STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE & GOVERNMENT SPONSORED ENTERPRISES

ON

SYSTEMIC RISK AND INSURANCE

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Statement Made by
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Mr. Chairman and members of the Subcommittee, my name is Patrick Baird, and I am Chief Executive Officer of AEGON USA. 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 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.

Today's hearing could not be more timely. The Administration is poised to unveil its proposals on financial regulatory reform, and this Subcommittee must carefully consider in the weeks ahead the most appropriate course of action to reform and restructure our financial regulatory system in a way that assures that a similar crisis does not occur in the future. Your statement announcing this hearing correctly notes that insurance is a significant and integral part of the U.S. financial system. As a consequence, regulatory reform must encompass insurance if the new regulatory structure you put in place is to operate effectively and without problematic gaps.

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 as a whole 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. 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. Without the financial protection provided by life insurance, these families may need to rely on the federal government for assistance.

Individual Life Insurance Companies and Systemic Risk

While the life insurance industry as a whole is systemically important, we do not believe any individual life insurance company can accurately be characterized as posing systemic risk. There are certainly a number of large life insurers, and the failure of any one of these companies would unquestionably send shock waves through the industry and put pressure on the life insurance guaranty system (the industry's financial backstop that serves a function roughly analogous to that of the FDIC).

The typical indicia of systemic risk would not, however, appear to be present even in the case of the failure of a large life insurer. These indicia 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; and 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.

Structural Considerations

In developing an effective overall U.S. financial regulatory structure, the key question with respect to life insurance is this: how do you deal with an industry that as a whole is systemically important but which comprised individual companies no one of which poses systemic risk? We believe the appropriate answer is to include two essential structural elements in any regulatory reform package. The first is to cover life insurance in whatever broad systemic risk oversight is made applicable to the banking and securities industries. The second is to create a federal functional insurance regulator and make it available to all life insurance companies within the industry on a voluntary basis.

We do not offer any comments at this time regarding which agency or agencies should serve as the systemic risk regulator. As far as how the jurisdiction of a systemic risk regulator should be established, we would observe that moral hazard and the potential risk of competitive imbalance can be minimized by avoiding a public, bright-line definition of systemic risk and by keeping as confidential as possible the role a systemic risk regulator plays with respect to an individual institution.

In the same vein, we have no strong views on the need for a resolution authority to address troubled institutions posing systemic risk and currently viewed as "too-big-to-fail." Most if not all of those horses appear to have left the barn, and we assume a principal objective of a revamped and more effective financial regulatory structure is to avoid such circumstances ever arising in the future. However, we have commented on the concept of a resolution authority from the perspective of how it would interact with

various life insurance regulatory mechanisms, most notably the state insurance guaranty system. If such an authority is to be included as part of Congress' regulatory reform package, we believe careful consideration must be given to making certain that it does not conflict with other essential life insurance regulatory functions.

We do feel strongly that the creation of a federal functional regulator for the life insurance business is an essential element of sound regulatory reform. This belief is predicated on three structural considerations: effective implementation of federal regulatory policy; effective coordination with the new federal systemic regulator and authority to coordinate global regulatory responses to the financial crisis..

This Congress will reach a number of important national policy decisions regarding how to improve the regulation of the U.S. financial markets and minimize the chances of a similar crisis occurring in the future. Implementation of these policy decisions will be carried out by federal financial regulatory bodies. However, absent a federal insurance regulatory agency, there will be no federal agency with the necessary expertise on insurance to either advise Congress on relevant policy matters or to implement policy with respect to life insurance companies. Understanding and implementing critical federal policy solely through reliance on hoped for cooperation on the part of 51 state regulators rather than through enforceable federal statute is not a model Congress should embrace.

Similarly, effective systemic risk regulation relative to life insurers, whether conducted by a single federal agency or a group of federal agencies, will be difficult absent any in-depth regulatory knowledge or understanding of the business at the federal level. Treasury's experience with life insurers applying for Capital Purchase Program funds bears out this fact. Having the systemic risk regulator rely on the states in this regard is certainly an option, but it will never be as effective as being able to partner with a knowledgeable federal regulatory counterpart.

We also believe that making a federal functional regulator available to life insurers on a voluntary (optional) basis is both realistic and appropriate. Two issues need to be addressed in this regard, the first being regulatory arbitrage and the second being the propriety of federal functional regulator – optional or otherwise - for an industry that is systemically important but which does not have any individual companies that pose systemic risk.

Concerns over regulatory arbitrage, which have been raised principally by state insurance regulators opposing an optional federal charter, are without merit. The life insurance business is not seeking, nor would this Congress ever consider enacting, a federal insurance regulatory system that is weak in terms of consumer protections and solvency oversight. Indeed, the ACLI has consistently advocated for a federal alternative that is as strong as, if not stronger than, the best state regulatory systems. If anything, a properly constructed optional federal charter would result in the states being challenged to raise their standards to meet those of the federal regime. And it should be kept in mind that insurers currently have the right to change their state of domicile (i.e., they can pick the state that will have primary solvency responsibility), and regulation from state-to-state is anything but uniform in terms of substantive requirements, staffing, expertise and enforcement. The creation of an additional but strong federal option can only encourage a flight to quality.

The propriety of having a federal functional insurance regulator needs to be considered from both a pre-crisis and a post-crisis perspective. Prior to the financial meltdown, life insurers had made a persuasive case to Congress that the inefficiencies of the state regulatory system, plus the fact that the states have no constitutional authority to bind the U.S. with respect to trade negotiations or global regulatory matters, justified the establishment of a federal functional insurance regulator with the ability to charter companies on an optional basis. Not a single aspect of this pre-crisis rationale in support of an optional federal charter has diminished. Post-crisis, the rational for a federal functional regulator is augmented by the points noted above – the need to effectively and

uniformly implement whatever federal regulatory policy Congress establishes and to coordinate most effectively with a new systemic risk regulator.

If a federal insurance charter were made available to life insurers on an optional basis, and assuming it provided for a strong and effective regulatory alternative for those companies doing business in multiple jurisdictions as well as globally, there is no question that life insurers representing a significant portion of the industry would elect the federal option. That, in turn, would mean that the federal functional regulator would have direct jurisdiction over a critical mass of a systemically significant industry – whether measured by assets or otherwise – and would be able to implement national regulatory policy in a meaningful manner with respect to that industry, partner more effectively with the new federal systemic risk regulator and effectively represent the U.S. internationally on trade and regulatory matters.

We would like to thank Representatives Bean and Royce for introducing H.R. 1880, the National Insurance Consumer Protection Act. This legislation sets forth the fundamental elements of a federal insurance charter that would dovetail appropriately with a broader financial regulatory reform measure.

There is one final structural point on insurance regulatory reform that we would like to raise, and that pertains to insurance solvency regulation. There are many regulatory elements that collectively constitute solvency regulation for a life insurance company, including capital and surplus, reserves, underwriting, risk classification, nonforfeiture, investments, accounting and, pertinent to this point, product regulation. For a life insurer, solvency regulation is inherently linked to the products it sells. Factors such as what is guaranteed, when the guarantee is triggered, the length of time the guarantee is in force and others product features are crucial to a determination of how the premiums are invested to assure assets will be available to pay claims. Effective solvency oversight necessitates that a single regulator have authority over all aspects of solvency, including product regulation. If different regulators assumed responsibility for any of these aspects of insurance solvency oversight, the net result would be an increase in systemic risk, not

a reduction of it. For this reason, concepts such as a financial product safety commission, if made applicable to life insurance, would raise significant concerns.

International Considerations

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. The G20 is clearly focusing on the need to coordinate a global response to the economic crisis.

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 for 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.

Office of Insurance Information

Mr. Chairman, as we have stated in the past, we appreciate and support your continued efforts to advance insurance regulatory reform through the creation of an Office of Insurance Information within the Department of the Treasury. While our ultimate goal with respect to modernizing the insurance regulatory system remains an optional federal charter for life insurance, we believe H.R. 2609 is a good first step consistent with this objective and would be beneficial to Congress as it considers issues that are vitally important to our business; would facilitate the handling of certain international insurance matters; and would provide a means for effectively involving the insurance industry as national policy decisions are made affecting U.S. financial institutions.

"Federal Tools" Approach

There has been discussion among some policymakers that an alternative approach to insurance regulatory reform could be the establishment of "federal tools" or "federal standards" that would be enforced by the existing state insurance regulatory regime. This approach is fatally flawed and would not achieve meaningful insurance regulatory reform.

The 10th Amendment to the U.S. Constitution prevents the federal government from commanding the states to carryout federal law. Although the federal government can constitutionally preempt state law in certain circumstances, or offer "incentives" in hopes that states will act in accordance with federal wishes, such action in response to the question at hand would leave a large and unacceptable enforcement void. In addition, even if states did agree to carry out federal law, absent a federal enforcement mechanism application of a "federal tools" approach would lack uniformity in both interpretation and application.

We have seen this approach fail before, most recently with the enactment of the original NARAB legislation. In 1999, Congress attempted to help the states standardize insurance producer licensing standards through the NARAB provisions in the Gramm-Leach-Bliley Act. States were given three years to have at least 29 jurisdictions enact uniform or

reciprocal producer licensing laws or lose their licensing authority. While the states initially met the 29 state/three year requirement, it is clear that subsequently many states have drifted away from the uniform standards imposed by NARAB with the result that today there is a real question regarding how many states are in fact in compliance with the applicable standards. The bottom line is that after ten years we are still waiting for the states to adhere to this federal standard.

Two final points argue against a "federal tools" approach. First, the international trade issues important to both policymakers and the life insurance industry would be left unresolved. There would be no means of addressing the many problems that both Congress and the Administration have heard about from leaders of other nations regarding the inability of the U.S. to enter treaties or mutual recognition agreements on insurance. Second, the concept is a far greater affront to states rights than an optional federal charter. Mandating that state regulators apply federal standards for all insurers and agents would essentially supplant a significant portion of state regulatory prerogatives.

Conclusion

Mr. Chairman, I again want to thank you for holding today's hearing. Regulatory reform is unquestionably one of the most important matters before Congress, and determining how best to deal with insurance as part of the structural changes you will be making will be critical in assuring that the resulting regulatory framework works effectively and minimizes the risk that a crisis such as the one we are presently experiencing will occur in the future. We pledge to work diligently with you and with members of this Subcommittee to see that effective regulatory reform becomes a reality.