



**STATEMENT OF**  
**THE AMERICAN COUNCIL OF LIFE INSURERS**  
**BEFORE THE**  
**UNITED STATES SENATE**  
**COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS**  
**ON**  
**STATE OF THE INSURANCE INDUSTRY: EXAMINING THE CURRENT**  
**REGULATORY AND OVERSIGHT STRUCTURE**

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Statement Made by  
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Mr. Chairman and members of the Committee, my name is John Pearson, and I am Chairman, President and Chief Executive Officer of Baltimore Life Insurance Company. I am appearing today on behalf of the American Council of Life Insurers, the principal trade association for U.S. life insurance companies. The ACLI's 353 member companies account for approximately 93% of the industry's total assets, 93% of the industry's domestic life insurance premiums and 94% of its domestic annuity considerations.

I appreciate the opportunity to appear before you today to discuss the critical need to comprehensively overhaul and modernize the insurance regulatory system in the United States. In the two years since this Committee last held a hearing on insurance regulation, the case for regulatory reform has become even stronger as domestic operational concerns have been joined by pressing international regulatory and competitive issues.

Mr. Chairman, in my testimony today I would like to cover four key points that I believe demonstrate the need for Congress to act quickly and comprehensively to reform the insurance regulatory framework by providing insurers with a federal charter option. The first is the vital role life insurers play in providing Americans with essential protection and retirement security products. The second is the enormous contribution life insurers make to the U.S. capital markets and to the overall U.S. economy. The third is the inability of state regulators and legislators to act collectively to transform a badly fragmented state regulatory system into a uniform, efficient national system that serves the needs of what is now a global industry. And forth is the growing prominence of international regulatory and competitive issues that fall largely outside the scope of states' authority.

## **The Importance of the Life Insurance Industry in Providing Protection and Retirement Security Products**

The life insurance industry must be well regulated in order to operate efficiently and be in the best position to serve the protection and retirement security needs of baby boomers and others. One of the most significant benefits of insurance regulatory reform will be the elimination of substantial barriers to innovation – particularly as they relate to the ability of the life insurance industry to leverage its unique franchise to help address the looming retirement security crisis as some 77 million baby boomers near retirement.

Changing demographics and other related factors have given rise to a true retirement security crisis in this country. Medical advances continue to extend life expectancies and lengthen the time spent in retirement. Medical costs are increasing, particularly for retirees, while retiree health coverage continues to decline. Employers are discontinuing defined benefit pension plans, and employees covered by these plans are leaving earlier with lower benefits. Rising retirement age thresholds and lower rates of benefit increases mean Social Security will replace a significantly lower percentage of pre-retirement income for future retirees. Lower interest rates mean fixed income returns are lower. Taken together, these factors lead to the inescapable conclusion – borne out by numerous studies – that one of the biggest challenges people will face in retirement is outliving their assets.

Life insurers provide an array of products and services that benefit Americans in all stages of life, including life insurance, annuities and other retirement savings plans, disability income insurance and long term care insurance. Currently, there are over 375 million life insurance policies in force, providing Americans with

over \$19 trillion in financial protection. In addition, Americans have saved \$1.7 trillion towards their retirement by saving through our annuity products.

Life insurers are in a unique position to help America deal with the retirement security crisis. Significantly, life insurers – and only life insurers – can convert retirement savings into a guaranteed lifetime stream of income. That capability may well be the most potent tool that the private sector possesses to address the retirement savings challenges this nation faces.

### **The Importance of the Life Insurance Industry to the Capital Markets**

The need for comprehensive regulatory reform should also be considered from an economic standpoint, since the life insurance industry plays a key role in capital formation and is a significant component of the overall U.S. economy.

The long-term commitments and investments of the life insurance industry make it one of the largest investors in the U.S. economy assisting in economic growth. In managing these obligations, the life insurance industry has invested \$4.8 trillion in the financial markets, representing 9% of the capital supplied to the U.S. economy by the financial services industry, or 4% of the total capital in the entire U.S. economy. Life insurers are one of the largest holders of long-term, fixed rate commercial mortgages in the U.S. These long-term financial commitments are generally ten years and longer in maturity, much longer than commitments made by other financial intermediaries. In addition, our most recent figures indicate that life insurers invested \$225 billion in new net funds in the nation's economy, an amount equal to about 30% of the net new funds saved by persons in the U.S. Fifty-seven percent of the industry's assets, or \$2.7 trillion, are held in long-term bonds, mortgages, real estate, and other long-term investments. This includes: \$523 billion invested in federal, state and local government bonds, helping to fund urban revitalization, public housing, hospitals, schools, airports, roads and bridges;

\$314 billion invested in mortgage loans on real estate; \$1.8 trillion invested in long-term U.S. corporate bonds; and \$1.5 billion invested in corporate stocks. The importance of the continued growth and vitality of the life insurance industry to Americans cannot be overstated.

### **Patchwork Regulation for a National Business: Needless Inefficiency, Wasted Costs and the Frustration of Product Innovation**

Despite the fact that the insurance industry has pressed state regulators and legislators for years to modernize the state regulatory system, the reality is that the state insurance regulatory system has failed to keep pace with marketplace developments. Life insurers today operate under a patchwork system of state laws and regulations that lack uniformity and are applied and interpreted differently from state to state. This Balkanized form of regulation makes no sense for the life insurance business, which is truly a national in nature with national rather than local issues and regulatory needs. Product standards, capital requirements, consumer protections – indeed every aspect of our business - need not and should not vary from one state to another. Yet we operate under a system in which companies must navigate a multiplicity of different regulatory gauntlets in parallel, each subject to its own timetable, in order to operate nationally, regionally or even in just a handful of jurisdictions.

Companies would be able to offer consumers more innovative products in a much more timely manner under an optional federal charter. Today, life insurers end up with multiple variations of any product they try to bring to a multi-state market due to differing state-mandated requirements. In contrast to the more centralized, uniform regulatory systems of the banking and securities businesses that allow them to get products to the national marketplace quickly – often within 30 to 90

days – it can take up to two years or more for life insurers to bring a product to market nationwide.

And the product approval process is not the only impediment to innovation. Virtually every aspect of our business is subject to disparate laws, disparate regulations and disparate interpretations of these laws and regulations that stifle innovation. Concerns in this regard include, among other things, the capital and reserving standards we must meet, the rules by which we must administer our products, our sales practices and the qualifications and licensing standards for the people who sell our products. The result fractionalizes what, for so many companies, is a national business – depriving insurers of the scale and speed to market necessary to sustain innovation.

Not surprisingly, the large number of product variations that result from the current regulatory system creates significant challenges for our operations and customer service areas that must manage and administer these multiple versions over the life of the contract – which in our business often means the lifetime of the customer. It also creates enormous inefficiencies for the individuals who we rely on to sell our products. That's one reason why so many life insurance producers have come out in favor of reforming insurance regulation. Thousands of them have joined a grassroots organization – Agents for Change – whose mission is to give voice to their frustrations with the current system. The National Association of Independent Life Brokerage Agencies has also endorsed the concept of an optional federal charter as has the Association of Advanced Life Underwriters. Among the most significant benefits that agents and brokers will realize in a federal regulatory system is the opportunity to get a single national license, with singular qualification, renewal and continuing education requirements.

While most aspects of insurance regulation are state specific, state boundaries do not constrain all aspects of state regulation. Paradoxically, in some cases, state regulation vests extraordinary extraterritorial reach in an insurer's home state regulator. For example, a home state regulator can determine capital requirements for business done nationwide. This, of course, creates the potential for radically disparate protections of consumers within the same state – and since capital is typically among an insurer's biggest costs, radically different costs of doing business for insurers depending on their state of domicile.

While working with Congress toward the implementation of an optional federal insurance charter, the ACLI and its member companies remain committed to the parallel track of working with the states to make state insurance regulation more modern and efficient. Without question there are many life insurers that would wish to remain state regulated even if a federal charter were available.

Incremental progress is being made in improving state regulation, particularly with respect to the interstate compact some states have embraced that would provide a centralized, uniform mechanism for life insurance product filing and approval. However, until all states, including in particular large insurance states, enact the compact legislation, its full value and utility will not be realized.

Some progress is also being made in efforts to make state regulation of the life insurance business more uniform in all jurisdictions, but overall positive change has been frustratingly slow to materialize. The National Conference of Insurance Legislators (NCOIL) and the National Association of Insurance Commissioners (NAIC) are reasonably effective in adopting model laws and regulations intended to promote a uniform and more national approach to insurance regulation. These organizations are trade associations, not regulatory bodies, so to benefit consumers these models must be enacted in each individual state. Unfortunately, many of these model laws and regulations never get adopted by the individual states or, if

the states act, the measures get modified to such an extent that the benefits of uniformity are lost.

The General Accountability Office last week noted this problem in the context of long-term care insurance.<sup>1</sup> In its report the GAO cited variations in state laws as the reason some consumers enjoy greater policy protections than other consumers when it comes to long-term care insurance.

Another telling example of the inability of the state regulatory system to implement important consumer protections on a national basis involves annuity disclosure. In 1998, the NAIC adopted the Annuity Disclosure Model Regulation to address important consumer protection issues. To date it has been adopted in only 16 states, notwithstanding the fact that annuity disclosure has repeatedly been the subject of highly critical articles in the financial press. State insurance regulators unquestionably have consumer interests at heart, but the fragmented state regulatory system all too often produces results like this.

### **International Considerations Argue for Federal Regulation**

The absence of a federal insurance regulator leaves the U.S. insurance industry at a distinct disadvantage in a variety of ways. For example, foreign markets offer additional growth opportunities. Life insurance premiums in the U.S. grew by only about 4% in 2006. In contrast, premium growth in India was 60% in 2006; in Africa, 22%; in Central and Eastern Europe, 19%; in Latin America, 14%; and in China life insurance premiums grew over 9% in 2006. Yet, when U.S. life insurers try to expand into these and other growing markets they are often rebuffed. The reason is that, from the European Union to China, other countries

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<sup>1</sup> <http://www.gao.gov/new.items/d07202.pdf>

perceive that our current insurance regulatory structure discriminates against foreign companies and is so complex, inefficient, and costly as to be a de facto trade barrier.

There may be merit to these concerns. For example, 27 states will not license insurance companies owned, even partially, by foreign governments. Moreover, states have widely varying requirements about who can serve on a life insurer's board of directors, based on the nominee's residency, citizenship and other attributes – all of which can pose particular problems for foreign based companies. Indeed the very terms the states use to describe a company based overseas, 'alien' (i.e., subsidiaries or branches of non-U.S. insurers) versus 'foreign' (i.e., subsidiaries or branches of a U.S. insurer domiciled in another state) are viewed as politically charged and discriminatory. And recently, the European Commission has expressed frustration that may force it “to explore other routes to ensure that EU reinsurers receive a fair treatment” in connection with states' requirements that even highly rated European insurers deposit liquid assets in the U.S. in an amount equal to their gross U.S. liabilities as a precondition to insuring U.S. life insurers on a cross border basis.

In addition, the absence of a federal insurance supervisory authority operationally impedes the ability of U.S. life insurers to compete overseas. For example, neither U.S. state governments nor the NAIC have the constitutional authority to enter international agreements of mutual recognition or joint supervision on behalf of the U.S. Similarly, the U.S. has no national insurance supervisor with the legal mandate to represent the government or the interests of U.S. consumers or industry in responding to crisis or maintaining stability.

The *Blueprint for a Modernized Financial Regulatory Structure* prepared by the Treasury Department and released last April recognizes the difficulty of

addressing insurance issues on the global stage through a state-based regulatory system. While calling for a federal insurance charter option in the longer term, the Treasury blueprint suggests the creation in the near term of an Office of Insurance Oversight within the Treasury Department to deal with, among other things, international insurance matters. Legislation has been introduced in the House by Chairman Paul Kanjorski consistent with this concept (H.R. 5840, creating an Office of Insurance Information). We see substantial merit in the creation of such an office as a means of gathering industry-wide information on insurance, providing Congress and the Administration with advice on critical insurance issues, and enabling the U.S. to deal more effectively with other countries and regulatory authorities on international insurance matters. We encourage this Committee to consider moving a similar measure in the Senate. While this would in no way be a substitute for an optional federal charter, it would in our view be a very worthwhile step toward where insurance regulation in the 21<sup>st</sup> Century needs to be.

### **Misperceptions Regarding an Optional Federal Charter**

**Consumer Protection** – Critics of the optional federal charter have asserted that consumer protections would be diminished relative to what they are under the current state-based system. We strongly disagree. It is unrealistic to think that Congress would ever enact federal charter legislation without mandating consumer protections that are at least as strong as – if not stronger than – those that are now in place. Moreover, the ACLI has made it clear from the outset of the debate over the optional federal charter that it is not seeking deregulation of the life insurance business and in fact advocates rigorous financial oversight and strong consumer protections as part of the federal charter framework.

In a number of respects, consumers would likely fare better under a federal charter than they would under the current state system. For example, we are an increasingly mobile society, and people are more likely than ever to purchase an insurance product in one state and then move to another state. If the issuing insurer is not licensed to do business in the state to which the individual moved, then the insurance regulators in that state will not have the authority to address problems or questions regarding the product. Similarly, if a consumer has a long-term relationship with a trusted insurance agent but moves to a state where that agent is not licensed, the consumer will be forced to find a new financial advisor. “Gaps” of this nature would not exist for those companies operating under a federal charter.

Similarly, under an optional federal charter, market conduct as well as financial examinations would occur more regularly (at least once every three years) and would be conducted pursuant to uniform standards. The national regulator would also have a Division of Consumer Affairs as well as a Division of Insurance Fraud. And the regulation of companies and producers in all respects would be uniform from state to state. Finally, regulation in a particular state would not be dependant on the relative expertise of the insurance department staff or on the relative level of financial resources available to that department.

Contrary to assertions from opponents of the optional federal charter, consumer complaints would not be handled exclusively from Washington, DC. The legislation pending in both the Senate and House, S. 40 and H.R. 3200, provides that the federal insurance regulator must have at least six regional offices. The legislation also expressly authorizes the regulator to delegate certain functions to one or more self-regulatory organizations. A useful parallel to consider is the way in which the SEC and FINRA address the training, testing, licensing and market conduct aspects of registered securities representatives and broker/dealers.

**Regulatory Arbitrage** - Some have suggested that the implementation of a federal charter option would lead to regulatory arbitrage as companies seek increasingly lax regulation and regulators rush to accommodate. However, we are highly confident that Congress would be careful to assure that any federal regulatory option was at least on a par with the strongest state systems. Indeed, the industry is seeking uniform regulation, not weak regulation. Moreover, the potential for regulatory arbitrage already exists in the current state-based system. Today, insurers have the right in virtually all jurisdictions to change their state of domicile – that is, to move to a different state that would have primary responsibility for the company’s financial oversight. We fail to see how adding the option of a strong federal regulator would increase the potential that exists today. Finally, we submit that these dire predictions find no support in the experience of the dual charter bank regulatory system.

**Smaller Companies** – We have heard it suggested that a federal charter option would be of benefit only to large insurers. While it may be true in the commercial banking world that only the larger banks gravitate toward a federal charter, that would not be the case with respect to life insurers. Many mid-sized and smaller insurers do business nationally or on a regional basis. As a consequence, they must clear all the same hurdles state-by-state as their larger counterparts in terms of getting licensed to do business, getting products approved, getting producers licensed and so on. However, smaller companies do not typically have the same in-house resources (e.g., legal and compliance personnel) as the larger companies to deal with these matters. Additionally, their projected level of sales would be such that it would take them longer to recoup capital expenditures associated with the product approvals and licensure processes. When viewed in this light, it is clear that the optional federal charter is every bit as significant to smaller companies doing business in multiple jurisdictions as it is to larger companies.

**State Premium Tax Revenue** - Opponents of an optional federal charter have suggested that if such an option were to become a reality, national insurers would, over time, somehow escape the payment of state premium taxes, which constitute a significant source of revenue for all states. This concern is unfounded. As this committee knows better than most, with the exception of Government Sponsored Enterprises, all for-profit federally chartered financial institutions such as commercial banks, savings banks and thrifts pay state income taxes. Insurers' state tax obligations predominantly take the form of a state premium tax. There is no precedent for, nor is there any expectation of, exclusion from this state tax obligation. Indeed, all versions of the optional federal charter legislation introduced to date expressly provide for the continuation of the states' authority to tax national insurers.

**Cost** – Skeptics of the optional federal charter have asserted that this initiative will result in some huge bureaucracy that will cost taxpayers untold millions.

However, the life insurance industry has made clear from the outset that it is asking for a new federal regulator that would be funded exclusively through filing and user fees. Moreover, the industry has recommended that the initial costs of the regulator be covered through a loan that the industry would pay back over time. Those concepts are reflected in the optional federal charter legislation pending in both the Senate and House.

In the same vein, two recent studies indicate that there would be significant cost savings to both companies and agents under an optional federal charter. The first study, conducted by Steven W. Pottier of the University of Georgia, focuses on potential cost savings to life insurers. It finds that life insurance costs could be reduced by an estimated \$5.7 billion annually if insurance companies functioned under a single regulator system as opposed to the current system of multiple

regulators. The full text of this study can be accessed here:

<http://www.acli.com/NR/rdonlyres/3A7453E3-FDF9-44DC-9A5B-66A41C949F97/9195/PottierPackage3.pdf>

The second study, by Dr. Laureen Regan of Temple University, focuses on the cost savings that could be realized by insurance agents under a federal charter option. The study estimates that the savings in producer licensing associated with moving to an optional federal charter from the current system of exclusive state regulation could range from \$268 million to \$377 million annually. In addition, an optional federal charter would benefit producers by creating uniform requirements for pre-licensing and continuing education. The full text of this study can be accessed here: [http://www.acli.com/NR/rdonlyres/EF95BEF6-506D-4D2B-B867-EADC09B42565/10737/OFC\\_ReganStudyFinal090409.pdf](http://www.acli.com/NR/rdonlyres/EF95BEF6-506D-4D2B-B867-EADC09B42565/10737/OFC_ReganStudyFinal090409.pdf)

As Congress has given more serious consideration to the reality of a federal charter option, questions have arisen regarding what a federal insurance regulator would actually look like in terms of budget, staffing and function. In order to provide some helpful perspective on these questions, the ACLI along with the American Insurance Association and the Financial Services Roundtable commissioned a study to analyze what a new Office of National Insurance would look like based on the provisions of S. 40, the National Insurance Act of 2007 introduced in this Congress by Senators Sununu and Johnson. We will share the results of that study with the Committee once it is completed.

## **Solutions**

The ACLI carefully considered various ways to address the issue of regulatory reform, and focused in particular on four possibilities: improving the state-based system; regulating by the state of domicile; establishing federal (national)

standards that would be administered by the states; and the creation of a federal charter option. Ultimately, the industry settled on a dual-track approach to regulatory reform under which we continue to work with the states to make a state-based regulatory system operate more efficiently and at the same time push for an optional federal charter. We believe the dual banking system provides an excellent template for a regulatory system that ensures company solvency and consumer protection, promotes efficiency and accommodates the operational needs of a diverse industry. The availability of a federal option would encourage state regulators to be more responsive and would establish a federal insurance regulator as a peer to other financial regulators in the critical Washington arena. For insurance companies doing business on a national basis, the ability to interact with one regulator rather than 56 would dramatically reduce what has increasingly become a logistical and administrative nightmare. In addition, the states' acknowledged lack of authority to address increasingly important international issues, including reinsurance regulation, mutual recognition and convergence with initiatives such as Solvency II point to the wisdom of a federal insurance regulator.

For these reasons, we strongly encourage Congress to move forward with an optional federal insurance charter. We also support the creation of an office of insurance information within the Treasury Department as a means of providing Congress, the Administration and other federal financial regulators with critical information on the insurance industry.

Mr. Chairman, for the benefit of our country, our customers and our industry we urge you to work with us on an expedited basis to put in place an appropriate federal regulatory option.