

TESTIMONY OF

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ON BEHALF OF

THE NATIONAL ALLIANCE OF LIFE COMPANIES

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BANKING, HOUSING AND URBAN AFFAIRS

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INTRODUCTION

Good morning Chairman Shelby, Ranking Member Sarbanes, and members of the Committee. My name is Rob Hardy. I am Vice President and General Counsel of Investors Heritage Life Insurance Company in Frankfort, Kentucky, a life insurance company that was started by my grandfather, Harry Lee Waterfield, in 1960. I am the third generation of the Waterfield family that has been involved in the management of the business, and I fully expect several more generations will follow. We have approximately 100 employees and we are licensed to do business in 30 states, primarily in the Midwest and Southeast.

We market life insurance products through various distribution systems; however, our primary markets are in the prearranged funeral market and the final expense market. More than 3,800 agents are appointed to sell our products and we have more than 400,000 policies in force insuring families and individuals across our marketing distribution system.

I am pleased to be here today on behalf of the National Alliance of Life Companies (NALC), a trade group that is primarily composed of small and mid-sized life and health insurance companies. Most of our members are regional in scope operating in up to 30 states and a number of members are licensed in all 50 states. The NALC has been in existence since 1993 and its predecessor organization, The National Association of Life Companies was in existence for more than 35 years. The NALC's primary mission is to promote fair and effective regulation that will allow the industry to thrive for the benefit of policy owners and shareholders.

The NALC supports state regulation of insurance for all participants and all activities and opposes the concept of an optional federal charter. In fact, I am confident that a number of small and mid-sized life insurance companies that are not members of our association also share the concerns I raise. A federal charter may make life simpler for some companies, especially large

insurance companies, but it is our belief that a federal regulatory scheme would not be in the best interest of the industry as a whole.

Others may argue that a federal charter simply allows companies a choice to submit to federal regulation. We do not believe it is that simple. Proponents of a federal regulator want a simple, one stop shop to provide greater efficiency and uniformity for the insurance industry. Based on that premise, one could argue for federalizing first responders, state health or environmental agencies, or even education. Should we simply federalize all of those functions for the sake of convenience?

No one who believes in our republic can seriously believe that such action would be a good idea. It is recognized that business convenience is often trumped by such factors as, consumer protection and unique market needs impacting a community. Insurance is no different.

The design for a federal charter, as contemplated in S. 2509, the National Insurance Act (also known as “Optional Federal Charter”), is based on the dual charter banking system. However, there is no national crisis, as there was when the federal banking system was established, compelling Congress to act in order to bolster consumer confidence. There is no outcry from consumers demanding the federalizing of insurance. To the contrary, according to ACLI’s own report, *Monitoring Attitudes of the Public 2004*, the life insurance industry is regarded as “either very or somewhat favorable by the majority of people” polled. Further, “a solid majority of consumers agreed that life insurers...provide good service and employ highly trained professionals.”

Another noteworthy outcome from that report is how consumers feel about life insurance agents. ACLI’s study found that “most consumers agreed that life insurance agents exhibit no more high-pressure than other sales people.” That’s good news. This is hardly a clarion call

from consumers for drastic changes like the creation of an entirely new regulatory structure in the federal government.

So what is it we're trying to fix here? We agree that there is still much work to be done to improve market efficiencies and uniformity, but indications are that states are moving in the right direction.

INSURANCE v. BANKING

The primary purpose of insurance regulation is to protect consumers by promoting competitive markets, enforcing insurance laws, and assuring financial soundness and solvency of insurers. It is essential that all financial institutions be subject to efficient regulatory oversight. However, attempting to mirror the system that regulates the banking industry is a lot like trying to put the square peg in a round hole.

First, unlike most bank products, which are based on a national commodity, insurance is sold based on individual needs. Second, the distribution channels are completely different with insurance companies, which rely primarily on agents, while banks rely on consumers coming in to their branches to withdraw or deposit their money. Insurance has to be sold to individuals by individuals.

The federal banking laws were enacted during a time of a national financial crisis, and without federal intervention, there was a very real risk of financial collapse. It was extremely important for the federal government to back bank deposits to give investors and customers the confidence to trust banks. There is no national crisis in the insurance industry that would require the creation of another federal bureaucracy.

A DUAL REGULATORY SYSTEM WOULD CREATE AN UNLEVEL PLAYING FIELD

Proponents of S.2509 suggest that since banks have successfully managed in a dual regulatory world, insurance companies could do the same. However, because of the differences between the industries discussed above, I believe it is inaccurate to compare the two industries.

Small to mid-sized insurance companies tend to be more regional in scope. With the introduction of a federal regulator for insurance, the rules will necessarily be different and the “playing field” will become unlevel. If all the presumptions supporting S.2509 hold true (e.g. greater efficiency, lower costs of doing business, etc.), then small companies, like mine, could be forced to move to a federal charter in order to remain competitive, or risk being gobbled up, or simply go out of business. Therefore, what is dubbed as “optional” is not really optional at all. It’s mandatory.

EFFECTUATING CHANGE WITHIN THE CURRENT SYSTEM

We certainly want to applaud this Committee, in particular, and Congress as a whole, for the vital role it has played in pushing states to take positive reform steps over the past few years. Without Congressional efforts, measures such as the Interstate Compact for Insurance, speed to market reform, the National Association of Registered Agents and Brokers (NARAB) licensing provisions, the financial accreditation system and the improvements being considered for better coordination of market conduct reviews would not have occurred as quickly as they have, if at all. These examples prove that what the states can not or will not do on their own, narrowly tailored federal legislation and guidance can lead them to do so.

The fact of the matter is that, notwithstanding what proponents would have you believe, the system is not completely broken. It is not perfect and it is in need of improvement but,

positive steps have occurred, and the march toward modernizing the state regulatory system continues. We are very concerned that the creation of a new, federal bureaucracy to regulate insurance will halt the forward progress and create an entirely new set of problems for everyone concerned.

Last month, the 26th and 27th states adopted the Interstate Compact for approval of life insurance policy forms, formally making the Compact functional. A great deal of work went into the drafting of the compact language and passage of compact legislation- a team effort by industry, consumer groups, and regulators. Indeed, it offers a promising opportunity to address many of the speed-to-market concerns you hear about today, without the need for making radical changes in our existing regulatory framework.

Of course, the first question that must be asked is how a federal charter or any other solution will impact consumers. Improving the state system is in the best interests of consumers. State officials are positioned to be responsive to the needs of the local marketplace and local consumers. We believe consumers are more comfortable with having complaints resolved with regulators in their local communities, rather than calling a hotline in Washington or some regional headquarters. Likewise, consumers have grown comfortable raising public policy concerns regarding insurance issues with elected state officials across the country.

If a new federal regulator is empowered, those complaints will now be added to the already busy agendas of United States Senators and Members of Congress. Simply put, state governments have a unique and deep knowledge of the insurance markets within their states, and a unique ability to address malfunctions when, and as, they arise. Is it a perfect system? No. Can it be improved? Like everything else in the world, it can, and should, be improved and work continues everyday to make it better and more efficient.

One example of this work is the relationship between the NAIC and NCOIL. I have been involved in the industry for almost 20 years now and I have seen real progress between these two organizations. I believe that progress is vital to the uniformity that we are all seeking.

Kentucky is a perfect example. The interaction between our NCOIL representatives, the Kentucky Office of Insurance and the NAIC was the primary driver in the adoption of the Interstate Compact by our legislature this spring. The relationship with NCOIL allowed our representatives to supplement the background and education that our state legislators received from our Office of Insurance and gave the legislature, as a whole, the confidence to pass the measure.

CHOOSING A REGULATOR

It is undeniable that some insurance industry groups have been intimately involved in framing the concept of an optional federal charter for insurance. We think the industry will be exposed to the very real criticism that it is not industry's intent to create a more aggressive regulator, but a friendlier regulator – a “champion of industry,” if you will. Creating an industry-friendly regulator seems somewhat at odds with the primary goal of insurance regulation, which is consumer protection.

Indeed, we need smarter, more efficient regulation, but the primary focus must remain on the protection of policy holders, not the convenience of the industry. This may seem odd coming from someone who runs an insurance company, but we wouldn't be in business if we didn't have the trust of our customers.

In order to create the proposed bureaucracy, the federal government will have to pull the expertise from somewhere; and that somewhere will be from the states, which have been

regulating insurance for over 150 years. This will have the effect of weakening the state regulatory structure. The ultimate and likely consequence will be that the industry will end up with two weak regulators rather than one strong system.

More importantly, there is a huge presumption that federal regulation will be more streamlined and more efficient. In looking at other federal agencies, all staffed by good people with good intentions, few can honestly conclude that this presumption is correct.

From my experience, when I need to speak to someone at a state department of insurance, I have that opportunity. We are not sure that the same result can be achieved under a federal bureaucracy without it being large enough to handle all of the inquiries that states now receive.

CREATION OF THE OFFICE OF NATIONAL INSURANCE (ONI)

In creating the Office of National Insurance, the Commissioner will basically have unlimited powers to employ as many people and create as many offices as deemed necessary. A current federal agency analogous to the proposed Office of National Insurance, based on the individual nature of required services is, arguably, the Social Security Administration (SSA). SSA has over 1,300 offices and employs over 65,000 people to service benefit recipients, not to mention constituent support provided by every Member of Congress. The NAIC has indicated that the state departments of insurance handle over 4 million consumer inquiries, including complaints. Can you imagine the Federal bureaucracy necessary just to handle even a fraction of those inquiries? And this would be in addition to the thousands of state insurance regulators currently employed, who will continue to do their jobs at the state level. I imagine we could end up with more insurance regulators per capita than any other area of business.

FUNDING

Funding is also a huge issue with regard to how the funding of a federal regulator will affect the states. Fees, assessments, and penalties will be charged to federally-chartered companies and producers. While states will still be allowed to receive premium taxes in the short-term, they will no longer receive revenues from other fees and assessments; for example, examination fees from federally-licensed insurers and producers. This will likely have a negative impact on state budgets.

Curiously, Section 1122 of the bill provides that fees and assessments charged against the companies and producers are not considered government or public monies. How can the government take money from the private sector and that revenue not be considered “government or public monies”?

Further, according to the NAIC, it took \$880 million to run the various state insurance departments. How much will it take to run the Office of National Insurance? No one knows the answer to that question, but it is clear that the Commissioner will have the discretion to assess whatever it takes. Since the intent is to establish a parallel system similar to banking, it should be noted that banking is regulated by at least six different regulatory bodies, employing over 30,000 people.

PREEMPTION

The recent federal district court decision in “*OCC v Spitzer*”, giving federal agencies full authority to promulgate preemption regulations, shows the extent to which federal agencies with unbridled authority are willing to go to usurp states’ rights. In that case, the court determined that the Office of the Comptroller of the Currency (OCC) possesses exclusive governmental

enforcement authority, which OCC granted itself by regulation, with respect to all laws – federal and state – that apply to national banks. In short, it means the OCC has the authority to prohibit states from using the court system to enforce applicable state laws against national banks. This bill gives the Commissioner of Insurance that same degree of authority. As a matter of public policy, this is a concern to us because, according to this federal court, states will have no standing to use the court system to inspect, examine, regulate or compel action by a national insurer or producer operating within its borders.

GLOBAL MARKETPLACE

We unquestionably live in a global marketplace today. But the United States still has the most sophisticated and largest insurance market in the world. I think it is reasonable to say that any company in the world that wants to do business here is doing business here. In recent years, this process has been streamlined and now all 50 states and the District of Columbia accept the NAIC's Uniform Certificate of Authority Application. This process has helped foreign and domestic companies alike.

CONCLUSION

The NAIC has worked hard since 2000 to modernize the regulatory framework and improve efficiencies in the process. Congressional initiatives have gone a long way in prompting the NAIC and the various states to adopt necessary model laws that will improve the state-based system. Now is not the time to create a whole new bureaucracy. Pay close attention and prod when necessary to keep the modernization effort going. There are better ways to improve efficiency, but regulation of the insurance industry should remain with the states. While

federal legislative tools to push states to improve would be a welcome addition, the creation of a large, new federal bureaucracy is not necessary. Thank you very much for the opportunity to share the views of NALC today.