March 11, 1999

The Honorable Phil Gramm
United States Senate
Washington, DC 20510
Dear Senator Gramm:

The American Academy of Actuaries recognizes your efforts to develop a sound legislative proposal for financial services modernization.

Based on our review of the amended draft of the Financial Services Modernization Act of 1999, we have prepared the enclosed report documenting our key concerns about this legislation. The Academy neither supports nor opposes the bill, but believes that policymakers should adequately address the implications for the public in expanding the federal agencies' role in the regulation of insurance activities.

With or without financial services modernization legislation, there are clearly trends toward blurring traditional distinctions among various types of financial risk (insurance risk included). As companies and products mix elements of banking, investment, and insurance, it is important to ensure that companies provide adequately for their risk exposure. If adequate provision for risk exposure is not required, a company might not be able to meet its obligations, exposing the company to possible bankruptcy, and the resulting serious consequences for the company's customers and the public.

We would be happy to work with you and your staff as the Senate develops the financial services modernization legislation to ensure that adequate protections are provided for the public and the financial services industry.

The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, regulators and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification, and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

Sincerely,

Lawrence A. Johansen, Vice President
Financial Reporting Council

Donald E. Sanning, Chairperson
Task Force on Banking and Financial Services

Enclosure

Statement of the Task Force on Banking and Financial Services and the Financial Reporting Council of the American Academy of Actuaries

The Financial Services Modernization Act of 1999

Summary

- Congress should not permit dual regulation to weaken the solvency and capitalization requirements for financial entities underwriting insurance.
- Congress should clearly prohibit federal regulators from preempting existing, effective State consumer protection laws unique to insurance.
- State regulators should be given a specific, reasonable period of time to respond to any requirement that an insurer contribute capital to an affiliated depository institution.
- To effectively regulate insurance risk, actuaries should be employed by each of the federal regulatory agencies overseeing the financial services industry.
- The Task Force on Banking and Financial Services and the Financial Reporting Council of the American Academy of Actuaries (the Academy) welcome this opportunity to comment on the March 1, 1999 Senate draft of the Financial Services Modernization Act of 1999 (the Act).

Our previous submissions to Congress have emphasized that any bill to reform the financial services industry must address all types of affected financial risk (i.e., insurance risk and investment risk), in order to protect the stability of the nation s financial services industry. The importance of strong functional regulation of financial entities insurance activities cannot be over-emphasized. The projection and management of insurance risk is a complicated science, involving the selection and application of models and assumptions which are appropriate and based on an educated, experienced understanding of the nature of the risks involved in each insurance product. It is critical that financial entities which underwrite insurance be subject to appropriate oversight by regulators who understand insurance risk.

The Act provides for state insurance departments to regulate financial entities insurance activities, which is one means to legislate appropriate regulatory oversight. However, the Act also calls for federal agencies which lack experience in regulating insurance risk to give broad oversight to financial entities activities overall. If the federal agencies come to dominate the regulation of financial entities, it could lead to a weakening of the capitalization requirements for entities engaged in insurance activities which could, in turn, generate insurer failures and consequent harm to consumers.

One way to provide adequate oversight of the regulation of insurance activities would be for the Senate Banking Committee to include in its report an unambiguous statement of its intent that federal and state regulators work closely together and cooperate to manage the activities of financial service providers. Unfortunately, the Act does not always clearly identify how and with which state regulators federal agencies are required to communicate. We therefore recommend that, where communication would relate to a specific financial entity, appropriate communication with insurance regulators in the entity s state of domicile be required. Where broader policy questions are at issue (for example, in Section 201 of the Act), we recommend that consultation with the National Association of Insurance Commissioners be specifically required.

The Act generally provides for consumer protection, but we are concerned its broad preemption provisions may lead to the preemption of state consumer protection laws and regulations that are unique to insurance. One example of such a regulation is the National Association of Insurance Commissioners model regulation on use of illustrations in the sale of life insurance. Under the model regulation, actuaries must certify to the disciplined current scale used to illustrate an insurance policy and illustrations cannot be more optimistic than the disciplined current scale permits. This actuarial certification provides a carefully-crafted regulatory check on insurers representations concerning the investment potential of insurance policies and without it, consumers may be misled. Similarly, state insurance laws contain specific non-forfeiture provisions to protect the financial interests of policyholders who permit their insurance payments to lapse. If the non-forfeiture laws were preempted, those policyholders could lose their entire investment despite months or years of payments.

We urge the Senate to carefully review the Act's potential to preempt insurance regulations that protect the public, and to take appropriate steps to prevent excessive preemption. The simplest and potentially most effective way to do so would be to move the first three subsections of Findings from Senator Grams' amendment on motor vehicle rental agency insurance activities into Title II of the Act. These findings would clarify Congress intent to shield carefully considered state law consumer protections from inadvertent preemption.

Section 112 of the Act permits federal regulators to require affiliated insurance companies to provide capital to depository institutions. The Act permits a State insurance authority to prevent the transfer of funds if it would have an adverse effect on the financial condition of the insurance company, but the Act does not set forth a time frame in which the State insurance authority may act. We are therefore concerned that federal agencies may require capital contributions from insurance companies before State regulators have a meaningful opportunity to protect the financial condition of those companies. We recommend that a specific, reasonable time for response from the State insurance authority be incorporated into Section 112.

Finally, with or without legislation, there are clearly trends toward blurring traditional distinctions among various types of financial risk. As companies and products mix elements of banking, investment, and insurance, it may become increasingly difficult for regulators to fully appreciate and oversee the various complex risks involved in financial entities activities. Actuaries are uniquely qualified to deal with the measurement and management of insurance risk, and can bring a valuable perspective to regulators. To help maintain the strong functional regulation called for by the Act, and to ensure that federal regulators have the necessary resources to deal appropriately with insurance risk in the financial services industry, we urge that the Act require the establishment of an Office of the Actuary within each of the federal agencies with responsibility for financial services regulation.

We would be pleased to work with the Senate to ensure that adequate protections are provided for the public, consumers and the financial services industry. The Academy can contribute to the discussion by sharing its report of findings based on its objective, nonpartisan actuarial analysis.

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