STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS

ON

PERSPECTIVES ON MODERNIZING INSURANCE REGULATION

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Statement Made by
Frank Keating
President & CEO
American Council of Life Insurers

Mr. Chairman and members of the Committee, my name is Frank Keating, and I am President and CEO of the American Council of Life Insurers. The ACLI is the principal trade association for U.S. life insurance companies. Its 340 member companies account for 93% of total life insurance company assets, 94% of the life insurance premiums, and 94% of annuity considerations in the United States.

All sectors of U.S. financial services are at a critical juncture given the current state of the domestic and global markets. I appreciate the opportunity to discuss with you today the views of the life insurance industry on how insurance regulation can be modified to improve the current structure and how insurance regulation can be integrated most effectively with that of other segments of the financial services industry as well as with overall systemic risk regulation.

Addressing systemic risk in the financial markets – both domestically and globally – has emerged as the driving force behind regulatory reform efforts. My comments today reflect that perspective and begin with the premise that the life insurance business is, by any measure, systemically significant.

The Life Insurance Industry Is Systemically Significant

Life insurance companies play a critically important role in the capital markets and in the provision of protection and retirement security for millions of Americans. Life insurers provide products and services differing significantly from other financial intermediaries. Our products protect millions of individuals, families and businesses through guaranteed lifetime income, life insurance, long-term care and disability income insurance. The long-term nature of these products requires that we match our long term liabilities with assets of a longer duration than those of other types of financial companies.

Life insurers are the single largest U.S. source of corporate bond financing and hold approximately 18% of total U.S. corporate bonds. Over 42% of corporate bonds purchased by life insurers have maturities in excess of 20 years at the time of purchase. The average maturity at purchase for all corporate bonds held by life insurers is approximately 17 years. As Congress and the Administration continue efforts to stabilize the capital markets and increase the availability of credit, the role life insurers play as providers of institutional credit through our fixed income investments cannot be overemphasized. We are significant investors in bank bonds and consequently are an important factor in helping banks return to their more traditional levels of lending.

Life insurers are also the backbone of the employee benefit system. More than 50% of all workers in the private sector have life insurance made available by their employers. Life insurers hold approximately 22% of all private employer-provided retirement assets.

Our companies employ about 2.2 million people, and the annual revenue from insurance premiums alone was $600 billion in 2007, an amount equal to 4.4% of U.S. GDP. Some 75 million American families - nearly 70% of households – depend on our products to protect their financial and retirement security. There is over $20 trillion of life insurance coverage in force today, and life insurers hold $2.6 trillion in annuity reserves. In 2007 life insurers paid $58 billion to life insurance beneficiaries, $72 billion in annuity benefits and $7.2 billion in long-term-care benefits.

Individual Company Systemic Risk

We do not presume to suggest to Congress any definitive standard for determining which, if any, life insurance companies have the potential to pose systemic risk. We assume, however, that relevant factors for Congress to consider in this regard would include: the extent to which the failure of an institution could threaten the viability of its creditors and counterparties; the number and size of financial institutions that are seen by investors or counterparties as similarly situated to a failing institution; whether the institution is sufficiently important to the overall financial and economic system that a disorderly failure would cause major disruptions to credit markets or the payment and settlement systems; whether an institution commands a particularly significant market share; and the extent and probability of the institution's ability to access alternative sources of capital and liquidity.

We do offer three general observations in this regard. First, moral hazard and the potential risk of competitive imbalances can be minimized by avoiding a public, bright-line definition of systemic risk and by keeping confidential any role a systemic risk regulator plays with respect to an individual company. Second, systemic risk regulation should have as its goal the identification and marginalization of risks that might jeopardize the overall financial system and not the preservation of institutions deemed "too big to fail." And third, and specific to life insurance, systemic risk regulation must not result in the separation of those elements of life insurance regulation that together constitute effective solvency oversight (e.g., capital and surplus, reserving, underwriting, risk classification, nonforfeiture, product regulation). Having different regulators assume responsibility for any of these aspects of insurance regulation would result in an increase in systemic risk, not a reduction of it.

Structural Considerations

Without a clear indication of how Congress intends to address systemic risk regulation, we make two fundamental assumptions for purposes of this testimony. The first is that the role of a systemic risk regulator will focus on industry-wide issues and on holding company oversight but will not extend to direct functional (solvency) oversight of regulated financial service operating companies (e.g., insurers, depository institutions and securities firms). The second is that the systemic regulator will be tasked with coordinating closely with functional (solvency) regulators and will facilitate the overall coordination of all regulators involved with the oversight of a systemically significant firm.

The absence of a federal functional insurance regulator gives rise to several important structural questions regarding how systemic regulation can be fully and effectively implemented vis-à-vis insurance. We urge Congress to keep these questions in mind as regulatory reform legislation is developed.

Policy Implementation

The first question involves the implementation of national financial regulatory policy. Whatever legislation Congress ultimately enacts will reflect your decisions on a comprehensive approach to financial regulation. Your policies should strongly govern all systemically significant sectors of the financial services industry and should apply to all sectors on a uniform basis without any gaps that could lead to systemic problems.

Without a federal insurance regulator, and without direct jurisdiction over insurance companies, and given clear constitutional limitations on the ability of the federal government to mandate actions by state insurance regulators, how will national regulatory policies be implemented with respect to the insurance industry? The situation would appear to be very much analogous to the implementation of congressional policy on privacy reflected in the Gramm-Leach-Bliley Act. Federal bank and securities regulators implemented that policy for banking and securities firms, but there was no way for Congress to compel insurers to subscribe to the same policies and practices. Congress could only hope that 50+ state insurance regulators would individually and uniformly decide to follow suit. Hope may have been an acceptable tool for implementing privacy policy, but it should not be the model for reform of U.S. financial regulation. The stakes are much too high.

Coordination of Systemic and Functional Regulators

As noted above, we assume that one aspect of effective systemic risk regulation will be close coordination between the systemic risk regulator and the functional (solvency) regulator(s) of a systemically significant firm. Moreover, we assume that the systemic regulator will be called upon to interact with the functional regulators of all financial service industry sectors to address sector risks as well as risks across sector lines. For firms deemed systemically significant, we also assume there will be a federal functional regulator with whom the federal systemic regulator will coordinate.

If there are insurance firms that are deemed systemically significant, the question arises as to how the federal systemic risk regulator will be able to coordinate effectively with multiple state insurance regulators? How will federal policy decisions be effectively coordinated with state regulators who need not adhere to those policy decisions and who may differ amongst themselves regarding the standards under which insurance companies should be regulated?

International Regulation and Coordination

Today's markets are global, as are the operations of a great many financial service firms. Consequently, systemic risk regulation necessarily involves both domestic and global elements. While state insurance regulators are certainly involved in discussions with financial regulators from other countries, they do not have the authority to set U.S. policy on insurance regulation nor do they have the authority to negotiate and enter into treaties, mutual recognition agreements or other binding agreements with their foreign regulatory counterparts in order to address financial regulatory issues on a global basis. How can multinational insurance companies be effectively regulated and how can U.S. policy on financial regulation – systemic or otherwise – be coordinated and harmonized as necessary with other countries around the globe?

Regulators, central governmental economic policy makers and legislators in Europe, Japan, Canada and many other developed and developing markets point to the lack of a comprehensive federal-level U.S. regulatory authority for financial services as one factor that led to the current instability of at least one of the largest U.S. financial institutions. Discussions at the upcoming G20 meetings in London will focus on the need to coordinate a global response to the economic crisis will include representatives of the comprehensive financial services regulators of 19 nations, with the only exception being the U.S. because of its lack of a federal regulator for insurance.

The G20 work plan includes mandates for two working groups. The first is tasked with monitoring implementation of actions already identified and making further recommendations to strengthen international standards in the areas of accounting and disclosure, prudential oversight and risk management. It will also develop policy recommendations to dampen cyclical forces in the financial system and address issues involving the scope and consistency of regulatory regimes. The second working group will monitor actions and develop proposals to enhance international cooperation in the regulation and oversight of international institutions and financial markets, strengthen the management and resolution of cross-border financial crises, protect the global financial system from illicit activities and non-cooperative jurisdictions, strengthen collaboration between international bodies, and monitor expansion of their membership.

We believe Congress needs to fill this systemic regulatory gap through the creation of a federal insurance regulatory authority like every other member of the G20. This federal authority is necessary so there can be a comprehensive approach to systemic risk allowing U.S. regulators to respond to a crisis nimbly and in coordination with other major global regulators. Only in this way will policy makers and regulators have confidence in the equivalency of supervision, and the authority to share sensitive regulatory information and the ability to provide mutual recognition as appropriate.

Monitoring the U.S. Financial System

A significant aspect of the mission statement of the Treasury Department is ensuring the safety, soundness and security of the U.S. and international financial systems. Long before the advent of the current economic crisis, the Treasury Department found it difficult to derive a clear and concise picture of the health of the insurance industry. In considering steps that might be taken to enhance the ability of Treasury to carry out these objectives – which now appear far more important than in the past - one must ask how, absent a federal functional regulator with an in-depth understanding of the industry, vital information on the insurance industry can be effectively collected and analyzed?

The Effects of Federal Decisions on a State Regulated Industry

As Congress considers how to address systemic risk regulation and how it might be applied to the insurance industry, it is important to take into account the ramifications of recent federal actions on the industry. Crisis-related decisions at the federal level have too often produced significant adverse effects on life insurers. Examples include: the handling of Washington Mutual which resulted in life insurers, as major bond holders, experiencing material portfolio losses; the suspension of dividends on the preferred stock of Fannie Mae and Freddie Mac and the fact life insurers were not afforded the same tax treatment on losses as banks, which again significantly damaged the portfolios of many life insurance companies and directly contributed to the failure of two life companies; the badly mistaken belief on the part of some federal policymakers that mark-to-market accounting has no adverse implications for life insurance companies when in fact its effects on these companies can be more severe than for most other financial institutions; and more recently the cramdown provisions in the proposed bankruptcy legislation that could potentially trigger significant downgrades to life insurers' Triple-A rated residential mortgage-backed investments.

These actions were all advanced with the best of intentions, but in each instance they occurred with little or no understanding of their effects on life insurers. And in each instance the only voice in Washington raising concerns was that of the industry itself. In this stressed market environment, legislators or policymakers can ill-afford miscues resulting from a lack of information on, or a fundamental misunderstanding of, an important financial industry sector. Actions taken without substantial input from an industry's regulators carry with them a much higher likelihood of unintended and adverse consequences. Insurance is the only segment of the financial services industry that finds itself in this untenable position as decisions critical to our franchise are debated and decided in Washington.

Conclusion

There is no question that assuring the stability of our payment system is of paramount concern. However, reforming U.S. financial regulation and advancing initiatives designed to stabilize the economy must take into account the interests and the needs of all segments of financial services, including life insurance. Unfortunately, the absence of a federal insurance regulator all too often means that we are afterthought as these important matters are advanced. We urge Congress to recognize the systemic importance of our industry to the economy and to the retirement and financial security of millions of consumers and tailor reform and stabilization initiatives accordingly. Failure to do so runs the very real risk of doing grave harm to both. We pledge to work closely with this Committee and with others in Congress to provide you with factual, objective information on the life insurance business along with our best ideas on how a comprehensive and effective approach to regulatory reform can be implemented. I am sure we all share the goals of maintaining confidence and strength in the life insurance business and restoring stability to the entire spectrum of U.S. financial services.