American Council of Life Insurers (ACLI) Statement for the Record
House Financial Services Committee
Hearing entitled "Examining the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation, Part II"

December 13, 2012

The American Council of Life Insurers (ACLI) is pleased to submit this statement for the hearing record expressing the concerns of the life insurance industry about the implementation of Section 619 of the Dodd-Frank Act (DFA), commonly referred to as the Volcker Rule. ACLI strongly supports the business of insurance exclusion to the Volcker Rule that was explicitly authorized by Congress in the Dodd-Frank Act and believes it should not be diminished or undermined by rulemaking in any way.

The American Council of Life Insurers is a Washington, D.C.-based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. ACLI advocates in federal, state and international forums. Its members represent more than 90 percent of the assets and premiums of the U. S. life insurance and annuity industry. In addition to life insurance, annuities and other workplace and individual retirement plans, ACLI members offer long-term care and disability income insurance, and reinsurance. Its public website can be accessed at www.acli.com.

Insurer Investments Support Guarantees Made to Families, Savers, and Retirees

Life insurers' financial products protect millions of individuals, families, retirees, and businesses through guaranteed lifetime income, life insurance, long-term care and disability income insurance. These products provide Americans with financial security through various stages of life and enable them to plan for their financial future, including retirement. Unlike nearly all other financial institutions, life insurers' obligations to policyholders are generally long-term, often extending for decades. In order to meet their obligations to policyholders, life insurers must acquire assets that match their liabilities. Accordingly, they are major institutional investors that provide a significant source of funding for issuers and liquidity for the financial markets in general.

Insurance companies collect premiums from customers in return for a promise to pay benefits to those customers at some future point. During the time between the collection of premiums and the payout of benefits, the insurer takes ownership of those premium dollars and invests them in conservative yet sophisticated ways in order to ensure that sufficient funds exist in the future to pay benefits when they come due. Although insurance companies are most certainly not 'proprietary trading institutions', their fundamental business model requires them to invest the company's own money in order to ensure a healthy portfolio for paying customer benefits and prudently running the company. In addition, as is expected and desired from sophisticated investors, insurers regularly use risk-mitigating hedging strategies to protect investment portfolios against interest rate risks, equity risks, credit risks and foreign exchange risks so that market movements do not endanger the health of the company or the company's ability to fulfill its promises to its policyholders.

The Financial Stability Oversight Council, in its 2011 study on the Volcker Rule, recognized the unique nature of insurance company investment activity, stating, "The investment activity of [insurance] companies is central to the overall insurance business model and could be unduly disrupted if certain provisions of the Volcker Rule applied."

Insurance Company Investments are Highly Regulated

Insurance company investment activities are subject to rigorous oversight and examination by state insurance regulators. State regulators have comprehensive regulatory and reporting regimes for examining an insurer's investment activities and guarding against excessive risk in their investment portfolios.

State insurance laws are specifically designed to promote the safe and sound operation of insurance companies *inter alia* by establishing limits and diversification requirements and by fostering investments in longer-term instruments that more appropriately correspond to the long-term liability structure of insurance companies. These laws directly impact prudent product design and help reduce the risk presented by the unique nature of insurance operations.

State insurance laws and regulations address many other aspects of the business of insurance, including, importantly, financial matters such as standards of solvency, statutory reserves, reinsurance and capital adequacy. Each insurance company is required to file reports, generally including detailed annual financial statements, with state insurance regulators in each of the jurisdictions in which it does business, and its operations and accounts are subject to periodic examination by such authorities. Each insurance company is subject to risk-based capital requirements, and reports its risk-based capital based on a formula calculated by applying factors to various asset, premium and statutory reserve items, as well as taking into account the risk characteristics of the insurance company. The formula is used as an early warning regulatory tool to identify possible inadequately capitalized insurance companies for purposes of initiating regulatory action. Insurance laws provide state insurance regulators the authority to require various actions by, or take various actions against, insurance companies whose risk-based capital ratio does not meet or exceed certain levels.

The Financial Stability Oversight Council, in its 2011 study on the Volcker Rule, recognized the existing constraints placed on insurer investments and the quality of supervision of these activities by state agencies, stating the following:

- "Insurance company investment is subject to relevant state investment laws which, while not uniform, are substantially similar and generally conform to standards set out in model laws and regulations developed by the National Association of Insurance Commissioners ("NAIC"). State investment laws aim at limiting the amount and type of investments insurers can make in order to limit their investment and counterparty risk exposure. For example, among other limitations, investment laws limit the amount of investment an insurer can make in equities, low-grade securities, or in the securities of any one issuer."

- "State insurance company investment laws and regulations govern the type of investment, and extent of such investments, an insurance company can include as "admitted" assets on their balance sheet for the purpose of determining whether the insurance company has the ability to discharge its obligations and meet capital and surplus requirements. Insurance companies can make otherwise prohibited investments, but such investments are not considered admitted assets and still have to be reported to state insurance regulators."
- "State agencies monitor insurer investments, through reporting, valuation, and examination, to ensure that such investments are in compliance with state insurance investment laws, regulations, and guidance, and, even when insurers are otherwise in compliance to ensure that such investments do not threaten the solvency of the insurer."

Congress Established the Business of Insurance Exclusion in DFA

In recognition of the unique insurance business model and the existing investment safeguards enforced by state insurance supervisors, Congress expressly authorized a business of insurance exclusion to the Volcker Rule in the Dodd-Frank Act. Congress recognized the need to "appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws." The specific reference to insurance company *investment* laws makes it clear that the accommodation required under the Volcker Rule relates both to the proprietary trading restrictions and the private equity and hedge fund investment restrictions.

The Final Rule Must Follow Congressional Intent and Accommodate the Business of Insurance

The business of insurance exclusion established by Congress applies to all insurance company investment activity. Rulemaking which prohibits an insurance company from engaging in any investment activity that is allowed under applicable insurance law would be inconsistent with the principle of accommodating the business of insurance. Therefore, the proposed rules should be revised and clarified to accommodate insurance investment activities.

In addition to the above, life insurers are also concerned that the Volcker Rule could impair market making, liquidity and depth in the securities markets. If the proposed regulations impede an insurance company's ability to manage its fixed income portfolio and to enter into and manage hedging transactions, the direct and indirect costs of reduced liquidity could ultimately cause higher premiums for customers or reduced product options and features. To ensure the efficient operation of securities markets and prevent increases in transaction costs, the final rule should implement the market making exception in a less restrictive manner that would not constrain liquidity.

Thank you for convening this important hearing and for your consideration of the views of ACLI and its member companies.