Statement

of the

American Council of Life Insurers

on

HR 5637

The Nonadmitted and Reinsurance Reform Act of 2006

before the

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

of the

House Financial Services Committee

of the

United States Congress

June 21, 2006

Mr. Chairman and members of the Subcommittee, I am David A. Gates, Senior Vice President, General Counsel and Secretary of Generali USA Life Reassurance Company (Generali USA), based in Kansas City, Missouri. My professional background includes serving as Insurance Commissioner of Nevada from 1984 to 1990 and on the Executive Committee of the National Association of Insurance Commissioners (NAIC) from 1986 to 1990. I was President of the NAIC in 1989. This background, together with my experience as an officer of a U.S. professional life reinsurer, gives me a bit of insight into the issue that this Subcommittee is addressing today.

As I understand it, we are here today to discuss the need for regulatory certainty and a level regulatory playing field. We support both. Life reinsurance is and always has been a fundamental underpinning of the life insurance industry and an international business. In order to strike a balance between solvency protection and access to capital and a competitive marketplace, life insurers must have modern, best-practices supervision by a single regulator.

My company began as a health insurer known as Business Men's Assurance Company and first sold life insurance in 1920. It first sold life reinsurance in 1928 and formally established its life reinsurance division in 1948. It was acquired by the Generali Group in 1990. Today my company is a wholly owned subsidiary of Assicurazioni Generali S.p.A. (Generali), a leading international insurer based in Trieste, Italy. Generali was established in 1831 and has grown to a conglomerate of 226 insurance and financial services companies worldwide. It is the leading life insurance group in Italy by market share and one of the largest insurance groups in Europe by market capitalization. Today Generali USA sells only life reinsurance and is recognized as one of our industry's top professional life reinsurers.

I am here today on behalf of the American Council of Life Insurers (ACLI). ACLI is the principal U.S. trade association for life insurers. ACLI's 377 members account for 91 percent of the industry's total U.S. assets. ACLI members offer life insurance, annuities, pensions (including 401(k)s), long-term care insurance, disability income insurance, reinsurance, and other retirement and financial protection products.

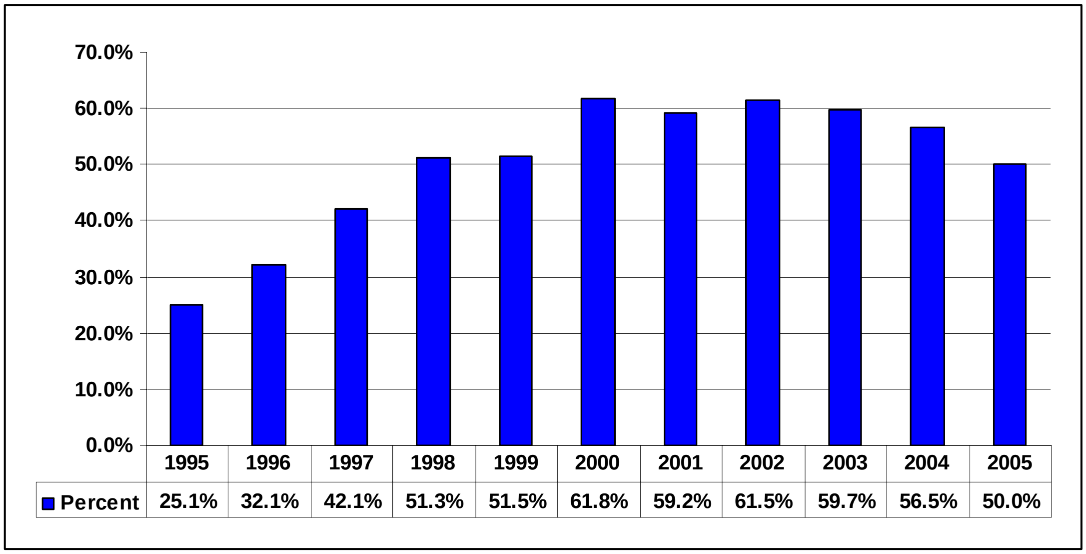
I appreciate the opportunity to appear this afternoon and present the views of the purchasers and sellers of life reinsurance on modernizing reinsurance regulation. As you know, modernizing insurance regulation continues to be an overarching priority for the entire life insurance industry. Our objective is a more efficient state-based system of regulation coupled with a comprehensive federal regulatory option, and we will continue to work with the Subcommittee on modernizing insurance regulation.

Life Reinsurance Is Commercial Insurance for Life Insurers

We agree with the premise of this hearing and the legislation—that U.S. supervision of reinsurance needs reform. Life reinsurance is insurance for life insurers, a business-to-business commercial transaction. Just as consumers purchase life insurance and annuities to protect themselves against risk, life insurers buy reinsurance to protect themselves against the risks inherent in life and health insurance policies and annuity contracts they sell to consumers. Those risks can be mortality and morbidity risks, investment risks, cash-flow risks, and other related risks. Regardless of reinsurance, life insurers remain directly obligated to consumers for the benefits of their life insurance policies and annuity contracts. Life reinsurance is an indemnity contract between a purchasing life insurer and a reinsurer, which is freely negotiated between those sophisticated commercial parties.

Life reinsurance has become increasingly important to life insurers (see illustration). It is a fundamental risk management tool and a source of capital and product innovation support for life insurers. Today, U.S. life insurers cede about half of all their risks to life reinsurers, on average. The total amount of life reinsurance in force as of year-end 2005 was U.S. $5.87 trillion.

Trends in Life Insurance—Percent Reinsured



Source: Society of Actuaries and ACLI

U.S. Regulation of Life Reinsurance Needs Improvement and Certainty

We recognize and appreciate the many experienced and dedicated insurance regulators currently serving the public, our industry, and our policyholders. We believe, however, that increasingly they are laboring under a system that is incapable of responding adequately to the realities of global risk and capital management. My comments, to the extent they may be interpreted as criticisms, are directed at the system itself and certainly not at the individuals charged with administering it.

We have concerns about the current 50-state system of regulating life reinsurance. U.S. regulation of life reinsurance has become increasingly ad hoc and inconsistent. It has not kept pace with the risk-based regulatory standards of competing financial sectors, such as banking. It has not recognized newer forms of reinsurance as prudent risk management tools for life insurers in their development of consumer-driven financial and retirement security products. In short, the current 50-state system of regulating life reinsurance has not adapted to current best-practices standards of financial supervision.

Regulatory improvement is needed. Life reinsurance agreements diversify risks that life insurers undertake in providing financial security for consumers. Simple economic proves that a wide diversification of life insurer risks lowers the ultimate costs to consumers. Insurance supervision should support responsible risk diversification.

Current U.S. regulation of life reinsurance impedes insurer risk diversification. It discourages innovation and encourages life insurers to buy one-size-fits-all reinsurance. A life insurer may purchase a different “size” of life reinsurance, but current U.S. regulation may recognize that reinsurance in one state but not another, thereby limiting life insurers’ ability to manage risk competitively and effectively. The following example proves the point:

> In New York, a life insurer can receive approval for counting reinsurance of certain high risk benefits in life insurance policies and yet be unable to count that reinsurance in its financial reports to California because California will not recognize it.

ACLI has repeatedly pressed state insurance regulators to modernize and unify life reinsurance regulation. In spite of substantial support, there has been no reform. We believe that this failure is due largely to the refusal by states to rely on each others’ assessment of their domestic insurers’ financial condition. The current system of overlapping and inconsistent reinsurance regulation—where states are permitted to second guess fellow states’—must be reformed in order to ensure a vibrant and competitive life insurance market for U.S. consumers.

Regulatory certainty is needed. Life reinsurance has been strictly and heavily regulated in the U.S. since 1985. In theory, the home state of a life insurer is responsible for regulating its reinsurance purchases based on standards set by the NAIC. In practice, however, many states apply their laws on reinsurance outside their borders. Sometimes the laws themselves are different and sometimes the regulations are different. More often, similar laws or regulations are interpreted differently—not infrequently through informal application of unwritten insurance department practices. There are many examples of the redundancies and inconsistencies that this overlapping and inconsistent regulation creates, but this one proves the point:

> A letter of credit acceptable to the New York Insurance Department is not acceptable to the California Insurance Department, and vice versa.

Such archaic constraints are unrelated to sound principles-based supervision and provide no regulatory or consumer benefit. Instead, they balkanize capital, increase its cost, and depress insurance and reinsurance capacity. We believe these constraints exist because in a 50-state system no single regulator is charged with balancing regulatory prudence with a vibrant marketplace.

Summary

We support and encourage the dialogue that this bill promotes. We appreciate the time and effort that this Subcommittee, its members and staff have invested in understanding our industry and its current regulation. We believe strongly that U.S. reinsurance regulation must be modernized and hope we have demonstrated that necessity. Inasmuch as this bill establishes a more efficient state-based system of regulating an important aspect of life insurer operations, we endorse it. At the same time, we urge the Congress to pursue a comprehensive federal regulatory option for insurers and reinsurers.