



Economic Impact of an Optional Federal Charter on the Life Insurance Industry

A Survey of Leading U.S. Insurance Companies





Table of Contents

1. Executive Summary	6
2. Introduction	10
2.1. Background of Insurance Regulation.....	10
2.2. The Current Regulatory Environment	10
2.3. Drivers for Regulatory Change	11
2.4. The Optional Federal Charter	11
2.5. Other Efforts to Achieve Reform	12
2.6. Objectives and Approach	13
3. Results of Industry Focus Groups	14
3.1. Purpose of the Meetings	14
3.2. Summary of Findings from the Meetings	14
3.3. Implications for the Industry Survey	19
4. Industry Survey Findings	20
4.1. Survey Scope and Content.....	20
4.2. The Survey Process	21
4.3. Findings: Regulatory Expense	22
4.3.1. Overall Expense.....	22
4.3.2. Expense for Key Life Insurance Functions	23
4.3.3. Expense by Company Size.....	24
4.3.4. Opportunity for Improvement.....	25
4.4. Findings: Lost Opportunity	27
4.5. Additional Survey Results.....	29
5. Conclusions on the Impact of an OFC.....	34
5.1. Ramifications for Life Insurance Carriers.....	34
6. Appendix.....	36
6.1. Survey Description.....	36
6.2. Prior Research.....	40
6.3. Additional Survey Results.....	40
6.4. Regulatory Cost and Redundant Reserving.....	42



Tables

Table 1: Survey Categories.....	20
Table 2: Overall Regulatory Expense.....	22
Table 3: Regulatory Expense for Key Insurance Functions.....	23
Table 4: Regulatory Cost per Policy vs. Company/Group Size	24
Table 5: Opportunity for Improvement	25
Table 6: State-Specific Regulatory Cost by Function	27
Table 7: Lost Opportunity Cost	28
Table 8: Lost Premium Income.....	28
Table 9: Survey Question Categories and Sub-Categories.....	37
Table 10: Detailed Cost Breakdown.....	41

Figures

Figure 1: Regulatory Cost Discussion Topics.....	15
Figure 2: Survey Respondents by Asset Size	21
Figure 3: Regulatory Cost Comparison	22
Figure 4: Regulatory Cost Components.....	23
Figure 5: Per-Policy Regulatory Cost by Size Group.....	25
Figure 6: Opportunity for Improvement – Industry Equivalent Costs.....	26
Figure 7: State-Specific Cost by Insurer Size	26
Figure 8: Potential Savings by Function.....	27
Figure 9: Lost Premium Income by Insurer Asset Size	29
Figure 10: Do You Create State-Specific Products?.....	30
Figure 11: How Many Variations?.....	30
Figure 12: Variations by Product Type.....	30
Figure 13: Incremental Cost of Product Variations.....	31
Figure 14: Delays Resulting in Lost Premium.....	31
Figure 15: Product Deferrals from Regulation	32
Figure 16: State-Specific New Business Organizations.....	32
Figure 17: Is the New Business Organization Driven by Regulation?	32
Figure 18: State-Specific Policy Service Organizations	33
Figure 19: Is the Policy Service Organization Driven by Regulation?.....	33



Executive Summary

Sixty years after the passage of the federal McCarran-Ferguson Act, the issue of state versus federal regulation of the insurance industry has never really gone away. Today, consumer groups, industry organizations, regulators and insurance carriers continue to debate the merits and limitations of multi-jurisdictional regulation and consider alternatives to the current system.

A number of voices within the industry — even the state regulators themselves — have called for modernization of the current state-based regulatory system. The question is about the approach to modernization. Could a new structural approach to regulation present an effective option to the current state-based system? Are the drivers for change persuasive enough to overcome the natural inclination of legislators, current regulators and many industry stakeholders to stay with the current system?

In pursuit of insurance regulatory efficiency and modernization, the American Council of Life Insurers (ACLI) developed a proposal for an Optional Federal Charter (OFC), one alternative to the current system. An OFC would allow life insurers to seek either a federal or state charter based on the particular circumstances of their business and the needs of their clients.

In early 2004, ACLI and Computer Sciences Corporation (CSC) began joint research into the economic impact of the current state-based regulatory system and the potential cost improvement of an OFC. ACLI and CSC focused on the life insurance industry and specifically on the economics of an OFC to life insurance carriers, as other studies have already investigated the potential impact on consumers and regulators.

The study involved conducting individual interviews and focus groups with industry executives to learn about carriers' experiences under the current state-based regulatory system, followed by a survey of the industry to gather quantitative data regarding regulatory costs. The research was structured to cover the full spectrum of the life industry by studying both small and large insurers, some of which operate in only one state and others of which do business all over the country. All participants in the study were familiar with the OFC and with areas of regulatory cost within their own companies.

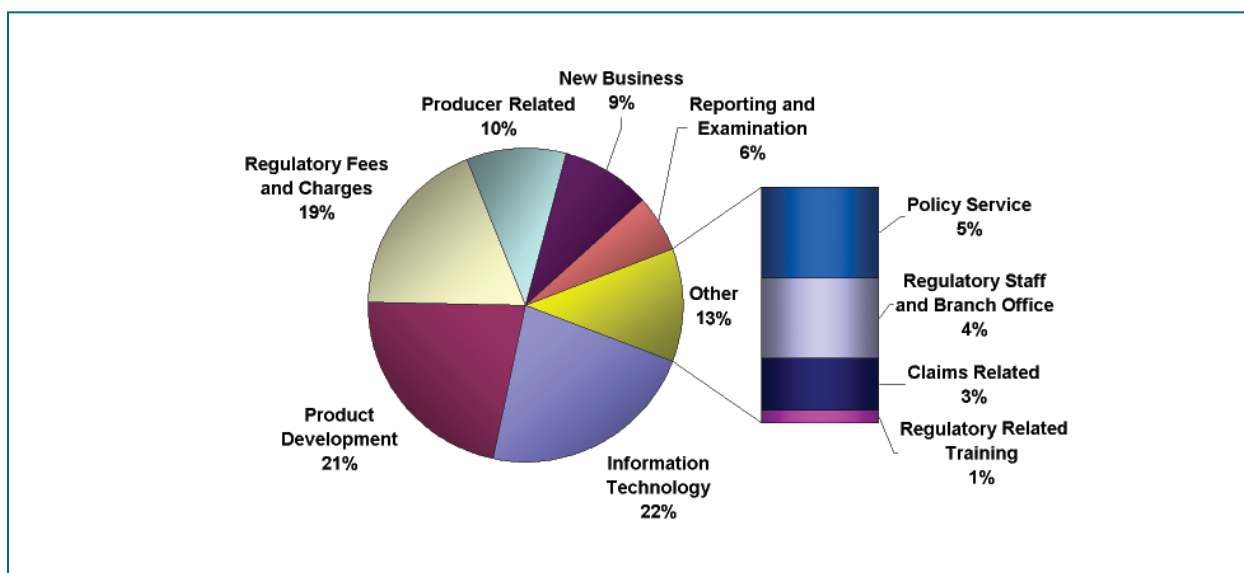
The survey included responses from more than 100 companies, representing \$160.2 billion in premiums, \$1.5 trillion in assets and 41 percent of the U.S. life insurance market.

The responses covered more than 100 companies, which in the aggregate are responsible for more than \$160.2 billion in premiums and over \$1.5 trillion in assets within the U.S. life insurance market. This sample represents more than 41 percent of the U.S. life insurance market based on both premiums and assets.¹

The study revealed several important points:

- (1) **Regulatory cost is a major part of a life insurer's cost structure.** Results of the survey indicated that compliance is a major cost for a life insurance carrier. In the survey, respondents identified a total of \$459 million in regulatory cost. This represents a total of more than **\$1.1 billion** when scaled to the total industry and more than **\$11 billion** over a 10-year horizon.
- (2) **A life insurance carrier's regulatory expenses typically cover far more than fees.** Nearly every aspect of a life insurer's value delivery system is affected by regulatory cost, beginning with the design and introduction of products and moving through the payment of claims. Survey respondents indicated regulatory costs appear in many areas, with the greatest percentage of costs in the areas of information technology and product development.

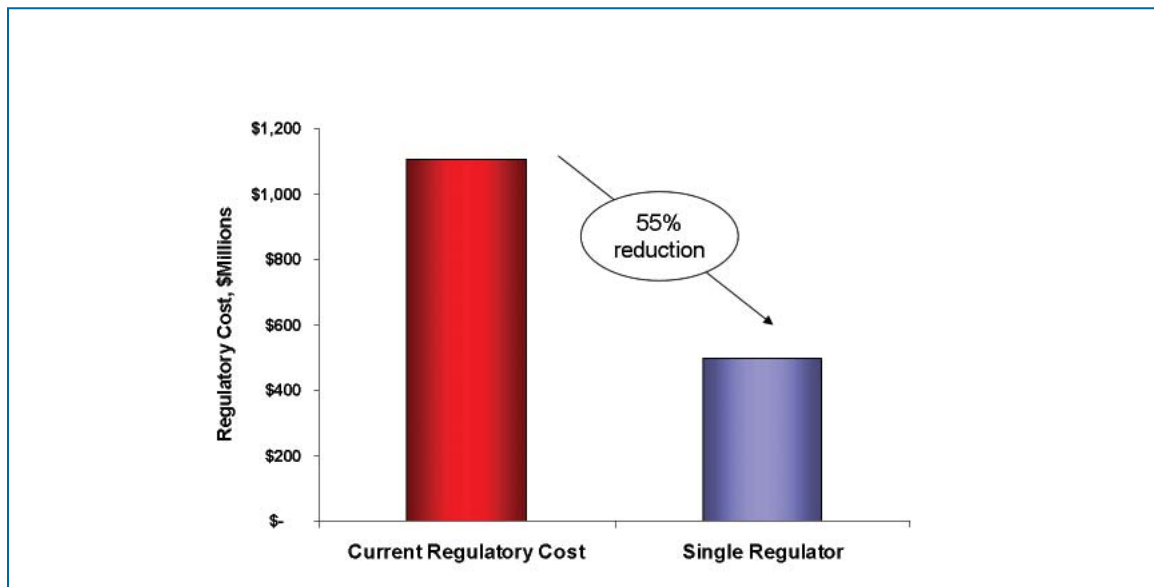
A life insurance carrier's regulatory expenses typically cover far more than fees.



Regulatory Cost Components

¹ Based on total life premiums of \$388.5 billion and assets of \$3.8 trillion as reported in the ACLI Life Insurers Fact Book 2004, which is based upon 2003 data.

- (3) **There is significant opportunity for improvement.** More than \$250 million, or 55 percent of all regulatory costs, are directly related to addressing the requirements of multiple regulatory jurisdictions. Under a single regulatory authority, then, insurers' regulatory expenses potentially could be reduced by more than half. Over time, industrywide savings could exceed \$600 million annually and more than \$6 billion in a 10-year period.



Opportunity for Improvement – Industry Equivalent Costs

- (4) **Industrywide regulatory cost should not increase under an OFC.** Under the model legislation as it stands currently, the cost of the federal regulator would be borne by the regulated carriers themselves, thus introducing additional cost into the system. Data from the survey respondents indicated that direct fees to regulators represented less than 25 percent of their cost of compliance. The added fee-based cost from a federal regulator should not be likely to offset the aggregated value of improvement opportunities seen elsewhere.
- (5) **OFC Uniform Product Approval and Producer Certification Rules have the most impact.** Survey respondents indicated an opportunity of \$174 million annually for cost savings in product development and producer-related costs on an industrywide basis, which represents approximately 30 percent of the total opportunity for improvement, which was identified within those costs surveyed. In terms of cost, this would make the uniform product and producer sections of the OFC model legislation, as well as the file and use product provision, key provisions of the legislation.

(6) **Under an OFC, the level of competition for the consumer’s insurance dollar should increase.** Survey respondents indicated more than \$842 million in premium income was either lost or deferred resulting from regulatory delays or differences in laws and regulations across states. On an industry-equivalent basis, this figure amounts to more than **\$2 billion** annually and **\$20 billion** over 10 years. Over 80 percent of the insurers surveyed had postponed or shelved product modifications or new products due to the regulatory approval process. Getting products to market faster in a streamlined regulatory system would not only benefit life insurance carriers by increasing the potential for premium income, but it also would benefit consumers by making a wider variety of products available for purchase.



Overall, the study indicated a significant opportunity to reduce the cost of regulation through structural change via an Optional Federal Charter. The OFC represents one of several proposals now receiving significant inspection and study. Although it is difficult to predict which proposal will move forward in Congress, there is a clear economic case for action for the OFC, and proceeding forward with action will benefit both consumers and the industry.

Overall, the study indicated a significant opportunity to reduce the cost of regulation through structural change via an Optional Federal Charter.



2. Introduction

2.1. Background of Insurance Regulation

The current state insurance regulatory framework has its roots in the 19th century with New Hampshire appointing the first insurance commissioner in 1851. Insurance regulators' responsibilities grew in scope and complexity as the industry evolved. In 1869, in *Paul v. Virginia*, the Supreme Court ruled that insurance policies “are not interstate transactions, though the parties may be domiciled in different states. They are then local transactions and are covered by the local law.”

This decision was reversed in the *United States v. South-Eastern Underwriters Association*, when the Supreme Court ruled that insurance across state lines is interstate commerce subject to federal law. Congress responded to *South-Eastern Underwriters Association* by enacting the McCarran-Ferguson Act in 1945 to declare that states should regulate the business of insurance and that the continued regulation of the insurance industry by the states was in the public's best interest. Congress' authority to delegate this power was subsequently upheld by the Supreme Court in the 1946 case of *Prudential Ins. Co. v. Benjamin*. However, a provision in the McCarran-Ferguson Act was included to allow federal control to be re-established if state regulation became inadequate.

The debate over state versus federal regulation gained significant momentum in 1999, with the elimination of barriers between financial services by the Gramm-Leach-Bliley Act (GLBA). Although GLBA acknowledged that states should regulate the business of insurance, Congress also called for state reform. Its intent was to allow insurance companies to compete more effectively in the newly integrated financial service marketplace and to respond with innovation and flexibility to evermore demanding consumer needs while continuing to protect consumers. This sets the stage for the current debate.

2.2. The Current Regulatory Environment

Today, insurers operate under a system of laws and regulations that vary according to the state having jurisdiction. In addition, the jurisdictional entities (i.e. the state departments of insurance) that interpret these laws and regulations are different as well as their enforcement practices.

Most insurers do business either nationally or in multiple states. Under the present state regulatory structure, insurance companies operating nationally must obtain 50 or more licenses and follow 50 or more different sets of rules. This means carriers operating across multiple states must ensure compliance with the specific rules of the jurisdiction, which can be a complex process. Further, compliance is not limited to the initial sales transaction, but each subsequent insurance transaction (such as claim or policy change) must comply with applicable jurisdictional requirements.

In addition, the scope of regulation extends well beyond the normal “customer-facing” insurance transactions that the insurance policyholder typically is familiar with. State insurance regulation covers company licensing, distributor (i.e. insurance agent) licensing, insurance product design, insurer and distributor conduct in the marketplace as well as the insurer's financial solvency, in addition to other areas. In short, regulatory coverage extends to essentially all business processes that are core to the insurance business.

The rationale for regulation of the insurance business is not in question. Both insurance carriers and regulators typically argue that regulation benefits both consumers and the industry. However, because of the variety and complexity of the current system, it is not surprising that insurers have long contended that the regulatory environment under which they must do business is unnecessarily complex and burdensome.

2.3. Drivers for Regulatory Change

It would be hard to imagine the world as it exists today when the original system of regulation was developed. In particular, the natural limits imposed by geography, distance and communication had significantly more influence on business compared to today. A quick Web search for whole life insurance may provide a prospective consumer with hundreds of options in a matter of seconds as compared to the more limited options present in the late 1800s when the system of regulation had its origin.

The insurance marketplace is radically different from what it was even a few years ago. Industry consolidation, globalization, the advent of e-commerce and the accelerating integration of financial services are only a few of the trends driving the marketplace.

The life insurance industry — which is the focus of this investigation — is also unique due to the persistence of the life contract itself. Insurance policies cover long durations, typically ranging from decades to the policyholder's entire lifespan. Thus, the contract between buyer and seller is for a much longer timeframe than many other industries. Contract length also makes the life contract different from property and casualty insurance, where the insurance contract covers a span typically of a year or less. When writing a policy, a life carrier commits to a contract that may span decades and is obligated to comply with the contract's terms and conditions as long as the policy remains in force. Thus, for the life carrier, the regulatory problem not only spans multiple jurisdictions but also may cover decades of regulatory compliance.

Life carriers are quick to point out that they compete not only with one another, but with banks and securities firms whose more centralized, streamlined regulatory systems allow them to get products to the national marketplace more rapidly. As a result, they contend that banks and securities firms can serve consumers' needs for innovative products and services more quickly and cost effectively. Insurers often point to the dual-charter banking system as a successful model and note that it preserves the best of state-based and federal regulation.

2.4. The Optional Federal Charter

In 2000 the American Council of Life Insurers developed a proposal to establish an Optional Federal Charter (OFC) for life insurers. ACLI's OFC proposal is modeled in concept after the current national banking system that allows for dual, exclusive regulation.

The OFC proposal does not imply insurers would be regulated using banking-specific laws. In the model legislation, the ACLI patterned specific provisions after what it considered the best state insurance regulatory practices. Many of the sections of the model act refer to specific laws and practices recommended by the National Association of Insurance Commissioners (NAIC), the body of state insurance commissioners.

The OFC proposal gives an insurance company the *option* of seeking a federal charter, if the company believes it to be more complimentary to its structure, operations or strategic plan. Under the proposal, each life insurer would seek either a federal or a state charter based on the particular needs and circumstances of its operations. For example, companies doing business in all 50 states might wish to obtain a federal charter, allowing them to deal with one regulator and one set of regulatory standards. Companies doing business in only a few jurisdictions might find the state chartering system to be more practical.

Although the OFC provides for a federal regulatory option, it does not change two key aspects of the current system: state taxation of insurance premiums and the state-based insurance guaranty associations. Life insurance companies would continue to pay state taxes at rates set by the state, just as they do now. States would continue to make their own determination of insurers' tax obligations under an OFC system, just as they have the ability to determine the state tax obligation of national banks under the dual regulatory banking system.

The OFC proposal also extends requirements that currently exist under the state-based insurance guaranty association mechanism to national insurers. National insurers would be required to become a member of the state guaranty association in each state where the national insurer does business. A national insurance guaranty corporation would be established to provide consumer protections and benefits in any state whose guaranty association does not meet specific standards established under the proposed new law.

The OFC proposal addresses optional federal chartering for life insurance companies — those issuing life, annuity, long-term care and disability income insurance products. However, the proposal is not exclusive to these products and can be written to accommodate federal regulation of other lines of insurance should those insurers wish to seek optional federal chartering.

2.5. Other Efforts to Achieve Reform

The OFC is only one of several initiatives targeted at life insurance regulatory reform. The NAIC has introduced an Insurance Regulatory Modernization Action Plan, which targets modernization of the current state-based regulatory system. The NAIC plan seeks to preserve and improve the current system without the creation of a federal regulator. One component, the System for Electronic Rate and Form Filing (SERFF), has been in production since the late '90s and is targeted for completion of a major redesign in 2006. Another more recent initiative is the Interstate Insurance Product Compact. The Compact is intended to establish a single point of filing for life insurance products under the state regulatory structure. At the current time, the Compact has been adopted in 15 states and is under consideration in 12 others.

The State Modernization and Regulatory Transparency (SMART) Act was introduced as a draft by Reps. Michael Oxley and Richard Baker in 2004 as a “roadmap” for insurance regulatory reform. The SMART Act has been described as a “middle ground” between the current state-based regulation and a full OFC. The SMART Act stops short of mandating a full federally based regulatory system but proposes a State-National Insurance Coordination Partnership in its place. The draft is complex, with more than 500 pages and 17 sections. In general, it would leave the current state system in operation but mandate a “top down” overhaul of the state system of regulations, including rates, licensing, market conduct examinations and product approval. SMART has the advantage of being supported by two influential members of the House of Representatives but has not been embraced by organizations such as the NAIC.

2.6. Objectives and Approach

As can be expected for any issue as complex as insurance regulatory reform, a wide range of positions have been published in the form of white papers, position statements, reports, press releases and similar documents. The large majority of those reports present positions and provide qualitative analysis, but to date little quantitative evidence has been available to support their conclusions. The joint objective of the research by CSC and ACLI is to examine the costs life insurers incur to comply in the current regulatory environment, and, in light of those costs, quantify the potential economic impact of an OFC on life insurers. Of the “three ships in the water” (The Compact, OFC and SMART), the OFC proposes the most extensive federal regulatory option and forms the primary target for the research.

To establish meaningful quantitative results, it was first necessary to get a strong base of facts about the costs of regulation within the life insurance industry. Information was first gathered from available publications and literature to gain context. The review uncovered several prior efforts to quantify the costs of regulation and the potential impact of an Optional Federal Charter. A synopsis of these sources is presented as an appendix.

ACLI and CSC then conducted a series of interviews with executives from life insurance companies of various sizes to determine the participants’ specific experiences with the current regulatory environment and their perspective on the OFC. The scope of these interviews was limited to insurance carriers and internal CSC and ACLI subject matter experts who were most familiar with the actual costs of regulation. Section 3 of this document discusses the rationale and findings of this step in more detail.

Following these sessions, a survey was developed based upon the data received during focus group sessions. The study team compiled a comprehensive list of areas in which interview participants noted regulatory costs were commonly incurred, and specific questions were designed to solicit responses in enough detail for the analytical work presented in Section 4.



3. Results of Industry Focus Groups

3.1. Purpose of the Meetings

In order to frame the issues associated with regulatory costs, the study team conducted a series of meetings and interviews with knowledgeable sources within the industry. The primary rationale was to gain perspective on regulatory costs from those most familiar with the problem — the carriers themselves and their staff who had firsthand experience with regulatory costs in the overall life insurance delivery system.

The study began with interviews of ACLI staff to determine the motivation for the Optional Federal Charter and understand prior work that had been done on the subject. The fact-gathering stage also included discussions with CSC staff familiar with regulatory cost issues. Within the CSC community, the study team obtained information about regulatory costs from two business perspectives: 1) that of a supplier of policy administration and other life insurance software and 2) that of an administrator of insurance policies. In the former case, the study team knew life carriers often ask for policy administration system modifications to support compliance rules. In fact, many systems have been designed from the ground up to support a multi-state regulatory environment where one insurance product may have to be administered in several forms, depending on requirements of each state in which it is offered. In the latter case, the team talked to individuals from CSC's own Business Process Outsourcing operations, which have several million life and annuity policies under administration as a third-party administrator (TPA).

In addition to internal discussions, the study team held individual and group interviews with life insurance carriers and financial institutions. The industry was segmented into four quadrants according to carrier size and number of states served, as initial discussions indicated these factors would be important in driving experiences with regulatory costs. The study team interviewed CEOs, senior-level executives and regulatory compliance staff members representing carriers from each segment. All participants were familiar with the OFC and with areas of regulatory cost within their own companies.

Although the discussions were driven with a structured question set, participants often raised unexpected issues or illustrated situations where regulatory costs were not anticipated. As a result, the interviews were crucial to understanding the issues from the “inside out” perspective and defining the questions for the industry survey.

3.2. Summary of Findings from the Meetings

The review of publicly available literature on the OFC, along with prior research, led the study team to four primary hypotheses to confirm or disprove:

- Regulatory costs are significant to life insurance carriers and the life industry.
- Regulatory expenses go beyond the “direct and visible” costs (e.g., licensing, compliance, approvals and exams).
- Support for OFC varies according to a life insurance carrier's size and strategic priorities.
- Regulatory cost change can be enabled by process and technology change.

Nearly all study participants held that life insurance carriers currently expend a significant amount of effort and cost in achieving compliance to federal and state laws and regulations. However, it became quickly apparent that most of the participants could only qualitatively outline areas in which they felt cost was significant. Some companies had participated in prior surveys and were prepared to produce some quantitative information.²

However, most of the discussions centered on where cost was incurred, as no company appeared to have accounting systems to capture all costs associated with compliance outside specific areas, such as regulatory fees. This finding confirmed the prior experience that a carrier’s ledger accounts and management systems typically are not structured to capture and accumulate all sources of cost across their enterprise. To meaningfully capture a company’s true compliance costs, the study team focused on the “cost drivers” to identify areas where cost could be present and then asked specific questions to allow the carrier’s staff to identify their regulatory expenses.

Early in the discussions, the study team defined regulatory costs as the costs a life insurance carrier bears to comply with state-specific regulatory requirements in order to eliminate the impact of federal regulations such as the Sarbanes-Oxley Act. Moreover, the team followed the tax neutrality of the OFC guideline legislation so participants understood no changes in the insurance tax structure were planned.

To guide the discussions, the study team used a trial set of categories in which ACLI and CSC expected a life insurance carrier would need to be concerned with the impact of state-specific regulations. **Figure 1** provides the initial discussion framework.

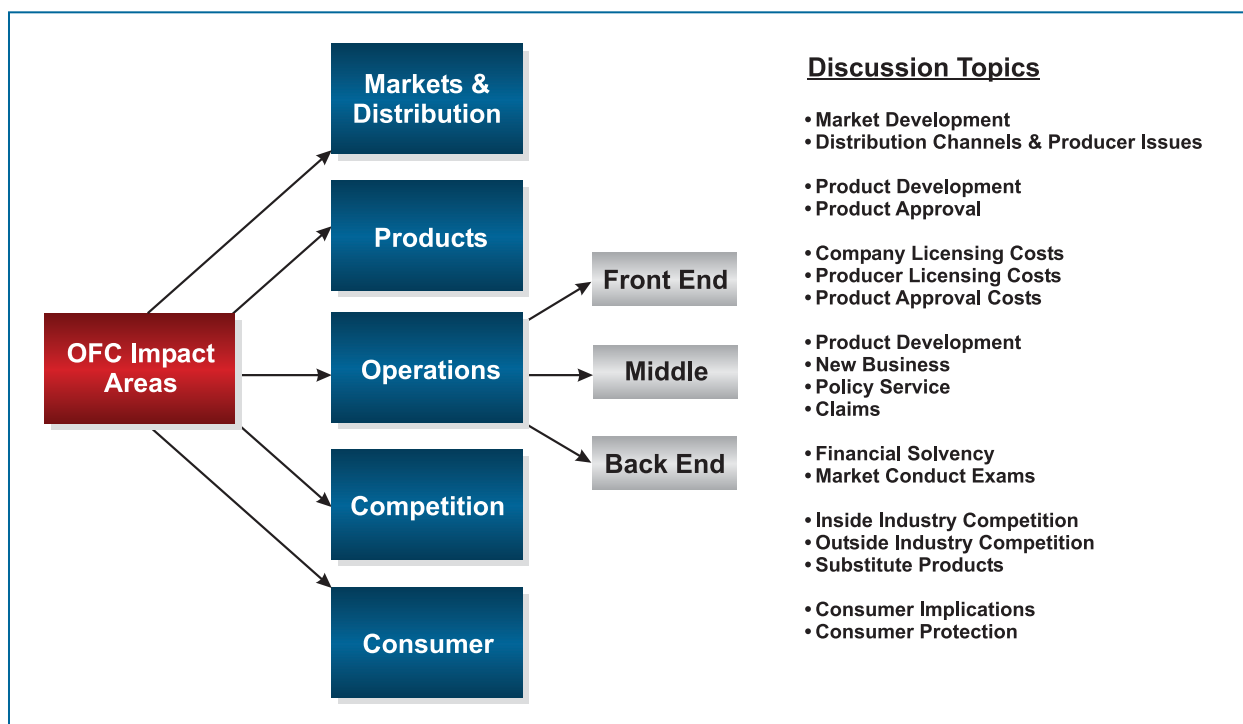


Figure 1: Regulatory Cost Discussion Topics

² A questionnaire was sent to the industry in 2003 sponsored by the University of Massachusetts and ACLI as part of an effort to understand the consumer ramifications of an Optional Federal Charter.

Protracted approval times for new life insurance products, particularly those with more complex market offerings, limit the freshness and marketability of the products ... many insurance departments, particularly those in smaller states, have limited actuarial resources skilled in the more complex offerings.

Although the greatest effort and thus cost was expected to be incurred in front-end (licensing and product approval) and back-end (examination) costs, the study team also knew that wherever there is a compliance issue, there should be an associated cost of compliance.³

Participants openly discussed areas in which they felt the impact of regulation. They also introduced areas the study team had not initially considered and were thus very helpful in framing the industry survey. Although participants provided important views, they represent individual positions and are not irrefutable evidence of specific problem areas. Participants were not speaking against the idea of regulation but instead providing examples of where regulation drives cost.

Market Development and Expansion: In order to compete on a uniform national basis, more and more insurers are consolidating multiple brands under a single corporate entity. Such changes generally require new certificates of authority from each state where a change occurs. Individual states differ in allowances and regulations and sometimes prefer state-specific corporate designation. A state may delay or deny approval to use the national brand, slowing the life insurance carrier's efforts to achieve uniformity.

Mergers, Consolidations and Demutualization: In the wake of recent mergers and acquisitions, many life insurance carriers are seeking to consolidate multiple legal entities under their control. One carrier noted that it needs to consolidate from 14 to seven legal entities, but because of the complexities of complying with multiple state laws and regulations, it can consolidate only one entity per year.

A second carrier attempting to streamline is also experiencing setbacks, although it is not known if the regulatory approval process introduced any substantial delay. Another carrier wanted to achieve a more streamlined structure as an end-state following demutualization, but had difficulty with approval from multiple state regulators. In both cases, the primary impact is a delay in achieving a more efficient cost structure, an example of "lost opportunity." These observations indicate that structural and organizational changes in the life insurance industry can be slower and more expensive under the current regulatory system than in other industries.

³ As an example, consider the claims process. In paying claims, each state has specific regulations concerning payment of post-mortem interest. Accordingly, a claims processor must make claim interest calculations according to state regulations, a more complex (and presumably more costly) process than if only a single regulation was present.



Product Development and Approval: Survey participants said that protracted approval times for new life insurance products, particularly those with more complex market offerings, limit the freshness and marketability of the products. Life insurance carriers have gone on record indicating substantial losses in revenue due to approval delays.⁴ New, more sophisticated products, such as long-term care insurance and wealth management products, or offerings which represent combinations of traditional products, create the greatest challenges. In the area of state approval, the introduction of the SERFF system was noted as providing a way to speed approval of more common insurance products such as whole life and term. More than one focus group participant noted one major problem is that many insurance departments — particularly those in smaller states — have limited actuarial resources skilled in the more complex offerings. One carrier noted that some states lack deep actuarial experience for certain kinds of products and resort to outside help, which can hinder review turnaround. In other states with more resources, additional scrutiny of complex products takes significant time. One carrier mentioned that one product required a three-year approval cycle, although this timeframe appeared to be outside of the norm.

Information Technology: Within operations, a frequently cited issue was the cost of creating and maintaining IT systems. Systems and ongoing system modifications can often represent a significant portion of a life insurance carrier’s typical operating expense. Examples include modifications to policy administration systems for state variations, tracking systems for producer appointments, and rules systems/engines to aid with complex servicing rules. One carrier noted that its costs to monitor compliance with producer appointment regulations were on a par with its cost of appointments. Another participant noted that regulators frequently do not understand the cost burden associated with system development and modifications and thus underestimate the eventual impact of compliance with requests and directives. One participant noted that regulators have a limited concept of how expensive it is to develop systems today.

Individual states differ in allowances and regulations and ... may delay or deny approval to use the national brand, slowing the life insurance carrier’s efforts to achieve uniformity.

⁴ There are numerous public statements by insurers noting lost revenue due to regulatory delay. One example is a statement made by William Fisher of the Massachusetts Mutual Life Insurance Company before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the House Financial Services Committee in November 2003. Mr. Fisher noted that “for 2002 alone we estimate that we lost up to \$60 million in sales (measured by premium) due to the inability to bring our products to market within 60 days of filing with our regulators.”

Extended time required for regulatory turnaround, particularly in the approval of new products ... often precluded carriers from launching products in states known for slow turnaround times.

Competitiveness: A subject of discussion for insurers that are part of larger financial services providers was the process of competition for capital investment dollars. One participant noted that life insurance has a more complex cost structure that puts development of risk-based (insurance) products at a disadvantage versus asset-based alternatives in the struggle for product development capital.

Premium Taxation: Although the OFC itself is intended to be tax-neutral for the states, the study team heard comments on the complex landscape of premium taxation as it exists today. Differences in taxing policy between states have prompted some companies to re-domicile their operations for a lower tax structure.

Surveys: Regulators often request surveys, which can be expensive for life insurance carriers to complete. One life insurance carrier spent more than \$350,000 in responding to a state survey. A frequent complaint was that different states surveys often asked for the same basic data, but in different form, requiring additional expenditures to “repackage” the information.

Perspectives of Small and Large Companies

The study team structured the conversations to include both small and large life insurers to gain the perspective of the single-state and regional carrier in addition to that of the large carrier. Prior to the interviews, the team presumed that smaller insurers would tend to favor the current regulatory environment and resist any efforts — optional or otherwise — to introduce a nationwide regulatory system. Conversations with small carriers actually indicated the opposite, with single-state carriers overwhelmingly expressing support for an OFC, even if they did not intend to “opt in” and become federally chartered.

Regulatory Cost Drivers

Besides regulatory costs in the system, the study team also needed to identify the key determinants or “drivers” of regulatory cost. In particular, the team wanted to identify circumstances or areas where life insurance carriers felt their added regulatory cost did not add any value to the regulator, carrier or consumer. In general, the discussions identified four general drivers of “non-value added” cost of regulation. These four factors came up repeatedly as the underlying determinants of cost or the “cost drivers”:

Redundancy: Focus group participants made frequent references to performing essentially the same functions many times to meet the specific needs of several states. Examples included the requirement for multiple examinations where much of the same information is presented to different state regulators.

Lack of Uniformity: Carriers also noted differing regulations drove multiple forms, products, and specialized offices or organizations. One carrier noted that the regulatory requirement itself was less important than its uniformity across multiple jurisdictions: “I don’t care about what the regulation is; I just want one consistent set of rules.” State-specific rules force insurers to maintain multiple variations of the same product, as well as multiple forms. Variations extend from products and forms to printed policies. One carrier noted that it even uses special policy covers to meet the requirements of a particular state.

Turnaround Time: Extended time required for regulatory turnaround, particularly in the approval of new products, was noted as a core issue, which often precluded carriers from launching products in states known for slow turnaround times.

Process Complexity: Interview participants noted that the processes of filing, approval and examinations are often costly and complex, although the participants understood that improvements to streamline the processes for new product filing and producer licensing are underway.

The latter two drivers of non-value added cost — turnaround and complexity — are areas that can potentially be addressed by streamlining or re-engineering the process, without changing the regulatory structure. Major changes to eliminate redundancy and create uniformity are more structural in nature and can be viewed as a byproduct of the current multi-jurisdictional system.

3.3. Implications for the Industry Survey

The discussions with life insurance carriers produced several lessons for the design of a survey to quantify regulatory cost and the potential for improvement. First, it was now clear that regulation had an impact on many areas within a life insurer’s business, beyond the areas ACLI and CSC had assumed were impacted. To accurately estimate the cost of regulation, the survey would need to include questions on many “core” insurance processes, starting with new product development and including new business, policy service, claims and key support areas, such as information technology. The study team suspected many of these questions had never been asked. The challenge was to develop a topic set that was both mutually exclusive (the questions had little overlap) and collectively exhaustive (the question set covered all areas where regulatory cost might be present).

Secondly, since carriers did not tend to have accounting or measurement structures that directly measured the impact of regulation, the study team would need to ask questions specific enough to quantify the costs. Several insurance company representatives said the survey would be distributed to multiple departments within their company, so definitions would have to be clear so that each recipient could easily identify the real costs incurred. Finally, it was also necessary to include direct costs (out-of-pocket costs such as fees), and indirect costs (internal costs such as labor and overhead), as well as “lost opportunity” costs, which could include either deferred savings or lost revenue.

4. Industry Survey Findings

4.1. Survey Scope and Content

Table 1 provides the cost category set for the survey. A more detailed breakdown, including specific definitions of cost categories and sub-categories is provided as an appendix.

Insurance Regulatory Fees and Charges
Product Development Related Costs
Producer Related Costs
Information Technology Related Costs
New Business Related Costs
Policy Service Related Costs
Claims Related Costs
Reporting and Examination Costs
Regulatory Related Staff Training Costs
Regulatory Staff and Branch Office Costs
Lost Opportunity Costs
a) Cost
b) Revenue

Table 1: Survey Categories

The study team asked specific questions to identify costs within each category. In all, the survey included 45 questions related to the carrier's 2003 regulatory cost. The survey asked for two data items for each cost question:

- a) The carrier's 2003 regulatory expenses for that area, including state assessments to support insurance regulation and all fees, charges or other payments to state insurance departments and the NAIC. Carriers were asked to exclude premium taxes and costs associated with federally mandated regulations such as the Sarbanes-Oxley Act.
- b) An estimate of the percentage of the cost noted in item a) (above) required to satisfy multiple state department of insurance regulations versus those of a single jurisdiction. This data item focused on the potential for reducing costs by eliminating the redundancy and lack of uniformity issues that life insurance carriers saw as key issues.

Carriers also were asked to include regulatory costs for life insurance-related products only including:

- Term Life
- Traditional Life (including universal life products)
- Variable Life
- Disability Income
- Annuities
- Long-Term Care.

Finally, the survey included an "Other Cost" category for each group because many insurers do not identify their costs in the same way.

4.2. The Survey Process

The ACLI released the survey to more than 200 life insurance companies and groups on November 16, 2004. The population included stock, mutual and fraternal companies, in addition to reinsurers. Respondents included smaller life carriers operating in a single state, regional carriers, and very large carriers operating in all U.S. regulatory jurisdictions.

The responses covered a total of 101 companies that in the aggregate are responsible for \$160.2 billion in direct premium and \$1.58 trillion in assets within the U.S. life insurance market.⁵ This represents 41.2 percent of the U.S. life insurance market based on premium and 41.5 percent of the U.S. market based on asset size.⁶

Responding companies represented a wide range of sizes on both a premium and an asset size basis. **Figure 2** provides a breakdown of respondents by asset sizes. A total of 14 individual company respondents and 21 groups reported. Respondents were asked to provide data for fiscal year 2003.

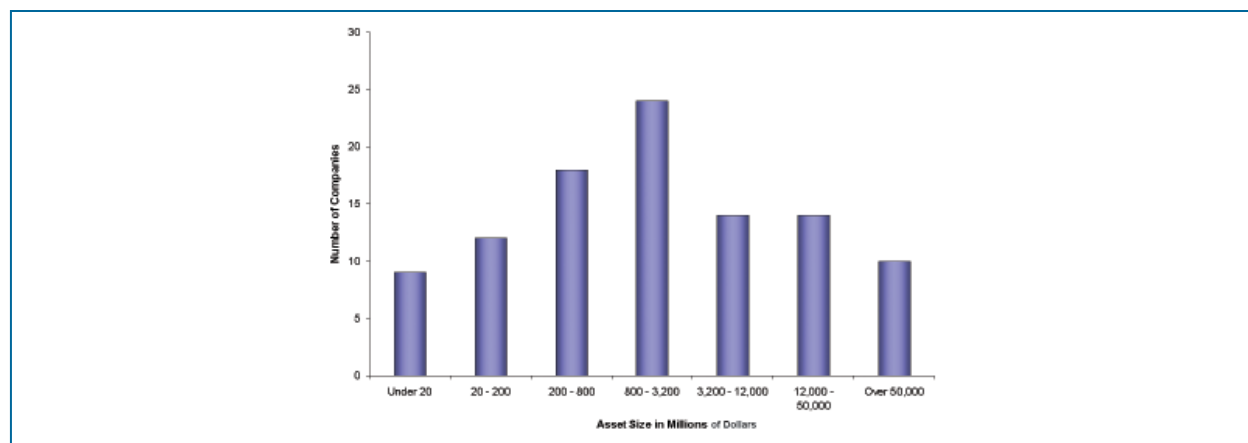


Figure 2: Survey Respondents by Asset Size

⁵ For the purpose of the survey a company is defined as a separate reporting entity to the NAIC. Agency companies or broker/dealer companies were not counted in the total.

⁶ Based on total life premiums of \$388.5 billion and assets of \$3.8 trillion as reported in the ACLI Life Insurers Fact Book 2004, which is based upon 2003 data.

4.3. Findings: Regulatory Expense

4.3.1. Overall Expense

Survey respondents identified a total of \$459 million in costs associated with regulation. This figure represents an aggregate total of both internal and external costs due to state department of insurance regulation. Respondents also identified \$31.6 million in lost opportunity costs, which are discussed in more detail in Section 4.4. When scaled to a total industry figure on the basis of the ratio of survey respondents' assets to overall industry assets, the equivalent costs are \$1.1 billion and \$76 million, respectively. These values are shown in **Table 2** along with values per in-force policy.

Category	Survey Values	Industry Scaled Values	\$/ In-Force Policy
Regulatory Costs	\$ 459,331,000	\$ 1,107,786,000	\$ 3.02
Lost Opportunity Costs	\$ 31,613,013	\$ 76,242,369	\$ 0.21
Total	\$ 490,944,013	\$ 1,184,028,369	\$ 3.22

Table 2: Overall Regulatory Expense

Although the regulatory cost identified in this study is only a fraction of the respondents' overall premium revenue, it is very significant when compared with insurers' overall operating costs. To put the regulatory expense in perspective, the study team compared the findings of this survey to an industry benchmark survey for life insurers' operations and IT expenses.⁷ The results are presented in **Figure 3**.

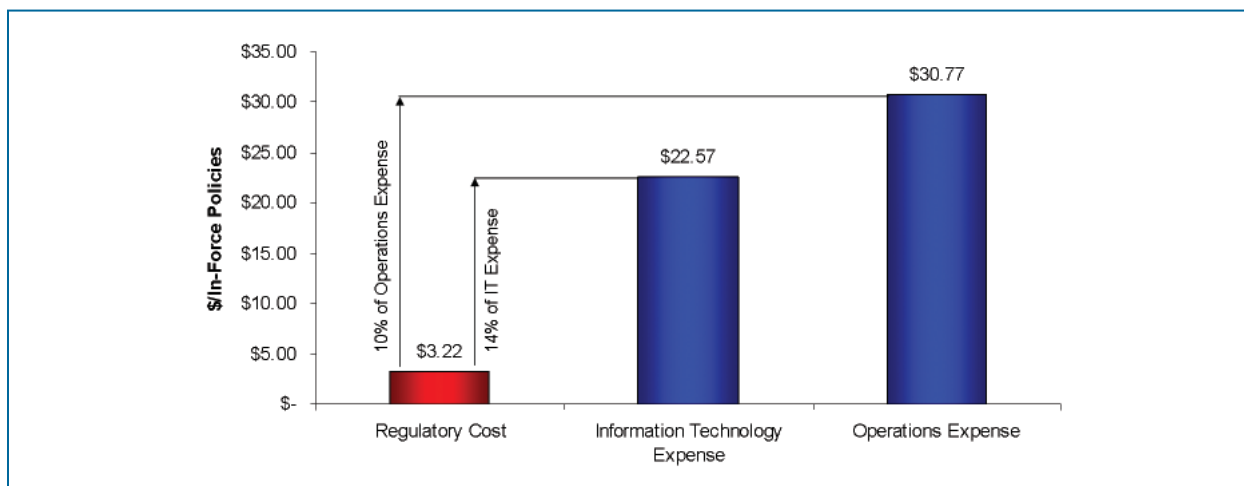


Figure 3: Regulatory Cost Comparison

Operations and IT expenses are typically areas in which insurers focus on expense control. Using the TCi study as a benchmark, the average insurer's regulatory cost represents approximately 14 percent of a typical insurer's information technology cost and 10 percent of operational expenses.

⁷ Benchmarking Study — Life Insurance Operations Expense Survey (LIONS) by TCi Consulting & Research, December 2004 — a benchmark analysis of nine life insurers' 2003 operations data. Several of the insurers in this study also participated in the ACLI-CSC survey. Although a similar study for annuity insurers was made, data was taken from the life insurance operations, as this represents the large majority of the policies reported on in this survey. Although the sample size is much smaller than the CSC-ACLI study, the LIONS study reports operations costs exclusive of overhead and is thus more representative of pure costs. IT and operations costs noted are for new business and customer service.

4.3.2. Expense for Key Life Insurance Functions

Table 3 presents the functional costs identified in the survey in addition to the industry-equivalent values based on asset size.⁸ Expenses are sorted by functional category, from largest to smallest.

Function	Total Survey Responses \$(000)	Industry Equivalent \$(000)
Information Technology	\$ 103,801	\$ 250,340
Product Development	\$ 99,938	\$ 241,026
Regulatory Fees and Charges	\$ 85,427	\$ 206,029
Producer Related	\$ 47,451	\$ 114,438
New Business	\$ 42,196	\$ 101,766
Reporting and Examination	\$ 26,989	\$ 65,089
Policy Service	\$ 20,723	\$ 49,979
Regulatory Staff and Branch Office	\$ 18,085	\$ 43,616
Claims Related	\$ 11,868	\$ 28,622
Regulatory Related Training	\$ 2,853	\$ 6,881
Subtotal	\$ 459,331	\$ 1,107,786
Lost Opportunity Cost	\$ 31,613	\$ 76,241
Total	\$ 490,944	\$ 1,184,027

Table 3: Regulatory Expense for Key Insurance Functions

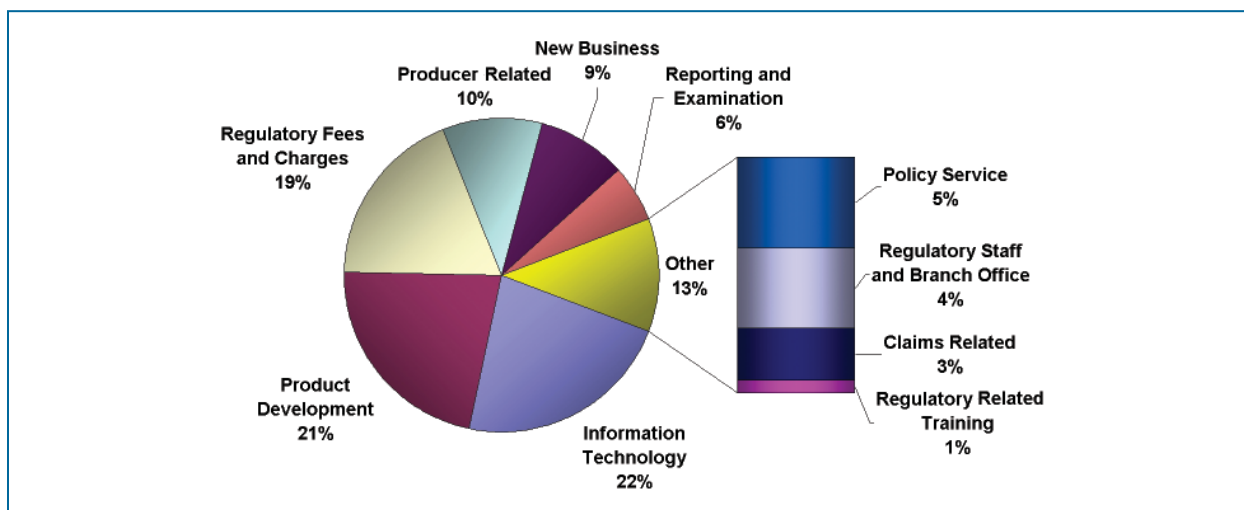


Figure 4: Regulatory Cost Components

Although regulatory fees and expenses — direct costs paid to state regulators and the NAIC — tend to be the most easily identified and visible, those costs represent less than 20 percent of the total reported cost of regulation. The overwhelming majority of the regulatory expense is indirect and is spread throughout the various service delivery functions that are part of an insurer’s normal course of business.

⁸ Based on a total life insurance industry asset size of \$3.805 trillion as reported in the ACLI Life Insurance Factbook for 2004.

The largest single regulatory expense category is IT. Survey respondents reported IT-related regulatory costs in excess of \$100 million, which represents an industry-equivalent cost of more than \$250 million — nearly one-fourth of all regulatory costs reported. IT and systems development serve as enablers of the insurer’s business and thus are reflective of costs elsewhere. The results also provide quantitative support for life insurance executives who commented in the focus groups on the difficulties in developing systems to capture information necessary for regulatory reporting.

Regulatory costs related to product development represented the second-highest category of regulatory expense, amounting to 22 percent of overall regulatory expenses reported in the survey. This category included regulatory cost attributable to product and forms design, filing, approval and product rollout costs. This represents a strong area of opportunity for reducing overall regulatory cost, either via the OFC effort or other means. The costs associated with regulatory reporting and examinations amounted to approximately 6 percent of the total reported costs of regulation, suggesting that efforts to standardize market conduct and solvency examinations may have limited effect on the industry’s overall cost of regulation.

4.3.3. Expense by Company Size

Regulatory cost data provided by the survey respondents generally correlated well with both asset size and reported premium of the company or group. This means that smaller companies tend to have lower regulatory costs than larger ones. In order to quantify the impact, the study team calculated the average per-policy cost of regulation for three company asset size ranges.⁹

Asset Size Range	Total In-Force Count	Regulatory Cost per In-Force Policy
Less than \$2 billion	3,548,861	\$ 4.54
\$2 billion - \$50 billion	58,443,926	\$ 3.80
Over \$50 billion	90,315,322	\$ 2.80
	152,308,109	\$ 3.22

Table 4: Regulatory Cost¹⁰ per Policy vs. Company/Group Size

The averages show a strong trend in per-policy regulatory cost although it should be noted that there is considerable variation between individual companies and groups within the same size category. This is likely due to the variation in policy types between companies, since it is generally more expensive to develop, sell and service more complex products such as long-term care or disability income versus products such as term insurance. Individual companies in the survey had different product mixes.

⁹ Selection of the small range was chosen to correspond to the size category of ACLI Forum 500 members. Other categories were chosen to make the number of respondents in the medium and large categories roughly equivalent.

¹⁰ Includes Lost Opportunity Cost identified by survey participants.

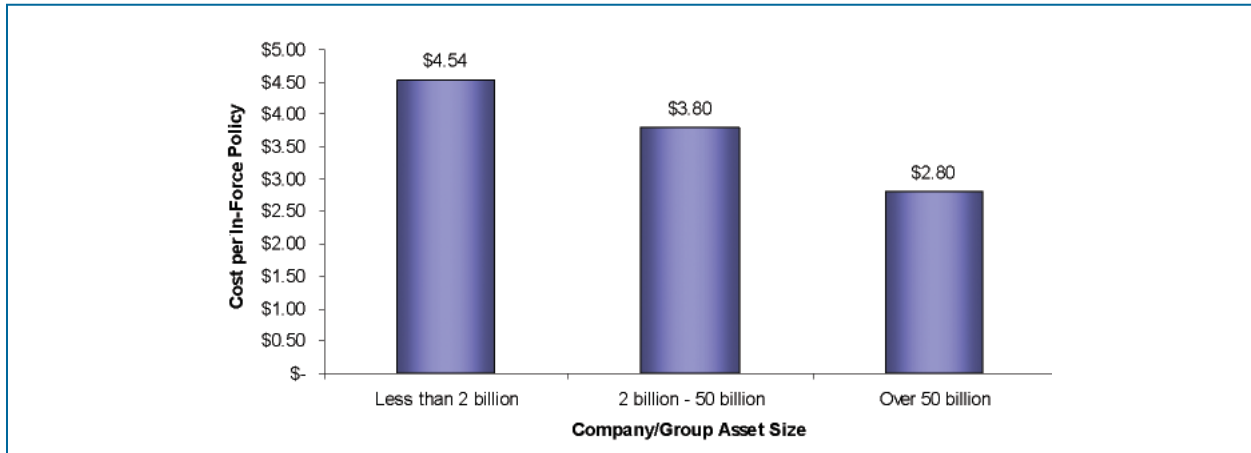


Figure 5: Per-Policy Regulatory Cost by Size Group

4.3.4. Opportunity for Improvement

For each cost category, the study team asked for an estimate of the percentage of the regulatory cost reported that is required to satisfy multiple state insurance department regulations versus those of a single jurisdiction. This question targeted two primary sources of regulatory cost noted during interviews: redundancy and lack of uniformity. **Table 5** presents aggregated results across all cost categories as both survey and industry-scaled results.

Category	Survey Values	Industry Scaled Values
Regulatory Cost	\$ 459,331,000	\$ 1,107,786,000
State-Specific Regulatory Cost	\$ 253,532,000	\$ 611,453,000
Potential Single Regulator Cost	\$ 205,799,000	\$ 496,333,000
Potential Savings		55%

Table 5: Opportunity for Improvement

Survey participants identified more than \$253 million in costs directly related to dealing with multiple regulatory jurisdictions.

This amount represents 55 percent of the total regulatory cost identified, which indicates that in the long run, survey participants indicated that under a single regulatory jurisdiction, their regulatory cost would be reduced by more than half.

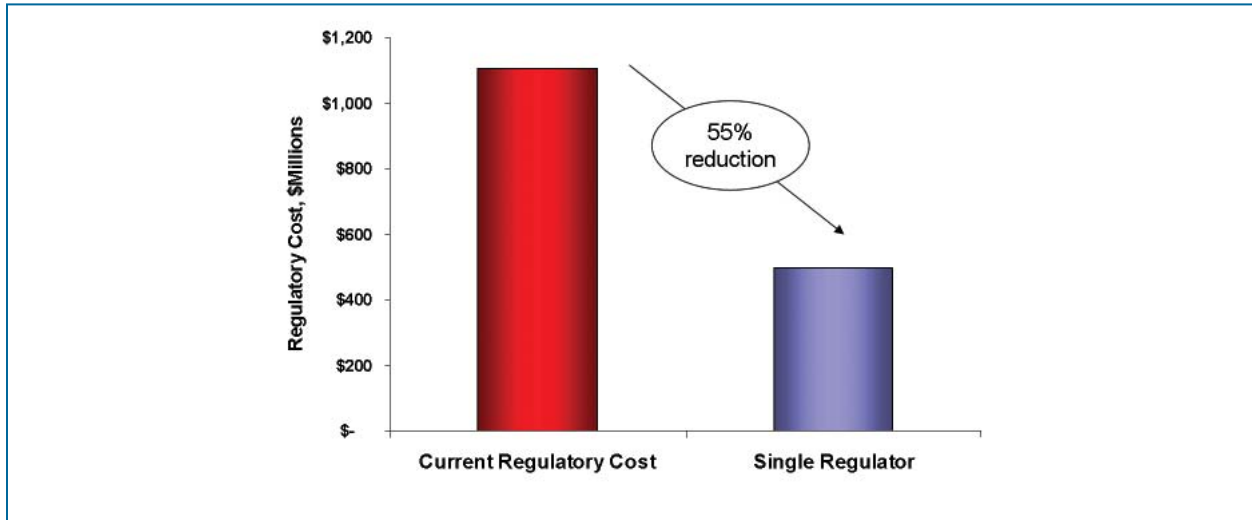


Figure 6: Opportunity for Improvement — Industry Equivalent Costs

Figure 7 provides a comparison of aggregated multi-state costs on a per-policy basis by various company sizes. Even though the overall cost per policy differs across the groups, the potential for savings is roughly the same.

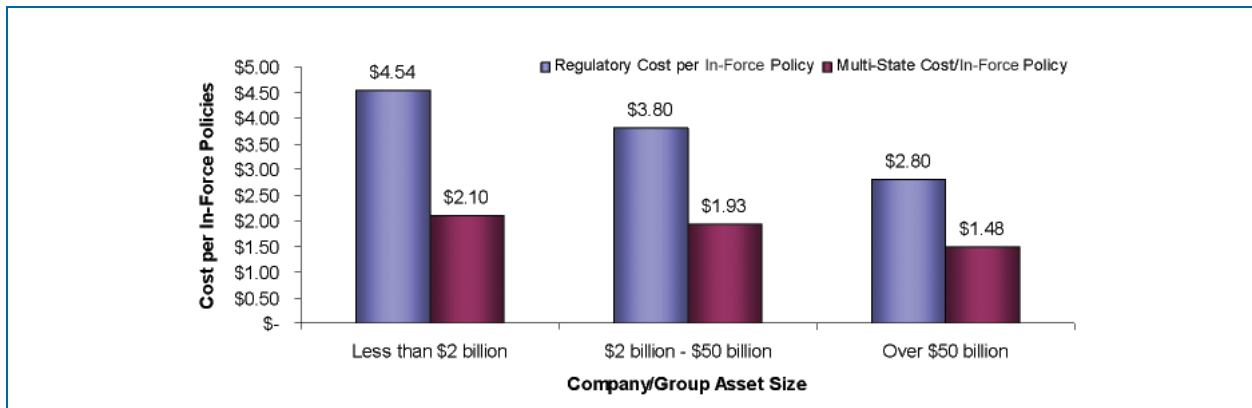


Figure 7: State-Specific Cost by Insurer Size

Table 6 provides a breakdown of state-specific regulatory cost by function for survey respondents and an industry-equivalent value. State-specific expenses for information technology represent the highest overall cost. Combined with state-specific regulatory fees, the second highest, these two categories represent almost half of the state-specific costs identified.

Function	Total Survey Responses	Industry Equivalent	Percent
	\$(000)	\$(000)	
Information Technology	\$ 59,625	\$ 143,801	24%
Regulatory Fees and Charges	\$ 58,157	\$ 140,261	23%
Product Development	\$ 47,013	\$ 113,384	19%
Producer Costs	\$ 25,294	\$ 61,003	10%
New Business	\$ 18,062	\$ 43,562	7%
Reporting	\$ 13,918	\$ 33,568	5%
Branch Office	\$ 13,881	\$ 33,478	5%
Policy Service	\$ 9,866	\$ 23,794	4%
Claims	\$ 5,206	\$ 12,555	2%
Training	\$ 2,508	\$ 6,048	1%
Grand Total	\$ 253,532	\$ 611,453	100%

Table 6: State-Specific Regulatory Cost by Function

Figure 8 shows the overall potential savings on an industrywide basis by function.

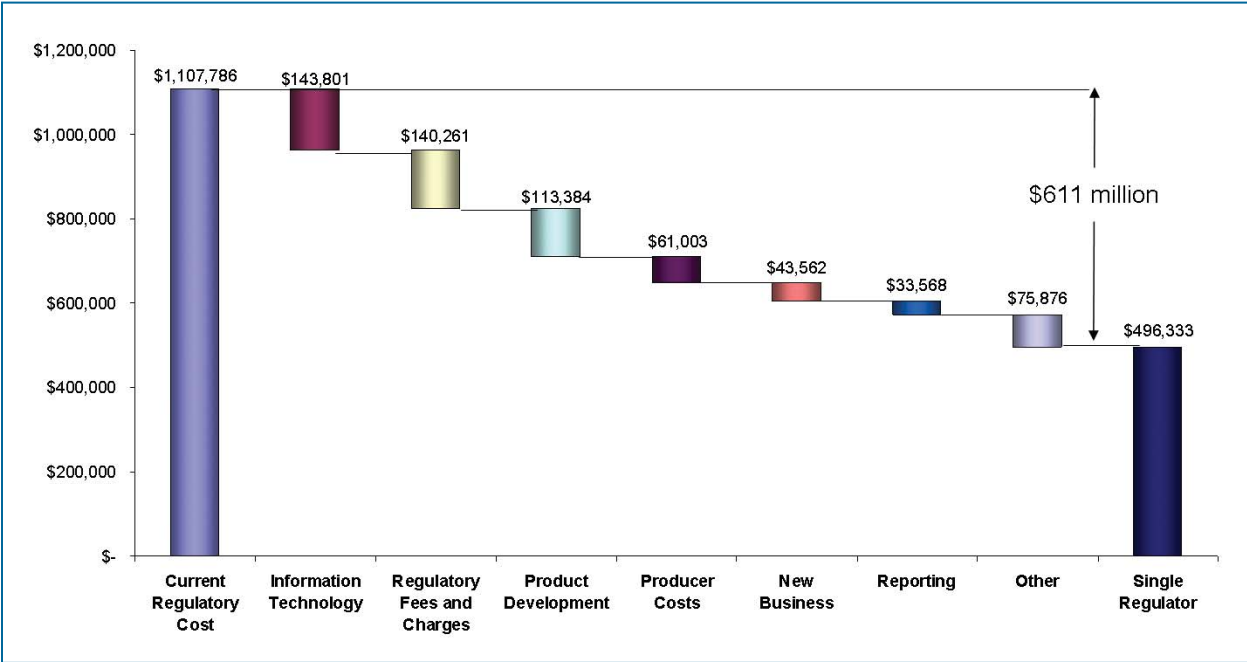


Figure 8: Potential Savings by Function

4.4. Findings: Lost Opportunity

Besides direct regulatory fees and internal costs, interview participants identified several categories that did not represent dollars actually spent or received but costs that could have been avoided in that year — if the regulatory process had been timelier. The questions pertained to both costs that could have been avoided and premium income that was either deferred or completely lost. Although this entire category can only be quantified subjectively, it does represent the potential value of improving regulatory turnaround — especially around the approval of new insurance products.

The survey asked questions in four specific areas about lost opportunity costs based upon what those interviewed told us:

- **Lost Value of Organizational Streamlining** – Identify lost expense savings associated with delays in securing state regulatory approval for expense-reducing initiatives, such as streamlining operations across multiple states or streamlining operations as part of demutualization.
- **Lost Value of Consolidation** – Identify deferred cost savings arising from delays in exchange or consolidation of corporate entities due to delays in state regulatory approval.
- **Other Lost Opportunity Costs** – Survey participants were asked to identify any other lost revenue or deferred cost savings associated with state-specific regulatory approval that does not fit any of the other categories.
- **Lost Premium Income** – Estimate any deferred or lost premium income associated with delays in securing state regulatory approval for new products or product variations.

Survey participants identified \$31.6 million in lost opportunity cost, which represents a total of \$76.2 million on an industry-equivalent basis. This is less than 7 percent of the costs identified in other areas. **Table 7** shows a breakdown of cost by survey category.

Category	Total Survey Responses \$(000)	Industry Equivalent \$(000)	Percent
Lost Value of Streamlining	\$ 11,907	\$ 28,716	38%
Lost Value of Consolidation	\$ 2,700	\$ 6,512	8%
Other Lost Opportunity Costs	\$ 17,006	\$ 41,014	54%
Totals	\$ 31,613	\$ 76,242	100%

Table 7: Lost Opportunity Cost

By far, survey respondents indicated the largest area of lost opportunity lies in lost or deferred premium income resulting from regulatory delays or difference in regulation across states. On an industry-equivalent basis, the survey respondents indicated that more than \$2 billion in income was either lost or deferred due to regulatory delays or differences. The results are shown in **Table 8** by company size range. By far, the largest portion of the losses was reported by large insurers — almost 80 percent. However, as a percent of new premium for those respondents citing losses, the lost premium income is largest for the small insurer group. It should be noted that this percentage is approximate only, as the survey did not ask respondents to identify total new premium income.¹¹

Asset Size Range	Total Survey Responses \$(000)	Industry Equivalent \$(000)	Approximate Percent of 2003 New Premium
Less than \$2 billion	\$ 12,180	\$ 29,327	15%
\$2 billion - \$50 billion	\$ 162,575	\$ 392,089	3%
Over \$50 billion	\$ 667,546	\$ 1,609,947	8%
Totals	\$ 842,281	\$ 2,031,363	6%

Table 8: Lost Premium Income

¹¹ Survey respondents were asked to provide new policies written by policy type as well as in-force premium and policies for each policy type. It was thus possible to create an approximate dollar value of new premium income based on prior per-policy premium and new policies written. The value is approximate only as per-policy premium in prior years and may not be representative of the premium for new policies written.

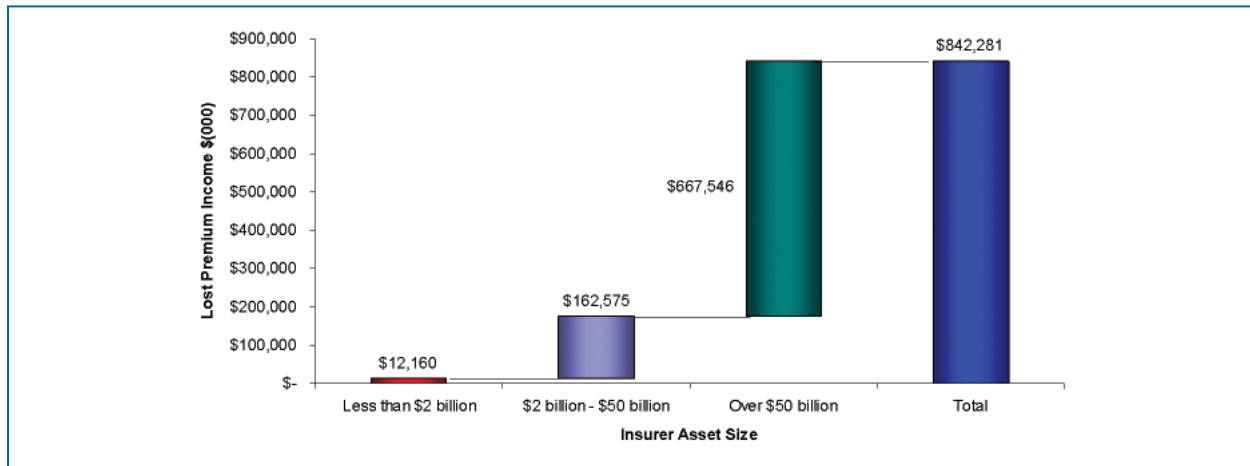


Figure 9: Lost Premium Income by Insurer Asset Size

Many survey respondents provided specific reasons or situations that drove the lost premium income they identified. Most of the reasons provided fell into one of three classes:

- 1) Delays in receiving approval of new products in selected states, especially for innovative new products, resulting in lost premium
- 2) Delays in product launch resulting from implementation of state-specific product requirements and forms to allow a full nationwide product launch
- 3) Premium income losses in states where approval for a specific product or product class was not obtained.

4.5. Additional Survey Results

Although the primary purpose of the survey was to gather quantitative cost data, the study team also asked a number of questions to help understand the results.

To better understand the items that drive regulatory costs within product development, the survey included questions concerning the variety of state-specific products that insurers tend to develop as well as questions concerning regulatory turnaround.

In the authors' experience, the number of versions of a product that must be developed and maintained as long as policies remain in force is a significant cost driver. Multiple versions require labor to develop and time to code into systems that will be used to sell and service the product on an ongoing basis. Respondents were asked how often state or region-specific products were created for a specific product during the product development process. Respondents who answered yes were asked how many variations were typically developed.

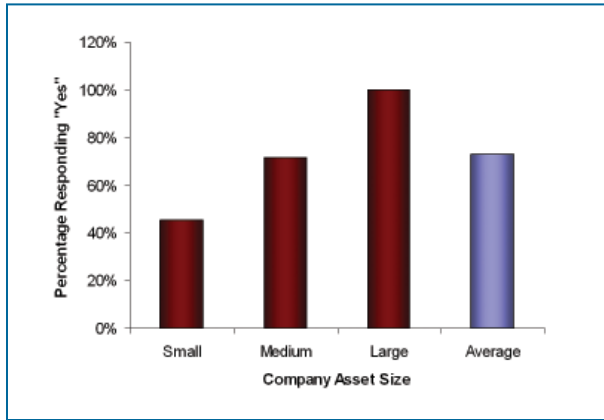


Figure 10: Do You Create State-Specific Products?

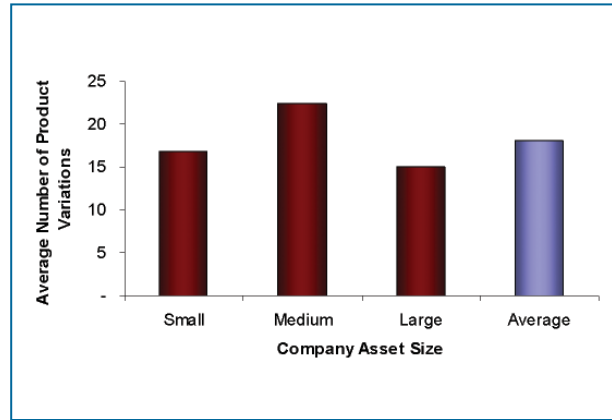


Figure 11: How Many Variations?

Overall, 73 percent of respondents answered yes to the former question, with the average number of product variations being 18. A breakdown by company size is shown in **Figure 10** and **Figure 11**.

Figure 12 provides a breakdown by product type.

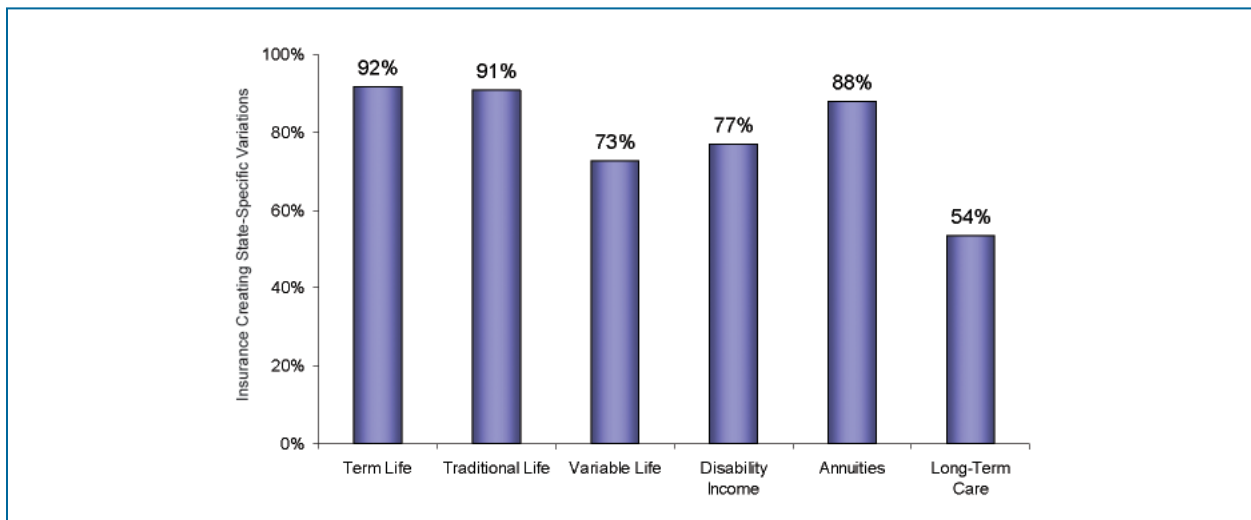


Figure 12: Variations by Product Type

The study team also asked respondents to identify the incremental cost associated with product variations within general ranges from very small to significant. The majority of respondents said costs were either moderate or significant and nearly half identified the incremental cost as being significant. **Figure 13** provides a breakdown of the answers received.

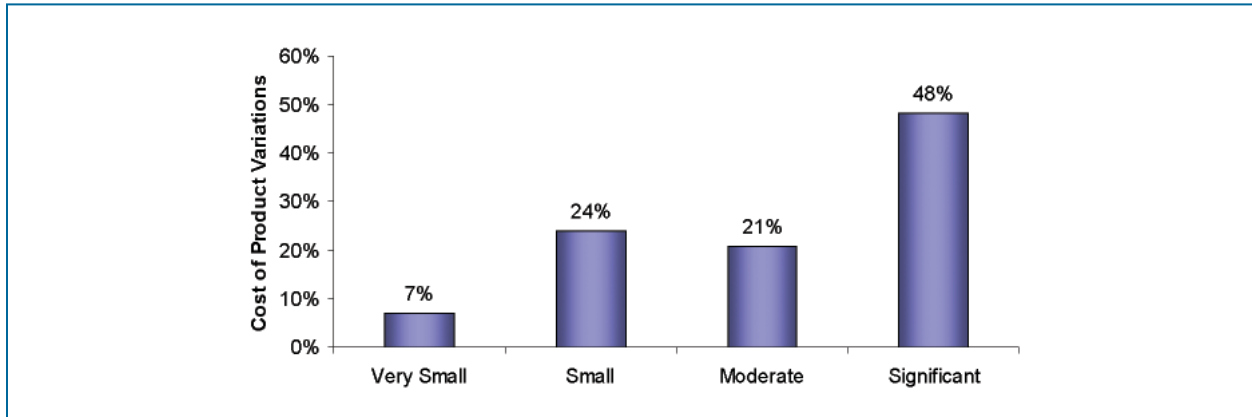


Figure 13: Incremental Cost of Product Variations

During focus groups, participants discussed experiences with delays in approval and new product initiatives that were shelved due to the regulatory process. The survey included two questions to see how widespread the difficulties are. Results are provided in **Figure 14** and **Figure 15**.

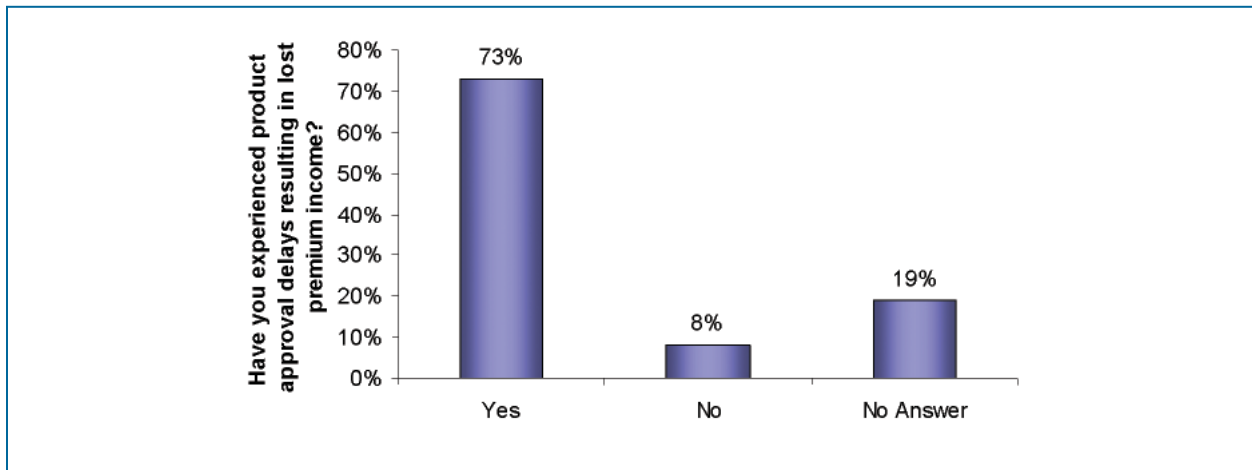


Figure 14: Delays Resulting in Lost Premium

Results from the survey generally confirmed what the study team heard during interviews and focus groups. A total of 73 percent of the survey respondents indicated they have experienced delays in obtaining product approval. In addition, 83 percent of respondents reported that they had deferred or shelved products due to the regulatory process.

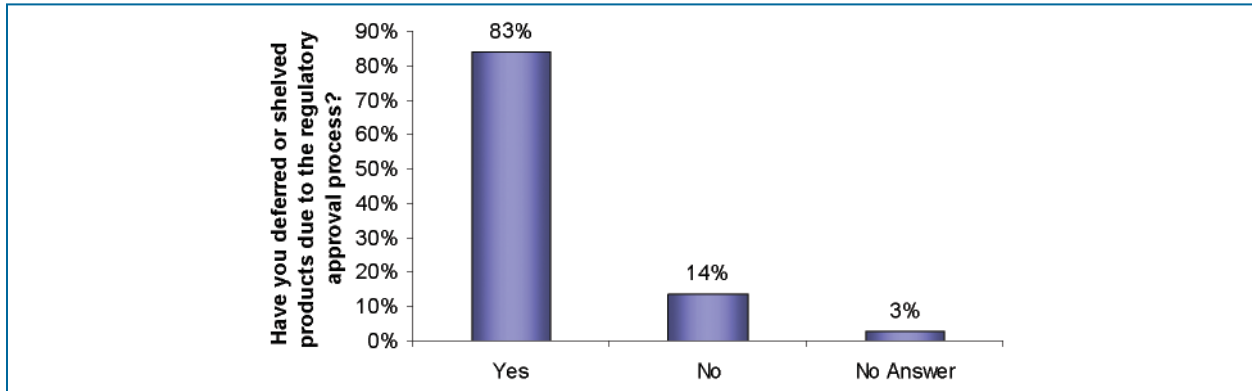


Figure 15: Product Deferrals from Regulation

More than 97 percent of respondents indicated that state-specific costs would be reduced “if the process of getting approval in multiple states could be streamlined.”

Having analyzed a number of new business and policy service operations, the study team knew that such functions are often organized around specific states or regions, requiring a more complex organization that tends to drive additional cost into the policy sales and servicing processes. For new business, however, the team knew many insurers organized around state lines as a way to service their agents more effectively. The study team wanted to know how many insurers organized around states or regions due to regulation differences.

For new business, 38 percent of survey participants indicated they do have specific groups for servicing states or regions. Of those who responded affirmatively, more than half indicated they are organized this way at least in part because of differences in regulation. Details are shown in **Figure 16** and **Figure 17**.

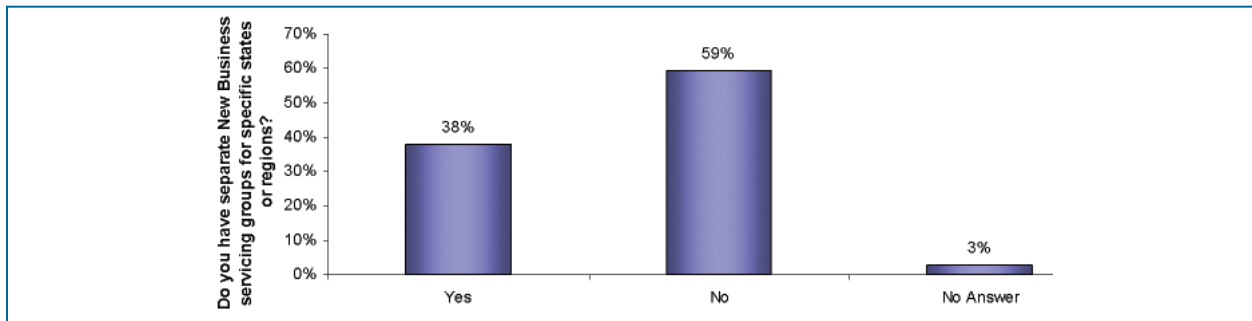


Figure 16: State-Specific New Business Organizations

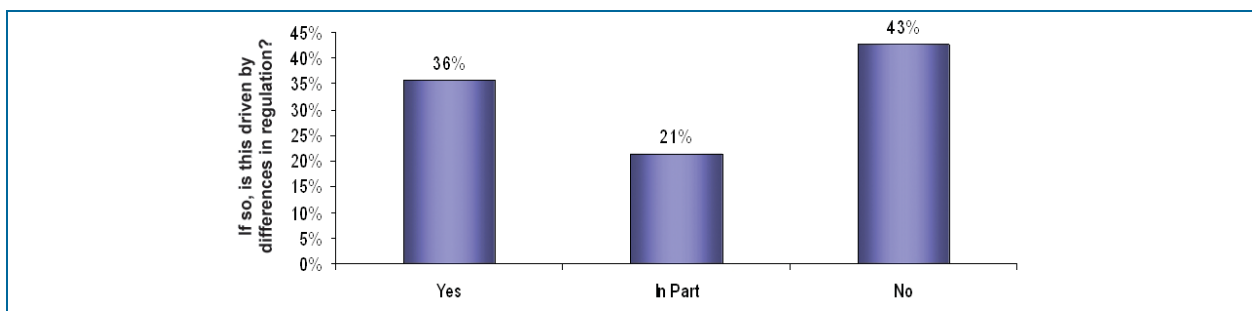


Figure 17: Is the New Business Organization Driven by Regulation?

Only 11 percent of survey respondents indicated they have specific policy service groups for states or regions. Of the 11 percent, roughly half stated that the reason for organizing by state was regulation. This correlates with quantitative findings on cost of regulation. Overall, state-specific regulatory cost identified by respondents for policy service was 55 percent of the state-specific regulatory cost for new business. Results are shown in **Figure 18** and **Figure 19**.

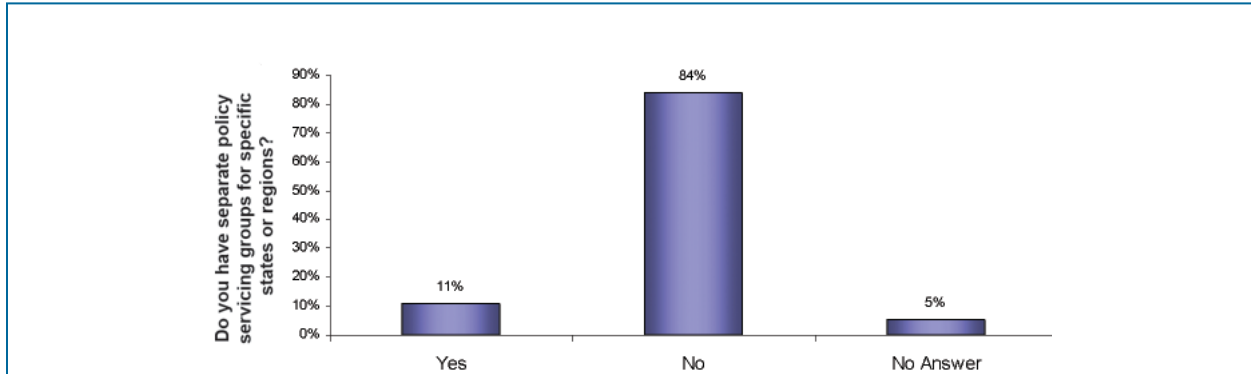


Figure 18: State-Specific Policy Service Organizations

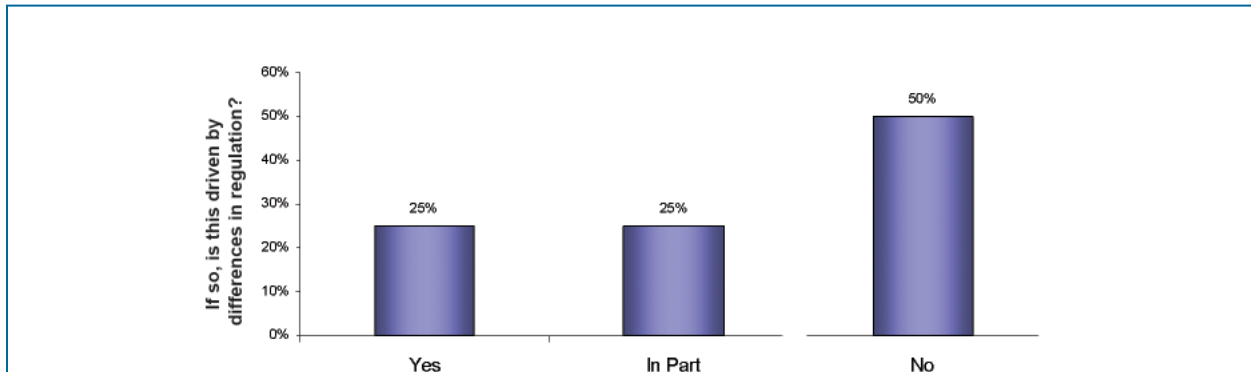


Figure 19: Is the Policy Service Organization Driven by Regulation?

Finally, the study team asked if the survey participants have regional offices to satisfy specific state requirements. Nineteen percent of respondents indicated that they do, reporting an average of about two remote branches. New York was mentioned most frequently as requiring an “office of significance.” Of the respondents reporting a regional office to satisfy state requirements, 29 percent said that they would consider relocating the office under an Optional Federal Charter.

5. Conclusions on the Impact of an OFC

5.1. Ramifications for Life Insurance Carriers

The ACLI and CSC believe the survey findings provide the quantitative justification for selected conclusions regarding an OFC, as follows:

1. **Regulatory cost is a major part of a life insurer's cost structure.** Outside regulation of participants in an industry typically results in some increase in the insurer's cost structure, and the added value to the industry stakeholders (e.g., consumers and industry participants) should offset the cost of regulation. ACLI and CSC are not suggesting regulatory cost does not add value. The survey findings indicate industrywide state regulation cost exceeds \$1.1 billion annually, and these expenses are significant when compared to other elements of the insurer's operating cost structure. In addition, survey data indicates regulatory cost is encountered throughout the insurer's service delivery chain, beginning with product creation and ending with claims payment.
2. **A life insurance carrier operating under an OFC has the opportunity to significantly reduce regulatory costs.** A life insurer opting for a single point of regulation addresses two of the key drivers of regulatory cost outside of the regulatory requirements themselves: dealing with multiple regulatory jurisdictions and with non-uniform laws and regulations. Survey results indicate that on the average a 55 percent reduction in regulatory cost was the improvement potential. The detailed results indicate that not all of this cost reduction would appear immediately. For instance, the carrier may continue to pay claims using the regulatory provisions that applied when a policy was sold, which would limit cost reductions in the claims process. However, the product development, producer relations and new business functions taken together account for over one-third of the opportunity, and these opportunities should be able to be captured relatively quickly. IT costs tend to follow the business processes that they support, and ACLI and CSC expect a portion of this improvement could also be readily addressed.

Industrywide state regulation cost exceeds \$1.1 billion annually ... survey data indicates regulatory cost is encountered throughout the insurer's service delivery chain, beginning with product creation and ending with claims payment.

Faster time to market would not only benefit life insurance carriers ... it also would benefit consumers by making a wider variety of products available.

3. **Industrywide regulatory cost should not increase under an OFC.** Under the model legislation as it stands currently, the cost of the federal regulator would be borne by the regulated life insurance carriers. This would introduce additional cost into the system. The ACLI and CSC study did not attempt to estimate the cost of a new federal regulatory program. However, data from the survey respondents indicates that direct fees to regulators represented less than 25 percent of their compliance cost. The added fee-based cost of a federal regulator is not likely to offset the aggregated value of improvement opportunities seen elsewhere.
4. **Uniform Product Approval and Producer Certification Rules have the most impact.** Survey respondents indicated an opportunity of \$174 million in cost savings for product development and producer-related costs on an industrywide basis, representing approximately 30 percent of the total costs surveyed. In terms of cost, this would make the uniform product and producer sections of the OFC model legislation, as well as the file and use product provision, key provisions of the proposal.
5. **Under an OFC, the level of competition for the consumer's insurance dollar will increase.** On an industry-equivalent basis, the survey respondents indicated that more than \$2 billion annually — \$20 billion over 10 years — in income was either lost or deferred due to regulatory delays or differences. This is an indicator of how an OFC has the potential to change the competitive field for a life insurer. Faster time to market would not only benefit life insurance carriers by increasing the potential for premium income, but it also would benefit consumers by making a wider variety of products available.

6.1. Survey Description

The findings presented in Section 4 of this document were compiled from a survey entitled “Life Insurer Impact of an Optional Federal Charter” sent to a population of 218 life insurance companies on November 16, 2004. The survey asked questions concerning the participants’ actual expenses in a series of 10 major cost categories, each broken down into one or more sub-categories. Cost categories and sub-categories are outlined in **Table 9**.

The survey participants were instructed to report two data items for each area listed in the table:

- The 2003 regulatory expenses for each cost area, including all fees, charges or other payments to state insurance departments and the NAIC, and state assessments to support insurance regulation. Premium taxes were excluded as well as costs associated with federally mandated regulations such as the Sarbanes-Oxley Act.
- The percentage of the 2003 regulatory expense required to satisfy multiple jurisdictions and regulations.

For each cost category, an “Other Cost” question was included to ensure that all regulatory costs for that question were being captured.

Since most life insurance companies do not capture the detailed cost information requested in the survey, a method for determining the reliability of the “estimated” costs in each category was determined. Companies were asked to rate their degree of precision for each answer: “based on actual expenses,” “pro-rated from total expenses” and “estimate based on professional judgment.” This degree of precision ranking also was captured for the “estimated” percent of regulatory costs required to satisfy multiple jurisdictions and regulations. In addition to direct and indirect costs incurred due to regulation, the Lost Opportunity Costs category was designed to address areas where the current regulatory environment creates possible opportunities for lost revenue, market penetration or cost savings. The survey also included certain demographic questions for analysis and segmentation of the results.

Table 9: Survey Question Categories and Sub-Categories

Regulatory Related Fees	
Company License Fees and Charges	<i>Fees/charges paid to all state insurance departments to renew or maintain certificates of authority</i>
Producer Fees and Charges	<i>Fees/charges paid to all state insurance departments to license producers</i>
Product Approval Fees and Charges	<i>Fees/charges paid to all state insurance departments to file forms related to product approval</i>
Market Conduct Examination Fees and Charges	<i>Fees/charges paid to all state insurance departments or their designee related to market conduct examinations</i>
Financial Solvency Examination Fees and Charges	<i>Fees/charges paid to all state insurance departments or their designee related to financial solvency examinations</i>
Annual Financial Statement Filing Fees and Charges	<i>Fees/charges paid to all state insurance departments to file an Annual Financial Statement</i>
Advertising and Brand Image Development Costs	
Advertising Material Approval	<i>Internal (staff or other) costs and external costs (such as attorney fees) related to state-specific regulatory review and approval of advertising material, marketing kits, etc.</i>
DOI-Associated Costs for Branding or Name Changes	<i>State regulatory related costs associated with change of corporate identity, name or branding if any such effort was performed in 2003</i>
Product Development Related Costs	
Product Development and Forms Design	<i>Internal (staff and other) costs and external costs (such as actuarial consulting) for state-specific product development, rate development and forms design</i>
Product Filing and Approval	<i>Internal (staff and other) costs and external costs for managing product filings in each state and costs for maintaining state-specific policy forms</i>
Product Rollout	<i>Internal (staff and other) costs and external costs (such as forms and marketing materials) for managing product rollout to distributors and customers and costs for maintaining state-specific product rollout materials</i>
Producer Related Costs	
Producer Training/Certification	<i>Internal (staff and other) costs and external costs for managing and tracking state-specific producer training and certification and costs for maintaining any state-specific producer training materials</i>
Producer Licensing	<i>Internal (staff and other) costs and external costs for managing and tracking producer state licenses and compliance with state licensing guidelines</i>
Producer Appointment	<i>Internal (staff and other) costs and external costs for managing and tracking producer state appointments and compliance with state appointment guidelines</i>
Producer Termination and/or Vesting	<i>Internal (staff and other) costs and external costs for managing and tracking state-specific producer termination and vesting rules</i>

Information Technology Related Costs	
Compliance Tracking	<i>Internal (labor and other IT costs) as well as external costs (contractor and vendor expenses, license fees, etc.) related to systems utilized for tracking compliance to state-specific regulatory rules</i>
Regulatory Reporting	<i>Internal (labor and other IT costs) as well as external costs (contractor and vendor expenses, license fees, etc.) related to systems utilized for state-specific regulatory reporting</i>
Product Development	<i>Internal (labor and other IT costs) as well as external costs (contractor and vendor expenses, license fees, etc.) related to systems utilized for state-specific variations in systems to support product development, such as policy system modifications to support state-specific variations</i>
Policy System Maintenance	<i>Internal (labor and other IT costs) as well as external costs (contractor and vendor expenses, license fees, etc.) for supporting state-specific regulatory requirements in your policy administration system</i>
New Business Related Costs	
Suitability Review	<i>Internal (staff and other) costs and external costs (such as forms) for managing state-specific suitability review, compliance with state-specific suitability rules and costs for maintaining state-specific suitability forms</i>
New Business Requirements	<i>Internal (staff and other) costs and external costs (such as forms) for managing state-specific requirements (medical, non-medical and delivery requirements) and authorizations for requirements and compliance with state-specific requirement rules</i>
Forms	<i>Internal (staff and other) costs and external costs (such as forms) for managing state-specific applications, policy forms, amendments, endorsements and other forms</i>
Replacements	<i>Internal (staff and other) costs and external costs for managing state-specific replacement review, compliance with state-specific replacement rules and costs for maintaining state-specific replacement logs/reports</i>
Policy Service Related Costs	
Complaint Logs	<i>Internal (staff and other) costs and external costs for managing state-specific complaint review, compliance with state-specific complaint rules and costs for maintaining state-specific complaint logs/reports</i>
Annual Statements and Confirmations	<i>Internal (staff and other) costs and external costs for managing state-specific annual statement and confirmation formats and requirements</i>
Third-Party Lapse Notifications	<i>Internal (staff and other) costs and external costs for managing and producing state-specific third-party lapse notifications</i>
Illustrations and Rejections	<i>Internal (staff and other) costs and external costs for managing state-specific illustration and rejections formats and requirements</i>
Loan Interest	<i>Internal (staff and other) costs and external costs for managing state-specific loan interest requirements</i>
Surrenders	<i>Internal (staff and other) costs and external costs for managing state-specific surrender charge provisions</i>
Free Look	<i>Internal (staff and other) costs and external costs for managing state-specific free-look provisions</i>

Claims Related Costs	
Interest on Claims Proceeds	<i>Internal (staff and other) costs and external costs for managing state-specific interest on claims proceeds rules and calculations</i>
Claims Procedures	<i>Internal (staff and other) costs and external costs for managing state-specific claims guidelines for premium refund provisions, suicide provisions and unfair claims settlement guidelines</i>
Claims Fraud Reporting	<i>Internal (staff and other) costs and external costs for maintaining state-specific requirements for reporting incidents of claims fraud</i>
Reporting and Examination Costs	
Regulatory Reporting	<i>Internal (staff or other) costs and external costs (such as outside consulting firm or outside counsel fees) related to the preparation of state-specific regulatory reporting</i>
Market Conduct Examinations	<i>Internal (staff or other) costs and external costs (such as outside accounting firm or outside counsel fees) related to any market conduct examination by a state insurance regulator</i>
Financial Solvency Examinations	<i>Internal (staff or other) costs and external costs (such as outside accounting firm or outside counsel fees) related to any financial solvency examination by a state insurance regulator</i>
Regulatory Related Staff Training Costs	
State Insurance Related Training Costs	<i>Internal (staff or other) costs and external costs (such as outside consulting firm or outside counsel fees) related to all training programs required by state laws</i>
Regulatory Staff and Branch Office Costs	
State-Specific Regulatory Staff	<i>Internal (staff or other) costs and external costs (such as attorney fees) related to state-specific regulation not included elsewhere in the survey</i>
State Expansions	<i>Cost related to procure additional certificates of authority or shell companies in order to operate in additional states</i>
State of Domicile Changes	<i>State regulatory related costs arising from change of state of domicile</i>
Cost of State Branch Offices	<i>The cost of state branch offices maintained solely for regulatory reasons</i>
Lost Opportunity Costs	
Lost Premium Income	<i>Estimate any deferred or lost premium income associated with delays in securing state regulatory approval for new products or product variations</i>
Lost Value of Streamlined Organization	<i>Estimate any lost expense savings associated with delays in securing state regulatory approval for expense-reducing initiatives, such as streamlining operations across multiple states or streamlining operations as part of demutualization</i>
Lost Value of Consolidation	<i>Deferred cost savings arising from delays in exchange or consolidation of corporate entities due to delays in state regulatory approval</i>

6.2. Prior Research

During the initial phases of this project three prior publications were identified that presented quantitative findings on the economic benefits of an Optional Federal Charter. Each publication is listed below along with a short synopsis. Further information can be found by consulting the original text of the publication.

1. **“Efficiency Implications of Alternative Regulatory Structures for Insurance,”** Martin F. Grace and Robert W. Klein, 2000. The authors present an analysis of NAIC Annual Statement data for both the property/casualty and the life/health insurance industries. They conclude that “potential savings could be achieved from delegating market regulatory functions to a federal entity.” They also present a very rough estimate of compliance costs to the industry at \$4.5 billion.
2. **“Economic Assessment of Optional Federal Chartering for the Life Insurance Industry,”** American Council of Life Insurers, September 2001. This publication presents results of a survey of 15 life insurance carriers conducted in May 2001. The regulatory costs for a typical life insurer with \$4 billion in life premiums and annuity considerations were estimated at \$21 million annually. The survey also asked respondents to estimate the cost of complying with a federal regulator modeled after the regulator in their state of domicile. Based on the response of 10 companies, the average expected decrease in compliance costs was 32 percent.
3. **“Consumer Ramifications of an Optional Federal Charter for Life Insurers,”** Sheila Bair, University of Massachusetts Isenberg School of Management, March 2004. This report provides an analysis of a life insurer survey conducted in 2003 as well as the results of surveys and interviews with life insurers and state regulators, consumer groups and the NAIC. The publication reported overall regulatory costs of \$2.56 per policyholder and aggregate industrywide costs of \$961,120,648. Potential savings from a single federal regulator, based on a proxy of home state regulatory costs, was reported as \$1.76 per policyholder.

6.3. Additional Survey Results

This section includes more detailed findings taken from the survey. The data are presented for each major cost category. All amounts are as reported by the survey participants and are in thousands, rounded to the nearest thousand (see **Table 10**).

Area	Function	Current Regulatory Cost	State-Specific Regulatory Cost	Single Regulator Potential
Regulatory Related Fees	Company License Fees and Charges	\$ 3,524	\$ 3,142	\$ 382
	Producer Fees and Charges	\$ 41,674	\$ 31,787	\$ 9,887
	Product Approval Fees and Charges	\$ 2,023	\$ 1,729	\$ 294
	Market Conduct Examination Fees and Charges	\$ 5,777	\$ 4,666	\$ 1,120
	Financial Solvency Examination Fees and Charges	\$ 9,631	\$ 1,124	\$ 8,508
	Annual Financial Statement Filing Fees and Charges	\$ 7,444	\$ 3,941	\$ 3,502
	Other Insurance Regulatory Fees and Charges	\$ 15,355	\$ 11,779	\$ 3,576
Advertising/Brand Image Development Costs	Advertising Material Approval	\$ 11,326	\$ 5,995	\$ 5,331
	DOI-Associated Costs for Branding or Name Changes	\$ 329	\$ 241	\$ 88
	Other Advertising or Forms Related Costs	\$ 1,019	\$ 561	\$ 457
Product Development Related Costs	Product Development and Forms Design	\$ 38,732	\$ 16,359	\$ 22,374
	Product Filing and Approval	\$ 17,523	\$ 11,484	\$ 6,038
	Product Rollout	\$ 28,186	\$ 9,994	\$ 18,192
	Other Product Development-Related Costs	\$ 2,824	\$ 2,379	\$ 445
Producer Related Costs	Producer Training/Certification	\$ 6,197	\$ 2,361	\$ 3,836
	Producer Licensing	\$ 12,268	\$ 7,662	\$ 4,606
	Producer Appointment	\$ 21,729	\$ 11,327	\$ 10,402
	Producer Termination and/or Vesting	\$ 4,505	\$ 2,602	\$ 1,904
	Other Producer Related Costs	\$ 2,751	\$ 1,342	\$ 1,409
Information Technology Related Costs	Compliance Tracking	\$ 7,963	\$ 5,714	\$ 2,250
	Regulatory Reporting	\$ 3,665	\$ 2,758	\$ 908
	Product Development	\$ 28,016	\$ 15,989	\$ 12,026
	Policy System Maintenance	\$ 55,455	\$ 27,007	\$ 28,448
	Other IT Costs	\$ 8,702	\$ 8,158	\$ 544
New Business Related Costs	Suitability Review	\$ 14,488	\$ 1,448	\$ 13,040
	New Business Requirements	\$ 6,405	\$ 4,698	\$ 1,707
	Forms	\$ 12,509	\$ 6,077	\$ 6,432
	Replacements	\$ 7,687	\$ 5,256	\$ 2,431
	Other New Business Related Costs	\$ 1,107	\$ 583	\$ 524
Policy Service Related Costs	Complaint Logs	\$ 4,116	\$ 2,454	\$ 1,663
	Annual Statements and Confirmations	\$ 3,946	\$ 1,491	\$ 2,455
	Third-Party Lapse Notifications	\$ 1,433	\$ 625	\$ 808
	Illustrations and Rejections	\$ 4,004	\$ 1,807	\$ 2,197
	Loan Interest	\$ 1,570	\$ 724	\$ 846
	Surrenders	\$ 2,674	\$ 947	\$ 1,728
	Free Look	\$ 1,531	\$ 646	\$ 886
	Other Policy Service Related Costs	\$ 1,449	\$ 1,173	\$ 275
Claims Related Costs	Interest on Claims Proceeds	\$ 5,288	\$ 1,367	\$ 3,921
	Claims Procedures	\$ 3,309	\$ 2,157	\$ 1,152
	Claims Fraud Reporting	\$ 1,358	\$ 676	\$ 681
	Other Claims Related Costs	\$ 1,912	\$ 1,005	\$ 908
Reporting and Examination Costs	Regulatory Reporting	\$ 9,857	\$ 4,212	\$ 5,644
	Market Conduct Examinations	\$ 5,916	\$ 5,237	\$ 679
	Financial Solvency Examinations	\$ 8,619	\$ 2,172	\$ 6,447
	Other Reporting and Examination Costs	\$ 2,596	\$ 2,297	\$ 299
Regulatory Related Staff Training Costs	State Insurance Related Training Costs	\$ 2,812	\$ 2,485	\$ 327
	Other Regulatory Related Staff Training Costs	\$ 41	\$ 23	\$ 18
Regulatory Staff and Branch Office Costs	State-Specific Regulatory Staff	\$ 10,946	\$ 6,899	\$ 4,046
	State Expansions	\$ 4,408	\$ 4,408	\$ 0
	State of Domicile Changes	\$ 70	\$ 50	\$ 20
	Cost of State Branch Offices	\$ 2,181	\$ 2,181	\$ -
	Other Regulatory Staff and Branch Office Costs	\$ 480	\$ 343	\$ 137

Table 10: Detailed Cost Breakdown

6.4. Regulatory Cost and Redundant Reserving

Just prior to the publication of this report, one large insurer participating in the survey noted an additional regulatory impact that had not surfaced in the focus groups. The insurer observed that state-specific rules such as the recent amendment to New York's Regulation 147 defining life insurance reserve rules can have significant impact on the industry. The insurer noted that the impact of the amendment increases its capital costs by \$50 million on a present value basis.

Questions associated with this regulation as well as the overall issue of redundant reserves created by this regulation were not included in the survey. However, the insurer estimated that redundant reserving will cost several hundred million dollars and is expected to grow \$100 million per year. Although additional reserving requirements do not fall into the same category as other direct regulatory costs, the insurer's observation demonstrates the presence of additional capital related costs and indicates that the regulatory costs identified in this report are conservative.



Computer Sciences Corporation

Financial Services Group

Suite #100
200 W. Cesar Chavez
Austin, Texas 78701
+1.512.345.5700
+1.800.345.7672

Worldwide CSC Headquarters

The Americas

2100 East Grand Avenue
El Segundo, California 90245
United States
+1.310.615.0311

Europe, Middle East, Africa

Royal Pavillion
Wellesley Road
Aldershot, Hampshire GU11 1PZ
United Kingdom
+44(0).1252.534000

Australia/New Zealand

26 Talavera Road
Macquarie Park, NSW 2113
Australia
+61(0)2.9034.3000

Asia/Pacific

139 Cecil Street
#08-00 Cecil House
Singapore 069539
Republic of Singapore
+65.6221.9095

About CSC

Computer Sciences Corporation, one of the world's leading consulting and IT services firms, helps clients in industry and government achieve strategic and operational results through the use of technology. The company's success is based on its culture of working collaboratively with clients to develop innovative technology strategies and solutions that address specific business challenges.

Having guided clients through every major wave of change in information technology since 1959, CSC combines the newest technologies with its capabilities in consulting, systems design and integration, IT and business process outsourcing, applications software, and Web and application hosting to meet the individual needs of global corporations and organizations.

About CSC in Financial Services

CSC distinguishes itself through its time-tested ability to plan, build and operate highly reliable, efficient and secure business and IT solutions for leading financial services firms around the world. To complement its capabilities in consulting, systems integration and outsourcing, CSC brings financial services industry knowledge and experience, a comprehensive portfolio of financial services application software and an extensive network of industry and technology partners. More than 10,000 CSC employees are dedicated to serving financial services clients, which include more than 1,200 major banks, insurers organizations, and investment management and securities firms.

www.csc.com

Copyright © 2005 Computer Sciences Corporation. All rights reserved.
Printed in USA 735051k

