STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

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

ON

REGULATORY RESTRUCTURING: ENHANCING CONSUMER FINANCIAL PRODUCTS REGULATION

June 24, 2009

Statement Made by
Gary E. Hughes
Executive Vice President & General Counsel
American Council of Life Insurers

Mr. Chairman and members of the Committee, my name is Gary Hughes, and I am Executive Vice President and General Counsel 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.

The ACLI appreciates the opportunity to discuss with you the Administration's proposals for enhancing consumer protections in the financial products area. In particular, we will provide you with our views on the proposed Consumer Financial Protection Agency (CFPA) and its relevance to life insurance products (life insurance, annuities, disability income insurance and long-term care insurance).

We understand the impetus for the creation of the CFPA is to address consumer protections relative to financial products that may have played a role in the current financial crisis and which are viewed as being either largely unregulated or are partially regulated by different agencies with dissimilar or conflicting regulatory agendas. The ACLI and its member life insurance companies unequivocally support strong consumer protections with respect to our products and remain committed to working with our functional regulators to improve those protections as appropriate. We do not believe, however, that the interests of life insurance consumers would be well served by subjecting life insurance products to the additional jurisdiction of the CFPA.

Our position is grounded on four relevant facts. First, life insurance products are already one of the most heavily regulated financial products in the marketplace. Second, there have been no assertions nor has there been any evidence suggesting that life insurance products contributed in any way to the present crisis. Third, unlike most other financial products, the regulation of life insurance products has a direct and fundamental relationship to issuer solvency and therefore cannot prudently be separated from those other aspects of insurance regulation that in the aggregate constitute solvency oversight. And fourth, life insurance product regulation demands a comprehensive understanding of the fundamental mechanics of the life insurance business, and that understanding does not presently exist at the federal level and would not exist within the CFPA should it be established.

Life Insurance Product Regulation

Life insurance products are already heavily regulated by all states, and in most instances that process entails prior approval. A life insurance company must first file each product form, and all related disclosure and other materials, 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 product form and related materials 51 different times and await 51 different approvals. And this process must be repeated for each product the insurer wishes to sell.[1] Only after a state has given final approval to each individual product filing can that product be offered and sold to consumers in that jurisdiction. Variable life and variable annuities and life insurance products sold in the pension markets are subject to additional layers of federal product regulation.[2]

Indeed, the repetitive and overly costly nature of life insurance product regulation by the states is one of the principle reasons the insurance industry has sought an optional federal charter. Under a federal regime, new products would be required to satisfy a single set of uniform standards and be subject to one rather than 51 product review filings.

[1] In response to the redundancy, cost and delay associated with the life insurance product approval process, the states have, with the full support of the industry, been working for several years to implement a streamlined life insurance product approval process. Through an interstate compact, the states are moving toward having a centralized commission adopt uniform product standards and then permit an insurer to make a single product approval filing with the commission. Once approved, a product would be deemed approved in all jurisdictions that have enacted the interstate compact legislation. This remains a work in progress and is not yet available for all life insurance products and is not yet operational in a significant number of states.

[2] For variable life insurance and variable annuities, the SEC and FINRA add a layer of federal regulation on top of individual state regulation, as those products contain securities characteristics in addition to their insurance features. And recently, both the SEC and FINRA have asserted jurisdiction over indexed annuities. In addition, for any life insurance product offered in the pension market, the Department of Labor adds yet another layer of regulation as required under ERISA.

In addition to reviewing product filings, the states impose extensive consumer protection requirements on life insurance products and their issuing life insurers. Every state in the nation has enacted a form of the Unfair Trade Practices Model Act. This act addresses a number of consumer issues, including: misrepresentation and false advertising; unfair claims practices; maintenance of consumer inquiry and complaint procedures; misleading statements to consumers regarding policy provisions; false or misleading statements about a company's financial condition; and unfair discrimination. Additionally, the states are moving toward uniform annuity disclosure and suitability regulatory standards that mirror to the extent appropriate those of the SEC and FINRA applicable to variable life insurance and variable annuity products.

Because life insurance products are already heavily regulated by the states, there is no justification for the added scrutiny of an agency like the CFPA. Fifty-one product approvals are more than sufficient. Adding a 52nd merely adds a regulatory burden, the costs of which will be born by consumers, without any corresponding consumer benefit.

In the same vein, we note that the Administration proposal would exempt SEC and CFTC regulated products form CFPA jurisdiction. The rationale for this exemption is presumably that these agencies already provide ample product oversight. We fail to see why the even more intense regulatory oversight of life insurance products by the states should not entitle these products to the same treatment.

Life Insurance Products and the Financial Crisis

There is no evidence that life insurance products were a cause of, or a contributing factor to, the current financial crisis. While there are unquestionably improvements that can be made to the way in which life insurance products can be regulated, the same can be said for every financial product extant, including those overseen by the SEC and the CFTC. The financial crisis has not highlighted or given rise to any additional and fundamental need for insurance products to be made subject to an agency such as the CFPA.

Life Insurance Product Regulation and Solvency

Life insurance product regulation and solvency regulation are inherently linked. The primary objective of insurance regulation is solvency, which is the most important consumer protection of all. Insurance regulators must assure that the companies they oversee have sufficient assets to pay all expected claims; claims that may arise today or 50 years from today. Strict solvency standards under current law define how life insurers can invest the premiums they receive. In addition, insurance regulators conduct regular financial and market conduct examinations to assure that insurance companies honor those standards.

In accordance with existing laws and regulations, life insurers use sophisticated mathematical techniques to assure that their investments are properly structured based on expected payouts. Thus, solvency regulation is inherently linked to the products a life insurer sells. Factors such as what is guaranteed, when the guarantee is triggered, and the length of time the guarantee is in force as well as other product features are crucial to the determination of how the premiums are invested to assure assets will be available to pay claims. This necessitates that product regulation be an integral part of solvency regulation.

Effective solvency oversight requires that a single regulator have authority over both solvency and product design. Separating these two functions undermines the essence of insurance regulation and harms the interest of consumers. A detached product regulator—one that focuses on product design and features without regard to solvency or life insurer financials—is not only unnecessary, but risky. Depending on its statutory mandate, this detached regulator may be solely concerned with imposing its own standards on the life insurance marketplace without regard to solvency.

For example, suppose that a life insurer designs an innovative new product. As part of that process, and based on sound actuarial data, the life insurer determines that individuals employed in certain high-risk professions should pay a higher rate due to a higher risk of loss. A detached product regulator, concerned solely with "consumer protection" and without any regard to financial issues, might object to this and similar risk classification criteria, even if they are necessary for adequate pricing and proper matching of assets to liabilities.

This example highlights the extraordinary importance of product regulation for life insurers, and its inherent link with solvency regulation. Efficient product regulation that is attuned to solvency concerns is critical to the financial health of life insurers. Bifurcating product and solvency regulation could force life insurers to choose between selling actuarially unsound products in order to maintain sales, or redesigning products that are actuarially sound, but which cannot gain timely market approval, or are not competitive with other financial products due to pricing requirements. This would lead to a breakdown of the entire risk classification system and potentially jeopardize the financial health of life insurers, and assuring the financial health of life insurers must be considered the most important consumer protection of all.

A number of months ago, and before the Administration conceived of the CFPA, the ACLI board of directors adopted a policy principle on regulatory reform providing:

> Legislation should not increase insurance systemic risk by separating the individual elements of effective life insurer solvency regulation (e.g., capital and surplus, underwriting, risk classification, nonforfeiture, product regulation) between either federal and state regulators or between two federal regulators.

Subjecting life insurance products to the jurisdiction of the CFPA and thus disaggregating important aspects of life insurance solvency regulation would run the very real risk of increasing, not decreasing, systemic risk for insurance and weakening, not strengthening, the protection of life insurance consumers. In the context of life insurance product regulation, the CFPA is simply not a vehicle that would serve the best interests of consumers.

No Federal Insurance Regulatory Expertise

The foregoing discussion makes clear that anyone presuming to regulate life insurance products must have a solid, in-depth knowledge and understanding of the technical underpinnings of those products as well as a full understanding of all other aspects of life insurance solvency. As this Committee well knows, there is not at present a federal functional regulator of the life insurance business. Consequently, the type of knowledge base that would be necessary to appropriately deal with life insurance product regulation simply does not exist at the federal level. Empowering the CFPA to delve into insurance product regulation while not functioning as the functional solvency regulator for life insurance would result in adverse consequences for life insurance consumers and for life insurance companies.

We note that the centerpiece of Administration's proposal with respect to insurance is the creation of the Office of National Insurance within the Department of the Treasury. The stated purpose of this office is to ". . . gather information, develop expertise . . . and coordinate policy development in the insurance sector." Should it become a reality, the new ONI would be the more appropriate federal agency to coordinate with state functional insurance regulators regarding any issues related to consumer protection and life insurance products. And in any event, unless and until a federal regulatory body is invested with the authority to act as a functional solvency regulator, the role of any federal body should be advisory only.

Conclusion

Mr. Chairman, the best interests of life insurance consumers would not be well served by extending the jurisdiction of the CFPA to life insurance products. Our products are already more highly regulated than most, and they were not a cause of, or contributing factor to, the financial crisis. Divorcing the regulation of our products from the rest of life insurance solvency oversight would result in weakening consumer protections and jeopardizing the solvency of life insurers, particularly in light of the fact that the requisite expertise to deal effectively with life insurance products is absent at the federal level. Under the regulatory construct as envisioned by the Administration, consumer issues relative to life insurance products could best be addressed by the Office of National Insurance working cooperatively and in an advisory capacity with state functional insurance regulators.