RECORD, Volume 26, No. 2*

San Diego Spring Meeting
June 22–23, 2000

Session 32OF
Enhancing Actuarial Input at the Federal Level on Life Insurance Issues

Track: American Academy of Actuaries

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Summary: Legislation aimed at ending the strict separation of banks, security firms, and insurance companies is the most recent example of the increasing involvement of the federal government in issues of interest to life insurance companies. A proposal to permit federally chartered insurance companies has been published. The American Academy of Actuaries formed the Committee on Federal Life Insurance Issues in 1997 to develop avenues for input into decisions that could have major impact on the profession.

The Committee Chair, Members of the Academy's staff, and a Washington lobbyist review legislative developments and discuss possible strategies to accomplish this goal.

Mr. Arnold A. Dicke: I am the chair of the AAA's Committee on Federal Life Insurance Issues. The session is titled "Enhancing Actuarial Input at the Federal Level on Life Insurance Issues," but the changes in Federal law that prompted this session raise an issue that is more than a life insurance issue. It is actually an insurance industry issue in the broadest sense. All of us in the insurance industry are going to be facing many of the same challenges; one of which is how we can work together more closely than we have in the past.

Our first speaker is Tom Wilder, director of public policy at the Academy. Prior to working for the Academy, he worked for the Kansas Insurance Department and also practiced law in Kansas and in Washington, D.C. Tom will give us the background of the new law and some of the implications for actuaries and for the Academy.

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Mr. Thomas Wilder: What's going on today reminds me of a story about an airline pilot who, as his flight is going along, comes on the loud speaker and says to the passengers, "Well, I have good news, and I have bad news. The bad news first, as you noticed, we've gone through a lightning storm. We've been hit by a bolt of lightning, and it's really affected our instrumentation. Our compass is out, so I'm not really sure where we're going. Our altimeter's out, so I'm not sure of our height. Our radio and our radar are out; I'm not sure where we're going. But the good news is, as you can tell, the engines are still working. Wherever we're going, we're getting there very quickly."

That, in a nutshell, is a good statement of what's going on in the financial services industry. You're aware of the factors, but just to touch on them: the Graham-Leach-Bliley Act (GLBA) has made some significant changes in the relationships among banks, insurance companies, and securities firms. A number of trade groups are now pushing for a more national treatment of insurance; and the NAIC is actually looking at some of these issues for the first time in a very serious way.

I would mention at the onset, we currently have significant federal regulation of insurance. There are tax code provisions that deal with health insurance premiums and reserving. There are significant tax and Labor Department regulations on Employee Retirement Income Security Act (ERISA) issues dealing with pension plans and with health plans maintained by self-insured employers. In 1996, Congress passed the Health Insurance Portability and Accountability Act of 1996 (HIPAA), or the Kasselbaum-Kennedy Health Insurance Act. Medicare is a major health program. There are major federal laws and regulations on Medicare supplement insurance. In 2000, Congress is looking at proposals dealing with issues ranging from prescription drug coverage to patient protection standards for managed care to reinsurance for catastrophic reserving. There's a lot of federal involvement already, and I think you're going to see a lot more of it.

Of course, the big issue that everybody is focusing on is the GLBA. Let me touch on three major points from GLBA. For the first time banks, through what's called a "financial holding company," will be allowed to own an insurance subsidiary and to have a significant amount of business activity with that insurance company. Second, there is something called "functional regulation." The idea is that the banking regulators will regulate the bank functions and the insurance regulators, the states, will regulate the insurance functions. No one is quite sure what that really means. The banking community and the insurance community have radically different ideas about what's banking and what's insurance. If you ask some folks in the Office of the Controller of the Currency (OCC), for example, almost everything is a banking function. The third issue has to do with agents and brokers. The Act says that if the NAIC does not act in two years there will be a national regulatory framework for licensing agents and brokers.

Another big push is the internationalization of insurance. The other day a magazine had a story about a trade delegation visiting the U.S. They were representatives of European financial service companies, and they were talking to officials at the World Trade Organization about how to break down what they perceive are barriers to market entry into the U.S. One of the officials was quoted as saying that in the

European Union (EU), if a company is licensed in one country, it can sell in all EU countries. The representatives were confused and mystified as to why they have to satisfy 50 sets of state laws to sell products in the U.S. I think that's a very appropriate question.

A number of the trade groups who in the past have said state regulation is the way to go are starting to rethink their positions. The American Bankers Association Insurance Group has called for a federal regulator. The American Council for Life Insurance (ACLI) has called for an optional national life insurance charter. Some of the other insurance trades are also looking at that idea.

In response to this situation, the NAIC has developed nine commissioner-level work groups to craft responses to GLBA. These groups were kicked off in March 2000 at the NAIC Chicago meeting. They had interim meetings in May in Kansas City and did some additional work in Orlando. I suspect they're going to meet again in Chicago or Kansas City in August 2000, and try to have most of their work wrapped up by their meeting in September 2000 in Dallas. For those of you that have dealt with the NAIC, this is light speed for them. Usually you talk about years and years and years to get something done. They've really put this on the fast track.

Unfortunately, a lot of the NAIC's work is being done in executive session which is closed to the public. Having worked as a regulator, I understand why they do that, but there's a lot of uncertainty about what's going on. I was at the Orlando meeting, as were Bob and Roy. You'd come into a room, they'd meet for a little bit, then they'd close it down and kick everybody out of the room. A couple hours later, they had you come back and they'd tell you some of the things they'd talked about.

Among the groups that the Academy is monitoring is a work group looking at a framework for allowing insurance companies to more easily operate in all states. One of the things that they are talking about is this: if you have a company that's, say, licensed in two or more states, meets certain minimum risk-based capital (RBC) standards and has a certain minimum premium sales volume, could it then sell in all states? As part of this, the work group is talking about how to divide up the responsibility for regulating such a company among the insurance departments in the states where they operate.

Also, there is a work group that is looking at what they call "speed-to-market." This group wants to streamline the process for product and form approvals. It is looking at some kind of process whereby policy forms that are approved for use in one state could be approved for sale in all other states.

Another work group is looking at cooperation with federal regulators. This work group consists of insurance department representatives and banking regulatory officials. They are talking about how functional regulation will work. Also, a work group is developing a process for oversight of financial holding companies. For these last two work groups, the real key is solvency regulation: how banking regulators evaluate risk and look at the solvency of banks, how insurance regulators do the same for insurance companies, how the two groups of regulators can share information, what kinds of information insurance departments or the

NAIC collect now, what other kinds of information they should collect, and who will have access to what.

Another big work group is dealing with privacy. It is developing a model NAIC regulation for the protection of consumer records held by an insurer and shared with a bank, including health records, which have not been specifically covered before.

The NAIC has other work groups on consumer issues, agent licensing, and even the "definition of insurance." I always assumed the NAIC knew what the definition of insurance was, but it now has a group that's working on a definition.

I would encourage you to look not only at the NAIC Web site, but also the Academy's Web site. We at the Academy will soon start posting some information on what the NAIC is doing. I visit the NAIC Web site fairly regularly, and I have not seen anything on these work groups yet, but I'm hoping they'll soon start to post this information.

I'd like to finish with some general observations about what's going on. I would stress these are my views, not necessarily the Academy's position. Change is coming. I'm not quite sure what it's going to be at the end, but I think down the road you're going to have more national, as opposed to state, regulation of insurance. I don't know if that means federal regulation. I'm not sure you're going to have a federal regulator, but I think the NAIC is going to push for a more national treatment by the states. If that fails in the eyes of the interested participants, including banks, insurance companies, and Congress, then I think you'll see federal regulation.

As for federal regulation, I think you need be careful what you ask for. Talk to your compatriots who deal with Medicare and Medicare supplement insurance, and ask them if they think having one federal regulator in the form of Health Care Financing Administration is a good idea. Federal and state approaches each have good points and bad points. You just need to understand what those are and try to work within them.

Sometimes the insurance industry is its own worst enemy when it comes to approaching policymakers to try to get changes made. When I was with the Kansas Insurance Department, we tried to push for deregulation of rate-and-form filing, and the biggest opposition we got was from the agents, who fought us tooth and nail. We also tried to loosen up some regulations to make it easier for outside companies to come into the state. We got a big fight from the domestic insurers who were interested in protecting their turf.

The real reason we have regulation of insurance is to protect consumers. Consumers have, in my mind, two interests in insurance. One is that their claims will be handled in a fair manner, and the other is that, when it comes time to pay off a claim, there's money available. The latter is solvency, and that goes to the heart of what actuaries do.

That leads to my next point: the actuarial profession needs to be involved in this discussion on financial services modernization. One of the things that I've noticed about the profession is that many actuaries say, "Just tell me what the rules are and I'll follow them." You can't take that approach anymore. You need to be involved in designing those rules. Actuaries are very much in-the-box thinkers; it's the nature of your work. Public policy is outside of the box. It's random, and actuaries don't like randomness. But these issues are important, and the profession needs to make sure the result makes sense from an actuarial standpoint.

The final point I would make is that I hope you will work with the Academy and through the Academy to provide input. We, in addition to monitoring what the NAIC is doing, have a banking committee that has begun discussions with federal regulators. Bob Wilcox is going to talk about that. Arnold heads up a committee that looks at federal life insurance issues. The Academy is trying to monitor and comment on what's going on in Congress and in the other forums. I would encourage you to become involved.

Mr. Dicke: Bob Wilcox is the former Utah Insurance Commissioner and a member of the Actuarial Standards Board. We all fondly remember Bob as the godfather of the model illustration regulation, which took quite a step forward in showing that actuaries have things to contribute to the industry that are not so much on the financial side as on the marketing side. Bob's presentation will cover some things that the Academy has already been doing at the federal level.

Mr. Robert E. Wilcox: I want to say at the outset that I hope one of the important messages that comes out of this meeting is that this session covers a topic that has the potential of affecting the professional lives of the people attending this meeting perhaps more than anything else that's taking place and there are so few here in attendance. That's a grave concern to me. It will be difficult for the actuarial profession to have the impact on this topic that it needs to have, because if we're not participating; we're not part of the process. I hope that the transcription of this discussion gets some circulation, so that people have an opportunity to understand what's taking place.

I'm here to talk to you specifically about a meeting that was held in March 2000 with the Federal Reserve at the Federal Reserve Bank in Boston. As the Federal Reserve became more aware of the potential role that it might have in insurance and insurance regulation, it parceled out some of its responsibilities. It gave to the Boston Bank the primary role with regard to regulation of banks and insurance. The Boston Bank proceeded to hire one of the senior people from the Massachusetts Insurance Department, Cynthia Martin, to assist in that role and to help educate the Federal Reserve as to what the insurance regulatory process was all about.

Cindy did a good job in getting that effort underway. She went to work for them around June 1999. Near the end of 1999, she approached me to talk about the possibility of my coming to the bank and making a presentation on some of the work that we had been doing at the Academy Valuation Task Force. This is the project that generated the unified valuation system (UVS). Cindy felt that this was something that the bank regulators needed to know about to assist development of regulatory strategy relative to insurance. The meeting that was held on the May 27, 2000, was the result of that contact.

Two weeks prior to the meeting in May, there was another full day of meetings at the Boston Federal Reserve Bank. A half-day discussion was led by actuaries from Liberty Mutual on property and casualty insurance issues from an actuarial perspective. That afternoon, actuaries from John Hancock came in to make a presentation on life insurance actuarial issues. All of this was done in an effort to educate skilled bank regulators.

When we came in to the May meeting, we had an audience that consisted of regulators from the Boston Federal Reserve Bank, regulators from the New York Federal Reserve Bank, and several people from the Federal Reserve Board in Washington, D.C. There were very knowledgeable people. It included senior supervisors, bank examiners, economists, and finance people that were involved in the regulatory process, as well as policymakers and people who were sincerely interested in finding out how insurance regulation ought to work from an actuarial perspective.

The participants in the meeting included myself, Jack Geis, who at that time was with the Connecticut Insurance Department; Dave Sandberg, who has taken my place as Chairperson of Valuation Task Force; and Moe Chambers from Canada. Moe is a prominent member of the SOA and, by the way, he's also the President-Elect of the International Actuarial Association. We wanted to give the Federal Reserve people a flavor of what the possibilities might be by explaining the regulatory strategy in Canada as an example.

Tom Wilder was there. Bob Praska, who was a member of the Academy Task Force on Banking and Financial Services, also attended the meeting. But the active participants were the first four people I mentioned.

The discussion that took place during the breaks may have been more valuable even than what we presented in the discussion and on the screen, as each of us ended up discussing the issues that were at hand with separate groups of 2–5 bank regulators. I talked about UVS. Actually, it was broader than just UVS. Jack Geis tried to give observations from a current regulator's perspective. Then Moe Chambers gave the Canadian experience, and Dave Sandberg talked about where UVS was going on a broader scale. A lot of time was spent answering questions that were asked by the bank regulators.

One of the things that I tried to do in my presentation was to give some background on insurance regulation generally. We talked about regulatory responsibility. We talked about the role of reserves and RBC with regard to solvency regulation. By the way, this half-day was spent primarily on solvency regulation as opposed to the other regulatory issues that are key parts of the GLBA. An important part of the background perspective is the idea that the right to succeed means that there's also a right to fail. The role of insurance regulators is not to prevent failure. The role of insurance regulators is to protect policyholders, the public, and creditors, but not to protect them from an insurance company failure, but from the damage that results from a failure.

We talked about the tools that are available for detecting insolvency: how we detect hazardous companies, what happens when intercession is timely, what happens when intercession is too late, the public perception with regard to solvency regulation of insurance companies, the actual solvency requirements with regard to the invested asset requirements, non-admitted assets, active life reserves, claim reserves and RBC, all concepts with which you're very familiar as actuaries. We also discussed the current structure involving the prescribed methods, asset-adequacy testing, the actuarial opinion memorandum, and, for health insurance, the gross premium valuation. We ran through RBC, what the pieces of RBC consist of, and finally got into the actual charge that was given to the Academy and created the Valuation Task Force.

Something that I learned as an insurance regulator, but that's awfully easy to forget in the actual process of regulation, is that there are two approaches that may be taken to regulation. One is the specific approach: where we identify specific problems, then we put specific restrictions in place to correct those problems. The result is that companies use specific avoidance.

Actuaries are very bright people. Tom talked about thinking inside the box and outside the box. What actuaries are really good at is getting as close to the edge of the box as they possibly can without going over the line. The result is that you get technical compliance without a very good outcome.

The alternative to the specific approach is what I refer to as a general or principles-based approach. We start at the same point, identify a specific problem, but then we determine what principles have been violated. Then we put in place a principle-based general requirement. Not a specific requirement, but a general requirement based on principle, and from that we can get general compliance, because instead of telling actuaries, "Here's the box. Your success will be measured by how close you can get to the edge without going over the line," we rather create a target and tell the actuaries, "Your objective is to hit the middle of the bull's-eye, not the outside ring, and that will be the measure of your success with regard to compliance."

In his candidacy address, Burt Jay talked about the idea that to measure solvency. We would determine a specific probability with which a company could establish sufficient assets to meet its obligations. We would begin with the obligations and satisfy that with a particular set of assets. We described this graphically with a probability S-curve, where, as you look across the horizontal axis, you're looking at resources versus obligations, and the vertical axis is the probability of survival. The more you increase resources relative to obligations, the greater your probability of survival. In a nutshell, that is what UVS is all about. We talked to the bank regulators about this concept.

Then we introduced Jack Geis from the Connecticut Insurance Department to give his reaction to what was happening to this concept and how meaningful it might be. His presentation was brief, but very meaningful.

Then we went to Moe Chambers. Moe is, of course, very familiar with the regulatory strategy in Canada. He gave some historical background, talked about the transition from the prescription approach to actuarial valuation, such as we have had in U.S., to a principles-based approach to valuation with a significant emphasis on dynamic financial analysis as the backup. I think his presentation was very helpful to the bank regulators.

The final presentation was by Dave Sandberg. Dave talked extensively about the UVS project and the work that's going on, particularly at the SOA, to do basic research to back up the UVS.

The bottom line is that there was significant interaction between the AAA and the Federal Reserve Board. This was more important than the specifics of the topics that we presented. The Federal Reserve Board now knows that when they have issues of a technical nature involving insurance regulation, the first place to call is the American Academy of Actuaries.

Will GLBA change what we do in the future? Absolutely. There's no question about that. Is it possible to predict at this point how it's going to change it? Not really, but I think that we can predict that, if actuaries are not involved, the outcome will be less successful than it might otherwise be. Also, if actuaries are not involved, our role in the future will be significantly diminished from what it might be.

I would like to think from a non-self-serving point of view that the first of those two outcomes is the more important. That is, that the result for the consumers of insurance products will be less satisfactory if we don't get involved to make sure that the national regulation that Tom talked about, whether it's federal or state-based, takes on a rational form.

Just before I became Utah Insurance Commissioner, I attended a meeting where one speaker was a staff person for the House Commerce Committee headed by Congressman John Dingel. At that time, the committee was pushing hard for federal regulation of insurance. She remarked, "We know how to regulate. We're not interested in help from the states. They've done a poor job, but we know how to regulate. It doesn't matter if it's insurance or something else, we can do it. Just turn the job over to us, and it'll get done quite well." It scared me to death that they would approach the task without significant input from the people who really do understand what insurance regulation is about, the very knowledgeable people that exist in the state insurance departments today.

I think that there's still the risk that that might take place. Right now we have people who are interested in talking to us. A lot of dialog is going on between the NAIC, individual state regulators, and people at the federal level, particularly at the Federal Reserve and the OCC. We can be a part of that dialog and help it take place, if we'll get involved.

Mr. Dicke: Bob, could you comment on the reception that you received at the Federal Reserve? Were they fairly open to input from the Academy? What was the reception like?

Mr. Wilcox: It was a very warm reception. They were very interested in what we had to say, and they were freely exchanging ideas and concepts about how they do things. They wanted to understand the differences between how things were taking place already at the Federal Reserve compared with the way things are regulated by the states in the insurance area. There didn't seem to be any barriers erected by them to this overall discussion. I thought from that point of view it was very positive.

I haven't had quite the same experience from some of the other areas of the federal government. I'm not sure that the OCC would be quite as open and ready to try to understand the differences as the Federal Reserve Bank. But, once the debate proceeds to the next level, who knows?

Mr. Dicke: Our next speaker is Roy Woodall, an attorney with the Washington, D.C. office of the Atlanta law firm of Morris, Manning & Martin. Roy has been active in insurance matters for over 35 years, having served as Commissioner of Insurance of Kentucky and as president and rehabilitator of three life insurance companies. He was also an official of two life insurance trade associations, the NALC and the ACLI. Roy will give us his point of view about where the industry is going, what the Washington scene looks like and how we might have input there.

Mr. S. Roy Woodall, Jr.: To start out, I'd like to hit a couple points that have been mentioned before, but put them in the perspective from which I'm going to discuss them.

Acronyms are a fact of life in Washington, and GLBA is now a fact. You're going to hear it referred to in different ways, but it's probably the most over-reaching, power piece of legislation affecting the insurance industry that we've had since McCarran-Ferguson back in the 1940s. It certainly ranks with Glass-Steagall, which had put walls up between securities, banking and insurance, because those walls are no longer there.

This meeting’s keynote speaker, Jim Bensen, in his comments said that he thinks that the industry needs a federal advocate. I congratulate Bob and the Academy for doing a presentation at the Federal Reserve. If you look what the scene in Washington is, they've got four to go: in addition to the Federal Reserve, you've got the FDIC, the OCC (the agency that regulates the national banks), the Office of Thrift Supervision (OTS) which regulates the thrifts, and the Federal Trade Commission (FTC). The FTC was involved in insurance issues over the years until some of their funds got cut off a few years back. That disabled them for a while, but they are back now as the default regulator under GLBA, at least as to Section 5 on privacy. The law says that these agencies are supposed to consult with each other and to consult with the states, and that the NAIC is recognized in the law as the organization that essentially speaks for state regulation.

If we want to see actuaries playing their key-player role, we've got to look at what the playing field they are going to play on is going to look like. More and more is obviously the key-players are going to Washington with GLBA. This resulted not only as a natural consequence of the public's demand that these services be put together, but also from globalization. The EU countries, for example, look at state regulation as a barrier to doing business in this country.

With the market demand that was out there, financial services reform was going to happen sooner or later. When I first started in regulation 35 years ago, going to NAIC meetings was totally different from what it is today. I couldn't begin to tell you the differences that I see. I generally go to all the NAIC meetings. At these meetings I generally try to go to the Life and Health Actuarial Task Force because I found out years ago that that's where a lot of it starts, and if you don't know what's behind it then you can't deal with it later. You, the actuaries, are the product designers.

The key is: how do you move from being the product designer for the insurance industry to the product designer for the financial services industry? The banks are going to have products. Remember the retirement CD not long ago, and the Blackfoot case, and all the pushing, pushing, pushing at the edge of the envelope that the OCC was doing to say, "These are bank products and we can sell them"? I don't know if the bank that set up the retirement CD had actuaries or not. It might be a good question, because for a lot of these products, the banks will say "We don't need actuaries." A guy we ran into after lunch said, "What's the SOA"? I said, "It's an organization." "Well, what's an actuary?" he asked.

My first experience on Capital Hill was back in 1984 on the 1984 Tax Act. Trying to explain insurance to some of the members of the committees in Congress was an almost impossible task, because they think, "Insurance is regulated back at the state level, and it's not anything we have to deal with." Of course, the tax was probably more complicated than anything to try to explain.

But back to the idea of trying to be the person that designs products for the new financial service industry. There are going to be more products coming on the market in the next few years than we've ever seen before. There's always been a flurry, but there's always somebody that can come up with a brand new product, whether or not it's going to be sold by a bank, whether or not there's a risk concern. One of the first things that they had to fight about before they passed GLBA was, "What is insurance?" It had never been defined in federal law. Where do we start? Of course, like everything else, it ended up in a great big compromise: any product regulated as insurance as of January 1, 1999 is defined as insurance.

What happens with new products? First of all, the state's got to determine that it's an insurance product. The state regulator will say, "This is insurance. You've got to come to me." But the bankers may say, "No, no, that's a banking product. We can sell it, and we aren't subject to your insurance regulations." Because, as mentioned earlier, it's functional regulation: if it's an insurance product, it's regulated by insurance commissioners at the state level; if it's a banking product, it's regulated by one of the regulators in Washington.

If they disagree, what happens? They go to court. One thing that Terry Vaughn, Iowa's Commissioner of Insurance and one of the officers of the NAIC, is trying to do is to set up a voluntary mediation process. Commissioner Vaughn is an actuary. I think you, as actuaries, are very fortunate to have her in the position she's in right now. I don't think in my 35 years I've ever seen a better insurance regulator. She is chairing the group that is to talk to the federal regulators. They call it the Coordinating with Federal Regulators Working Group.

One thing that you can be doing is just what Bob did with the Federal Reserve. Anytime that Terry is going to any of these federal regulators, (she has a schedule to meet with every one of them), it would be good if the Academy could have somebody there, to make the identification the actuary as someone that is respected by the NAIC representative, Terry Vaughn. It would be a very good first step to try to get a little higher profile with the various federal regulators that will be involved with insurance matters.

The OCC, for example, has been pushing the envelope because the banks want these products. Under GLBA, the federal regulators can regulate bank sales of insurance, but, in an attempt to compromise, GLBA also has states regulating bank sales of insurance. I see plenty of good lawsuits there for attorney because I have an idea that that's going to be a big fight.

Already bankers in West Virginia and in Massachusetts have gone to the OCC and said, "We want you to opine on the state laws in those two states that go beyond the safe harbors that are in the law." The writers of GLBA hammered out 13 safe harbors, such as no direct tie-ins, for the states that have been regulating bank sales of insurance. But if the states take action that goes beyond those 13 safe harbors, the federal laws may preempt it.

There's also what we call a reverse preemption when you get to privacy. Instead of the federal law taking over from the state, if state law gives more privacy rights than the federal law, then the state law preempts the federal. That's reverse preemption.

The privacy part of GLBA, which is Section 5, also expands the law's jurisdiction more than I think anyone ever anticipated, because it defines financial institutions, financial transactions, and financial products. The regulations that have come out have been a little bit clearer in defining what the financial product or financial institution or financial transaction would be. Essentially, it's just about anything.

It could include an agent, if he or she is an independent agent. The privacy rules subject anyone doing certain things to give notices to consumers annually.

A coalition of some of the financial institutions is trying to work to get the states not to go beyond the privacy provisions of GLBA so that they can get the preemption. They're saying that with GLBA, there will be 2.5 billion privacy notices put in the mail within the next year; every individual family will get at least 20 of them. That is, assuming that everybody knows what they're supposed to do.

For example, I talked with some people in the life insurance secondary market. There's no question but these transactions are financial transactions under GLBA. In some states, these transactions are regulated, but not as the business of insurance. They're licensing their people, but nobody ever said the secondary market in insurance policies is actually the business of insurance. A lot of questions are still left.

GLBA also provides for a National Association of Registered Agents and Brokers (NARAB). NARAB is a very strange creature of Congress. If there's not either uniformity or reciprocity in the licensing of the agents in all the states within three years, then this federal structure is going to be set up, which NAIC would run. But GLBA also has a way to get the NAIC kicked out if they don't do a good job.

The NAIC's first big test was to come up with a producer licensing bill that would give the reciprocity is needed to satisfy GLBA. After the NAIC had gotten buy-off from a lot of the national trades, the bill ran into trouble in the first few states it was introduced in. George Nichols (KY), who is the president of NAIC, was most unhappy at the last meeting because he said that he felt he had buy-off from the agents on all of this. In his own state (and my home state) of Kentucky, he ran into big trouble in the state legislative committee. Local agents came in and wanted it all amended. If that happened in every state, state regulators would not have the reciprocity that they would have to have under GLBA, and NARAB would go into effect.

The last thing I want to mention is the position of the ACLI. I just retired from the ACLI last year. I was familiar with all of the work done to come up with what now has become ACLI policy. That policy is to do everything possible to keep state regulation effective, to make it work, and to make it more responsive to the needs in the industry and the consumers. But the ACLI cannot just sit back and let things go in Washington. It needs to at least be proceeding with some sort of optional federal regulation scheme. I think the reason they did that is because the American Bankers Association (ABA), its own insurance association subsidiary, came up with its own federal option plan about a year ago. When the plan was presented to the ACLI Board by a former Congressman that had been hired by the ABA, the board had one question. The ACLI Board asked, "If we're going to have a federal regulator, are we going to let the banks write the legislation for it? We've got to be involved in whatever happens on this."

That is the dual track that you see now, and why there is all this talk about an optional federal charter, under which, just as a bank can choose between the federal regulator and a state regulator, an insurance company would be able to do the same.

From the Floor: You said there would be 2.5 billion privacy notices. One percent of that is 25 million. If 25 million of the privacy notices were not properly sent out, in your legal opinion, would anybody find a way to turn that into a class-action lawsuit? How many class-action lawsuits?

Mr. Woodall: There's no question that somebody will turn it into a class-action lawsuit.

Mr. Dicke: Ron Gebhardtsbauer started out as a life actuary just as I started out as a pension actuary. We've switched positions and the boat is still on an even keel. Ron is now the senior pension fellow at the Academy. He's also former chief actuary of the Pension Benefit Guarantee Corporation (PBGC), former chief pension actuary of the Office of Personnel Management (OPM) responsible for the federal retirement plan, and the former head of the retirement practice for Mercer in New York City before that. You might ask, "Why do we have a pension actuary here?" I think you'll find out. Pension actuaries, from 1974 on, have had federal regulation to deal with. It's greatly affected the actuarial profession. But the one piece of good news is that there are now pension actuaries involved in the federal government. I asked Ron to join us because I thought the experiences of an actuary who has spent time in and around the federal government might be useful to us as we look forward to what might be the future for life insurance actuaries.

Mr. Ronald Gebhardtsbauer: Arnold said that I started out in insurance. I had three years of insurance and that was back in the mid 1970s. I have enough insurance knowledge to make me dangerous. In fact, I had the same question when Arnold called me up and asked me to come here and talk: "Why? I don't know anything about insurance."

As Arnold said, I started out in insurance for just three years. Since then I've been in pensions, in the private sector and in the federal government. In the federal government, I was chief actuary of the PBGC, a federal agency that makes sure that you get your pension, if your company has a defined benefit pension plan. It was a new, young agency when I got there. The federal government had just created a new agency, and it was not a pretty sight for actuaries.

When I arrived at the PBGC, there were just a handful of actuaries. Now insurance actuaries start out in the insurance world; that's why our examination structure covers everything. We don't just do reserves. The reason why we have that big, broad exam structure is because we're involved in all aspects of insurance. The same thing is true with pensions. Actuaries are the primary guys there, too, and there are some lawyers and accountants as well.

When you start up a federal agency, what do you do? When I started out in the actuarial field the PBGC didn’t exist. When Congress passed the pension law (ERISA), it said to the Department of Labor, the Treasury Department and IRS, could you put something together? They got together and created this new, young agency that hired a lot of their friends and people they knew. They understand lawyers, so there were a lot of lawyers. There were also a lot of accountants, auditors, and maybe economists, but they didn't know any actuaries.

They didn't hire many actuaries. In fact, when I got there, as I said, there were just a handful of actuaries, but they weren't really actuaries under your definition. Most of them didn't have exams, and the ones that did were from Social Security and life insurance areas. They didn't really understand pensions.

When you're starting an agency, you probably will get some bureaucrats together, and they'll try to figure out the reporting structure for the new agency. If you're started by another agency, you'll probably report to that agency. If the new agency is started by a bank agency, the OCC or the Federal Reserve may be involved. The original agency will have the new agency report to it, so it'll have control.

There were several agencies involved in setting up the PBGC so we had to report to all of them. There were would be fights. "No, we want them to report to us." "No, we want control." Most of the people in the actuarial world that go into the private sector go there because they want money. If you're willing to be in the public sector, you go there because you want power. The people setting up the new agency formed a board consisting of the Secretary of Labor, the Secretary of Commerce, and the Secretary of Treasury. Any time the PBGC wants to change its regulations, increase its size or change its budget, it has to go through all three agencies, and these three agencies don't always agree.

For instance, because PBGC guarantees pensions, it wants to make sure pension plans have lots of money in them. It wants to encourage more money. The Department of Labor would agree with that, but the Department of Treasury and the IRS wouldn't, because the more money you put in your pension plan, the bigger your deductions are and the lower your taxes. The IRS, of course, wants to raise revenue. You have conflicting ideologies and biases and constituencies in these agencies.

But in addition, suppose PBGC wants to change the law to fix it. Not only do they have to go through these agencies, but they also have to go to Congress. In Congress, PBGC generally has to deal with four committees. Two are in the Senate: Finance and Labor (the tax writing and the labor committee). Two are in the House: Education/Labor and Ways & Means. If the law deals with bankruptcy, then it goes to the Judiciary Committee, too.

The agencies in the executive branch, even though they have different constituencies, at least all report to the same person at the White House, and he can bang their heads together and get them to come up with some consistent rules. But in Congress, there are various committees that are very jealous of their powers and prerogatives.

In this case, apply the analogy: who are the agencies that might start up or be in charge of putting together a federal insurance agency? The main point is what Roy is saying, that you all do need to get involved in, not the national, but the federal area, because if you don't, the banks are going to do it.

All of the agencies that would be involved are banking agencies. There's OCC, OTS, FDIC, and the Federal Reserve. Also, the FTC, Treasury and Commerce may become involved. Maybe they're all going to be more involved. I don't know who will be in charge.

What about the committees on the Hill? Because of McCarran-Ferguson, over the past many years you've had the luxury of not having to deal with the federal government. But that also means the federal government doesn't consist of people related to the insurance industry. There's no insurance committee on the Hill. Where will it be? Graham and Leach are from the Senate and House banking committees, and Wiley is from Commerce. A commerce, banking or finance committee that's over Treasury or Ways & Means Committee, may be involved.

I think you really want, not only a federal advocate in the executive branch, but ultimately your own insurance committee instead of a banking committee. The banking committees are all friends of bankers. They're going to know what the bankers want; they're not going to know what you want. They're not your advocates, either. You're going to want advocates, not only in the executive branch, but also in the legislative branch.

Once you've figured out how your new federal insurance committee fits into the hierarchy, who are you going to hire? The agencies that are helping put this new agency together are not going to know actuaries. They probably won't hire actuaries. They'll probably hire economists and lawyers and auditors instead.

When I got to the PBGC, they had lots of auditor/accountants. There were hundreds of them, or at least 100. The accountant/auditors were really good at finding problems. Their job was to collect all the data on a pension plan that went under, and then make sure everybody's benefit was calculated right. They were really good at finding the problems, but not the solutions.

As for the lawyers, I'll give you an example. This is 20 years after the PBGC has been in existence. The law is very well-known, and, still, when we took over Eastern Airlines, it took the lawyers two years to figure out exactly how the law applied to the Eastern Airline Pension Plan.

What I learned about economists—and here I am probably stereotyping—is that they are great at coming up with theories. The top economist would go over to the George Washington University Library and write his book all day.

The actuaries were the ones that solved the problems. In fact, I demonstrated this at the PBGC with my nine actuaries after a couple of years. The accountant/auditors were doing everything with paper and pencil. There's no way they could have done that with Eastern Airlines or Pan Am and paid benefits to 40,000 people. The actuaries had to take these cases over and automate them.

In addition, there was no database of covered plans. The actuaries created a database so that we could figure out what the PBGC's liabilities will be in the future. PBGC had been around for 15 years and had never had a clean audit of its financial statement from the GAO. We finally got one. There are lots of examples to show that actuaries were the ones who were able to solve a lot of the problems at the PBGC. I developed a real pride in what actuaries can do. Once you convince the powers that be, that actuaries are the ones that can solve the problems, they will hire actuaries. We're now up to 100 actuaries at PBGC, just as many as there are auditors and lawyers.

PBGC is very involved in litigation. The actuaries would come up with the liability for an underfunded pension plan, say Eastern Airlines, and then we'd sue them for $1 billion in under-funding liability. Usually, we would only get 10 cents on the dollar. When I first got there, the actuaries just came up that one number, the liability. Since we were calculating everybody's benefits, all we had to do was to push a couple of extra buttons to be involved in the process of determining people's guaranteed benefits, helping the benefit administrators and the whole process.

The other thing Arnold wanted me to talk about was my job as the Senior Pension Fellow at the Academy. Having worked in Washington, D.C., I realized when I was interviewing for this job that it would be a pretty big task to become one of the Washington players. But luckily, it's working. The Academy is very much a player, because of people like Tom Wilder and his policy shop, and also our communications shop and Lauren Bloom, our general counsel. Also, we have had some lucky breaks. It wasn't just me, it was this whole group of people that helped us get our foot in the door. Now the Academy is definitely a player in Washington D.C.

One of the lucky breaks came about like this: I do a lot of town hall forums all around the country. Members of Congress will invite me to come and talk to their constituency at a big meeting. Social Security is the big, hot topic. I am the expert. I'm there in case the member gets a tough question.

I didn't realize that the Academy and I had gotten a name until the White House decided to have some town hall forums, and I was invited to do one with Vice President Gore in Rhode Island.

Then in December 1996, we did one in Washington, D.C., at the Sheraton, this one to be led by the President. A couple days before, Al Gore's dad died, and the President had to go to the funeral. I got a call from the White House on a Sunday evening, the day before the event. My heart was pumping: why is the White House calling me? How did they find me? They have ways, though. They have a great database.

I realized they were probably going to want me to take his place. Sure enough, they asked me to be the substitute for the President the next day. He had to leave early and go off to the funeral. He gave me the microphone, and I took over as the moderator of the White House conference on Social Security. The audience was pretty spectacular: members of Congress, a few people like Jessie Jackson, Betty Friedan, and Tom Sweeney, the head of the AFL-CIO.

I introduced the speakers. The White House gave me all their telephone numbers, so I called them all and got to know them. I asked them the first question, then went out and did my Oprah, getting the members of Congress to ask the tough questions. It was a great experience. It's amazing that we've gotten to this point from where we were a few years ago. Actuaries and the Academy are players in Washington, D.C.

I used to be on TV and radio a lot. We haven't done much of that lately, but I'm in the press more. I frequently talk to reporters. I talked to an Associated Press reporter last week. Jeff Speicher* at the Academy, our assistant director of media relations , said we've had 50 hits since then. Fifty newspapers have had articles talking about the Bush and Gore plans and where the AAA stands.

We're visible. I'm on a first-name basis with regulators, people on the Hill, members of Congress, the think tanks, and the lobbyists in town. We need to be a player. We need to be involved. By being more visible, we have been able to, for example, encourage the Congressional Budget Office, General Accounting Office, and the Veteran's Affairs Department to hire actuaries. We've held forums on the Hill on very controversial issues that a lot of members and staff came to, not only in the health area, which I don't know anything about, but also in the pension area. We've held one on whether the Social Security's actuary's assumptions are too conservative or too liberal. Are cash balance plans good or evil? We've had really good speakers for those events, and we've had tremendous turnout. In pensions, the Academy is very much a player. It's important for you to have something like that for life insurance.

What are some of the things you as life insurance actuaries can do? I was going to say there are no life insurance actuaries in the government. Actually, Joe Applebaum, the chief actuary at the Department of Labor, worked at John Hancock for many years. He might be the insider life insurance actuary that can help you when they set up a federal insurance agency. You might want to talk to him.

In addition, you might want to start thinking of people to be Senior Life Insurance Fellow at the Academy. I talked to Tom Wilder before this session to see if it was all right for me to mention it, and he said, "Go ahead." Now is the time when you need a Life Insurance Fellow at the Academy, where you get the Academy support that I was talking about. I don't know if you'll be able to find someone who's willing, but I encourage you to try.

It's been a fun job for me. I think you'd find it an interesting job, and it would not be a permanent thing, because if an actuary works for a while at the Academy, I'm sure he or she could find a job in the government or jobs around the country. As Tom knows, I'm getting offers all the time. It's a great job.

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* Mr. Speicher, not a member of the sponsoring organizations is assistant director of media relations at the American Academy of Actuaries, in Washington, D.C.

In summary, I'd encourage you to think about these possibilities: having some life insurance actuaries on the inside of government and also maybe a Senior Life Insurance Fellow at the Academy.

Mr. David J. Hippen: What chance does the NAIC have of becoming an effective federal regulator of insurance?

Mr. Wilcox: There is no chance of the NAIC being an effective federal regulator, but perhaps a national regulator. I think you see the difference. David, you have seen I have the kind of battles that can go on between the regulators of the various states. Perhaps even more difficult are the battles that go on between the various state regulators and certain constituencies that are out there.

The ACLI can be troublesome at times, but perhaps not as troublesome as some of the other organizations. Those that represent particular segments of the marketing side of the business can be, I think, even more difficult. To be an effective national regulator is a very daunting task. I commend the state regulators right now for what they're doing.

Tom mentioned the number of meetings they've had in a very short period of time. I think they're accomplishing a lot, but the task is so monumental, a lot may not be nearly enough.

Mr. Woodall: I'll just add one thing. The key to whether they can do it, first of all, is, as you said: can they get their act together? But, second, is there a legal framework in which they can do it, or under which they can do it? That's the question that's been put off to the side for now, because it is too controversial.

If you really want the NAIC to be a national regulator doing functions other than the statement blank, the Securities Valuation Office, and the other things that it already does on a national scale, there are three possible ways to go. Congress could give the NAIC the authority, which would make it almost like a self-regulatory organization. The state legislatures could pass uniform legislation, enabling the NAIC to carry out the needed functions. This creates a legal problem, because some of the things the NAIC wants the legislature to do may be unconstitutional, because the legislature can't delegate that sort of authority.

That leaves only one way for the state legislatures to enable the NAIC and be constitutionally sound: a 50-interstate compact. That would be the ideal way. Some people really think it could happen. But what is the practicality of going to an insurance committee in a state legislature and saying, "We want you to give a blank check to the NAIC to do some of the things that you've been doing up to now." These people have good contacts in the industry and contributions coming in for their campaigns from the industry. I just cannot see too many of them wanting to give that authority over to the NAIC. But it could be done if you can get past these practicalities.

Mr. Wilcox: The catalyst is the state premium tax. State premium tax is a product of McCarran-Ferguson. If McCarran-Ferguson goes by the wayside, the states lose the ability to collect that tax. Right now, the premium tax is far in excess of what states would collect from insurers under the general corporate income tax. That may be the catalyst that brings people to the table. Is it enough? Maybe, but I'm still skeptical.

Mr. Woodall: It's kind of a no-no, too. In the American Banker's plan and in the ACLI's plan, the premium tax is left at the state level.

Mr. Dicke: I'd like to focus the discussion on the future role to be played by actuaries. A lot of players have things to win or things to lose. Obviously, the insurance industry and the banking industry are, to some extent, facing off, although their interests aren't exactly opposed to one another. My company, for example, is both an insurance company and a bank. There is also the question of state versus federal regulation. We've heard a lot about those conflicts. But for this meeting, we need to focus on the proper positioning for actuaries.

It sometimes sounds like actuaries are identifying with the insurance industry, and to some extent, with state regulation. It seems to me that these are not optimal roles. What does the panel think about the proper positioning for actuaries?

Mr. Wilcox: I think we have to favor a sound solution. We cannot take a position of advocacy for anything other than a sound solution. It's clear to me that there's not just one sound solution. There are a variety of sound solutions that could be talked about. Our role as actuaries is to help the people who must establish policy to understand the goods and bads associated with each of those solutions so that they can pick from among them the one that, hopefully, will work the best.

But if we go in advocating the insurance industry's position, advocating the self-interest of actuaries as a profession, or advocating a position in favor of state regulation over federal regulation, we lose. First, we lose credibility, and once we've lost credibility, there isn't much more to lose.

Mr. A. Grant Hemphill: Policy analysts have a lot of tools, but they've got one tool that they use above all others: cost-benefit analysis. That's the bottom line. They argue that cost-benefit analysis applies to everything. This is good news for actuaries. Actuaries are really good at cost-benefit analysis. I don't see the policy analysts doing anything that wouldn't be fairly natural for an actuary.

Now, the bad news. The Academy, the ACLI, and the NAIC constantly propose things without doing a cost-benefit analysis. Should we have Section 8 opinions or not? Should we have XXX or not? Should we have federal regulation? On one issue after another, we take positions without a good cost-benefit analysis. We lose credibility in Washington by doing that. It frankly shows bias. If you know what your opinion is without having an idea of the costs and benefits to society, then you've adopted a biased opinion, it seems to me.

Mr. Woodall: I might just mention that the ACLI two years ago did a cost-benefit analysis on state regulation because it was getting complaints from companies saying that it was beginning to be a burden. Instead of having one market conduct exam, we had some companies that had 13 states doing separate market conduct exams. That's when the benefit gets kind of hard to see.

Mr. Joseph L. Nichols: I don't really know where I stand with respect to state or federal regulation, but one of the things that we heard during James Benson's keynote address was that he was trying to get us as actuaries to be a little bit more innovative in our product development. He certainly showed very vividly, throwing numbers around, how we're losing a lot of dollars to the financial services industry.

From a practical point of view, anytime that our company does try to come up with new or innovative products and file them for approval at the state level, the states, if they've never seen the product before, are very slow to embrace innovation. Tom, I'm wondering what your perspective on that is.

Mr. Wilder: I think it's true. There are states where it's more difficult to introduce new products, or to have innovative approaches to business, because of the insurance department. They have a set of rules, and you need to follow the set of rules no matter what. But I'm not sure that the federal government is going to be more flexible. You're still going to have a set of rules and a set of approaches.

The HCFA has a phone-book size set of rules for how Medicare should be run, and that's not very hospitable to innovation either.

Mr. Dicke: There's also the SEC with variable products. It's not usually a smaller filing. But, it's one filing.

When we think about state regulation, it seems to me that the barriers aren't always, or even usually, the actuaries in the state department. Maybe that's a role actuaries actually can play in federal regulation: to help more innovative products to be approved.

Mr. Wilder: Very often the barriers are not with the actuaries. Sometimes they are, but usually they're not. But one of the things to keep in mind in terms of barriers to entry: if you have one regulator, and you get turned down with an innovative product, you're done. If you have 50 regulators and one of them accepts an innovative product, you have a laboratory in which to prove that your innovative product can work, and a platform to go to the other 49 states. Federal regulation is not all positive in terms of innovation.

Mr. Nichols: Well, that's what I said. I don't know where I stand with state versus federal regulation.

Mr. Wilder: I'm not sure either. I think I can make a case either way. But I'm a strong proponent of companies being able to innovate, to bring new products to market to determine if they're viable and if consumers want to buy them. One of the things that has been wrong with the industry for a long time is the bias that we've had toward self interest rather than consumer interest.