Statement of the
American Council of Life Insurers

before the

Subcommittee on Capital Markets, Insurance & Government Sponsored Enterprises of the House Financial Services Committee

On

Insurance Product Approval: The Need for Modernization

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on behalf of
The American Council of Life Insurers

Mr. Chairman and members of the Subcommittee, I am William B. Fisher, Vice President and Associate General Counsel for Massachusetts Mutual Life Insurance Company based in Springfield, Massachusetts ("MassMutual"). MassMutual is the parent company of a global financial services organization that operates under the marketing name, the MassMutual Financial Group. The member companies of the MassMutual Financial Group, which include OppenheimerFunds, Inc., have $213 billion of assets under management as of December 31, 2000, and offer life insurance, annuities, disability income insurance, long term care insurance, retirement planning products, trust services, money management and other financial services and products.

I am appearing today on behalf of the American Council of Life Insurers. The ACLI is the principal trade association for life insurance companies, and its 426 member companies account for over 80% of the life insurance in force in the United States.

Within the ACLI, I co-chair the Policy Advisory Group that has developed the industry's agenda for modernizing the regulation of life insurance companies and their producers. I appreciate the opportunity to appear this afternoon and present the views of life insurance companies on the issue of "speed-to-market" and its competitive implications for our business.

Improving the efficiency of life insurance regulation has unquestionably become one of the most important matters confronting our business. I think it is fair to say that the CEOs of many of the ACLI's member companies view it as nothing short of a survival issue in the current competitive environment. As a consequence, regulatory reform has been made a top priority at ACLI.

Competitive Implications: Speed-to-Market Versus Functional Regulation

At the outset, it should be understood that the competitive considerations associated with speed-to-market are distinctly different from those that were at issue in the context of the Gramm-Leach-Bliley Act. In GLB, we sought statutory certainty that when commercial banks or others were engaged in the business of insurance, their activities would be governed by the same laws and regulations applicable to traditional insurance companies and agents. The requirements of functional regulation mandated by GLB assured a high degree of competitive equality – but only in the context of firms or individuals engaging in the business of insurance.

Speed-to-market connotes a very different, external competitive consideration that reflects the new marketplace environment in which life insurers increasingly find themselves. Historically, life insurers competed only against other life insurers. Whatever the inefficiencies of multi-jurisdiction insurance regulation, companies incurred them equally. Things have changed radically in recent years. Financial services integration and modernization is occurring at a breakneck pace throughout the insurance and financial services sector. Life insurers, as providers of life insurance, annuities, and other financial security and retirement security products, must compete directly with non-insurance financial institutions such as banks and mutual funds. These firms enjoy regulatory efficiencies that translate into significant marketplace advantages.

The ability of our competitors in other industries to introduce new products nationally in a very short timeframe and to have any requisite regulatory approvals handled just once rather than 50-plus times are now critical considerations for life insurance companies. Therefore, insurers increasingly judge the effectiveness of their own system of regulation by comparing it with the regulatory systems of their non-insurance competitors.

In the context of this new competitive environment, life insurers' inability to bring new products to market in a timely and efficient manner is one of the most serious shortcomings of the current regulatory system. In the age of the Internet, when consumers expect to be able to consider many sophisticated financial products rapidly, the insurance industry will be left behind by its major competitors as a result of its current regulatory environment.

The competitive inequality is amply demonstrated by the time it takes to bring a product to market on a nationwide basis. Life insurance products typically are subject to state-by-state prior approval by state insurance regulators, a process that can take anywhere from six months to as much as two years to complete. In addition to being long, the product approval process also involves application of differing state laws and, even where the laws are uniform, widely divergent state standards, interpretations, and requirements applicable to identical products. For a company such as MassMutual, the result is unnecessary dedication of resources and lost opportunities.

For our individual life insurance products, it takes approximately four weeks for an experienced person working full time to put together a single product filing in all states. This is exclusive of the product development time and the time spent in responding to regulators' comments and questions. We also preliminarily estimate that last year alone, we lost at least $50 million in sales (measured by premium) due to the inability to get products to market more quickly.

In contrast, national banks do not need explicit regulatory approval to bring most new products to market on a nationwide basis, and can be in the marketplace in a matter of weeks. Securities firms typically get regulatory approval for new products in three to four months from a single regulator.

As a result of the slow pace with which insurance companies can get products to market, consumers select other financial service providers to meet their planning needs. According to an ACLI-sponsored study entitled *Monitoring of Public Attitudes 2000*, "Banks are consumers' top choices for a wide array of financial services (47%) and on par with stock brokerages in using up-to-date technology (36% vs. 35%)." On the other hand, consumers view life insurers "at the bottom in both categories, at 5 percent and 4 percent, respectively."

As a result, organizations with both insurance and non-insurance operations are being forced to allocate capital away from their insurance operations in response to the inefficiency of the insurance regulatory system. Over the long run, the implications for insurers and their customers of these adverse capital allocation decisions are serious, and they can be expected to worsen as consolidation and cross-industry diversification continue in the post-GLB environment.

Consumers also suffer from the inability of life insurers to bring their products to market quickly, because product approval delay often translates into consumers' inability to obtain the best price or most favorable product features a company can offer. The life insurance marketplace is highly competitive in terms of both price and product features, as illustrated by the increasingly shorter life cycles of insurance products. When I joined MassMutual in 1971, it was not uncommon for our products to be on the market for eight years or more before they required replacement or significant modification. Today, the life cycles are substantially shorter, due primarily to the need to remain competitive on price and product features, as well as the need to comply with new regulatory requirements, such as the new reserve regulation for term insurance and the development by the National Association of Insurance Commissioners ("NAIC") of new mortality tables. For example, the life cycle for our variable life and universal life insurance products is approximately two years; for term insurance, approximately one year; and for disability income insurance, approximately two to four years.

Although regulatory efficiency is clearly a key issue of concern to the entire insurance industry, I should note that the ACLI is not speaking on behalf of the property and casualty insurance industry. Since the property and casualty insurance products are generally not in direct competition with bank and mutual fund products, the property and casualty industry's concerns about speed to market may well differ from those of life insurers.

ACLI Study of Insurance Regulation

Within the ACLI membership, CEO concerns over time delays and other regulatory inefficiencies grew so serious that the association's Board of Directors concluded that it was imperative that we address the issue of regulatory reform as aggressively as possible. The first step in this process involved a comprehensive study of the current state of life insurance regulation that was undertaken in 1998 and completed in late 1999. The objective of the study was to pinpoint those aspects of regulation that were working well and those that were hindering insurers' ability to compete effectively and thus in need of improvement. The following was the principal conclusion reached in this study:

> While laws and regulations governing life insurers are generally viewed as necessary and appropriate, they are seldom uniform from state to state and, even where generally uniform, frequently subject to divergent applications and interpretations from one state to another. These factors lead directly to concerns over unnecessary regulatory costs and, even more importantly, concerns over matters of timing (e.g., product approvals or licensing of agents and companies). Life insurers believe that competitors in the securities and banking industries are increasingly able to act in a more timely and efficient manner as they serve the needs of consumers of financial products and services. Even the short-term implications of this situation are viewed as extremely serious.

This study has served as the blueprint for the ACLI's regulatory reform efforts. In addition to identifying speed-to-market as an increasingly critical factor in our ability to operate effectively, the study established the principle, which is noted in the above excerpt, that life insurers are not using regulatory reform as a means of escaping appropriate regulatory requirements, be they oriented toward solvency protection or consumer protection. To the contrary, life insurers are seeking a strong system of regulation – but one that operates on a much more efficient basis.

CEO Survey

The ACLI's efforts to modernize the life insurance regulatory system have from the outset been led by chief executive officers of its member companies. These executives have set the association's agenda, orchestrated its activities, and established its priorities. As the ACLI completed its study of regulation, these CEOs concluded they should prioritize the shortcomings identified in the study for two reasons: first, to explain more precisely to our state regulators which concerns are the most pressing from our perspective, thereby enabling the states to better set their own agenda for change; and second, to assist the ACLI in evaluating its own options for change.

The ACLI surveyed all its member company CEOs in 2000 to identify their most prominent concerns about the current regulatory system. The most significant conclusion derived from this survey was that policy form/contract approval (speed-to-market) is far and away the one element of insurance regulation

CEOs believe is most in need of reform. An executive summary of the CEO survey is appended to this statement.

Examples of Speed-to-Market Difficulties

In order to more fully appreciate the severe practical and competitive implications of speed-to-market limitations, the following MassMutual examples illustrate the types of difficulties life insurers encounter on a daily basis.

MassMutual Financial Group offers a fairly typical individual universal life insurance product. Of the 52 jurisdictions in which we do business, only eleven have accepted our “standard” version; 41 jurisdictions have special requirements that result in our having a separate version for each of those jurisdictions. While the variations range from a total repricing of the product to reasonably minor wording changes, nevertheless the result is the need for a separate version for virtually every state.

Even where the laws are relatively uniform, we have encountered interpretive issues that are as problematic as statutory differences. For example, MassMutual is currently seeking approval of its latest generation disability income insurance product. Since we began issuing disability income insurance in 1965, we have routinely included a provision permitting us to require proof of continued disability after a claim is initially approved. Many disabilities are not permanent and last for short durations; the purpose of the provision is to counter fraud and permit the insurer to identify claims where the disability has ended. One state is currently refusing to approve this provision on the basis that it would constitute an unfair claim practice and result in harassment of the insured. Even if we are successful in convincing the policy form reviewer that there is no legal or public policy basis for the department's position, resolving the problem takes time and delays the availability of the product to consumers in that state.

Solutions

In June of 2000, the ACLI Board of Directors put in place a policy position on regulatory reform establishing a two-track approach for dealing with the issue. Under the first track, the ACLI committed to redouble its efforts to work with the NAIC and individual states to improve our state-based system of life insurance regulation. Under the second, the ACLI was directed to draft legislation providing for an optional federal charter for life insurers. Both tracks were given equally high priority.

Summary of ACLI Report on Optimal-Product Regulation Approach

In November 2000, the ACLI prepared a report, which was made available to the NAIC, that contains recommendations for improving the uniformity, efficiency, and timeliness of regulatory review of policy forms. These recommendations form the conceptual foundation for our suggested improvements to a state-based system of insurance regulation and for the product approval process incorporated in our working draft of optional federal charter legislation (albeit with different implementation considerations). The following discussion is limited to our recommendations vis-à-vis state insurance regulation and the NAIC's response.

Based upon its review and analysis of the problems with the current system of product regulation, the ACLI report, entitled "An Optimal Approach to Insurance Product Regulation," proposes a regulatory structure for insurance products that protects consumers while allowing ACLI member companies to bring their insurance and annuity products to market with the speed and efficiency enjoyed by non-insurance competitors in the financial services marketplace. The report observes that, in order for insurers to remain competitive in the future, philosophic and systemic modifications to the structure and process of insurance product regulation are needed.

The ACLI believes that moving products to market more quickly and effectively enhances consumers' ability to plan for their insurance and retirement needs. Accordingly, the report recommends that a single point for insurance product filing be established, where much of the product-based regulatory review is shifted to a “back end” review of product compliance and administration in the marketplace, rather than the current “front end” prior review and approval of products. Insurance and annuity products that meet established national standards should be filed with a single entity acting on behalf of insurance regulators for informational purposes only, with no prior approval required, before they are marketed and sold.

The proposed optimal structure developed in the report is summarized below:

1. A single entity would be established with sole jurisdiction over products.
2. National standards for the product lines marketed by ACLI members would be identified.
3. Companies would certify that they meet the national standards before issuing a product (except for certain types of products that are entered into with sophisticated clients).
4. No prior approval would be required for most products.
5. If national standards for a particular product are unclear, the company could seek an interpretive ruling from the single entity regarding the product’s compliance with applicable national standards.

6. Products would be filed with the single entity for dissemination to the states through an electronic means.

7. Products could be monitored through a back end system of review through the market conduct examination process. However, the single entity would be the arbiter/interpreter of a product's compliance with the national standards.

The ACLI report acknowledges that substantial time and effort will be necessary to fully develop this recommendation and implement it at the state level. This should be viewed as a long-term solution (over several years), rather than one that could be implemented quickly.

NAIC Response to Date (CARFRA)

The NAIC has launched a pilot project involving 10 states that seeks a centralized, coordinated review and approval process for policy forms, named "The Coordinated Advertising, Rate and Form Review Authority" or "CARFRA." CARFRA currently provides insurers with a single point of filing for 3 product lines (individual term life, individual flexible premium deferred annuities, and Medicare Supplement) for the 10 states. National standards for these products are identified, as well as individual state deviations to those standards. Companies must use a specific electronic filing repository established by the NAIC ("SERFF") to file a product, and the CARFRA regulators, who have pooled their resources and formed expert teams to review the filings, have guaranteed a response to a filing within 45 days. The "limited launch" of CARFRA began on May 1, 2001. Other states and other products are expected to be added to CARFRA later this year.

Industry View of CARFRA

The ACLI commends the NAIC and the regulators' efforts to craft an interim measure designed to achieve a single point of filing and uniform standards. While CARFRA in its initial phase does not achieve many of the objectives set forth in the ACLI report, it is recognized that state regulators must operate within the constraints of the existing legal structure, where deviations in product content and filing processes exist state by state. The ACLI believes that CARFRA is a good "first step" toward the realization of a broader solution, and is working closely with the NAIC to implement CARFRA.

Practical Considerations

The achievement of a single point of filing with national product standards within the existing state regulatory system is a challenging task. The fact that 10 states have agreed to national standards for 3 product lines, as well as a process for jointly reviewing a product filing within 45 days, is encouraging. However, there are a number of practical considerations that will need to be worked through in order to realize this goal.

First, the states' laws and rules governing product content are by no means uniform. This problem is evident in reviewing the "deviations" to the national standards reported by the 10 CARFRA states. While several states have reported no deviations or only a few deviations for each product line (Alabama, Arkansas, Ohio), others have identified 8 to 20 deviations (Oregon, Pennsylvania, Texas). The State of New York has over 140 reported deviations to both the life insurance and the annuity product. Accordingly, companies must alter their product filings for CARFRA based on the deviations identified by each state. Until the states adopt uniform product standards for the many lines of insurance sold today, as well as interpret them uniformly, national product standards are impossible to achieve.

Second, state membership in CARFRA is voluntary. States may be unwilling or unable to cede sufficient authority to a separate body to approve a product for sale in their respective states. Even when a state is a CARFRA member, this difficulty is also apparent in the CARFRA process. A recommendation whether to approve a product is an "advisory" recommendation only. Member states retain the ability to make a separate decision regarding a filing. In addition, states must also review the product separately if they have identified any "deviations" to the national product standards. This sovereignty issue could impede states from establishing a single review process that is efficient and meaningful.

Thus, while the NAIC has produced a significant accomplishment with CARFRA, the establishment of national product standards and a single review process for the lines of business marketed by ACLI members in all fifty states is, at best, very challenging. Whether the state system of insurance regulation can meet this challenge remains to be seen.

Conclusion

Insurance constitutes a vital component of the financial services industry and the overall U.S. economy, providing innumerable retirement security products and services to consumers all across the country. It is imperative, however, that insurance regulation be modernized and made more efficient as the competitive landscape of the 21st century evolves. The current framework is unacceptable, and that fact is widely acknowledged today by regulators and regulated alike.

In sum, the financial services marketplace has changed very dramatically in the past several years, and our system of insurance regulation has not kept pace. Immediate and substantial reform is necessary to assure the short and long-term well-being of our business.