

NATIONAL CONFERENCE OF INSURANCE LEGISLATORS
FINANCIAL SERVICES & INVESTMENT PRODUCTS COMMITTEE
HILTON HEAD ISLAND, SOUTH CAROLINA
MARCH 4, 2005
DRAFT MINUTES

The National Conference of Insurance Legislators (NCOIL) Financial Services & Investment Products Committee met at the Hilton Oceanfront Resort in Hilton Head, South Carolina, on Friday, March 4, 2005, at 1:30 p.m.

Rep. Joe Hune of Michigan, Chair of the Committee, presided.

Other members of the Committee present were:

Rep. Mark Young, VT
Rep. Bill Brady, IL
Rep. Terry Parke, IL
Rep. Fulton Sheen, MI
Rep. Brian Kennedy, RI
Del. Harvey Morgan, VA
Rep Alan Sanborn, MI
Sen. William Larkin, Jr., NY
Rep. Terry Parke, IL
Rep. Brian Kennedy, RI
Rep. Mark Young, VT
Rep. George Keiser, ND
Rep. Shirley Bowler, LA
Rep. Dave Hildenbrand, MI
Rep. Gabe Leland, MI
Rep. Morris Hood, MI
Rep. Leslie Mortimer, MI

Other legislators present were:

Rep. Craig Eiland, TX
Assem. Nancy Calhoun, NY
Assem. Ivan Lafayette, NY
Sen. Pam Redfield, NE
Rep. Virginia Milkey, VT
Donald Flanders, NH
Sen. Jerry Klein, ND
Sen. Stewart Greenleaf, PA
Sen. Nancy Sullivan, ME
Rep. Michael Reese, VT
Rep. David Robertson, MI

Other present were:

Susan Nolan, Nolan Associates, NCOIL Executive Director
Paul Donohue, NCOIL Director of State-Federal Affairs

MINUTES

Upon a motion duly made and seconded, the Committee voted unanimously to approve the minutes of the November 19 meeting in Duck Key, Florida.

FINANCIAL SERVICE PRODUCTS OFFERED BY BANKING AND INSURANCE

Professor Matthew Will, MBA Director, University of Indianapolis, spoke on insurance products and how they sometimes overlap with financial products. He said that Sarbanes-Oxley had changed much in the business community and there were questions on its applicability to insurance. He spoke about annuities that represent an important product for banks. He asked legislators if they thought an insurance agent selling annuities for a bank would fall under insurance regulation laws or banking laws.

Rep. Bowler asked if Sarbanes-Oxley had specific language that applied to the insurance industry. Upon his response that it did not, Rep Bowler opined that the McCarran- Ferguson Act would exempt the insurance industry. Professor Will responded that the Securities and Exchange Commission believes that it does apply and that state legislatures have a choice to either fight it or adjust to its applicability. He pointed out that broker services were now offered by insurance companies and that it was causing problems. He indicated that while there was theoretically a Chinese wall between the banking and insurance aspects of a business that offers both products, he questioned whether in practice that would work. He stated that he believed it could but that term and whole life would present the biggest challenges.. He suggested that when a producer in one state is selling product licensed from a carrier in another state, questions arise on who would regulate the transaction and how the regulation would be applied. He predicted it would be a difficult challenge.

Professor Will next spoke on insurance company banks. He pointed out that when an insurance company sells banking products, it raises questions about how it should be classified for purposes of regulation. He offered two examples, an insurance company that sells banking products and a bank that sells insurance products. He noted that “click-through agreements” are now present on many Web sites and that such “agreements” may cause problems with consumers understanding of and dependence on the Web site language. He asked legislators if they thought consumers knew enough to determine which products were backed by insurance and which were not. He said consumers might not know where to go to complain, to the insurance commissioner or the Comptroller of Currency. He said he believed that there would be questions for legislators and consumers as to what parts of the new compound companies would financially support other parts of the company. As an example he questioned whether the banking part of the hybrid company will cover losses from the insurance part.

POSSIBLE ISSUES FOR COMMITTEE INVESTIGATION

A. PREDATORY LENDING, INCLUDING PAYDAY LENDING

Rep. Hune next discussed possible issues for committee investigation. He said that “payday lending” is a big issue with many legislators as is regulation of annuities, privatization of Social Security and tax incentives for variable annuities.

Professor Will explained that payday lending fills a void created by banks that do not want to be involved in short term lending. He indicated that they do not want involvement because of high default rates and because banks are forbidden from charging appropriate risk adjusted rate for such transactions. Professor Will asserted that as a result of the high default rate, many banks have left such lending areas.

Rep. Sheen pointed out that in Michigan the payday lenders began their businesses after the legalization of casino gambling. He explained that the legislature had to cap the interest rate charged by payday lenders. Rep. Parke reported that in Illinois payday lenders and legislators have worked together because payday lenders fill an important niche in society. Professor Will opined that loosening regulation and allowing for competition would do more to bring down rates than regulation.

PRIVATIZATION OF SOCIAL SECURITY

Rep. Hune asked Professor Will to speak briefly on the privatization of Social Security. Professor Will indicated that the debate was becoming too politicized. He explained that Social Security was created as a savings account but that over the years it was transformed into a transfer payments system. He maintained that at present, the money comes in one door and goes out the other. He estimated that 12 years from now the money coming in will be less than the money going out. He explained that the President is proposing to bring the system back in line with its original design, with the exception that it will not be government-controlled and therefore not subject to government whim. He predicted that the problem with such a plan is that it will cost money to implement, because the government must pay out money while at the same time saving money for future use. He theorized that to do that, you will have to cut benefits, increase taxes, or take out a trillion dollar loan. He estimated that a loan that size would add 35 billion dollars to the yearly budget.

Rep. Sheen observed that the only solvent retirement systems existing today are those that allow private investment. He also indicated that when he was in Washington last year he spoke with the author of the Social Security privatization plan. He stated that his understanding of the plan was that:

- Money would be invested in the federal thrift plan.
- Such a system could not collapse because whatever Social Security was going to get, it would continue to get, therefore the risk is removed.
- At worst the plan would triple the money invested after 10 years of investment and the portfolio would do better under the new plan in 10 years than the old plan could have done in 40 years.
- Money would be safe from being used by the federal legislators for other projects because it would go into a separate account that could not be applied to the general fund.

Professor Will then followed up on the subject of the current investment value of the Social Security system. He asserted that there is no investment value to the current system since no money is invested. He said that it is simply a money transfer system funded by income. He

explained that the income brought in is being paid out to those on Social Security and that the surplus is being put in the government's general fund.

REGULATION OF VARIABLE ANNUITIES

Nancy Davenport from the American Council of Life Insurers (ACLI) and Eric Dupont from Met Life spoke on the regulation of securities. Mr. Dupont stated that securities administrators in the states had been trying to expand their jurisdiction to include variable annuities. He explained that they had been trying to accomplish that goal through an update of the Securities Act. He said while the Securities Act does not in itself provide the authority to control variable annuities, securities administrators have taken the position that by removing the exclusion for variable insurance products from the definition of securities they gain jurisdiction to control variable annuities. He theorized that ultimately they are trying to get control over the sales process. He explained that industry takes the position that variable annuities are already regulated by state insurance departments. He indicated that variable annuities are considered "insurance" in every state of the nation and are therefore regulated as such. Mutual funds that contain invariable annuities are controlled by the Securities and Exchange Commission and the sale of mutual funds is regulated by the National Association of Securities Dealers, he said. He pointed out that this means that at least three agencies are already watching over this product. He said industry does not believe this is fair and believes that it is confusing for consumers. He concluded that this ultimately weakens state insurance regulatory schemes by introducing another regulatory authority; one that has not been part of introducing and integrating the NAIC Producer Licensing Model Act and the interstate compact into the regulatory system.

Ms. Davenport spoke on state activity regarding this issue. She indicated that no state that has enacted the Uniform Securities Act has chosen to reverse their current laws. She pointed out that there are 47 states where the insurance code gives the insurance Commissioner exclusive jurisdiction over these variable products. She indicated that there are 37 states where securities codes exclude all variable products from the definition of security. She said that in 2003 and 2004 there were nine states that enacted the Uniform Securities Act and they excluded variable annuities. She noted that there were two states which, in their current law, do not exclude variable annuities and that was not changed when they adopted the Uniform Securities Act. She predicted this issue would be coming before legislators in other states this year. She reminded those present that NCOIL, several years ago, passed a resolution in support of the Insurance Commissioner having exclusive jurisdiction over variable annuities and asked those present to keep that in mind as their states voted on this issue.

In response to a clarifying question from Sen. Sullivan a bill sponsor in her state, Ms. Davenport said that, according to the NCOIL resolution, the language of the bill should specify that the Insurance Commissioner has exclusive jurisdiction over variable products. She added to accomplish that within the Uniform Securities Act, one has to make sure that variable annuities is excluded from the definition of securities.

TAX INCENTIVES FOR LIFE CONTINGENT ANNUNITIES

Ms. Davenport next talked about tax incentives for life contingent annuities. She explained that a number of groups from government, industry and the nonprofit sector had joined

together to form a coalition called Americans for Secure Retirement (ASR). She said that one of the proposals that ASR suggested would allow individuals or families to not pay federal taxes on one half of the income tax due from a nonqualified life contingent annuity, up to \$40,000. She said the result would be an exclusion of \$20,000, which would result in a tax break of about \$5,000. She explained that a life contingent annuity guarantees individuals that they will receive regular monthly income payments for their life and often it may allow payments to a spouse or significant other. This legislation had been introduced in both the US Senate and House and had bipartisan sponsorship although its ultimate chances for successful enactment were currently unknown, she said. In response to a question from Assem. Calhoun, Ms. Davenport said that it was the understanding of those involved with the legislation that it would be.

DISCUSSION OF CORPORATE GOVERNANCE AND ACCOUNTABILITY ISSUES

Neil Alldredge from the National Association of Mutual Insurance Companies (NAMIC) spoke on the issue of applying Sarbanes-Oxley to privately held insurers; specifically, mutual insurance companies. He explained that NAIC had three different subgroups looking at this issue.. He stated that industry had repeatedly asked the NAIC to provide some kind of rationale as to why this was needed. He pointed out that industry not only had a problem with what the NAIC was doing but with how they were trying to accomplish it. He said they were trying to accomplish it by amendment to the model audit rule. He advised that most states adopted changes to the model audit rule in their state code by reference, so changes made by the NAIC became law in those states by reference to the statute. He explained that the procedure for amending the model audit rule was created to handle technical changes and that its purpose was to save the legislature from having to amend legislation every time there was a small change that had to be made. He noted that in this case the impact of the changes were so great that they were, in effect, usurping the role of legislators and the legislative process. He said the estimated cost of instituting the proposed changes could be more than \$1 billion for the insurance industry. He maintained that the current cost for all insurance regulation was currently about \$900 million so this proposal would double the cost of insurance regulation by reference.

Rep. Hune stated that he while at a Griffith Foundation seminar in February, he asked NAIC President-Elect Al Iuppa, Maine Superintendent of Insurance what the goals of NAIC were in regards to applying Sarbanes-Oxley to mutual companies. He said Maine Superintendent Al Iuppa replied that they were going to take a “slow and deliberate approach to the issue.” Rep. Young suggested that NCOIL weigh in on this issue with the NAIC. He explained that he had long thought that the fix presented by Sarbanes-Oxley is far more expensive to consumers than the original perpetrated frauds.

Robert Zeman of the Property Casualty Insurers Association of America (PCI) explained that the NAIC was taking this action at the “working group” level. He noted that PCI had sent letters to NAIC commissioners to make them aware of what was happening at the working group level. He said that they had requested that the NAIC working group conduct a cost-benefit analysis before proceeding further but that the working group declined to do so. He added that PCI was encouraging state-by-state discussions of this issue through individual meetings with US legislators, commissioners and members of the industry to complement the national dialogue that was taking place.

Del. Morgan added that he encouraged industry to assist by setting up dialogues between commissioners, legislators and industry representatives.

DETERMINATION OF 2005 COMMITTEE CHARGES

Ms. Nolan asked for input as to committee charges for 2005. She mentioned predatory lending, privatization of Social Security, jurisdictional issues regarding regulation of annuities, tax incentives for variable annuities and corporate governance as possible subjects. Rep. Hune asserted that he thought predatory lending was a very important issue, especially in his state, and he would like to see NCOIL go forward with a model act. Del. Morgan mentioned the related area of tax refund loans as being another possible area for focus. Rep. Sheen suggested that NCOIL weigh in on the Social Security issue. Rep. Eiland thought that Social Security would be an issue best discussed in committee before becoming a general session topic.

ADJOURNMENT

There being no further business, the meeting adjourned at 3:45p.m..

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