Statement of the
Massachusetts Mutual Life Insurance Company

before the

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

On

Reforming Insurance Regulation –
Making the Marketplace Competitive for Consumers

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Mr. Chairman and Members of the Subcommittee,

I am William B. Fisher, Vice President and Associate General Counsel, for Massachusetts Mutual Life Insurance Company ("MassMutual") based in Springfield, Massachusetts. MassMutual was founded in 1851 and conducts business in all 50 states, the District of Columbia and Puerto Rico. We are one of the largest life insurers in the United States and are one of only a handful of companies in our industry holding the highest possible financial strength ratings from Standard & Poor's, Fitch Ratings and A.M. Best. MassMutual is the parent company of a global, diversified financial services organization that operates under the name, MassMutual Financial Group. The member companies of the of the MassMutual Financial Group, which include Oppenheimer Funds, Inc., serve more than 10 million clients, have over $240 billion in assets under management as of December 31, 2002, and offer a broad-based portfolio of financial products and services including life insurance, annuities, disability income insurance, long term care insurance, retirement planning products, structured settlement annuities, mutual funds, money management and trust services.

I appreciate this opportunity to appear before you today on the subject of regulatory modernization for the insurance industry. We applaud the Chairman's and Subcommittee's continuing interest in modernization of insurance regulation, since it is one of the most critical issues facing both MassMutual and the entire insurance industry.

My testimony will cover the challenges facing an insurer within the current regulatory structure, our view of the status of current modernization efforts, and our support for enactment of optional Federal insurance charter legislation. At the outset, I note that my testimony is provided from the perspective of a life insurer that offers life insurance, annuities, disability income insurance and long term insurance. MassMutual does not issue property and casualty insurance. Many of the concerns with the current state of insurance regulation are common for all segments of the insurance industry. In some respects, however, there are differences in the concerns of life insurers and property and casualty insurers due to differences in their respective product lines and associated regulatory requirements. My remarks will be limited to the life industry issues.

<u>Current Environmental Challenges.</u>

The need for modernization of insurance regulation is well established and acknowledged in virtually all quarters. Over the past few years, this Subcommittee has held a series of hearings on various aspects of insurance regulation, including the inefficiencies and lack of uniformity in product regulation, producer licensing, and market conduct regulation. From MassMutual's perspective, these are the areas of regulation most in need of reform. However, I should also note that the underlying lack of uniformity and efficiency is systemic and permeates virtually all aspects of insurance regulation, albeit in many cases to a lesser extent.

The regulatory community, as represented by the National Association of Insurance Commissioners ("NAIC"), readily acknowledges the need for modernization and efficiency of state insurance regulation. In March of 2000 the NAIC released its *Statement of Intent* affirming its commitment to the goal of protecting insurance consumers as well as the need for efficient, market-oriented regulation of the business of insurance. More recently, in September of this year the NAIC adopted its *Reinforced Commitment: Insurance Regulatory Modern Action Plan* which sets forth its blueprint and timing for implementation of regulatory modernization.

For a life insurer, such as MassMutual, that markets national products on a nationwide basis, the lack of a comprehensive, uniform and efficient regulatory system is more than a matter of frustration. Simply put, it translates into both a disservice to our customers and a competitive disadvantage for the company.

Our customers ultimately bear the cost of our having to comply with the duplicative and often conflicting state requirements. In addition, our inability to bring new products to market in a timely manner means that our customers do not have access to these products as rapidly as they should. New products typically incorporate the new features that benefit consumers. They also typically cost less than predecessor products, as is illustrated by the steady industry wide decline in the cost of life insurance over a long period of years.

Increasingly, life insurers compete with non-insurance financial institutions, such as banks and mutual funds. At one time life insurers competed only with each other, and the burden of any regulatory inefficiencies was borne by all. The environment has changed dramatically in recent years. Financial services integration and modernization is occurring throughout the insurance and financial services sector. For life insurance, consumers have a choice of buying a cash value product from a life insurer or buying term life insurance and investing the difference with a non-insurance competitor. More importantly, the product mix offered by life insurers has changed. Retirement security products and variable contracts have become an increasingly significant element of life insurers' product offerings in order to meet the needs of the marketplace. Industry statistics developed by the American Council of Life Insurers illustrate this point. A generation ago, the average life insurer took in almost 90 percent of its premiums from the sale of life insurance, compared to only 13 percent from annuities. Today, those numbers are almost completely reversed, with 70 percent of premium receipts coming from annuities compared to only 30 percent from life insurance products. Today, life insurers administer over $1.8 trillion in retirement plan assets, amounting to over 25 percent of the private retirement plan assets under management in the United States.

Our non-insurance competitors are subject to regulatory systems that are far more efficient than our current fifty-state insurance regulatory structure. The resulting competitive disadvantage for life insurers is amply demonstrated in a number of ways. Our greatest concern is with the current system of product regulation. Our competitors in other segments of the financial services industry are able to introduce new products nationally in a very short time frame and typically are able to obtain any requisite regulatory approvals from a single regulator. In contrast, a life insurer's products generally are subject to state-by-state prior approval in all jurisdictions in which the insurer does business. This is a very time-consuming process that, in the case of MassMutual, can take anywhere from one to one and a half years to complete, depending upon the product involved. In addition, the product approval process also involves application of differing state laws and, even when the laws are uniform, widely divergent state standards, interpretations and requirements are often applied to identical products.

The result is lost opportunities and unnecessary dedication of resources, and MassMutual's experience demonstrates this point. In June of 2001 I had the opportunity to testify before this Subcommittee on the need for modernization of the product approval system. At that time I stated that MassMutual estimated a loss of at least $80 million in sales (measured by premium) during the prior year due to inability to bring products to market on a timely basis. We recently updated this estimate. For 2002 alone we estimate that we lost up to $60 million in sales (measured by premium) due to the inability to bring our products to market within 60 days of filing with our regulators. While the updated estimate reflects some improvement, it also demonstrates the continued need for regulatory reform. The lack of uniformity in product regulation is also a serious problem. On a product-by-product basis, it is common for us to have anywhere from 30 to 40 versions of a single product due to variations in state laws and requirements. For one product, we have 48 versions. Imagine the issues this Subcommittee would be dealing with if mutual funds, securities and bank products were required by state laws to be customized on a state-by-state basis.

The current inefficiencies are not limited to product approvals. A national life insurer is subject to the market conduct requirements of every state in which it does business. Although in many respects the market conduct laws of the states are similar, substantial differences exist among the states in other areas, such as mandated disclosures, replacement requirements, complaint notices, and interest on death proceeds requirements. In addition, the process for conducting market conduct examinations has not been coordinated among the states and has resulted in duplicative examinations, the associated unnecessary expense, and sometimes substantially differing findings. By way of example, in the past five years, MassMutual has undergone 14 separate state market conduct examinations. The average duration of these examinations from initiation to issuance of the final report generally ranges from six to twelve months, and the examinations often involve on-site reviews lasting 90 days.

The Gramm-Leach-Bliley Act of 1999 ("GLBA") provided for federal control of producer licensing if fewer than 29 states adopted a uniform or reciprocal producer licensing system by November 2002. While the states surpassed this number with ease and 50 jurisdictions have adopted laws designed to satisfy the requirements of GLBA, the result has been a reciprocal licensing system as opposed to a uniform licensing system. While today's producer licensing system is more efficient than that which existed in 1999, insurers such as MassMutual continue to devote resources to comply with licensing requirements that unnecessarily vary among the states. For example, several states maintain appointment, continuing education, fingerprint, and bonding requirements that differ from others. With regard to producer appointments, before a licensed producer may market the products of a particular insurer, the insurer must first process an "appointment" with the insurance department of each state in which a producer is licensed and will market its products. The effective date of these appointments still varies widely among the states. Some states require an insurer to submit an appointment request and wait for a response that will inform the insurer of the effective date of a particular appointment; other states make the appointment effective on the date it is submitted electronically; still other states permit insurers to pick the date the appointment will be effective. While these variations have been the subject of much debate at the NAIC and efforts continue to resolve them, the result of reciprocity rather than uniformity has resulted in the need for insurers to maintain costly systems and experience needless delays to respond to state specific requirements. In short, while the threat of federal control prompted marked improvement in producer licensing from an insurer perspective, the improvement falls short of the uniformity that is required to achieve regulatory efficiency.

<u>Current Modernization Efforts.</u>

Since the NAIC's original *Statement of Intent* in March of 2000, state insurance regulators have dedicated extensive commitment and resources to reforming state insurance regulation. The NAIC's recently released *Reinforced Commitment: Insurance Regulatory Modernization Action Plan* outlines the actions taken thus far for the system as a whole. In addition, some states have worked diligently to initiate reforms within their respective jurisdictions, such as creation of product filing and approval checklists.

While most of the activity thus far has been in the state insurance regulatory community, there has also been activity in state legislatures. Since the passage of the NARAB provisions of GLBA, 50 jurisdictions (including one major state in the past few weeks) have passed the NAIC's Producer Licensing Model Act. As currently implemented, this Act provides for reciprocity among states relative to non-resident producer licensing. At the national level NCOIL is working on development of its Market Conduct Surveillance Model Law that would establish a market conduct analysis and examination legislative framework to provide greater efficiency in market conduct regulation and examination processes. The NAIC is an active participant in the NCOIL process. Finally, the NAIC has adopted Interstate Insurance Product Regulation Compact model legislation that has been endorsed by both the NCSL and NCOIL.

MassMutual has supported and will continue to support all of these efforts toward modernization of insurance regulation. Our support is more than just words, since we have actively participated in a number of these efforts. For example, I personally have been a lead industry voice working with the NAIC and NCSL on development of the Interstate Compact legislation. More recently I and others at MassMutual have been actively involved in the NAIC's development of sample product standards for the Interstate Compact. The NAIC is developing these standards largely for the purpose of showing legislatures considering passage of the Interstate Compact what the product standards might look like. In all likelihood, the product standards developed by the NAIC will serve as the basis for the final standards adopted by the Interstate Compact Commission when the Compact becomes operational.

MassMutual has no doubt about the good faith and commitment of the states toward modernization of insurance regulation. Given the basic nature of a fifty-state regulatory system and the accompanying political and other challenges, however, we are concerned about the ability of the states to achieve the comprehensive uniformity and regulatory efficiency that is sorely needed. Our reasons are several fold.

First, within a fifty-state regulatory system the primary responsibility of each state insurance regulator is to protect the residents of that state. To the extent that consistent application of uniform laws and standards is recognized by state officials as fulfilling this responsibility, the current system of regulation would achieve uniform and efficient regulation. As a practical matter, however, there have been and undoubtedly will continue to be differences in policy, opinion and processes among the states on how best to protect consumers. These continuing differences defeat the efforts to achieve the goal of true regulatory modernization.

A recent development illustrates this point. Several years ago the NAIC developed an electronic filing system for insurance products known as System for Electronic Rate and Form Filing (SERFF). SERFF offers a one-stop, single point of electronic filing and is becoming increasingly available to and utilized by insurance companies. The NAIC's recently released *Reinforced Commitment: Insurance Regulatory Modernization Action Plan* establishes the goal of insurance departments to be able to receive product filings through SERFF for all major lines and product types by December of 2003. Notwithstanding the common acceptance of SERFF by both regulators and industry, in July of this year one major state adopted a regulation requiring all filings to be submitted through a totally different electronic filing system.

Second, regulatory efficiency in a 50 state system assumes a very high level of cooperation and interdependence among regulators. Assuming uniformity of the underlying laws and regulatory requirements to be enforced, achieving this cooperation and interdependence is conceptually possible. The fifty state regulatory system, however, almost necessarily involves differing legal requirements, which seemingly will inhibit the ability of regulators to achieve the necessary cooperation and interdependence.

An illustration of this concern is the NAIC's action plan for regulatory modernization, the *Reinforced Commitment*, which relies heavily upon deference by insurance regulators to the home state regulator. For example, insurance producers would be required to satisfy only their home state pre-licensing education and continuing education requirements. Similarly, in the market regulation arena reliance is placed upon the home state regulator of a "nationally significant" company to produce a market regulatory profile for that company and to conduct market conduct examinations of those companies. Non-home state regulators would not be permitted to conduct a market conduct examination in the absence of a specific reason that requires a targeted market conduct examination by that state. Whether the requisite level of deference will be achieved remains to be seen, since the *Action Plan* does not envision changes to the substantive market conduct standards that vary from state-to-state in areas such as advertising, disclosures, and replacement requirements. The varying state requirements place an inherent limitation on the ability of one state to rely upon another state's market conduct examinations, and state regulators cannot delegate to another state the responsibility of enforcing their own state's laws.

Finally, uniformity within a fifty state system will require more than action by regulators. In many cases, such as product regulation, legislation will be required to eliminate the more problematic differences in state requirements. The need for legislation introduces another level of complexity, both substantive and political.

The NAIC affirmed the need to improve regulatory efficiency in March of 2000. Today, more than three years later, the NAIC, again to its credit, is recommitting itself to the goal of regulatory efficiency, but this time with an explicit goal of year-end 2008--more than five years from now and the goal is partial uniformity. Aside from concerns about the extent of progress achieved to date, the extended period of time of five years to achieve partial uniformity is of concern. Business activity often moves at a faster pace than does regulatory or legislative activity. That said, we need to state plainly--full uniformity is needed today.

<u>Product Regulation – A Case Study.</u>

The current status of life insurance product regulation reform efforts provides a good case study of our concerns about the prospect for complete success in modernizing state regulation.

When I testified before this Subcommittee in June of 2001 on the need for modernization of the insurance product approval system, the NAIC had just launched a pilot project involving ten states known as the "Coordinated Advertising, Rate and Form Review Authority" ("CARFRA"). CARFRA was designed to provide insurers with a single point of product filing. Although products filed with CARFRA would be reviewed using newly developed national product standards, participating states had the ability to retain their own state-specific product requirements. Unfortunately CARFRA has not been a success, primarily because it did not address the underlying problem of a lack of uniform state laws. By its nature, CARFRA must operate within the constraints of the existing legal structure, where deviations in product content exist state-by-state.

In order to address the uniformity problem, in March of 2002 the NAIC initiated work on developing its Interstate Insurance Product Regulation Compact model legislation. That effort was completed in July of 2003 with the NAIC's adoption of the Interstate Compact model. The Interstate Compact has also been endorsed by the National Conference of Insurance Legislators and the National Conference of State Legislatures.

The Interstate Compact would provide a single point of filing and approval for life insurance, annuities, disability income insurance and long term care insurance. Approval of a product filing by the Compact Commission would enable an insurer to issue the approved product in all states which participate in the Interstate Compact.

The Interstate Compact addresses the lack of uniformity problem by authorizing the Compact Commission to establish product standards for filings made with the Compact. These standards would be established through a regulatory process provided for in the Interstate Compact legislation. A participating state may opt out of a Compact product standard by legislation or by regulation. In the case of an opt out by regulation, the state Insurance Commissioner must make certain specific findings of fact and conclusions of law and determine that the Compact product standard does not reasonably protect the citizens of that state. In the absence of an opt out, the Compact product standard is binding upon each participating state and, subject to certain exceptions supersedes the individual state law applicable to the content and approval of the product covered by the Compact standard.

By its terms the Interstate Compact becomes operational only after 26 states, or states representing 40% of the national business as measured by premium volume, become participating states. Passage of the Interstate Compact legislation in a state will be required before that state can participate in the Compact.

MassMutual supports the Interstate Compact, but also sees a very uncertain prognosis for its success in the future. At the NAIC there has been broad-based support for the Interstate Compact by most, but not all, state insurance regulators. At this point, the depth of this support is not entirely clear in terms of the commitment of each state insurance regulator actively to seek passage of the Interstate Compact in the legislature of the applicable state. The level of regulator support may depend in part upon the nature of the product standards to be developed for the Interstate Compact. As noted previously, the NAIC is currently working diligently to develop sample national product standards in connection with the Interstate Compact. Several large states, however, reportedly are engaging in an effort separate from the NAIC to develop product standards for the Interstate Compact.

Even assuming full regulatory support for the Interstate Compact, its passage by each state legislature is not clear. Passage of the Interstate Compact constitutes a significant delegation of regulatory authority to a multi-state entity, and there will undoubtedly be political opposition on a state-by-state basis to passage of the Interstate Compact.

The NAIC's *Reinforced Commitment* seemingly recognizes these obstacles to making the Interstate Compact a success. The stated intent in that document is to have the Compact operational in at least thirty states or states representing 60% of the national premium volume for the products involved by year-end 2008. Even if this goal is achieved, it would all far short of achieving comprehensive, uniform and efficient product regulation.

Optional Federal Charter Is Needed.

Although the product regulation, market conduct and producer licensing issues are of the greatest concern to MassMutual, the need for regulatory modernization is more extensive. Insurance regulation covers a broad array of other issues, such as insurer solvency (e.g. reserves, risk based capital, valuation actuary opinions, accounting standards, investment requirements), company licensing, holding company requirements (e.g. registration statement filings, material transactions among affiliates, oversight of mergers and acquisitions), oversight of changes in corporate form (e.g. demutualization), redomestication laws, and underwriting and insurable interest requirements. Depending upon the area of regulation involved, the state requirements range from almost total uniformity to greatly differing standards. These areas should not be left out of any regulatory modernization solutions.

As noted above, MassMutual remains committed to working with the NAIC and the states to achieve regulatory modernization, but we harbor doubts about the ability of the state system to achieve fully the necessary modernization. Even assuming comprehensive modernization is achievable at the state level, all indications are that successful completion of this effort will be an extended process. Simply put, a life insurer such as MassMutual that is facing increased competitive pressures does not have the luxury of waiting to see how successful the state modernization efforts will be.

For those reasons, we support Congressional enactment of Optional Federal Charter legislation for insurers. The Optional Federal Charter concept also enjoys broad support across the entire life insurer industry. The system we envision is similar to the banking regulatory structure under which banks have the option of being chartered at either the Federal or state level. The key attributes of the Optional Federal Charter system that we envision are as follows:

> Consumer Protection. The purpose of any insurance regulatory system is to provide strong protection for the consumer, and there is no doubt that consumer protection can be fully achieved under an Optional Federal Charter. A Federally chartered insurer would be subject to the jurisdiction of a strong Federal insurance regulator.
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> MassMutual supports enactment of an Optional Federal Charter law that incorporates the same strong level of legislative and regulatory standards as are currently found in state insurance regulation. These standards include strict requirements for insurer licensing; insurer solvency; market conduct including sales and marketing practices; oversight of corporate transactions including mergers and acquisitions; and product administration including claim administration and complaint handling. We support legislation that continues product regulation for life insurance, annuities, disability income insurance and long term care insurance, utilizing substantive standards of the same strictness as are found in the states today.
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> Uniformity and Efficiency. Since an Optional Federal Charter provides a single point of insurance regulation for federally chartered insurers, by definition it provides a comprehensive system of uniform national regulation for products, agent licensing, market conduct and other regulatory activities and requirements associated with a Federally chartered insurer. No other solution could provide the same level of comprehensive uniformity, particularly if only certain areas of regulation are targeted for modernization. In terms of efficiency, the single regulator system embodied in Optional Federal Charter also offers the best solution for avoiding duplicative requirements and duplicative efforts.
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> Washington Presence. The life insurance industry is an important element of the Nation's economy. According to industry statistics, fifty-seven percent of the industry's assets -- $2 trillion -- is held in long-term bonds, mortgages, real estate and other long-term investments. The industry ranks fourth among institutional sources of funds, supplying 9% of the total capital and financial markets, or $3.4 trillion. Investments include: $417 billion in Federal, state and local government bonds, $251 billion in mortgage loans; $1.2 trillion in long-term U.S. corporate bonds; and $791 billion in corporate stocks. In 2002, life insurers invested more than $304 billion in new net funds in the Nation's economy.
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> Notwithstanding this economic presence, the insurance industry is the only segment of the financial services industry that does not have a regulatory presence in Washington. The importance of a Washington presence on insurance issues cannot be underestimated. A Federal insurance regulator will serve as an important and expert resource on insurance issues for Congress and the Administration at both the national and international levels. The need for such a presence is becoming increasingly evident as the Federal Government becomes more involved with the insurance industry. Last year Congress enacted the Terrorism Risk Insurance Act of 2002. The Patriot Act applies to insurers, and the Treasury Department is in the process of adopting implementing regulations for

> the insurance and is exploring with state insurance regulators the possibility of having those state regulators examine insurers for compliance with the Patriot Act. In addition, Title V of the Gramm-Leach-Bliley Act calls for privacy regulation of the financial services industry by the functional regulators. In the case of insurance the functional regulators are the state insurance regulators, and the result is a relatively inefficient, multi-state implementation of the Federal privacy requirements. Any changes to the notice or other privacy requirements under Gramm-Leach-Bliley would require action by the states.

Opponents of an Optional Federal Charter for insurance companies have raised a number of concerns. For the reasons set forth below, we do not agree that those concerns have merit.

<u>State Tax Revenues Will Not Be Lost.</u> Currently life insurance companies pay taxes to the states in the form of a tax on premiums received. A primary argument of Optional Federal Charter opponents is that enactment of Federal charter legislation will result in elimination of Federally chartered insurers' obligation to pay these taxes either at the outset or at least after some period of time. This concern is unfounded for several reasons.

First, MassMutual and the entire life insurance industry support the continuing imposition of these taxes on Federally chartered insurers to the same extent that they are levied upon state chartered insurers. This position is evident in the industry draft Optional Federal Charter proposals that MassMutual has seen, which expressly provide for the continued obligation of Federally chartered insurers to pay these taxes.

Second, elimination of this tax obligation would require an Act of Congress, and we cannot conceive of Congress taking such action. One apparent underlying theory for such action is that Congress would be motivated to repeal the provisions subjecting Federally chartered insurers to state premium tax obligations in order to divert those tax revenues to Federal Government coffers. Given the longstanding precedent of having other federally chartered institutions, such banks and thrifts, pay state taxes, it makes no sense that Congress would treat the insurance industry any differently.

<u>Regulatory Arbitrage Will Not Result.</u> Some fear that Optional Federal Charter will lead to a regulatory "race to the bottom". Under this theory, regulators will compete to have the least stringent regulation, in order to woo insurers to their regulatory system. Through the ability to change charters at will, insurers will naturally migrate to whatever jurisdiction has the most relaxed regulation at the time.

This argument is premised on several erroneous concepts. One is that enactment of a Federal Charter option will somehow create a new and far less stringent regulatory system than is currently found in the states. This makes no sense, because the industry is seeking a strong Federal regulatory system that is equivalent to the current system of state insurance regulation. We do not see any rationale or motivation for Congress to act otherwise or to permit the Federal insurance regulator to adopt loose regulatory standards. Finally, there is a fatal flaw in the underlying assumption changing a charter from state to Federal or vice versa is a simple and easy transaction. The reality is that a change in an organization's basic governance and regulatory oversight is a major corporate transaction that cannot be taken lightly in view of the business disruption, cost and requisite dedication of corporate resources that would necessarily be involved.

States' Rights Are Preserved. The argument that an Optional Federal Charter is a direct assault on states' rights is wrong for several reasons. First, under the structure we propose a Federal charter is an option, not a mandate. While it is true that some insurers will opt for a Federal charter, it is equally true that many insurers will elect to remain state chartered. Certainly this has been the longstanding experience in the bank regulatory system. Thus, Optional Federal Charter preserves state insurance regulation. Unlike S. 1373 introduced by Senator Hollings, Optional Federal Charter does not represent a Federal takeover of regulation of interstate insurance. Nor does it infringe on states' rights as would be the case with Federally mandated minimum standards.

Second, seeking comprehensive, uniform and efficient insurance regulation, as well as a Washington presence on insurance issues, should not be viewed as an assault on states' rights. Rather, a Federal insurance regulatory structure and the state insurance regulatory system complement each other. One of the longstanding arguments for state regulation is that the states serve as laboratories for innovation. Necessarily, this argument assumes that there should and will be diversity in standards and laws from state to state. A Federal regulator also serves as a laboratory, but in a different way. Through a Federal regulator is achieved the value of applying uniform national standards to insurers that have national products and markets.

Conclusion.

The need for comprehensive, uniform and efficient regulation of insurance is pressing in view of the competitive pressures faced by the life insurance industry, the current inefficient regulatory structure, and the attendant resulting costs that are ultimately borne by consumers. State regulators have demonstrated a tremendous commitment to modernizing the state system of insurance regulation, but serious obstacles stand in the way of their efforts.

An Optional Federal Charter for insurers represents the best way of achieving comprehensive, uniform and efficient insurance regulation. In order to protect consumers, such a system must include insurance regulation that is as strong as the regulation currently found in the states.

Mr. Chairman and members of the Subcommittee, I thank you for this opportunity to make our views known to you on this critical issue.