STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

**COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS
OF THE
UNITED STATES SENATE**

ON

THE INSURANCE REGULATORY STRUCTURE

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Statement Made by

John D. Johns
Chairman, President and CEO
Protective Life Corporation

Mr. Chairman and members of the Committee, my name is Johnny Johns, and I am President and Chief Executive Officer of Protective Life Insurance Company. I am appearing today on behalf of the American Council of Life Insurers. The ACLI is the principal trade association for U.S. life insurance companies, and its 377 member companies account for approximately 90% of life insurance premiums, 95% of annuity considerations and 91% of the industry's total assets.

I appreciate the opportunity to appear before you today to discuss the current framework for regulating the life insurance business in the United States and to present our views on ways in which that framework can and should be modernized. Each year the ACLI surveys its board of directors to establish the organization's advocacy priorities, and once again this year regulatory modernization tops the list. This is a critically important issue for the life insurance business, and on behalf of my company as well as the ACLI and its other member life insurers, I want to thank you for holding this hearing and placing insurance regulatory modernization on the Committee's agenda.

The fundamental point I would like to make today is quite simple. As the business of insurance has evolved over the years from an enterprise that was largely local in nature to a $4.5 trillion industry that is predominantly national and increasingly global in scope, the accompanying system of regulation has failed to keep pace. As a consequence, insurers are significantly handicapped in their ability to compete efficiently and serve the best interests of their consumers.

Today's Life Insurance Business and the Importance of Efficient Regulation

From the outset, I want to make it clear that, while we believe the regulatory framework of our current state-based system is inefficient and unresponsive to the needs of today's marketplace, we appreciate very much the highly professional and competent regulators who work within that system. In the many instances in which I have had the privilege to work with state regulators, I have been impressed with their diligent and conscientious efforts to protect policyholders and ensure insurer solvency. Their job is not an easy one, especially when they must regulate, not only within their own state law, but in some cases also cooperatively within the laws of their fellow regulators in other states. This testimony would not be complete without a sincere recognition of the remarkable contributions that are made by the regulators under such a challenging regulatory structure.

The present state-based system of insurance regulation was instituted at a time when "insurance" was not deemed to be interstate commerce. Consequently, the underpinnings of that system - which remain pervasive today - contemplate doing business only within the borders of a single state. Today, most life insurers do business in multiple jurisdictions if not nationally or internationally. In short, our system of regulation has failed to keep pace with changes in the marketplace, and there is a wide gap between where regulation is and where it needs to be.

Life insurers today provide an array of unique products and services that benefit Americans in all stages of life with products like life insurance, annuities, disability income insurance and long-term care insurance. These products not only protect a family's finances, but also enable Americans to save money, accumulate wealth for retirement and convert it into a guaranteed lifetime stream of retirement income. No other financial intermediary can do that.

Currently, there are over 373 million life insurance policies in force, providing Americans with $18.4 trillion in financial protection. In addition, Americans have saved $2.2 trillion towards their retirement by investing through our annuity products. Our long-term commitments and investments place us as one of the largest investors in the U.S. economy assisting in economic growth. In managing these obligations, the life insurance industry has invested $4.3 trillion in the financial markets, representing nine percent of the total capital. 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.

Life insurers are also a vital component of the U.S. economy. Fifty-one percent of the industry's assets, or $3.6 trillion, are held in long-term bonds, mortgages, and real estate. This includes: $512 billion invested in federal, state and local government bonds, helping to fund urban revitalization, public housing, hospitals, schools, airports, roads and bridges; $295 billion invested in mortgage loans on real estate financing for homes, family farms and offices; $1.5 trillion invested in long-term U.S. corporate bonds. Twenty-nine percent of the industry's assets, $1.3 trillion, are invested in corporate stocks.

Beyond this significant investment we make in the economy, it is in the area of long-term savings and retirement security that life insurance may have the greatest positive impact on public policy in the coming years. With 76 million baby boomers nearing retirement, the U.S. faces a potential retirement crisis. We must confront the fact that the average American nearing retirement has only $78,000 in savings and assets, not including real estate. Industry research indicates that 65% of Americans believe they will not be able to save enough for retirement.

Future retirees will have fewer sources of guaranteed income than previous generations due to the decline of traditional defined benefit pension plans and the fact that Social Security, on average, replaces only 42% of earnings. If nothing is done, there is a real possibility that millions of Americans will outlive their retirement assets.

The life insurance industry is uniquely positioned to help American workers prepare for their financial futures. Our business continues to be a prominent resource in helping both large and small employers provide the right qualified retirement or savings plan for their employees. Insurers act as asset managers or administrators for defined benefit, 401(k), 403(b) 457 plans and other tax-qualified arrangements.

However, for the life insurance business to remain viable and serve the needs of the American public effectively, our system of regulation must become far more efficient and responsive to the needs and circumstances of a 21st century global business. 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. The result is a system characterized by delays and unnecessary expenses that hinder companies and disadvantage their customers. We believe it is appropriate, and we are asking for your help, to modernize our regulatory structure to ensure that we are able to continue to serve our customers in the most efficient and effective way.

Lack of Uniformity Hampers Multi-State Life Insurers

A significant impediment for multi-state insurers is the current state-based system's inability to produce, in crucial areas, both uniform standards and consistent application of those standards by the states. I'd like to give you a brief outline of the business and regulatory complexities commonly faced by life insurers under the current system.

Before a company can conduct any activities, it must apply for a license from its "home" or "domestic" state insurance department. A license will be granted if the company meets the domestic state's legal requirements, including capitalization, investment and other financial requirements. If the company wishes to do business only in its home state, this one license will be sufficient. However, in order to sell products on a multi-state basis, a company must apply for licenses in all the other states in which it seeks to do business. Each additional state may have licensing requirements that deviate from those of the company's home state, and the company will have to comply with all those different requirements notwithstanding the fact that the home state regulator will remain primarily responsible for the insurer's financial oversight.

Once a company has all its state licenses in hand, it can turn its attention to selling policies. To do that, a company must first file each product it wishes to market in a particular state with that state's insurance department for prior approval. A company doing business in all states and the District of Columbia must, for example, file the same policy form 51 different times and wait for 51 different approvals before selling that product in each jurisdiction. And this process must be repeated for each product the insurer wishes to offer. Since these 51 different insurance departments have no uniform standards for the products themselves or for the timeliness of response for filings, a company may receive approval from one or two jurisdictions in 3 months, from another ten jurisdictions in 6 months, and may have to wait 18 months or longer to receive approval from all jurisdictions.

This process is further complicated by the fact that each insurance department may have its own unique "interpretation" of state statutes, even those that are identical to the statutes in other jurisdictions. As a result, a company will be required to "tweak" its products in order to comply with each individual department's "interpretation" of what otherwise appeared to be identical law. Since a company has to refile each product after it has been "tweaked," the time lapse from original filing to final approval can very well be double that which was originally expected. And, as a result of the various "tweaks," what started out as a single product may wind up as thirty or more different products.

After a company has received approval to sell its products in a state, it needs a sales force to market those products. Here again we encounter the inefficiencies of the current state system. Each state requires that anyone wishing to act as an insurance agent first be licensed as such under the laws of that state. Each state has its own criteria for granting an agent's license, and these criteria include differing continuing education requirements once the license is issued. Like companies, insurance agents wishing to work with clients in more than one state must be separately licensed by the insurance departments in each of those states. And, because of the differing state form filing requirements for companies noted above which results in products being "tweaked" for approval in each of the various jurisdictions, persons granted agent licenses by more than one state will not always have the ability to offer all clients the same products.

After this multitude of licenses and approvals has been secured, a company can begin to sell products nationwide. However, the lack of uniformity in standards and application of laws will continue to be a complicated and costly regulatory burden that the company must constantly manage. The very basic things that any business must do to be successful--such as employing an advertising campaign, providing systems support, maintaining existing products, introducing new products and keeping a sales force educated and updated--are all affected by 51 different sets of laws, rules and procedures.

Add to this the fact that states also police actual marketplace activity by subjecting a company to market conduct examinations by the insurance departments of the states in which it is licensed. Even though state market conduct laws nationwide are based on the same NAIC model laws, there is minimal coordination of these exams among the various states. As a result, a company licensed to do business in all jurisdictions is perpetually having states initiate market conduct examinations just as one or more other states are completing theirs, with the cost of each exam being borne by the company – and ultimately its policyholders. And, because these examinations are largely redundant, the benefits derived relative to the costs incurred are marginal at best.

This tendency of the states to eschew uniformity, even when developed through the NAIC, may soon play itself out in the need to reform the reserving methodology used by our industry. The formulaic approach currently mandated by state law is outdated and out of step with more robust methodology used in, among others, European countries and Canada. The current formulaic approach adds significant costs to many of our products. Therefore, our products are unnecessarily expensive, and consumers are adversely affected. Although the NAIC is currently working to address the reserve problem, the structure of the state-based system is inherently a significant impediment. This is the case because each state has the ability to regulate the standards by which the statutory reserves are established for insurers doing business in that state. If one state refuses to enact reform, the insurers doing business in that state are subject to the outdated regulation, even if all other states enact the reform. In other words, each state has veto power. If a state with a particularly large population is the state that refuses to enact the reform, as a practical matter that state's law will be the governing law for all multistate carriers. Again, notwithstanding the efforts of outstanding regulators at the state level, the very structure of the system is the impediment.

I cannot overemphasize that the current regulatory system results in unnecessary costs that, of necessity, are passed on to the consumer. Today, every dollar spent on life insurance purchases less in coverage than it should, due to the unnecessary cost of the current regulatory system.

Competitiveness is restrained by the current system. The current regulatory process creates unnecessary barriers to entry. Due to the unnecessary costs imposed by the regulatory structure, equity investors seeking an adequate return on capital are discouraged. Product innovation is impeded by the regulatory structure, resulting in fewer choices for consumers.

ACLI Policy on Insurance Regulatory Modernization: State and Federal Solutions

The ACLI Board of Directors, after careful consideration and extensive discussion with member life insurance companies – large and small – determined to approach improving regulatory efficiency and modernization on two tracks. One is to work with the states and the NAIC to improve a state-based system of regulation. The other is to work with Congress to put in place a federal charter option for life insurers and insurance producers.

While my remarks today focus on the need for a comprehensive federal solution to modernizing the insurance regulatory framework, I would be remiss if I did not compliment the NAIC and the states for the substantial progress they have made on developing an interstate compact for expediting the filing and approval of life insurance products. Recently, more than half the states enacted the compact legislation, meaning that the compact commission – the body that will actually handle product filings and approvals – can now be established and made operational. Until all states, and certainly all states with significant populations, become part of this compact mechanism, the full benefits of this initiative will not be realized.

The ACLI is fully committed to the interstate compact concept and is working with state regulators and legislators to pass legislation necessary to have every state become a part of this mechanism. However, it must be understood that the NAIC's interstate compact addresses only a single issue – getting new products filed, approved and into the marketplace in a timely manner. It does **not** address the many other areas in which lack of uniformity in law or regulation from state to state affects the ability of life insurers to provide their customers with products and services in a timely and efficient manner. Other issues that are in need of modernization include: reserving; coordination of market conduct examinations; company licensing; producer licensing; quantitative investment limitations; nonforfeiture laws; state taxation of life insurers; replacements; reinsurance; and national advertising programs. The interstate compact has no effect on any of these issues, and that fact points out why the ACLI believes it is imperative for Congress to move forward with an optional federal charter as the most appropriate comprehensive solution to regulatory reform.

S. 2509

The ACLI is extremely encouraged to see the introduction by Senators Sununu and Johnson of S. 2509, the National Insurance Act of 2006. This is a comprehensive approach to insurance regulatory reform and one that ACLI strongly supports.

Of course, we understand it is early in the process. ACLI and its member companies look forward to working with this committee on the mechanics of this legislation and making additional changes to refine it as the legislation moves forward.

One of the fundamental values of a federal charter option such as that provided by S. 2509 is that it can achieve uniformity of insurance laws, regulation and interpretations the moment it is put into place. And only Congress can enact legislation that has this broad-based, immediate effect. Many life insurers believe that regulatory modernization is nothing short of a survival issue, and in that context the speed with which progressive change takes place is critical. Today's marketplace is intolerant of inefficient competition, and the prospect of having to wait years for the states to address individually the many areas in which efficiency of regulation must be improved is not encouraging.

We believe it is appropriate for Congress to focus its attention on a global, comprehensive alternative to state insurance regulation as provided by S. 2509. This measure meets the needs and circumstances of today's national and multinational life insurers and will enable them to much more effectively serve the needs of Americans in need of life insurance protection and retirement financial security.

Unfounded Criticisms of the Optional Federal Charter

Critics of S. 2509 and the optional federal charter it provides have made several unfounded allegations that we would like to address in this statement.

States Rights – S. 2509 is not an attack on states rights. Insurance is the only segment of the U.S. financial services industry that does not have a significant federal regulatory component. Under S. 2509, the states would retain a significant a role in insurance regulation as their state regulatory counterparts now have in the banking and securities industries.

S. 2509 does not mandate federal insurance regulation of all insurers. Rather, it allows an insurance company the **option** of seeking a federal charter if company management believes that to be more complementary to the company's structure, operations or strategic plan.

It is not an affront to states' rights to seek the elimination of conflicting or inconsistent state laws. A principal objective of S. 2509 is to reduce the regulatory burden caused by such conflicts and redundancies and to do so by adopting the best state laws and regulations as the applicable federal standards.

A further objective of S. 2509 is to modernize the insurance regulatory framework and, in so doing, make insurers significantly more competitive in the national and global marketplace. Enhancing competition is a sound and legitimate role for Congress and substantially outweighs concerns over any diminution of the regulatory role of the states.

<u>Regulatory Arbitrage</u> - Some have suggested that S. 2509 will lead to regulatory arbitrage and a "race to the bottom" as companies seek increasingly lax regulation and regulators rush to accommodate. From our perspective, nothing could be further from the truth.

First and foremost, the ACLI and its member companies are not seeking to migrate to a federal system of insurance regulation that is lax. S. 2509 provides for a strong system of life insurance regulation that draws on the best existing state laws or NAIC model laws. It does not free life insurers from strong solvency regulation and consumer protection.

Second, the notion that adding one more system of regulation on top of the 51 that already exist will somehow give rise to regulatory arbitrage is groundless. Today, companies 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. Consequently, there are 51 opportunities for regulatory arbitrage today.

The federal regulatory option made available by S. 2509 is at least as strong as the better - if not the best - state system. How, then, would the enactment of this legislation create some new opportunity for this dreaded "race-to-the-bottom?" What possible harm would come from companies moving to a federal system of regulation that is as strong as, if not stronger than, the one they are leaving?

Inherent in this assertion of possible regulatory arbitrage is the notion that a company executive could wake up one morning and simply decide to flip a company's charter. Quite simply, business does not work that way. Such a change carries with it countless significant consequences and considerations and is not entered into lightly. It is costly, time consuming and initially highly disruptive. The notion of regulatory arbitrage implies that companies would be inclined to move into and out of regulatory systems on a whim or whenever decisions were made or likely to me made that would be adverse to their interests. In the real world, this does not and would not occur.

<u>The Federal Charter is Optional</u> – S. 2509 provides for a federal charter **option**. It in no way mandates that companies be federally regulated. Companies that do a local business or that for other reasons would prefer to remain exclusively regulated by the states are perfectly free to do so. As we read S. 2509, is appears to be "charter neutral" in that it does not create tax or other unnecessary advantages relative to state chartered competitors.

While individual motives may vary, ACLI member life insurance companies are strongly united in their support for an optional federal charter. Some feel that a federal charter is in the long-term best interest of their company and its customers. Others have indicated that while they intend to remain state chartered even if a federal charter were available to them, they see the threat of the federal charter option providing motivation to the states to continue their efforts to enhance the efficiencies of state regulation.

State Premium Tax Revenues – Critics of S. 2509 and the optional federal charter have suggested that if such an option were to become a reality, national insurers would somehow over time escape state premium taxes, which constitute a significant source of revenue for all states. This concern is totally 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. For insurers, this state tax obligation takes the form of a state premium tax. There is no precedent for, nor is there any expectation of, exclusion from the authority of the states to levy a premium tax. Indeed, S. 2509 expressly recognizes the states' authority to tax national insurers.

Consumer Protections – While critics have argued that consumer protections would suffer under an optional federal charter, we believe a careful reading of S. 2509 suggest quite the contrary. By drawing on strong individual state laws or NAIC model laws, S. 2509:

- Guarantees that consumers are protected against company insolvencies by extending the current successful state-based guaranty mechanism to national insurers and their policyholders.
- Ensures the financial stability of national insurers by requiring adherence to statutory accounting principles that are more stringent (conservative) than GAAP.
- Duplicates the stringent investment standards currently required under state law.
- Mirrors the strong risk-based capital requirements of state law to ensure companies have adequate liquid assets.
- Duplicates state valuation standards that ensure companies have adequate reserves to pay consumers' claims when they come due.

- Mirrors the existing nonforfeiture requirements under state law that guaranty all insureds receive minimum benefits under their policies.

S. 2509 then goes further than many states by providing for:

- A Division of Insurance Fraud
- A Division of Consumer Affairs
- An Office of the Ombudsman
- Financial and market conduct examinations at least once every three years

In addition, consumers who deal with national insurers established pursuant to S. 2509 would enjoy significant added protections and benefits over those afforded by the states. For example, consumers will experience uniform and consistent protections nationwide and will enjoy the same availability of products and services in all 50 states. Consumers will also benefit from uniform rules regarding sales and marketing practices of companies and agents, and for the first time consumer issues of national importance will receive direct attention from a federal regulator.

Conclusion

Mr. Chairman and members of the Committee, I again thank you for recognizing the importance and urgency of insurance regulatory modernization and placing this critical issue on the agenda of this Committee. My company, the ACLI and its member companies look forward to working with you in the months ahead to address in a timely, appropriate and comprehensive manner the critical issue of modernizing this country's insurance regulatory system.