ACLI AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

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Via E-Mail

Financial Crimes Enforcement Network (FinCEN)
U.S. Department of the Treasury
Section 352 Insurance Company Regulations
P.O. Box 39
Vienna, Virginia 22183
regcomments@fincen.treas.gov
Attention: Section 352 Insurance Company Regulations

Re: Anti-Money Laundering Programs for Insurance Companies Under Section 352 of the USA PATRIOT Act; Notice of Proposed Rulemaking ("*Proposed Rule*")

To FinCEN:

We write on behalf of the American Council of Life Insurers ("ACLI"), the largest trade association in the United States representing the life insurance industry. Our members consist of three hundred ninety-nine (399) legal reserve life insurance companies operating in the United States. Of these companies, seven (7) are domiciled in Canada. These 399 companies account for 76 percent of the life insurance premiums, 75 percent of annuity considerations, 46 percent of disability premiums, and 65 percent of long-term care premiums in the United States among legal reserve life insurance companies. ACLI member company assets account for 75 percent of legal reserve life company total assets.

Summary

We appreciate Treasury's oft-repeated and laudable goal in the promulgation of regulations under the USA PATRIOT Act of avoiding burdensome and unnecessary regulation for an industry. With that goal in mind, we submit a comment letter addressing seven issues of great importance to life insurers and life reinsurers. In this letter, we explain in detail certain aspects of the business of life insurance and life reinsurance and respectfully request Treasury to make important changes to the *Proposed Rule* to enable our industry to comply with the USA PATRIOT Act and to avoid burdensome and unnecessary regulation. To achieve efficiencies of compliance, the finite resources of our members need to be directed to efforts in which we are able to satisfy the goals of the USA PATRIOT Act. In particular, letter requests revisions to the *Proposed Rule* in order for life insurers utilizing independent agent distribution channels to be able to comply with the *Proposed Rule*, requests clarification concerning Broker-Dealers already subject to anti-money laundering requirements, requests exemption of life reinsurance, requests exemption of group insurance, requests exemption of term life and credit life insurance, requests some minor language clarifications, and requests revision to the Supplementary Information section of the *Proposed Rule*.

Concerning the Supplementary Information section of the *Proposed Rule*, we respectfully request Treasury to excise some of the text in the *Proposed Rule* from also appearing in the final promulgated Rule. As currently drafted, the *Proposed Rule* contains what we believe are gratuitous and unwarranted attacks on the integrity of life insurance companies and those who sell our products. We explain our request in greater detail in section numbered "7" of this letter.

Finally, we wish to emphasize the serious compliance difficulties the *Proposed Rule* presents to the life insurance industry concerning distribution channels. Absent the ability to first have in place rules covering section 326 of the USA PATRIOT Act (verification of accountholder identification) and suspicious activity reporting, life insurers are presented with a situation that – at best – leaves compliance to hypothesis and best-guessing scenarios. That is, we are being asked to have anti-money laundering programs in place before two key components of these programs - verification of accountholder identification and suspicious activity reporting – are finalized. As drafted, the *Proposed Rule* approaches independent distribution channels in a very general manner in that it completely relies on a mistaken assumption that life insurers have control over independent distribution channels. As explained in greater detail in section numbered "1" of this letter, this mistaken assumption creates a rule for which life insurers cannot comply.

1. *Proposed Rule* section 103.137(a)(2)(C)(ii)

Background on Insurance Distribution Channels

Multiple distribution channels exist for life insurance companies. In many of these distribution structures, the life insurer does not exercise direct control over the agent. That is, the relationship is controlled by a contractual arrangement. Under these contracts, parties accept specified obligations and neither side has the power unilaterally to impose others. Parties to such a contract may be the agent and the life insurer, but, frequently, the parties are the life insurer and another entity, which entity in turn has relationships with agents. Therefore, there may exist many layers of distribution, that is, relationships (effectively acting as "wholesalers") between the life insurer (which "manufactures" the life insurance product), and the agent (which "retails" the life insurance product). Life insurers compete for access to these distribution channels – sometimes referred to as "shelf space" – and thus cannot dictate the manner in which distributors do business. In this respect, distribution of life insurance products is analogous to distribution of other types of manufactured products in our economy. Some of the distribution entities are independent financial institutions, such as banks that sell life insurance and independent Broker-Dealers that sell variable life and variable annuity products. Therefore, the assumption in the Supplementary Information section of the *Proposed Rule* (*i.e.*, sections I through III, 67 Fed. Reg. 60,625-629 (to be codified at 31 C.F.R. § 103.137)) – that life insurers exercise direct control over all agents in all distribution channels - is not accurate.

As noted above, in many ways, distribution of life insurance products is analogous with distribution of other types of manufactured products in our economy: there is a product manufacturer, and there may be a direct distributor, a wholesale distributor, and subsequent layers of distributors under wholesale distributors which may be geographically dispersed throughout the United States, and so on and so on. As one can readily discern, the further away that an agent is from the first layer relationship directly with the life insurer, the more remote (and impossible) it is for a life insurer to directly control the seller of the product. Therefore, it is simply impossible to "integrate" these distributors into the life insurer's anti-money laundering program (as stated in section II *Proposed Rule*, 67 Fed. Reg. 60,627). Equally impossible is requiring the life insurer to "remain[ ]fully responsible" for application and "effectiveness" of a program to an entity over which the life insurer has no ability to implement a program upon, or, to require the life insurer to "ensur[e] that federal examiners are able . . . to inspect the agent or third party for purposes of the program." (*e.g.*, section III *Proposed Rule*, 67 Fed. Reg. 60,628).

The difficulties that life insurers would face if they were required to assume responsibility for all agents in their distribution channels is immediately apparent in the context of distribution by other segments of the financial services industry. For example, bank sales of insurance and the sale of variable products by independent Broker-Dealers. These other segments of the financial services industry already have in effect their own anti-money laundering programs and cannot be forced to accept supervision by life insurers. It would be as incongruous to suggest that life insurers should incorporate agents in these institutions into their anti-money laundering programs as it would be to suggest that investment companies – whose mutual funds these agents also sell – should do likewise. Life insurers, we respectfully submit, cannot be required to adopt anti-money laundering programs that purport to control agents over which they in fact do not exercise control and which agents even represent multiple life insurers. Moreover, the difficulties inherent in any regulation attempting that approach would be most acute in the context of the independent agent distribution channel.

The Independent Agent Distribution Channel

A very common distribution channel for life insurers is that of the licensed independent life insurance agent (hereafter "independent agent"). The independent agent is not an employee of the life insurance company; there is no employer/employee relationship between the independent agent and the life insurance company. The independent agent (sometimes referred to as a non-captive agent) is a person licensed by one or more State Departments of Insurance. That licensed agent is then able to sell the life insurance policies of insurers once he or she is appointed by a life insurance company. The appointment requirement is, like the licensing requirement, a State Department of Insurance requirement requiring submission of documentation. The independent agent is not limited to sales of any one company's products. It is the industry practice for an independent agent to be appointed by a number of different life insurance companies. Therefore, an independent agent has the authority to sell simultaneously many different types of life insurance products from many different life insurance companies.

The independent agent utilizes his or her professional judgment when informing a customer of products available and companies to choose from, when answering a customer's question, and in helping the customer make an informed choice. A customer could be an existing policyholder of a life insurance product or a customer could be an individual with no existing life insurance product. Many State Departments of Insurance have continuing education ("CE") requirements for all licensed agents; depending upon the State, the CE requirements must be maintained on a certain basis and in a certain manner (*e.g.*, such as annually and such as setting the number of hours of CE credit required). The relationship between the life insurance company and the independent agent is contractual, with the obligations and all terms of the relationship set forth in the contract document. It is not at all unusual for life insurers to have only independent agents selling their products, therefore, the entire distribution of their product is completely by contract. Many of these arrangements are long-standing with long-term goodwill built into the relationship. Whether life insurers distribute their products exclusively through independent agents, or partially through independent agents, it is not unusual for life insurers to have in place at any one time dozens or even hundreds of contracts with independent agents in geographically dispersed regions. It is not unusual for many life insurers to have appointed at any one time thousands of independent agents, in fact, a number of life insurers may have over 100,000 appointed agents.

The importance of and growth of the independent agent distribution channel for the life insurance industry is not to be underestimated, indeed, it is now the dominant distribution channel for life insurance products. It is not uncommon for independent agents to work within large structures known as managing general agencies ("MGAs"). The growth of MGAs is evidenced by the millions of dollars of premium that is written annually through these structures. For some life insurers, the bulk of premium for a company or for a particular line of insurance is possible through just a few independent agents or through a few MGAs. However, there are also independent agents who operate on their own or in offices with just a few of their independent agent colleagues and thus comprise the quintessential notion of a small business operation.

Application of *Proposed Rule*

The myriad variations of contractual business models within the independent agent distribution channel allows life insurers and independent agents to have a symbiotic relationship. These arrangements allow flexibility in sales and marketing beneficial to the life insurer (so the product is sold), for the independent agent (so commissions are earned), and for the consumer (so there is easy access to neighborhood insurance agents available to offer the valuable benefits afforded to consumers through a variety of products written by life insurers).

However, when the requirements of the *Proposed Rule* are overlaid upon the contractual relationship between the life insurer and the independent agent, extraordinary difficulties and burdens are imposed upon the life insurer. It is unclear precisely what is intended by the suggestion that independent agents should be "integrated" into a life insurer's anti-money laundering program. The life insurance industry is confronted with the following tasks (which also involve large infusions of capital and manpower) are:

- the life insurer would have to renegotiate dozens, hundreds, and even thousands, of contracts to obligate independent agents to provide information the life insurer must maintain under the *Proposed Rule*;

- the anti-money laundering programs of life insurers may conflict with one another causing confusion for the agent;

- how a life insurer is to ensure an independent agent is trained in an anti-money laundering program;

- how an independent agent may satisfy the training requirement without undergoing training in every insurer's anti-money laundering program – to require training in the anti-money laundering program of every insurer which has appointed the independent agent would sap valuable marketing time away from the independent agent's schedule, deprive the agent of servicing his or her customers, and result in unwarranted duplicative training; and

- how a life insurer is to audit an independent agent's anti-money laundering program when the independent agent is not required to have an anti-money laundering program under the *Proposed Rule*.

The issues set forth above cannot be remedied by renegotiation of contracts. If renegotiation is the relied-upon remedy, the result will be that some independent agents may shop around for life insurers with the most bare bones of anti-money laundering program requirements, resulting in a least common denominator compliance attitude that hurts competition between life insurers and negates any appreciable effort to curb perceived money laundering using life insurance products. As previously noted, life insurers compete for distribution, and agents will seek to exploit differences between life insurers.

The life insurance industry is committed to advancing the very important public policy underlying the USA PATRIOT Act. Moreover, we recognize that it is difficult for Treasury to fashion regulations applicable to a group that is as numerous, diverse, and decentralized as the agents that distribute life insurance policies in the United States. Nevertheless, we believe that it is both unworkable and unduly burdensome to impose the mandate on life insurers to integrate agents into the life insurers' anti-money laundering programs. As noted above, we believe that Treasury should consider whether regulations dealing specifically with accountholder identification programs and suspicious activity reporting are the best place to address the special issues that agents present. We respectfully request that guidance accompanying the regulations be clarified so that life insurers are not required to integrate independent agents into their anti-money laundering programs or are required to undertake massive recontracting efforts. In addition, we suggest the following amendments to the *Proposed Rule*, which we believe would ensure that life insurers could rely on the cooperation of agents in implementing their own anti-money laundering programs.

- <u>The *Proposed Rule* should be amended to reflect information the independent agent is to provide to the life insurer</u>

  The difficulty here is that the proposed rule for section 326 has not yet issued, therefore, the universe of the information to be provided by the independent agent to the life insurer is not known. It is difficult to establish a section 352 program without the section 326 component. A life insurer must be able to rely on agents to collect and supply information required by section 326. Accordingly, we request guidance from Treasury on its expectations concerning the type of information a life insurer is to maintain on a customer, without losing Treasury's approach to avoid a "one-size-fits-all" regulation. We propose language to section 103.137(b), a new sentence, to be inserted after the first sentence therein: "An agent or broker of any business described in paragraph (a)(2)(i) of this section shall provide to such business information upon request pursuant to the anti-money laundering program of such business."

- The *Proposed Rule* should be amended to allow an independent agent to certify training in a life insurer's anti-money laundering program

  To avoid burdening the independent agent with training in the anti-money laundering program of each life insurer which has appointed the independent agent, allow the independent agent to certify that he or she has satisfied the training requirement by executing a certification. We propose a form, attached to this letter, for such certification so there is standardization for this certification. We propose language to section 103.137(c)(1), a new sentence, to be inserted after the first sentence therein along with a certification form called for by this amending language (this language also proposes a new section to the *Proposed Rule*): "An agent or broker of any business described in paragraph (a)(2)(i) of this section may satisfy training and education described in paragraph (c)(2)(iii) of this section through certification of attendance and completion of an anti-money laundering program. Such certification must be provided by the agent or broker to any business described in paragraph (a)(2)(i) of this section upon request by such business. Such certification may be evidenced by utilizing the form set forth in paragraph (e) of this section. The anti-money laundering program must cover the core elements of Title III of section 352(a) of the USA PATRIOT Act of 2001 (Public Law 107-56), which amends section 5318(h) of the Bank Secrecy Act. As used herein, the term core elements may correlate to the nature and volume of products sold by the agent or broker. The certification shall satisfy for a business described in paragraph (a)(2)(i) of this section the independent audit function element requirement of section 5318(h) of the Bank Secrecy Act, as amended."

- The *Proposed Rule* reflects creation and maintenance of a repository for agents who satisfy the certification requirement

  The appointment process for independent agents is a function that life insurers conduct on a daily basis. Part of the appointment process includes termination of appointment. As a result of these constant business changes, contracts between life insurers and independent agents are, on a daily basis, drafted, signed, or terminated; the other variable is the expiration of contracts by the terms of the contract. As a result, a means needs to be established by which life insurers may check whether an independent agent has indeed satisfied the education and training components of the *Proposed*

> *Rule* by certification. We propose that the U.S. Treasury establish a central registry of these agent certifications, much in the same manner that Treasury will establish a central registry of financial institution notices under section 314 of the USA PATRIOT Act.

We wish to emphasize the importance of providing resolution to independent agent distribution channel issues we outline in the above paragraphs. The issues center around the ability of a life insurer to exercise control over an agent. The employee agent does not present the compliance issues otherwise present with the independent agent. As currently drafted, the *Proposed Rule* inaccurately assumes the nature of the various relationships between life insurers and their independent agent distribution channels. These inaccuracies make compliance for life insurers impossible under the current draft of the *Proposed Rule* and, thus, these inaccuracies must be addressed. The impossibilities, however, must be weighed against the policy approach which has been staked out and clearly outlined for agents and brokers, which is to totally exempt those persons from the definition of "insurance company" and thus exempt those persons from the "anti-money laundering program requirements for insurance companies" of the *Proposed Rule* (*see* proposed codification at 31 C.F.R. § 103.137 (a)(2)(i) and 31 C.F.R. § 103.137 (b)).

If the current policy approach for agents and brokers (*i.e.*, exemption) remains in the final promulgation of the *Proposed Rule*, then the current policy approach would be indicative of a permanent policy approach toward anti-money laundering compliance. That approach is federal acceptance of the inability of life insurers to integrate independent agents into their anti-money laundering programs and that such inability is an acceptable compliance gap. Thus, we respectfully request that life insurers be exempt from implementing any anti-money laundering program requirements applicable to any products sold through independent distribution channels.

On the other hand, if the current policy approach for agents and brokers (*i.e.*, exemption) remains in the final promulgation of the *Proposed Rule*, <u>and</u> if the compliance gap described in the above paragraph is not acceptable, then we respectfully request that the *Proposed Rule* be <u>revised</u> utilizing the language we propose above in order to provide life insurers with the tools necessary to comply with the letter and spirit of federal anti-money laundering regulations.

2. *Proposed Rule* section 103.137(d)

We respectfully request that the current language of this section of the *Proposed Rule* be clarified. It is our understanding that the intent of this section is to avoid placing a burden on the life insurer by requiring duplicative anti-money laundering compliance if the life insurer is selling through a registered representative who is already subject to an anti-money laundering program implemented by his or her Broker-Dealer. In such a circumstance, it is unnecessary for the registered representative to be subject as well to the anti-money laundering program rules implemented by the life insurer. The logic lies in the recognition that registered representatives already have in place anti-money laundering program rules.

As currently drafted, however, the language applies only to <u>life insurers</u> which are registered as opposed to the registered <u>representatives</u> of a Broker-Dealer with an anti-money laundering program.. To provide this provision with its intended scope, we propose adding language to section 103.137(d): "An insurance company or a Broker-Dealer with an anti-money laundering program distributing the insurance company's products that is registered or required to register . . . for those activities regulated by the Securities and Exchange Commission and the National Association of Securities Dealers to the extent that the company or the Broker-Dealer with an anti-money laundering program distributing the insurance company's products complies with the anti-money laundering program requirements applicable . . ."

For additional background and historical perspective, we attach the 1968 Interpretive Letter issued by the Securities and Exchange Commission stating that a life insurer is not required to register as a Broker-Dealer under the Securities Exchange Act of 1934 when performing administrative or ministerial functions in distributing variable contracts. *See*, SEC Securities Exchange Act Release No. 8,389 (Aug. 29, 1968), *reprinted in* [1968 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 77,594. The first product innovators of variable insurance, however, registered with the Securities and Exchange Commission. In recent years, though, the product manufacturers do not register because distribution is made through independent or affiliated Broker-Dealers and their registered representatives.

3. *Proposed Rule* sections 103.137(a)(2)(i)(A), (C)

Background on Reinsurance

As used in this section, "reinsurance" refers to reinsurance of risks inherent in life insurance policies and annuity contracts, as those terms are defined in the *Proposed Rule* sections 103.137(a)(3) and 103.137(a)(1), respectively. The business of reinsurance is an integral part of the life insurance industry as it allows for the spreading of risk undertaken by life insurers. The business of reinsurance involves variations as to transactions as well as to the myriad products over which the business reinsures. In North America, the business of reinsurance is generally composed of a relatively few, well-capitalized companies. According to ACLI statistics, of the 1,268 life insurers in the United States in the year 2000, seventy-three percent reinsured their products with a reinsurer.

It is important to note that on the most fundamental of levels, the business of reinsurance differs significantly from the business of life insurance. The contractual relationship present in a reinsurance relationship is between two corporate entities – the reinsurer (which is assuming a risk from a life insurer) and the ceding insurer (which is the life insurer). The contract governing this relationship is called a reinsurance treaty. In a reinsurance relationship, the reinsurer indemnifies or compensates the ceding life insurer for all or a portion of losses incurred by the ceding life insurer on particular group of policies or on a particular policy. Therefore, the ceding life insurer transfers the insurance risk to the reinsurer.

The business of reinsurance enables the ceding life insurer to provide coverage to insureds in three important ways. First, reinsurance permits the ceding life insurer to issue greater amounts of insurance on single policies. Second, reinsurance permits the ceding life insurer to underwrite a greater number of policies than the ceding life insurer otherwise would be able to underwrite. And, third, reinsurance permits a ceding life insurer to underwrite types of risk and concentrations of risk than the ceding life insurer otherwise would be able to underwrite.

These three points are explained in more detail in the Appendix attached to this letter. In that Appendix, the manner in which reinsurance assists ceding life insurers in the management of risk transfer and risk selection, along with expanded product knowledge and business planning and management, are described and illustrated.

The regulation of the business of reinsurance is robust by the State insurance departments. When ceding life insurers cede business, usually these life insurers are interested in being able to account for the reinsurance receivables as admitted assets and in being able to reduce their statutory liabilities for risks transferred to a reinsurer. In order to do so, regulations in most States require the reinsurer to (1) be licensed to write direct insurance in the ceding insurer's State of domicile, or (2) be accredited as a reinsurer by the State, or (3) be regulated by a State which has substantially similar standards relating to reserve credit for reinsurance ceded, or (4) maintain a trust fund in the United States for the benefit of all its United States policyholders and ceding life insurers, or (5) secure its obligations to the ceding life insurer by providing a letter of credit permitting the ceding life insurer to withhold funds, or, by placing funds in a trust account. Additionally, if the ceding life insurer seeks reserve credit for reinsurance ceded, the reinsurance treaty is required under appropriate circumstances to include clauses pertaining to submission of venue and jurisdiction of United States courts in the event of dispute, insolvency of the ceding life insurer, and, where the reinsurance broker mediates the reinsurance treaty parties' relationship a reinsurance intermediary clause. Finally, the National Association of Insurance Commissioners (NAIC) adopted in September 1992 the principal regulation applicable to reinsurance – the NAIC Life and Health Reinsurance Agreements Model Regulation.

Application of Proposed Rule

When the business of reinsurance is examined in light of the rationale defining the scope of the *Proposed Rule*, we believe application of the *Proposed Rule* to reinsurance of those products is not appropriate. Therefore, the ACLI respectfully requests that reinsurance be specifically excluded from the *Proposed Rule*. We believe the exemption can be accomplished with specific exclusionary language in *Proposed Rule* sections 103.137(a)(2)(i)(A),(C), or, by striking reference to "reinsuring" in these sections.

The nature of the business of reinsurance does not allow for a seamless transfer of funds to disguise the true origin of the funds. On the contrary, the transactions of reinsurance typically involve two corporate entities heavily regulated by the States. In the case of individual variable insurance products, the ceding life insurer also has a degree of regulation by the Securities and Exchange Commission and the National Association of Securities Dealers; for the reinsurer and ceding life insurer whose stock is listed on a national exchange, there is further regulation by the Securities and Exchange Commission. These layers of regulation capture critical identifying information about the corporate entities, such as disclosure of shareholder ownership and background information on corporate officers and directors. Any funds transfer triggered by the reinsurance treaty or the reinsurance relationship are traceable, must be accounted for in statutorily mandated reports filed quarterly and annually, and are not "funds" in the sense of cash. Funds transfers in reinsurance transactions are executed in the manner that funds transfer occur every day in the United States between sophisticated, corporate entities – *i.e.*, with checks or wire transfers drawn on corporate accounts at financial institutions regulated by the United States Government (*i.e.*, banks).

Additionally, the business of reinsurance neither encompasses or possesses the elements of "stored value" and "transferability" as described in the *Proposed Rule*. Though these two terms are not specifically defined in the *Proposed Rule*, discussion in the Supplementary Information lends context to the terms (*e.g.*, section II *Proposed Rule*, 67 Fed. Reg. 60,626). As discussed in the *Proposed Rule*, the terms focus on the ability of a product to be used as an investment for an income stream, whether immediate, deferred, or otherwise. That is, a type of investment product enabling a money launderer to park - in essence, to store - monies in a product, and then to be able to move the monies out of the product at will – in essence, to transfer - through a financial system and back into the pocket of the money launderer. Thus, through such activities, the money launderer is able to engage in the three steps commonly identified with successful cleansing of dirty monies: placement, layering, and integration.

Analysis of reinsurance, however, clearly shows that it does not even satisfy the first step of the *Proposed Rule* – of being an investment product. Reinsurance allows for the continued solvency of the ceding life insurer because it spreads all or a portion of the risk to one or more reinsurers Indeed, the very nature of an investment product indicates a return to the investor on the monies invested in the form of a profit, or of a revenue, or of an income. With reinsurance, however, the ceding life insurer is not paying a premium with the expectation of receiving a return for the purpose of generating a profit, or a revenue, or an income, because the premium is not an investment. The premium on reinsurance is for coverage of a risk, not for a return on investment.

In addition, reinsurance does not satisfy the next level of rationale in the *Proposed Rule*. This level focuses on "stored value" and "transferability". Reinsurance provides many different functions to ceding life insurers, however, reinsurance does not store value. As set forth in the *Proposed Rule*, the concept of stored value implies that the person doing the storing has an unfettered ability to access the value of the funds (*e.g.*, section II *Proposed Rule*, 67 Fed. Reg. 60,626). This implication is an assumption which is not accurate when applied to reinsurance. The reinsurance treaty, much like any contract, controls the behavior, obligations, and performance of the parties (here, the only parties are the reinsurer and the ceding life insurer). The ceding life insurer does not have the ability to access at will the monies payable by the reinsurer under a reinsurance treaty. Payment is made under the reinsurance treaty only upon the occurrence of certain events as specified in the treaty. These specified events are inextricably tied to claims made upon the ceding life insurer on policies of life insurance issued by the ceding life insurer. To distill down to simple terms, the reinsurance treaty is not a bank savings account for the ceding life insurer. The ceding life insurer cannot store value in the reinsurance treaty or with the reinsurer. Therefore, the concept of stored value does not apply to reinsurance.

Similarly, the concept of transferability does not apply to reinsurance. As set forth in the *Proposed Rule*, the concept of transferability implies that the person doing the transferring can assign or negotiate a particular instrument and pass it on to others (*e.g.*, section II *Proposed Rule*, 67 Fed. Reg. 60,626). It is with this concept that the *Proposed Rule* confuses assignment clauses that may be in generic contract forms (and not even clauses in life insurance contracts) with the sophisticated provisions governing the complex transaction that is reinsurance. As applied to reinsurance, the *Proposed Rule* implies that a reinsurance treaty is akin to title to real property or title to personal property, that is, that the treaty is property that can be transferred by the parties through assignment or negotiation. The reinsurance treaty is a contract between sophisticated insurance companies, it is not property that can be transferred or assigned like a commodity. The parties are obligated to perform under the treaty; changes cannot be made to the treaty without the written consent of both parties. If other parties are to perform under the treaty, then the treaty is terminated and a new treaty negotiated; an existing treaty is not simply transferred. Therefore, the concept of transferability does not apply to reinsurance.

Because none of the elements that give rise to money laundering concerns are present in transactions involving the reinsurance of products (seamless transfer of funds, investment, stored value, and transferability), the reinsurance of these products should be excluded from the scope of the *Proposed Rule*.

4. *Proposed Rule* sections 103.137(a)(1), (3)

Background on Group Life and Group Annuity Insurance

The business of group life insurance and group annuity insurance (hereinafter referred to as "group insurance") provides some of the most common forms of employee benefit plans. In the United States, almost forty percent of all life insurance in force by face amount is with group plans. *See*, K. Black, Jr. & H. Skipper, Jr., *Life & Health Insurance* 456 (Prentice Hall, 13th ed. 2000). Per certificate, the average amount of group insurance in force exceeds $32,000.00; more than eighty-nine percent of group insurance is offered by employer-employee groups. Other types of groups offering group insurance include trade associations, professional associations, college alumni associations, veteran associations, religious groups, customers of large retail chains, and, savings account depositors, to name just a few (generally, these types of groups are referred to as discretionary groups). *Id.* Our discussion in this letter, however, will focus on group insurance plans offered to employees by employers.

Generally, group annuity insurance is in the form of a pension plan providing annuities at retirement to a group of people under a master contract usually issued to an employer for the benefit of employees. Individual members of the group hold certificates as evidence of their annuities.

Group insurance is regulated by the States; variable products offered under group insurance plans have an additional layer of regulation by the Department of Labor . A group insurance plan may cover ten or fewer lives, or, it may cover hundreds of thousands of lives. State law stipulates the minimum proportion of eligible employees that should be insured under a group insurance plan. The premium for a group insurance plan usually is paid monthly by the employer (this is called a noncontributory plan). Other premium modes are possible; generally, quarterly premiums are used only with small group insurance plans. There are group insurance plans into which the employee pays an amount for coverage, these plans are called contributory plans.

Group annuity products also are regulated under the Employee Retirement Income Security Act of 1974 (ERISA). The ERISA statute was patterned after the Investment Company Act of 1940 concerning prohibitions against self-dealing, fiduciary duty, and information reporting. As a general standard, employee benefit plans must be operated for the exclusive benefit of and solely in the interest of plan participants and beneficiaries. Plan sponsors are subject to high standards of prudence in executing their responsibilities, and are subject to liability for breaches of fiduciary duty that are punishable by severe penalties.

A plan sponsor has a fiduciary duty to select appropriate funding vehicles, such as group variable annuities, and to continually monitor their performance. This responsibility includes a thorough evaluation of the insurance company and the investment manager's experience, and execution of due diligence in ascertaining the manager's good professional character and appropriate licensing. If the fiduciary fails to act prudently and exercise due diligence, the fiduciary is liable to plan participants for any losses attributable to the inexperience of the investment manager.

ERISA requires that a fiduciary act solely in the interest of and for the exclusive benefit of plan participants and beneficiaries. In addition, ERISA specifically prohibits a fiduciary from dealing with assets of a plan in his/her own interest or for his/her own account.

ERISA prevents any person who has been convicted of certain crimes from serving: as a plan administrator, fiduciary, trustee, custodian or representative in any capacity of any employee benefit plan; as a consultant or advisor to any employee benefit plan; or, in any capacity that involves decision making authority or custody or control of plan assets.

ERISA requires extensive recordkeeping, and mandates that certain plan administrators must furnish to participants an individual statement containing information about each participant's benefits. Additionally, ERISA requires each administrator of a pension plan to furnish to any plan participant or beneficiary who so requests in writing, a statement indicating, on the basis of the latest available information, the total benefits accrued and the nonforfeitable pension benefits which have accrued or the earliest date on which such benefits will become nonforfeitable. These parameters also place limits on amounts that can be contributed to an account in a plan, withdrawals, loans from an account, and other similar transactions.

The fundamental structure of ERISA and State fiduciary laws place the responsibility for the investment of retirement plan assets on plan fiduciaries, who select and monitor institutions managing plan assets and, with respect to 401(k) plans, also assure participant access to a prudent and diverse range of investments for individual accounts. Failure to fulfill these obligations in a prudent manner and solely in the interests of plan participants and beneficiaries subjects the fiduciary to ERISA's enforcement regime.

Features of Group Life and Group Annuity Insurance

Eligibility for coverage under a group insurance plan is clearly defined in the master contract. Generally, only regular, full-time employees are eligible for group insurance. All such employees, or all employees in certain classes, determined by conditions pertaining to their employment must be included in the group as eligibles. Examples of classes are "all salaried employees", or, "all hourly paid employees". Another aspect of eligibility for an individual employee is that the person must work no fewer than the normal hours in a workweek at his or her job on the date he or she becomes eligible for coverage. This requirement assures a reasonable minimum threshold of health and physical well-being and also protects the insurer from serious adverse selection. Also, a waiting period – commonly called a probationary period – is applicable to employees before they are eligible for coverage under the group insurance plan. Examples of waiting periods can be one month, or, six months. At the expiration of the probationary period the employee becomes eligible for coverage under the group insurance plan. the waiting period minimizes administrative expenses involved in setting up records for employees who remain with the employer for only a very short period of time. In contributory group plans, the employee is given an additional period of time known as the eligibility period during which the employee is entitled to apply for insurance without submitting evidence of insurability. This period is limited (usually to 31 days) to minimize adverse selection.

For an employee covered under his or her employer's group insurance plan, the protection offered under the plan continues for as long as the employee remains in the service of his or her employer (this assumes, of course, that the employer maintains the group insurance plan in force; if a contributory plan, this assumes that the employee continues to pay any contributory premium required). The master contract of a group insurance plan generally gives the employer the right to continue premium payments for employees who are temporarily off the job, provided the employer does so on a basis that precludes individual selection. Many group insurance plans continue coverage on the employee after retirement and provide as least enough life insurance to cover the employee's last illness and funeral expenses. If an employee's employment is permanently terminated, the employee's coverage under the group insurance plan usually continues for 31 days beyond the date of termination. This time period allows the employee an opportunity to replace the expiring coverage with the purchase of an individual insurance policy, or, to obtain employment with another employer with group insurance coverage, or, to convert the expiring term insurance to a cash-value form of insurance.

Employers have many different ways in which to fashion the benefits offered under a group insurance plan. To minimize adverse selection, the amount of group insurance for which an employee is eligible usually is determined by a system that precludes the employee from selecting the coverage amount. Generally, this system utilizes four functions for determining the amount of group coverage: first, a set amount for all employees; second, a function of each employees' compensation; third, a function of employees' positions; and, fourth, a function of each employees' length of service. In the United States, group life insurance benefit schedules that tend to discriminate in favor of highly compensated or executive-level employees can cause the loss of important tax benefits.

Additional safeguards are in place with group insurance plans to ensure that all employees in the group are extended protection as a whole. For example, there is a minimum amount and a maximum amount that an insurer will write on any one insured in the group. Factors driving these minimums and maximums are the number of persons insured and the average amount of insurance per employee in the group. Insured employees may convert his or her group insurance protection to an individual policy of cash-value insurance but only under certain conditions. Usually, this occurs after termination of employment or cessation of membership in an eligible class. If such an individual policy is pursued, the employee may purchase a cash-value policy at a standard rate for his or her age. Usually, such a purchase may be accomplished without evidence of insurability. During the conversion period, the death benefit provided under a group insurance plan is continued (usually for 31 days) after the employee withdraws from the eligible group. If the employee dies during this period, a death benefit is paid under the group policy and any premiums that may have been paid on a conversion policy are returned.

Application of *Proposed Rule*

The limited reach of the *Proposed Rule*, when read with the manner in which group insurance is conducted in the United States, we believe leads to a conclusion that group insurance should be excluded from the *Proposed Rule*. Our conclusion encompasses all group insurance, including group insurance covering discretionary groups. Therefore, the ACLI respectfully requests that group insurance be specifically excluded from the *Proposed Rule*. We believe the exemption can be accomplished with specific exclusionary language in *Proposed Rule* sections 103.137(a)(1), (3). In section (a)(1), a new sentence may be added stating "Annuity contract shall not include any group policy." In section (a)(3), a new sentence may be added stating "Life insurance policy shall not include any group policy."

Fundamentally, group insurance does not enable an individual insured to manipulate contributions made into a group insurance plan. The relationship in a group insurance plan is that of a contract between the employer and the life insurance company. Contributions into the plan are made by the employer – not the employee. Therefore, any funds being paid as premium are defined amounts covering a specified risk enunciated in the master contract. Even in circumstances where the employee is making the premium payments based on a contributory plan, the eligibility parameters restrict the amounts paid and the frequency of payment. Therefore, the circumstances giving rise to the rationale stated in the *Proposed Rule* – seamless transfer of funds – is not able to occur in the group insurance plan.

Likewise, the focus of the *Proposed Rule* on features of "investment", "stored value", and "transferability", do not apply to group insurance. The nature of group insurance is not an investment. Group insurance is an employee benefit offered by employers in the United States. Employees are covered by the group insurance plan so long as eligibility criteria are met under the plan. Benefits for eligible employees accrue under the group insurance plan until specified events trigger payment. Sometimes, due to circumstances, no benefit may ever trigger under the plan to particular employees. Because of the manner in which premiums are paid into a group insurance plan, *i.e.*, by the employer, there is no "investment" in the sense of an expected return on funds invested. There is indeed a return on investment of human capital as group insurance plans are benefits that employers may use to attract and retain valuable employees. However, this "investment" of human capital is not the type of investment governed under the *Proposed Rule*.

Similarly, a person will not be able to "store value" or "transfer" funds using a group insurance plan (*e.g.*, section II *Proposed Rule*, 67 Fed. Reg. 60,626-627). Applying the concept of stored value as explained in the *Proposed Rule* to a group insurance plan implies that funds paid into the plan (*i.e.*, the premium) may be moved freely and at will under the plan, in an arrangement somewhat akin to a savings account at a bank. However, such free movement of funds cannot be accomplished in a group insurance plan. Premium is paid into the plan in order to continue coverage under the plan and to prevent lapse of coverage. Applying the concept of transferability as explained in the *Proposed Rule* to a group insurance plan implies that funds paid into the plan (*i.e.*, the premium) may be conveyed to accomplish other purposes. In other words, that the premium monies may be extracted from the plan and used for other purposes. A group insurance plan is not a liquid account. The plan is governed by a master contract which sets forth the amount of premium to be paid for specified coverage for eligible employees.

Finally, notwithstanding the above analysis, prior rulemaking by the U.S. Treasury recognized that, at a minimum, even the risk of laundering money through a group plan is remote at best. In the Notice of Proposed Rulemaking issued by FinCEN on Bank Secrecy Act Regulations – Requirement of Brokers or Dealers in Securities to Report Suspicious Transactions, it was stated "[t]hus, for example, transactions involving securities trades by the pension fund of a publicly traded corporation, even though involving a large dollar amount, would likely require a more limited scrutiny then less typical transactions such as those involving customers who wish to deposit currency in their brokerage account or to open a brokerage account using money orders even though the dollar amounts in those latter cases may be relatively small." 66 Fed. Reg. 67,674 n.18 (2001) (to be codified at 31 C.F.R. pt. 103) (proposed Dec. 31, 2001). Though we believe justification for exemption of group insurance plans is amply demonstrated by the prior paragraphs, the risk analysis in the Notice of Proposed Rulemaking also supports our request for exemption of group insurance from the *Proposed Rule*.

5. *Proposed Rule* sections 103.137(a)(3)

Background on Term Life and Credit Life Insurance

The business of term life insurance concerns a policy that promises to pay benefits only if the insured dies during the policy term. Likewise, if the insured dies after expiration of the term, then no benefits are paid. Term policies may be issued for a number of years (*e.g.*, anywhere from one year to twenty years, or longer), or, are issued to a stipulated age (*e.g.*, to age 65, or, to age 70, etc.).

Term life insurance policies have no cash value and do not offer any dividends. Because of the nature of term life insurance, commentators describe this life insurance as

> . . . more comparable to property and liability insurance contracts than is any other life insurance contract. If a building valued at $100,000 is insured for that amount under a five-year term property policy, the insurer will pay this amount only if total destruction occurs during the term. Similarly, if a person insures his or her life for $100,000 under a five-year term life policy, the insurer will pay $100,000

> only if the insured's death occurs before the expiration of the five years; nothing is paid if death does not occur during the policy term.

See, K. Black, Jr. & H. Skipper, Jr., *Life & Health Insurance* 77, *supra.*

The business of credit life insurance concerns the issuance of term life insurance through a lender or lending agency to cover payment of a loan, an installment purchase, or other obligation in case of death. Credit life insurance is considered a variation of group life insurance. Payment under a credit life insurance policy is that of a death benefit equal to the unpaid consumer debt of the insured.

In credit life insurance, the creditor – which is usually a bank – is <u>both</u> the group policyholder and the beneficiary under the credit life policy. The amount of insurance protection under a credit life insurance policy is tied directly to the debtor's account balance. The premiums on the credit life insurance policy are most often paid by the debtor as a component of the cost of servicing the debt. However, any dividends payable under the credit life insurance policy are paid to the creditor (*i.e.*, the group policyholder).

Regulation by the States of credit life insurance is as intense as any other line of life insurance. Many States have promulgated maximum rates in order to avoid excessive charges being made to the debtor. The reason for these rates is to prevent the situation where the creditor receives large dividends at the expense of the debtor.

Application of *Proposed Rule*

After reviewing the manner in which the business of term life insurance and credit life insurance functions when compared to the concerns expressed in the *Proposed Rule*, we respectfully request that term life insurance and credit life insurance be specifically excluded from the Proposed Rule. We believe the exemption can be accomplished with specific exclusionary language in *Proposed Rule* section 103.137(a)(3). In section (a)(3), a new phrase may be added to the end of other exclusionary language where we propose "Life insurance policy shall not include any group policy" and add to the end of that proposed language "or any term life insurance or any credit life insurance policy."

Because term life insurance does not have a cash value feature, there is no savings (*i.e.*, investment, stored value, transferability) element to this type of life insurance. Without a savings feature, the policy contains no mechanism through which the launderer may cleanse ill-gotten gains. The Supplementary Information section to the *Proposed Rule* mistakenly states that "term life insurance policies also pose a significant risk of money laundering because they possess elements of stored value and transferability that make them attractive to money launderers." *See* section II *Proposed Rule*, 67 Fed. Reg. 60,626. This conclusion in the *Proposed Rule* is not correct because term life policies have no cash value.

Additionally, footnotes 8 and 9 in the *Proposed Rule* support our request for exclusion of term life insurance from the scope of the *Proposed Rule*. Footnote 8 is in error in that it assumes a contract of insurance will issue notwithstanding application of the doctrine of insurable interest. Insurable interest must exist at the time of inception of the contract of insurance - not at the time of loss. Under the doctrine of insurable interest, a person must reasonably expect to receive pecuniary gain from the insured's continued life (or, conversely, a person must reasonably expect to suffer financial loss from the death of the insured). The example given in footnote 8 indicates the policyowner has no insurable interest in the insured, therefore, a policy of insurance will not even issue. However, even if an insurable interest can be established, the footnote once again reaches an incorrect conclusion because it assumes the insured will die during the term of the policy and that the beneficiary will receive the proceeds of the policy. As explained above, a term policy pays only if the insured dies during the term of the policy. If the insured dies after expiration of the term, the policy pays nothing . However, even if the insured dies during the term of the policy, the payout under the term life policy is no different than a payout under a term property policy, as discussed previously. The *Proposed Rule* clearly exempts from its scope property and casualty insurance, reasoning that ". . . such products [do not] possess the elements of stored value and transferability that pose a significant money laundering risk." *Proposed Rule*, 67 Fed. Reg. 60,626 n. 9. Because the mechanisms triggering coverage and payment of benefits under term life insurance products and term property insurance products are similar, there exists no rationale under which term life insurance products should be within the scope of the *Proposed Rule*.

Because credit life insurance is offered through lending institutions as protection against the risk of an unpaid debt, there is no opportunity for funds to be laundered through this type of policy. Lending institutions already are covered by anti-money laundering requirements. To then require the issuer of the credit life insurance policy to engage in these same anti-money laundering requirements results in unnecessary duplication of effort without resulting in any assistance to law enforcement in its anti-money laundering efforts. Furthermore, the debtor is not able to utilize credit life insurance to seamlessly transfer funds through the financial system for the purpose of laundering. A product needs to be purchased by the consumer upon which a loan is secured. The consumer debt brought about by the product purchase is the event causing a lender to insure against the risk of the debt going unpaid, hence, the market for credit life insurance. Premiums on credit life insurance are very small, many are well below $50.00 per month. The product itself is not positioned to be used as a vehicle for investment or transfer.

Finally, many irregularities with term life and credit life insurance are the result of fraud and are already captured under the anti-fraud surveillance programs of life insurers.

6. *Proposed Rule* sections 103.137 (a)(1), (c)(1)

We respectfully request revisions to the current language in these sections in order to achieve accuracy and clarification. First, the definition of "annuity contract" in *Proposed Rule* section 103.137 (a)(1) should be revised from ". . . agreement between the insurer and the insured whereby . . ." to ". . . agreement between the insurer and contract owner whereby . . ." An insured may not be the contract owner. The agreement in an insurance contract is between the insurer and the contract owner and not necessarily the "insured". Second, *Proposed Rule* section 103.137 (c)(1) should be revised from "... the insurance company obtains all the information necessary ..." to "... the insurance company obtains all the relevant information necessary ..." This revised language parallels the language in the second sentence of this section (c)(1) and further reflects the risk-based theme in the *Proposed Rule*.

7. *Proposed Rule* – Supplementary Information, Sec. II, 67 Fed. Reg. 60,626-27

FinCEN has provided helpful background into the logic of the *Proposed Rule's* development in the Supplementary Information section preceding the text of the *Proposed Rule*. This section contains guidance enabling us to better understand the purpose and scope the *Proposed Rule*.

However, we respectfully request that the final rule reflect revised text in the Supplementary Information concerning the use of life insurance products and alleged acts of money laundering. Consequently, we believe the Supplementary Information produces an inaccurate, incomplete, and misleading administrative record.

To the uninformed reader, the text of the Supplementary Information creates a distinct impression that life insurance (and to a lesser extent, life insurers themselves) are the preferred products and vehicles for money launderers, and specifically, drug traffickers. We are offended by the two pages of the above-cited text. To repeatedly describe the products offered by our Member Companies as "posing a significant risk of money laundering" – without any supporting facts or statistics – is an affront to the valuable benefits offered by life insurance products and to the service we offer to our policyholders, insureds, and beneficiaries.

To date, in our review of publicly-available materials from law enforcement agencies, international organizations, and standard-setting groups, we are aware of only one case involving a life insurance product used to launder money – and the involvement was tangential. *See,* Financial Action Task Force on Money Laundering, *Guidance for Financial Institutions in Detecting Terrorist Financing*, p. 3, example 2 (April 24, 2002) (case described in the example is reported to be under investigation).

Myriad laws exist to prevent the abuse and misuse of life insurance. The life insurance industry has decades of experience in anti-fraud efforts. Our industry wants to ensure that our products are not abused and misused. In that regard, we strongly encourage FinCEN to release any information on cases concerning the use of life insurance products – without compromising any investigations or prosecutions - so that our industry may learn the scams in which criminals are engaging and thereby enhance our abilities to identify red flags.

We appreciate your attention to our views. Kindly address any questions concerning our submission to our attention (carlwilkerson@acli.com)(202-624-2118) (victoriafimea@acli.com) (202-624-2183).

Cordially,

Carl B. Wilkerson

Carl B. Wilkerson

Victoria E. Fimea

/encls.(3): (Appendix, Certification, SEC Interpretative Letter)

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Appendix
ACLI Comment Letter to Section 352 Insurance Company Regulations
Notice of Proposed Rulemaking

In this Appendix, we explain in greater detail the business operations of the reinsurance industry. This Appendix also discusses the important role played by reinsurance in enabling ceding life insurers to provide coverage for insureds.

The business of reinsurance requires the reinsurer to perform pricing analyses, underwriting analyses, and claim investigation. An interesting note about reinsurers – as contrasted with property/casualty reinsurers – is that reinsurers are not subject to increases in liability in the same way as property/casualty reinsurers. For example, social and economic factors in this century have been far more likely to reduce the mortality exposure of reinsurers as much as they have increased the exposure of various property/casualty reinsures.

Illustrative of the myriad products covered by reinsurance include group and individual life insurance, group and individual annuities, and, group and individual long-term care and disability income insurance. The reinsurance treaties governing these products have unique clauses demonstrating the loss protection and risk spreading strategy exercised by a ceding life insurer. For example, claims under a reinsurance treaty by a ceding life insurer for long-term care and disability income insurance typically are incurred on the date a disability begins or on the date a person enters a nursing facility, but, the ceding life insurer pays the claims under these policies over an extended period of time. Therefore, the reinsurer must establish adequate disabled life liabilities (*i.e.*, reserves) for future payments to the ceding life insurer. Another example is a claim under a reinsurance treaty by a ceding life insurer for life insurance. In life insurance, a claim is incurred on the date of death of the insured; when the ceding life insurer makes a claim under the reinsurance treaty, the reinsurer then makes a lump sum payment to the ceding life insurer. Therefore, with life insurance – unless the insurance on the life at issue is reduced, terminated, or recaptured before death – the reinsurer knows that in time the reinsurance cession will turn into a claim of a predictable amount.

The following nine paragraphs provide an overview of business realities of great importance to ceding life insurers and how reinsurance enables ceding life insurers to manage those realities.

- Mortality/Morbidity Risk Transfer: Ceding life insurers will purchase reinsurance in order to issue policies on a single life for an amount in excess of a limit which the ceding life insurer believes it can prudently retain at its own risk (the risk retention limit). Without a risk retention limit a ceding life insurer could face insolvency if it experienced a number of large claims over a short period of time. The risk retention limit is set at a level which enables the ceding life insurer to use reinsurance as a tool to smooth out fluctuations in statutory earnings and surplus that may result from large individual claims. Risk retention limits are not mandated by law and are within the discretion of company management.

- <u>Lapse or Surrender Risk Transfer</u>: Generally, ceding life insurers will cede business to cover excessive mortality or morbidity risks. A ceding life insurer may, on occasion, cede risk to cover the possibility of excessive lapses or surrenders. The lapse risk or surrender risk is the greatest on products where the first year sales commission paid to the agent (or, the sum of first year sales commission and the first year policy cash value) exceed the first year premium paid to the life insurer. Life insurance products with steeply increasing premiums and with heavy policy loan activity also are prone to high rates of lapse or surrender.

- <u>Investment Risk Transfer</u>: Ceding life insurers may reinsure a block of business in order to take advantage of the reinsurer's investment facilities or to otherwise shift part of the ceding life insurer's investment risk to the reinsurer. This strategy may occur when the reinsurer has access to particular investments which are not available to the ceding life insurer. This strategy may also occur when the ceding life insurer seeks to avoid high concentration of assets arising from a single product or from a single large policy.

- <u>New Business Financing</u>: Ceding life insurers may use reinsurance to assist in financing the acquisition of new business. Acquisition costs and reserve requirements associated with the underwriting of new business may depress statutory earnings. The ceding life insurer, therefore, may seek a reinsurer willing to share the burden of the acquisition costs. Usually, the sharing of acquisition costs are in proportion to the mortality or morbidity risk sharing.

- <u>Risk Selection Assistance</u>: Ceding life insurers may seek reinsurance as a solution to risk selection (*i.e.*, underwriting needs). In the past, all life insurance business subject to reinsurance was underwritten by reinsurers because of the underwriting expertise of the reinsurers. Today, many ceding life insurers utilize underwriting manuals developed by reinsurers, and, the reinsurers may provide training for the ceding life insurer's underwriters. Reinsurers today may be utilized to provide second opinions on underwriting and to obtain a more competitive rating.

- Gaining Product Expertise: Ceding life insurers may form an alliance with a reinsurer to obtain expertise in an area in which the ceding life insurer is unfamiliar; this can include product development and use – for a fee - of the reinsurer's administration systems. Usually, this arrangement will terminate once the ceding life insurer gains sufficient experience to administer the business on its own.

- Limiting Catastrophic Claims: Multiple life insurance claims can occur from a single event (*e.g.*, the horrific attacks on the World Trade Center and The Pentagon in September 2001). Though rare, when these claims occur the impact on a ceding life insurer can be dramatic. Such claims can impact both small and large ceding life insurers. Because of this type of risk, many ceding life insurers will purchase catastrophic life reinsurance coverage.

- Limiting Total Claims: Small size ceding life insurers are particularly concerned with fluctuations caused by an excessive number of retained claims in any one year. In order to protect against this risk, come ceding life insurers obtain stop-loss reinsurance coverage. A stop-loss program provides the ceding life insurer with reimbursement by the reinsurer for all (or for a specified percentage) of retained claims in excess of a specified amount up to a defined maximum. This specified amount (referred to as the "attachment point") usually is expressed as a percentage of the expected claims. Usually, the reinsurance treaty limits the amount of any claim to be included in the stop-loss calculation to the ceding life insurer's retained portion of the claim.

- Capital Planning and Management: Ceding life insurers can utilize reinsurance to increase statutory earnings and surplus. By enabling a reinsurer to share in the future statutory profits and losses on a block of business reinsured, the ceding life insurer can receive ceding allowances from the reinsurer equal to a portion of the reinsurer's expectation of future profits from the reinsured business. The ceding life insurer is allowed to account for these payments by the reinsurer in the year paid and, therefore, increase its statutory earnings and surplus as a result of the reinsurance.

Insurance Producer Certification Under § 352 of USA PATRIOT Act

I, **[name of producer]**, by completing and signing this Certification, hereby certify to **[name of life insurer]**, that I have taken and completed training under an anti-money laundering program satisfying the elements of 31 C.F.R. § 103.137 **[subpart to be numbered]**. This training was sponsored by **[name of company]** and I completed training on **[date]**.

Name of producer: ___________________________________

Signature of producer: ___________________________________

Date: ___________________________________

Attachment to ACLI Letter to the Department of the Treasury dated November 25, 2002

Release No. 8389, Release No. 34-8389
Securities and Exchange Commission (S.E.C.)
Securities Exchange Act of 1934

Distributions of Variable Annuities by Insurance Companies Broker-Dealer Registration and Regulation Under the Securities Exchange Act of 1934

September 13, 1968

The recent increase in the public offering of those investment contracts frequently referred to as 'variable annuity contracts', 'variable annuity interests' or simply 'variable annuities' [FN1] has resulted in a number of inquiries to the staff concerning the application of the registration and other regulatory requirements applicable to brokers and dealers under the Securities Exchange Act of 1934 ('the Act'). Some of the more common problems which have arisen in this connection, as well as the views expressed by the staff are noted below for the guidance of interested persons and their counsel.

Sections 3(a)(4) and (5), and 15(a)(1) of the Act--Broker-dealer registration requirements. A life insurance company created a Separate Account under State law as the funding medium of a Group Annuity Contract to provide fixed and variable annuity benefits under a retirement plan for self-employed members of a professional organization and their employees. The insurance company proposed to offer and sell variable annuity interests in the retirement plan by direct mail, by using its representatives to explain details of the Group Annuity Contract at meetings of the members of the professional organization, and by direct solicitation through such representatives of the members of the professional organization at such meetings.

The following views were expressed by the staff:

Since the insurance company engages in the purchase and sale of its own portfolio securities, will make purchases and sales of securities for the portfolio of the Separate Account, and will distribute the variable annuity interests of which it and the Separate Account are coissuers, the insurance company would be a 'broker' as defined in section 3(a)(4) of the Act as well as a 'dealer' as defined in section 3(a)(5) of the Act. Accordingly, the insurance company will be required under section 15(a)(1) of the Act to register with the Commission as a broker-dealer, However, upon being informed by the insurance company that it contemplated the formation of a wholly owned subsidiary to engage in the offer and sale of the variable annuity interests, the staff stated that if the subsidiary becomes registered as a broker-dealer and complies with all applicable rules and regulations, including the requirement to direct and supervise all persons engaged directly or indirectly in the offer and sale of such securities, the staff would not recommend action by the Commission if the insurance company itself did not become registered as a broker-dealer. Such an arrangement, however, would not serve to relieve the insurance company, or the persons in control thereof, from the responsibilities imposed upon persons directly or indirectly controlling a broker or dealer of carrying out the standards embodied in section 15(b)(5)(E) of the Act.

Form BD (17 CFR 249.501) Application for Registration. A life insurance company desiring to become registered as a broker-dealer in order to offer and sell variable annuity interests in a Separate Account which it had created under a State law pointed out that it has more than 150 officers, the vast majority of whom would have no function, directly or indirectly, with the variable annuity operation. Upon inquiry as to whether all of such officers must be listed in response to Item 3(b) of Form BD (17 CFR 249.501) the staff stated it would raise no question if the officers who were listed were limited to the president, the secretary, the treasurer, such vice presidents as have authority to act 'vice' the president, and such other officers of the insurance company who would be directly or indirectly engaged in activities relating to the variable annuity operations.

Rule 15b1-2 (17 CFR 240.15b1-2), Statement of financial condition-- Schedule of securities--Example No. 1. A life insurance company proposing to engage in the offer and sale of variable annuity interests funded by a Separate Account created by it under State law was preparing its application for registration as a broker-dealer on Form BD (17 CFR 249.501). The applicant referred to the provisions of Rule 15b1-2 (17 CFR 240.15b1-2) requiring an applicant to file with its application a verified statement of financial condition disclosing in detail the nature and amount of its assets, liabilities and net worth as of a date within 30 days of filing, and pointed out that its operation is so vast as to render it physically impossible for it to complete any such statement, even on an unaudited basis within the prescribed 30-day period.

The staff stated that 'no action' would be recommended, if, in lieu of such a 30-day statement, the insurance company filed with the Form BD (17 CFR 249.501) application a statement of its financial condition containing the required information as of the most recent practicable date, accompanied by a statement by a responsible financial official of the applicant, verified within 30 days of the date of filing, to the effect, if true, that the applicant's financial position on the date of such verification is not materially different from the condition reflected in such statement of financial condition.

Example No. 2. The life insurance company referred to in Example No. 1 also pointed out that the number of items on its list of portfolio securities rendered it impractical for the company to furnish a schedule of such securities valued at market within 30 days of the filing of the Form BD (17 CFR 249.501) application, as is required by Rule 15b1-2 (17 CFR 240.15b1- 2). The staff took the position that it would raise no question regarding failure to meet this requirement if the company filed its most recently printed schedule of securities containing market valuations and if, following its yearend audit, the company filed, as soon as possible after it becomes available, the yearend schedule of securities prepared by the company's auditor containing valuations at market at such yearend.

Rule 15c3-1(b)(3) (17 CFR 240.15c3-1(b)(3)), Exemptions from net capital requirements. Exemptions pursuant to Rule 15c3-1(b)(3) (17 CFR 240.15c3-1(b)(3)) from the net capital requirements of Rule 15c3-1 (17 CFR 240.15c3-1) have been granted to life insurance companies registered as broker- dealers which are required under operative State law to maintain the bulk of their investments in the form of interests in real estate and real estate mortgages which, when deducted from net worth in the computation of net capital as required by subparagraph (c)(2)(B) of Rule 15c3-1 (17 CFR 240.15c3-1), would preclude such companies from achieving compliance with the ratio between aggregate indebtedness and net capital as prescribed by the rule, upon a specific showing by each such company of a substantial financial position composed of substantial assets as well as unassigned surplus or net worth, with the bulk of liabilities consisting of policy reserves. (One of such companies had assets of $25 billion and unassigned surplus of $470 million. One of the smallest of such companies had total assets of approximately $346 million and net worth of $40 million). In addition to the foregoing, the companies, as required by the exemptive rule, demonstrated the existence of satisfactory safeguards for the protection of the funds and securities of customers, including the maintenance of a blanket fidelity bond covering all officers, employees, agents, and general agents; arrangements under which all customers' payments are sent directly to the company and are not handled by sales personnel and certificates are mailed directly by the company to the customer; restrictions on the withdrawal of funds and securities from the company's Separate Account; and internal and independent audit systems.

Section 17(a)--Inspection of Records.
Rules 17a-3--Maintenance of Records, and 17a-4--Preservation of Records (17 CFR 240.17a-3 and -4).
Rule 15c1-4--Confirmation Requirements (17 CFR 240.15c1-4).
Section 3(a)(18)--Associated Persons.
Section 15(b)(5)(E)--Supervision and Control.

A life insurance company which has created a Separate Account under state law for the offer and sale of variable annuity interests funded by the Separate Account has formed a subsidiary which has become registered as a broker-dealer to act as the distributor of the variable annuity interests. The records of the broker-dealer will be maintained by the accounting department of the insurance company which will also send to the participants confirmations of the transactions and pay the sales commissions due to the 'persons associated' with the registered broker-dealer who also happen to be insurance agents for the insurance company.

No question will be raised by the staff respecting such arrangements upon adherence to the following conditions:

1. That a binding agreement exists between the insurance company and the broker-dealer registrant that all the books and records maintained by the insurance company in

connection with the offer and sale of variable annuity interests funded by a Separate Account are to be maintained and preserved in conformity with the requirements of Rules 17a-3 and 17a-4 (17 CFR 240.17a- 3 and -4) under the Act, to the extent that such requirements are applicable to the variable annuity operations; that all such books and records are maintained and held by the insurance company on behalf of and as agent for the broker-dealer registrant whose property they are and shall remain; and that such books and records are at all times subject to inspection by the Securities and Exchange Commission in accordance with section 17(a) of the Act. A copy of such agreement shall be furnished to the Commission.

2. That the making of payments by the insurance company to the sales personnel of the broker-dealer registrant be performed as a purely ministerial service and that the records in respect thereof are properly reflected on the books and records maintained by or for the broker-dealer registrant.

3. That, since the crediting of a payment by a participant on the books and records maintained by or for the broker-dealer registrant constitutes the sale of of a security and, therefore, a 'transaction' as that term is used in Rule 15c1-4 (17 CFR 240.15c1-4) under the Act, a confirmation for each such transaction will be sent to the participant at or before the completion thereof; and that the confirmation will reflect the facts of the transaction, and the form thereof will show that it is being sent on behalf of the broker-dealer registrant acting in the capacity of agent for the insurance company.

4. That the broker-dealer registrant has and assumes full responsibility for the securities activities of all persons engaged directly or indirectly in the variable annuity operation, each such person being a 'person associated' of the registrant as defined in section 3(a)(18) of the Act, and, therefore, a person for whom the broker-dealer registrant has full responsibility in connection with training, supervision, and control as contemplated by section 15(b)(5)(E) of the Act.

Rule 17a-5 (17 CFR 240.17a-5)--Financial reporting requirements. If an insurance company is registered as a broker-dealer in order to offer and sell variable annuity interests funded by a Separate Account created under State law, and if it has been exempted pursuant to an order under Rule 15c3-1(b)(3) (17 CFR 240.15c3-1(b)(3)) under the Act from the net capital requirements of Rule 15c3-1 (17 CFR 240.15c3-1), no question will be raised by the staff respecting compliance with the financial reporting requirements of Rule 17a-5 (17 CFR 240.17a-5) if the company files a copy of the most recent certified financial statement filed with the Commission pursuant to the requirements of the Securities Act of 1933 in lieu of a report complying with Form X-17A-5 (17 CFR 249.617).

By the Commission.

ORVAL L. DUBOIS, Secretary.
AUGUST 29, 1968.

[F.R. Doc. 68-11202; Filed, Sept. 13, 1968; 8:49 a.m.]

FN1 The Supreme Court has held that if the benefits to a member of the public from his contributions to a fund fluctuate to any degree with the fortunes of the fund, the arrangement between him and the fund or the person creating the interests in the fund, constitutes a security in the form of an 'investment contract' for the purpose of the Securities Act of 1933 and the Investment Company Act of 1940. SEC v. United Benefit Life Insurance Co., 387 U.S. 202; SEC v. Variable Annuity Life Insurance Co., 359 U.S. 65. That such arrangements are investment contracts encompassed within the term 'security' as defined in section 3(a)(10) of the Securities Exchange Act of 1934 also appears quite plain from the reasoning of the Supreme Court in Tcherepin v. Knight, 389 U.S. 332, that a security as defined in section 2(1) of the Securities Act of 1933 was intended by Congress to be included in the term 'security' as defined in section 3(a)(10) of the Securities Exchange Act of 1934 (Act).

Release No. 8389, Release No. 34-8389, 1968 WL 86051 (S.E.C. Release No.)