113 domestic insurance companies and almost 1,000 non-domestic insurance companies with a combined \$31.9 billion in written premiums.

The Division of Banking regulates 94 state-chartered banks and 19 credit unions with combined assets of \$69.5 billion.

There are approximately 2,400 consumer credit licensees, 4,600 mortgage bankers and brokers, over 34,000 mortgage solicitors, 146,000 real estate brokers and salespeople, 142,000 insurance producers and 1,100 public adjusters.

In fiscal year 2005 the Department responded to over 100,000 consumer inquiries, 15,000 consumer complaints; 3300 investigations were completed and \$11.8 million was recovered for consumers.

The Public Affairs Unit conducted more than 500 consumer education and information sessions throughout the state on subjects as diverse as how to protect against identity theft, insurance fraud, and predatory lending. We are redesigning and consolidating our brochures and programs to make them more interactive, practical and cost effective.

The Department has partnered with other state agencies and private industry to provide financial literacy information and education to middle school and high school students and at public libraries through its participation in the NJ Financial Literacy Awareness Network. Building on that success, the Department will now reach across Department lines to share what we do with other departments, seeking to eliminate duplication of effort and to provide the most up to date information to the broadest base of constituents.

Many legislative district office staff recently participated in a training session which we offered at the Department describing its functions and staff. I want to personally extend an offer to you and to your staff to use DOBI as a resource for information and guidance on the regulatory functions of banking and insurance.

With your permission I would like now to touch briefly on some key issues moving forward, starting with health insurance.

The basic problems with our health insurance system (nationally as well as here in NJ) are well known: it costs a lot and too few people have it.

The Department's regulatory oversight is limited to only 30% of the market. The rest, including Medicare, Medicaid and self-insured plans are regulated by Federal oversight.

The current health care delivery system is inefficient. In the short time that I have been at the Department, I've learned that doctors, hospitals, carriers, employers and subscribers are all dissatisfied with the way the system works and the way the financial burden is distributed. It leaves too many people totally uninsured and is often too expensive for those who are covered.

You will not be surprised to hear that I do not have a magic-bullet answer for this complicated problem.

We intend, however, to work hard to seek a solution. The Department is seeking ways to bring about real change in the health insurance market. Comprehensive solutions will necessarily involve grinding work and compromise by all stakeholders, all of whom we intend to engage in an ongoing dialogue.

The Department is prepared and eager to work with members of the Legislature, the business community, the carriers and all other constituencies in addressing the problems posed by this difficult issue.

Related to health insurance issues are the problems of our medical malpractice market.

In the past several years, problems in the medical malpractice insurance market have impacted New Jersey patients and physicians. While most insurance is about protecting economic interests, malpractice coverage is tied to the accessibility of quality health care for citizens.

In 2004, the Legislature passed a reform bill that addressed many issues within this multifaceted problem. The bill also established the Medical Malpractice Liability Premium Assistance Fund that is administered by our Department.

In the first of the three cycles provided by the legislation, 1203 physicians in eligible high risk specialties received checks in the amount of \$10,892 to use for malpractice insurance premium relief.

The Department will continue to look for ways to balance the needs of physicians, patients and carriers alike.

We will be reaching out across Departmental lines, meeting with members of the legal community, with physicians and with insurers to seek a realistic way forward.

I believe there are potential areas of agreement despite some competing interests. It will take a concerted effort on the part of all those involved. Reform cannot succeed without an honest discussion of the nature of the problems and willingness to compromise on all sides.

Next, I'd like to speak about an issue that has the potential to impact New Jerseyans from both banking and an insurance perspective ---- planning for and mitigating damage from man-made or natural disasters.

Since 9/11, we have become increasingly sensitive to New Jersey's position as a major population center with a tremendously important physical and financial infrastructure.

By virtue of its geography New Jersey has been blessed with a beautiful and thriving coastline. While we are admittedly less vulnerable to total destruction than the Southern and Gulf States, the events of last summer remind us of the devastation that global warming and the cyclical resurgence of hurricane frequency can bring. Indeed, meteorologists have recently warned that the Northeast is long overdue for a potentially destructive storm. Katrina should be a wake-up call.

Insurance is all about providing financial security in the event of a major loss. We need to be certain that we have done everything we can to be ready for such a crisis.

Public safety is the first priority, and obviously principally outside of the Department's jurisdiction. However, property damage and potential economic loss should be addressed by thinking through the logistical challenges of claims adjustment and payment following such an event, and by planning to ensure a process of prompt claims payments to property owners and businesses. These steps will be one key to mitigating economic impact.

With respect to a more familiar topic, I am pleased to be able to report the continuing development of a competitive auto insurance market in our state

The reforms of 2003 are working as intended. The availability crisis has been addressed. We have now reached the half-billion dollar mark with respect to rate reductions and special dividends for over 75% of NJ policyholders.

The marketplace is still in a transition into this new competitive environment, and is still fragile. We should not declare victory and stop paying attention or give in to the temptation to react to anticipated cyclical changes and other concerns by imposing the kind of regulation that this Legislature so wisely reformed in 2003.

We have a number of additional carriers interested in entering the New Jersey market. We need to be sure that we do not put any unreasonable obstacles in their path or discourage them from doing so.

We have a lot to be pleased about in an area that previously commanded a great deal of negative public attention and legislative time and effort

I think it is also important to reiterate the key role of this and other regulated industries in the economic vitality of the State. Bringing in new insurers, and retaining existing ones, is about more than securing price competition and the availability of coverage. It is about maintaining and growing an important part of the economic base of our state and making life in the Garden State more enjoyable and affordable.

With respect to banking issues, I'm happy to be able to report on the success, thanks to the Legislature, of the Banking Division's transition to dedicated funding.

With its implementation on July 1, all of the Department's Insurance and Banking oversight and regulatory functions are now entirely funded by the Banking and Insurance industries.

Indeed, total assessments and other specified revenues exceed expenses, creating a net contribution to the General Fund. With respect to the Banking Division, certain fees have been preserved and the revenues generated will be sent directly to the General Fund.

Finally, I want to highlight a topic that directly affects the Department and directly affects you, the Legislature; namely, the growing preemption of state consumer protection laws by federal banking regulators.

Over the years, you have done an excellent job of authoring and passing a variety of progressive laws that protect the State's consumers while allowing a vigorous financial services market to prosper. The legal structure you have been so instrumental in creating is among the nation's best.

As you know, the laws you pass in banking and consumer finance apply to all depository institutions chartered non-depository lenders licensed by the Department. However, federally-chartered depository institutions do not have to comply with these laws because their federal regulators have preempted them, relying on the supremacy clause of the U.S. Constitution. As a result, federal entities operate in our state without being bound by most of the laws you have passed.

Until the last fifteen years or so, the dual banking system of competing state and federal charters had worked well for the most part. As the financial services industry has expanded, state legislatures have enacted new consumer protection laws. In response, federal regulators have increasingly used their preemptive power to exempt their institutions from these laws.

The regulatory scheme that they provide offers less of a compliance burden, with insufficient staff to handle and they do not return nearly as much money to consumers as do state regulators.

This preemptive strategy has become a centrally important way in which the federal chartering regulators are competing with the state for charters and has produced and continued a strong trend toward a federally-dominated system.

Even though the regulatory cost of being in the state system is about 40% of being in the federal system, there has been a significant flipping of charters to the federal system. This is true not only in New Jersey but across the nation. A few of the former, large New Jersey banks that are now in the federal system include Summit, Hudson United, Hudson City Savings and Trust Company of New Jersey.

Rather than a healthy competition between the chartering authorities, we have a federally-dominated system that makes it unfairly difficult for state institutions to compete.

Let me be clear, the effect of this system is to diminish your authority and your say in how financial services are provided to the people of New Jersey because the good laws that you pass are applying to a smaller and smaller universe of providers.

The shift also has broader economic implications. State-chartered banks tend to be smaller community banks that have a strong commitment to their communities.

Because of this commitment, they have a heightened understanding of local needs, and history indicates their responsiveness to those needs. They make a disproportionate number of small business loans that are such important drivers of the economy.

As an example, larger banks that at the time were headquartered in New Jersey played a crucial role in the financing of the New Jersey Performing Arts Center in Newark. Local headquarters do make a difference.

We should all be very concerned about this shift because we all have a responsibility to see that the state banking system is preserved and flourishes.

Together we need to preserve the dual banking system which has served us so well. I plan to approach you in the future to explore your interest in finding and implementing a solution to this difficult problem.

I want to thank you, Mr. Chairman for the opportunity to come before you. I look forward to working with all of you through this budget process and am happy to respond to any questions you might have.