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**Testimony of
JOE W. DUNLAP
EXECUTIVE VICE PRESIDENT, OPERATIONS
American Amicable Life Insurance Company of Texas
Before the United States House of Representatives
Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
of the
Committee on Financial Services
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INTRODUCTION

Chairman Baker, Ranking Member Congressman Kanjorski and members of the Subcommittee, my name is Joe Dunlap. I am here on behalf of the American Amicable Group. I have worked at American Amicable for 26 years and have served as Executive Vice President, Operations for the past year and a half. I served as Vice President, Policy Administration for 18 years before that. My resume is attached.

Thank you for this opportunity to appear before you to address certain issues that have been raised in connection with the sale of insurance policies and financial products – including mutual funds, securities and other investment vehicles – in the military market. We, like you, have a strong interest in ensuring that these products are marketed and sold responsibly by responsible companies.

I. Background

As the Subcommittee is well aware, numerous types of financial products and insurance policies are sold to the men and women of the United States armed forces. These products and services range from mutual fund products to a variety of securities and other

investment vehicles to life insurance policies. The sale of these products is governed by specific regulations that have been propounded by the various branches of the military as well as other regulations, including certain state and local regulations.

As an initial matter, we believe that a good number of the products – including our insurance policies – that are sold to the military can be of great benefit to those who purchase them. We are troubled by recent reports of incidents that may have undermined public confidence in these products and the sales techniques of the companies that sell them to the military. We believe it is of paramount importance to restore public confidence and protect members of the military from non-compliant sales techniques.

We commend the Subcommittee on holding this hearing at this time. We believe that our company and, more importantly, our customers will benefit from a sales environment in which all salespeople and agents from all companies are in compliance with applicable regulations to the maximum extent possible.

In addition, we embrace and encourage all reasonable measures to help educate military personnel on financial planning and related matters. American Amicable – like so many companies that promote and sell insurance to the military – markets its products to a wide range of military personnel with differing backgrounds and levels of financial sophistication. We firmly believe that an educated customer base is beneficial to both our insureds and the industry as a whole because such increased financial education will help enable our servicemen and women to make intelligent financial decisions for themselves and their families. Those who understand our products and use them as part of a broader financial plan will be more likely to utilize the products' benefits and, consequently, hold the policies longer.

We further commend Representative Burns on the legislation he is sponsoring. We support those provisions of the proposed bill that pertain to insurance products. We welcome the clarification and strengthening of the role of state regulators with respect to on-base military sales and have no objection to the disclosure that the bill would require

insurance companies to make. Like Representative Burns, we oppose any deceptive and predatory sales practices on military installations. The other provisions of the proposed bill relate to investment products that we do not sell.

II. About American Amicable Group

American Amicable Group traces its roots back to 1910 when the Amicable Life Insurance Company was organized. Through the years, Amicable Life Insurance Company has experienced considerable growth, and today American Amicable Group is comprised of American Amicable Life Insurance Company of Texas, Pioneer Security Life Insurance Company, Pioneer American Insurance Company and Occidental Life Insurance Company of North Carolina. These companies employ over 110 individuals in the home office in Waco, Texas and have contracts with over 3,000 independent agents.

At American Amicable, we are proud of our organization, our employees and the services we provide to our valued policyholders. We have a longstanding tradition of offering innovative and reliable programs that meet the diverse financial needs of people in all stages of their life. Anchored by a foundation of financial integrity and responsible management, the American Amicable Group provides whole life, term and interest sensitive life insurance products to civilians, federal employees and members of the U.S. military in the United States, Puerto Rico, U.S. Virgin Islands, Guam, Anguilla, Cayman Islands, Europe and Japan. Currently, the American Amicable Group provides protection to over 180,000 policyholders whose side fund balances total over \$86 million. We do not sell mutual fund products.

American Amicable has historically provided excellent service to its policyholders and their families. Over the past 20 years, the companies affiliated with the American Amicable Group have paid beneficiaries more than \$428 million in death benefits across all lines of business. In the last year alone, we paid more than \$8.2 million in death claim payments on policies issued in the military market, and in the past 5 years, we paid more than \$37 million in death payments on such policies. To date, we have paid nearly \$1.5

million in death benefits to the beneficiaries of service members who lost their lives in the current conflict in Iraq. As a result of the American Amicable Group's financial strength, A.M. Best, the leading insurance industry analyst, has given us (and all of our affiliated companies) a rating of B++ (very good).

III. American Amicable's Products, Compliance and Training

The Subcommittee has expressed an interest in knowing more about certain aspects of our business including our Horizon Life product, how we react to instances of potentially improper sales practices by agents on military bases, and how we train agents to sell our products.

Let me say at the outset that American Amicable does not condone the apparent violations of military regulations committed by certain of our agents at Fort Benning in 2002 and Camp Pendleton in 2003. Such conduct is inconsistent with our standards and policies, not to mention the certification we require our agents to sign pledging compliance with all applicable military, state and local regulations. We take these matters very seriously and already have expended a considerable amount of time, resources and effort to take meaningful steps to investigate these matters and take appropriate corrective action including, among other things, terminating the contracts of the agents involved, offering refunds to affected policyholders, developing new and improved compliance programs (which we believe will make us a compliance leader in the industry), and working with outside counsel on a company-wide investigation of agent compliance.

A. Horizon Life

Horizon Life is a multi-faceted innovative product that we are proud of, and we are pleased that we have this opportunity to describe it, explain how it works and enumerate the many benefits it offers our policyholders.

Horizon Life combines a 20-year level term life insurance plan that is paid-up in seven years with an annuity accumulation fund, which we call the “Horizon Life Fund” or the “Fund.” Thus, Horizon Life provides a unique and balanced program that pays a life insurance death benefit and provides accumulation value through capital appreciation in the Fund.

The dual life insurance/accumulation fund aspect of Horizon Life has made it a popular choice for both our military and non-military policyholders. As a result, we have marketed the Horizon Life product in all of our lines of business since the product was first approved by state regulators in September 1993. About two-thirds of the Horizon Life policies have been sold to military personnel and the remaining third to civilians.

Horizon Life Is an Innovative Combination Product

Horizon Life includes two distinct, but complementary, elements that fill unique needs. First, it has a flexible life insurance component that allows purchasers to receive term life insurance coverage with a level death benefit. At the end of the term coverage (20 years), the coverage is renewable for another 20 years. In addition, the term coverage can be converted to a permanent life policy without the insured having to submit to a physical examination and without regard to the health of the insured. Second, Horizon Life has an accumulation fund component that allows policyholders to build cash value through their monthly payments. The accumulation is enhanced by additional contributions to the Fund, which can be made at any time without any loads or deductions. Let me explain how this works in more detail.

How it Works

In the first policy year, the insured’s entire base contribution is allocated to life insurance and any additional amounts the insured elects to deposit, which many policyholders do, are allocated to the Fund. In years two through seven, 75 percent of the base contribution is allocated to insurance, and the other 25 percent plus any additional contributions are

deposited into the Fund. After seven years, the life insurance premiums are fully paid-up, and 100 percent of the contributions plus any additional payments are deposited into the Fund. Our typical policy is issued to a 20-year-old male and has a monthly contribution of \$100. For the purpose of this document, we will call this our “Base Plan.” In addition, the average policyholder also contributes an additional \$25 per month to the Fund. For the purposes of this document, we will call this combination of the Base Plan with the additional contribution of \$25 per month our “Average Plan.”

As I will discuss in more detail below, the Fund is a unique vehicle that has no load (i.e., money can be contributed to the Fund at any time without any fees being deducted or other restrictions affecting that contribution) and a fairly high contractually guaranteed rate of return of 4 percent with the added benefit of a potentially higher rate of return. Indeed, the average rate of return on the Fund has historically been more than 10 percent a year since its inception in 1993, and right now, the Fund is paying 6.5 percent.

Because of the dual nature of Horizon Life, once the life insurance component is paid-up, a policyholder can stop making payments and the life insurance will remain in effect. While this would significantly limit the cash accumulation benefits of the product, it is an example of the flexibility of Horizon Life. In addition, as long as a policyholder is paying his or her premiums or has paid the life insurance component fully, if a policyholder dies, the beneficiary receives both the life insurance amount and the balance of the insured’s Fund. That is a significant benefit compared to traditional “whole life” products, which pay only the death benefit, not the cash value.

Another benefit of Horizon Life is that at the end of the 20-year contract, the policyholder receives a full return of the paid life insurance premium, which significantly increases the policyholders’ cash buildup. Therefore, assuming a policyholder keeps the policy in force for the full 20 years, American Amicable places an amount equal to the base life insurance premiums paid by the policyholder during the first seven years into the policyholder’s Fund. Several other major insurance companies, including Fidelity and

Guaranty Life, AIG, Aegon and Federal Kemper Life, now offer insurance policies with this type of feature.

Another advantage of Horizon Life is the flexibility it offers policyholders at the end of the 20-year period. At that time, a policyholder has many alternatives to choose from based upon his/her own individual needs or wants. He or she can: (i) withdraw all of his or her funds (including the returned life insurance premiums) without penalty and use them for any purpose; (ii) renew the contract, including the life insurance for another 20 years without submitting to a physical examination and without regard to the insured's health; (iii) convert the policy to a permanent life insurance plan; (iv) allow the insurance to lapse, but make additional contributions to the accumulation fund, which will continue to grow at a guaranteed rate of return with a potential for a higher rate; or (v) stop making new payments, but leave the principal in the account to keep earning interest.

Other Special Features of Horizon Life

In addition to the features I just described, there are several other features of Horizon Life that make it a valuable product to our policyholders:

- Unlike the vast majority of life insurance products, the death benefit is guaranteed for war-related fatalities. Additionally, once a policy has been in force for a full year, the death benefit is increased by 50 percent in the tragic case of a combat-related death. In other words, the beneficiary on a \$40,000 life insurance policy would be paid \$60,000 if the insured died in combat. This is a very meaningful benefit to military personnel since many commercial products do not pay benefits for combat-related deaths, much less add 50 percent to the base amount for such deaths.
- While the death benefits of Horizon Life begin immediately, the total death benefits increase over time. For example, using our Average Plan, a 30-year-old male who purchased Horizon Life in 1994 would have a total death benefit of

\$41,976 (\$56,976 if he died in combat) at age 30 and would be projected to have a total death benefit of \$73,379 (\$88,379 if he died in combat) at age 40. Most level term insurance does not have a rising benefit, but rather remains at the initial level for the entire term of the policy.

- There is no tax penalty for early withdrawal. In addition, after 10 policy years, there is no withdrawal charge by the company. In the first 10 years, the withdrawal fee is only 5 percent. Moreover, the accumulation fund can be accessed at any time. In fact, many of our policyholders choose to access this money as it offers an opportunity to fund a college education, make a major purchase, supplement retirement income, or undertake home improvements more affordably than a loan or credit card.
- At any time, the policyholder may withdraw a lump sum or keep the principal on deposit and receive interest only.
- Additional payments to the Horizon Life Fund are accepted at any time without any loads, deductions or restrictions. In fact, other than the 5 percent withdrawal fee that applies for the first 10 years (as discussed above), no loads or charges are ever deducted from the Fund.
- The plan provides for guaranteed convertibility. In other words, a policyholder can convert the plan to permanent life insurance at the end of the term with the same premiums of a healthy individual, regardless of his or her health condition.
- Many of our Horizon Life policies are sold with additional term coverage. About 25 percent of military purchasers take advantage of this option to increase their insurance coverage for a relatively modest additional premium.
- Additional term insurance coverage is also available for all family members for as little as \$3.55 per month.

- Many Horizon Life policies include a waiver-of-premium benefit that pays the insurance premium as well as the scheduled fund contribution in the event of a disability resulting in an inability to work.

Persistency and Lapse Ratios

According to data reported in *A.M. Best's Insurance Reports (Best's)*, a leading guide to the insurance industry, there was a lapse ratio of 13.6 percent in 2003 for American Amicable Life Insurance Company's military and non-military policies combined. Based on our understanding of the formula used by *Best's* to calculate lapse ratio, we estimate that the 2003 lapse ratio for all of the American Amicable Group's companies was approximately 11.7 percent. While there is no separate lapse ratio calculated or reported for military policies (or Horizon Life) only, we estimate that the 2003 lapse ratio for our military business across all companies was approximately 13.5 percent (13 percent for American Amicable Life alone), which is consistent with the reported lapse ratios of our competitors. For instance, *Best's* reports that Colorado Bankers and American Fidelity, which are both significantly involved in the military market, had lapse ratios for 2003 of 18.2 percent and 12.8 percent respectively.

Comparison of SGLI with Horizon Life

Recently, the Horizon Life product has been compared to the Department of Defense's term life insurance plan called Servicemen's Group Life Insurance (SGLI) as if the two were competitive products. These comparisons are inappropriate. The two products have very different purposes and very different features. The Horizon Life policy is a supplement to – not a substitute for – the military-sponsored SGLI. As a result, we sell Horizon Life as a complementary product that provides benefits that are not provided by or available through SGLI, which offers only a death benefit.

In complementing SGLI, Horizon Life can be particularly attractive to military personnel who have purchased the maximum SGLI life coverage of \$250,000 at a government subsidized rate but want additional protection for their family because Horizon Life is among a small number of commercial products that cover war-related deaths.

Horizon Life also fills the potential insurance void for individuals who choose to leave the military and therefore lose the subsidized SGLI coverage. While ex-servicemen and women can convert their SGLI coverage to Veteran's Group Life Insurance (VGLI), the premium will rise substantially over time. These premiums can become quite prohibitive as the veterans grow older. Because Horizon Life's insurance component is paid-up after 7 years, veterans continue to have the life insurance long after they have left the service without any increasing premiums.

Furthermore, if a soldier chooses to terminate his or her SGLI or VGLI policy after 20 years, he or she would have nothing to show for what they paid into SGLI and VGLI over those 20 years. Horizon Life, on the other hand, combines life insurance with an annuity accumulation fund, which means that after that same 20 years a Horizon Life policyholder has something to show for his or her 20 years of contributions. The following chart illustrates the projected cash value that would accumulate in the Fund assuming our Average Plan issued in 1994.

Projected Cash Values at Ages 30 and 40 for the Average Plan¹			
	Using Actual and Current Rates	Using Current Rate in All Years	Using Guaranteed Rate in All Years
At Age 30	\$11,976	\$10,787	\$9,778
At Age 40	\$49,979	\$47,748	\$39,443

¹ This chart calculates the projected cash value for a policyholder's Fund after 10 years and after 20 years using three different rates of return. The first column uses the actual rates of return over the past 10 years, which were over 10 percent and uses the current rate of 6.5 percent to project the Fund's cash value in the next 10 years. The second column applies the current rate of 6.5 percent over the full 20 years. The third column applies only the guaranteed rate of 4 percent to all 20 years.

Another added benefit of Horizon Life is the policyholder's ability to withdraw money at any time. For instance, the same soldier discussed above who bought a Horizon Life policy 10 years ago would have built a cash value of \$11,976 after just 10 years, and that money would be available at any time for any reason, including funding an education, buying a car or making a down payment on a home.

The cash accumulation program is a substantial benefit that can help young adults build a foundation for their financial future, without the risk involved in alternatives like stock mutual funds. It also provides a guaranteed rate of return of 4 percent on all payments that have been, or will be, made into the accumulation fund, which is better than any bank savings account or money market fund. Additionally, there is the potential that the rate of return will be greater than the guarantee – the current rate is 6.5 percent and has historically averaged over 10 percent.

Importantly, Horizon Life is not a mutual fund. American Amicable Group does not sell the high fee “contractual plan” mutual funds that have come under increased recent scrutiny or any other mutual fund products for that matter.

In summary, Horizon Life is a versatile life insurance product that complements the military-sponsored term life insurance by providing many additional benefits, including a return of the life insurance premium at the end of the policy, a guaranteed accumulation rate for Fund contributions, the option of providing additional contributions allocated to the Fund and flexible access to the money in the Fund.

B. Conduct of American Amicable's Independent Insurance Agents

In the past year, we learned that a few of our agents at Fort Benning appear to have used inappropriate methods in 2002 to sell our products. We believe this and another incident at Camp Pendleton in 2003 are not characteristic of our company or the industry. Since 1995, we have had more than 2,650 agents selling our products in the military market.

Less than one percent of those agents have been found by the military to be in violation of regulations regarding solicitation on military bases. While even a single non-compliant agent is one too many, military records reflect that the conduct of our agents is as compliant – if not more so – with applicable regulations than the conduct of many of our competitors’ agents. We believe we have a solid track record of taking prompt and decisive corrective action – including agent termination – when we learn of agent misconduct. Indeed, we have disciplined agents for compliance deficiencies even absent any notification from the military.

What appears to have happened at Fort Benning and Camp Pendleton should not have occurred. We do not condone the conduct of the agents involved, and we apologize to those affected. In order to ensure that we have adequately addressed all concerns about the conduct of our agents, we have taken several actions, including retaining the law firm of Hogan & Hartson to conduct an independent review of the Fort Benning allegations and the operations of our other agents in different regions of the country. That review, which is ongoing, already has led to, among other things, the termination of certain Fort Benning agents’ contracts, as well as a decision to develop and implement a more stringent and formalized compliance investigation policy designed to enhance – both in terms of speed and substance – the company’s response to potentially inappropriate agent conduct in the future.

Earlier this week, we also announced a series of improvements in our compliance and complaint-handling procedures designed to position us as the industry leader in this area. The improvements include a rigorous procedure to audit independent agents in the field, including surprise inspections by an independent compliance team. We believe that this and the other procedures that have been and will be adopted will decrease the likelihood of non-compliant behavior by our independent agents in the future.

We are firmly committed to honoring and supporting our military and those who serve our country. And, we do not want a single member of our Armed Forces to ever feel taken advantage of by our products or by the agents who sell them. We also want to

make sure that all of our customers, including those in uniform, are given the information they need to make the right choices about insurance. In instances where regulations appear to have been violated, we believe that refunds should be provided to all affected policyholders who request them. Thus, we will offer refunds to soldiers who purchased the Horizon Life policy in an improper setting at Fort Benning in 2002. Similar actions, including terminating the responsible agents and offering refunds, were taken at Camp Pendleton.

C. Training and Compliance

We always have trained our agents to follow the rules and regulations applicable to their sales and sales-related activities on and off military bases. In the past few years, we have strengthened our agent training and compliance program and we continue to implement new policies to further ensure that the independent agents who sell our products know and follow all applicable regulations. To that end, we have taken the following steps as part of our effort to become an industry leader in the area of training and compliance:

Communications with Consumers

- To help ensure customer satisfaction, all money that is paid to American Amicable is refunded if, for any reason, purchasers change their minds and request refunds within 90 days after purchase, which is substantially longer than required by the most state laws.
- A statement of understanding, which explains the insurance purchase, is attached to the compliance materials provided to purchasers. This material is intended to ensure that service members fully understand what they have bought, the terms of the purchase, whom to contact if they have questions and how to remain in contact with the company. This is a long-term product. We want our policyholders to feel confident in the product they purchased and to contact us with any questions throughout the length of our relationship.

- We provide a toll-free number and customer service representatives to answer questions and address any concerns our policyholders may have. We also provide extensive information to our customers about their policies via our company website.
- We mail a confirmation letter to each military applicant at his or her military address immediately upon receipt of an application in our home office.
- On each anniversary of purchase, policyholders receive an annual statement that shows the value of their accumulation fund.

Continuing Education of Sales Force

- Every agent receives training in compliance with (1) DOD Directive 1344.7, (2) other regulations specific to the individual branches of the armed forces, (3) state regulations and (4) local base requirements. All agents are required to execute a certificate indicating that they understand and agree to abide by the regulations and acknowledge the consequences to them if they violate those regulations.
- Several years ago, we created a “Building Success” training program with emphasis on the off-base sales of our insurance products. As a result, the majority of our sales are now made off the military installation. This program is now part of our required training for agents in military sales. One of the key building blocks of this program is to stress to potential policyholders the importance of the long-term commitment to their insurance products as well as all their investments. This program also helps agents better match clients’ needs with the right policy.

- We have a compliance manual that each new agent is required to read and sign. It includes a discussion of solicitation practices prohibited by DOD and all the service branches.
- We send numerous field communications to all agents reminding them of the importance of complying with all military sales regulatory requirements and the consequences of violating those regulations or our company's compliance policies.
- We believe in continuing education. In-person seminar presentations are given each time agents gather for meetings or conventions. Any changes to the regulations are immediately distributed for compliance.
- We recently hired Carl Ross, a retired Civilian Chief of Staff for Training – Naval Training Center, to review and build upon American Amicable's training program and to increase our emphasis on ethics, customer service, quality control and customer feedback. With the assistance of outside expertise, we expect to continue strengthening our training program.

In addition to what we are doing to try to ensure that our agents comply with DOD rules and regulations, as well as local and state regulations and our own compliance program, we support all reasonable measures that would allow military purchasers of insurance and all other financial products to make more informed decisions when purchasing those products and when using credit. As a result, we support an initiative by the American Council of Life Insurers and the National Association of Insurance and Financial Advisors called the "Best Practices for Military Insurance Sales & Their Function Regulation." The program is based on the notion that such education must be a joint effort among the companies, agents, DOD, service branches and state regulators. The program advocates a DOD-sponsored initiative of financial literacy for junior enlisted personnel to help them understand the differences among banking, securities and insurance products and services. Such education would be provided by a credentialed

instructor teaching from a standard educational program. We would be happy to work with these groups, as well as the Subcommittee, to take steps to ensure that our enlisted men and women are provided with the tools to make informed decisions about their financial future. It is in that environment that we believe our company, our products, and, most importantly, our customers will be most successful.

Thank you, Mr. Chairman and members of the Subcommittee for your time and attention today. We, at American Amicable, pride ourselves on our integrity. We assure you that we already have taken steps to address issues relating to the conduct of certain of our insurance agents and will take any additional corrective action that is warranted based on the continuing investigation we are conducting with the assistance of outside counsel. Additionally, we will gladly work with the Subcommittee to assist in the development and refinement of legislative measures that will strengthen customer knowledge and the sales practices of companies selling any financial or insurance products to members of the military.

If you have any questions, I would be pleased to respond to them.