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- Economic Stabilization Legislations Also Includes Tax and Health Provisions
- House Oversight Committee Holds Hearing on AIG Bailout
- Update: New Laws Affecting Group Health Insurance
- SEC Reopens Comment Period on Proposed Rule 151A
- NAIFA Encourages In-District Meetings with Federal Legislators During Congressional Recess
- House Education and Labor Committee Holds Hearing Examining Losses to Retirement Savings
- Senators Offer Health Benefits Disclosure Discussion Draft
- NAIFA Government Relations Staff Announces Restructuring, Promotions
- Did You Know?

Economic Stabilization Legislations Also Includes Tax and Health Provisions

Unless you have been living under a rock for the last two weeks, you are well aware that Congress and the White House crafted a massive financial package designed to calm very troubled financial markets. With all the notoriety focused on the so called “bailout” bill it may have escaped notice that the package also contained health and tax provisions.

President Bush signed the Emergency Economic Stabilization Act (H.R.1424) on October 3, 2008. The bill will authorize the Treasury Department to purchase up to \$700 billion in “troubled assets” from the nation’s financial institutions, including insurance companies. NAIFA retained law firm of Steptoe and Johnson has prepared a report of the Economic Stabilization Act that provides more detail. That summary is available at www.naifa.org/advocacy/documents/HR1424_summary.pdf.

For more details on the provision expanding mental health insurance benefits see the explanation provided in a previous GovWatch at www.naifa.org/advocacy/govwatch/20081003_HouseApprovesERP.cfm

Rounding out the 400-plus page bill are tax law provisions that will significantly impact the lives of millions of workers and their families. For a full explanation from the Joint Committee on Taxation of the tax law changes is available at www.naifa.org/advocacy/documents/HR1424.pdf.

Those most relevant to NAIFA members include:

- **Alternative Minimum Tax:** This is a provision that will personally impact approximately 24 million higher earning taxpayers, including many NAIFA members and their clients. The legislation “patches” the individual AMT for 2008 income. Generally, the AMT patch would allow an exemption from AMT taxable income of \$46,200 (up from \$44,350 in 2007) for individuals and \$69,950 (up from \$66,250 in 2007) for married couples. It also allows use of personal credits against AMT tax liability.
- **Extending expired or soon to expire tax incentives:** Many of provisions in H.R.1424 extend tax laws that expired December 31, 2007 or will expire on December 31, 2008. The provision of direct interest to some NAIFA members is the tax authority to give a direct tax-free gift from an IRA to a charity. Authority has been extended through 2009.

The tax benefit package will result in the federal government collecting a projected \$150.5 billion less in tax revenue over 10 years. However, the lost revenue will be partially offset by a handful of revenue raisers. Provisions relevant to NAIFA members include:

Basis reporting on securities transactions: Securities brokers will be required to report the cost basis of most trades to the Internal Revenue Service (IRS) and to the individuals entering into the transactions. The reporting requirement would apply to stock, debt, commodities, derivatives, and other items specified by the Treasury. JCT estimates the basis reporting provision will raise \$6.7 billion over 10 years.

Nonqualified deferred compensation (NQDC) paid to a narrowly-targeted group (mostly, hedge fund and certain other investment managers): Generally, the restriction on NQDC applies to executives who receive their deferred compensation through a “tax indifferent party,” such as an entity based in an offshore tax haven country. The Joint Committee on Tax (JCT) scored this NQDC restriction as an almost \$24 billion (over 10 years) revenue raiser.

The offshore NQDC provision is not likely to affect the business of NAIFA members, but the tax provision combined with a provision in the main economic stabilization package could be harbingers of things to come for deferred and executive compensation practitioners next year.

The Emergency Economic Stabilization Act requires that limits on executive compensation be imposed on any company that sells the U.S. Treasury \$300 million or more in illiquid mortgage backed securities. Those limits include a cap of \$500,000 on the amount of deductible compensation such a company’s executives could be paid. These companies would also face new restrictions on golden parachutes and severance payable to their executives—three times their salary, with any excess nondeductible and the executives liable for a 20 percent excise tax on the excess. Executives affected by these new limits are a company’s top five--subject to the compensation limits contained in Internal Revenue Code (IRC) section 162(m). The legislation also would expand the definition of compensation to include performance based compensation.

These two deferred compensation provisions taken together point a spotlight squarely on executive and deferred compensation practices as an area of potentially high interest to Congressional tax writers. NAIFA members will recall that severe restrictions on deferred compensation were proposed in a major Senate tax bill early in 2007. Those restrictions were successfully blocked in the House. During the drafting stage for the Emergency Economic Stabilization Act, it was widely rumored that key legislators wanted to extend the restrictions they applied to troubled financial institutions to all businesses. Come next January, the issue could easily resurface again.

NAIFA Staff Contact: [Michael Kerley](#), Senior Vice President of Federal Government Relations, (703) 770-8155.

House Oversight Committee Holds Hearing on AIG Bailout

On October 7, the House Oversight and Government Reform Committee (Chairman Henry Waxman, D-CA) held its second in a series of five hearings on the current financial crisis. The hearing, which focused on the collapse of AIG, was designed to investigate “corporate greed and regulatory voids.” Members asked three main questions: 1) Was AIG’s Executive Compensation Package fair and appropriate; 2) Did former Chief Executive Officers of AIG mislead investors after receiving negative internal audit reports; and 3) What regulatory steps should lawmakers take to prevent future turmoil?

Federal Loans

The hearing followed an announcement by the Federal Reserve on Sept. 16 that it would offer an \$85 billion line of credit to AIG’s holding company in return for an 80 percent stake in the company. The 2-year loan was extended to AIG by the federal government because it was determined AIG’s insurance assets have value and can be sold off in an orderly fashion to repay the loan. AIG has since announced that it may sell off its U.S. life insurance operations but plans to retain its property and casualty and foreign general insurance businesses, as well as its ownership interest in its foreign life insurance operations. In addition, the Federal Reserve Board announced on October 8 that it will borrow investment-grade fixed income securities from AIG’s U.S. life insurance subsidiaries in exchange for \$37.8 billion in cash collateral. The \$37.8 billion will provide AIG’s life insurance subsidiaries necessary liquidity to meet immediate collateral obligations with its Securities Lending program.

Executive Compensation

[Committee members](#) interrogated two former CEO’s of AIG, Martin Sullivan (2005-2008) and Robert Willumstad (Chairman of the Board 2006-2008 and CEO June - September 2008) about the appropriateness of enormous, performance-based executive compensation packages received by AIG executives. Sullivan admitted that during his tenure he asked the AIG board to alter the performance-based compensation rules and forgo consideration of recent losses from pay formulas for executives despite AIG’s significant financial losses. The board agreed and compensated all executives, including Joseph Cassano, who headed AIG’s Financial Products Division (AIGFP) that managed the risky credit default swaps (CDS’s) that played a major role in AIG’s financial crisis. Willumstad agreed not to accept his multimillion dollar severance compensation package, while Sullivan did not offer to forgo his severance agreement from June of this year. Cassano was fired from AIG in February and was allowed to keep \$34 million in unvested bonuses in addition to being placed on a \$1 million a month retainer that was still in effect at the time of the hearing.

Retreat at the St. Regis

The second AIG expenditure that received a great deal of attention was a retreat at the exclusive St. Regis Hotel costing the company nearly \$500,000. This retreat took place only one week after Congress approved the \$85 billion loan to AIG. Both Sullivan and Willumstad agreed that the expenditure was highly inappropriate. They further noted that the retreat occurred after they had left the company and therefore they each were unable to comment specifically on the corporate decision to hold the retreat. AIG CEO Edward Liddy has since written to Treasury Secretary Henry Paulson to clarify the retreat was planned months in advance for top-producing independent agents at American General.

A copy of AIG CEO Edward Liddy's Letter to Treasury Secretary Henry Paulson is available at www.naifa.org/advocacy/documents/AIG_retreat.pdf.

Causes of the Collapse

Witnesses and committee members identified a variety of causes for AIG's collapse including lack of transparency in accounting, poor AIG management, lack of risk management controls, lack of Securities and Exchange Commission (SEC) oversight or jurisdiction, lack of regulation of credit default swaps (CDS), and that AIG had been allowed to grow too large. Lynn Turner, former chief accountant of the SEC, even suggested that AIG conducted illegal transactions. It should be noted that AIGFP is currently under investigation by the U.S. Department of Justice for violation of federal securities laws. Further, lawmakers claimed that AIG officers ignored internal warnings regarding the risk management practices of AIGFP while simultaneously misleading investors as to the health of the company. Chairman Waxman introduced negative internal audit reports by Price Waterhouse Cooper and The Office of Thrift Savings regarding the risk management practices in question.

Willumstad and Sullivan identified mark-to-market accounting methods as a significant reason for the downfall of AIG since mark-to-market requires companies to book tens of billions of dollars in accounting losses, even if the underlying securities are not in default. They asserted that these requirements led to unnecessary fear in AIG's health, causing a downward spiral. They also blamed AIG's failure on the general "financial tsunami" that currently plagues the entire market.

Maurice Greenberg, also former CEO of AIG, was asked to testify. Greenberg could not attend the hearing due to illness. He submitted a written statement, however, that blames AIG's failure on the poor management of Sullivan and Willumstad in exposing AIG to risky credit default swaps and subprime loans. Both Sullivan and Willumstad denied these allegations, asserting that AIG had greater risk controls under their tenure than under Greenberg's rule.

Credit Default Swaps

The hearing included lengthy discussion on the future regulation of credit default swaps (CDS), an unregulated estimated \$62 trillion market. A credit default swap is a contract under which the seller promises to pay the buyer if the provider of a bond cannot pay principal and interest. Unlike a regulated insurance contract, there are no reserving requirements for a CDS.

Therefore, when the trickle down effect of the housing crisis left AIG's holding company financially vulnerable, it was unable to meet its extensive CDS obligations. To address the reserving issue, New York State Insurance Superintendent Eric Dinallo said New York will begin in January 2009 regulating CDS's as an insurance contract provided the CDS is purchased to hedge against a bond issuer becoming unable to pay interest and principal of the bond. He called on Congress to consider national laws to regulate all CDS contracts, including "naked swaps" that make up an estimated 90% of the CDS market and cannot be treated as insurance contract. With a "naked swap," Dinallo compared the investor to a gambler. Frequently, speculators use "naked swaps" to bet that a bond will default.

Insurance Regulation

Congressman Bruce Braley (D-IA) asked Superintendent Dinallo if Congress should, in light of the integrated financial services marketplace, revisit the 1945 McCarran-Ferguson Act and allow for federal oversight of insurance. Dinallo replied that he remains "agnostic" on federal oversight, state oversight or a hybrid like optional federal charter, but noted that states should stay in the solvency business because they have done an extremely good job. He stated that the states, "are clunky on other things like product registration and licensing of agents, we're pretty

clunky on that” but they are good at regulating the solvency of insurance companies. At another point in the hearing, Dinallo suggested that Congress reevaluate the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 which allowed for the integration of banking, investment and insurance services

Future Hearings

Members also discussed the role of other financial giants in the nation’s financial crisis. Chairman Waxman (D-CA) asserted that the failures of AIG and Lehman Brothers were “fundamentally the same,” as executives in each took excessive risk and walked away with millions. Republican Members requested that Fannie Mae and Freddie Mac be the subject of a future Oversight Committee hearing. Chairman Waxman said a committee investigation into the two companies is underway and hearings will follow.

In addition to two hearings this week on the collapse of Lehman Brothers and AIG, the Oversight Committee will hold hearings on the regulation of hedge funds on October 16, on the breakdown in credit ratings on October 22, and on the role of federal regulators on October 23.

The following is a list of the witnesses and links to their testimony.

Witness List and Prepared Testimony: Panel One

Eric R. Dinallo, the Superintendent of the New York State Insurance Department
<http://oversight.house.gov/documents/20081007100906.pdf>

Lynn E. Turner, former chief accountant of the Securities and Exchange Commission
<http://oversight.house.gov/story.asp?ID=2211>

Panel Two

Robert B. Willumstad, former Chief Executive Officer of AIG
<http://oversight.house.gov/documents/20081007145302.pdf>

Martin J. Sullivan, former Chief Executive Officers of AIG
<http://oversight.house.gov/documents/20081007101236.pdf>

Maurice Greenberg, former Chief Executive Officer of AIG (did not attend)
<http://oversight.house.gov/documents/20081007101236.pdf>

NAIFA Staff Contact: [Jill Edwards](#), Assistant Vice President of Federal Relations, (703) 770-8158.

Update: New Laws Affecting Group Health Insurance

Mental Health Parity – Also included in the Emergency Economic Stabilization Act (EESA) signed into law on October 3 (see previous GovWatch at www.naifa.org/advocacy/govwatch/20081003_HouseApprovesERP.cfm) are mental health parity rules.

The mental health parity provisions expand upon the Mental Health Parity Act of 1996 which required employers with over 50 employees to equate aggregate lifetime limits and annual limits for mental health benefits with aggregate lifetime limits and annual limits for medical and surgical benefits.

The new law prohibits employer group health plans, including self-insured employers, from adopting mental health (including substance abuse) treatment limitations, financial requirements, or out-of-network coverage limitations unless comparable limitations and requirements are adopted for medical and surgical benefits. Employers with fewer than 50 workers will be exempted from the parity requirements.

The new law also provides a one-year transition period for employers for whom the cost of compliance would exceed two percent of their health insurance costs in the first year and one percent in each subsequent year. It does not apply to health insurance plans that do not include mental health/substance abuse benefits.

Sick Student Coverage - On October 9, President Bush signed a bill ([H.R. 2851](#)) into law that will ensure dependent college students who take a medically necessary leave of absence do not lose health insurance coverage under a new tax code Section 9813.

The House passed the legislation, known as Michelle's Law, by voice vote in July, and in the midst of the financial rescue debate, the Senate passed it by unanimous consent on September 25.

The new law requires group health plans to continue coverage for dependent college students on medical leave for one year after the first day of the medically necessary leave of absence, or until the date on which such coverage otherwise would terminate under the terms of the plan. NAIFA/AHIA Staff Contact: [Diane Boyle](#), Executive Vice President of AHIA, (703) 770-8252.

SEC Reopens Comment Period on Proposed Rule 151A

The SEC announced on October 10 that it was reopening for 30 days the period for the public to submit comments on proposed Rule 151A, which would classify most indexed annuities as securities. The SEC indicated this action was in response to numerous letters it had received requesting an extension of the comment period as well as the significant amount of public interest in this proposal. NAIFA had submitted a letter to the SEC on August 21 requesting an extension of time; when the SEC failed to extend the September 10 deadline for submitting comments, NAIFA completed and submitted its comments prior to the deadline.

- NAIFA's Comment Letter is available at www.naifa.org/advocacy/documents/SEC09102008.pdf

NAIFA opposes proposed Rule 151A because NAIFA does not believe indexed annuities should be classified as securities. While NAIFA strongly believes that people who engage in unscrupulous or misleading sales practices should be aggressively prosecuted and subject to appropriate and meaningful sanctions, issues surrounding suitability and marketing practices are not the criteria that should determine whether a financial product is or is not a security. An insurance product that does not meet the test for being classified as a security should be regulated by state insurance departments and should not be under the jurisdiction of the SEC or FINRA. This is an important principle which must be preserved in order to protect the appropriate regulation of all insurance products. An additional concern that NAIFA has with the SEC proposal is that the application of proposed Rule 151A would not be limited to indexed annuities, and that other annuity and insurance products that fit the rule's criteria could be brought within the scope of the rule. In fact, the SEC has specifically asked for public comment on whether the proposal should apply to life insurance and/or health insurance.

In addition to NAIFA's submission of comments to the SEC on this issue, over 1,000 NAIFA members have submitted individual comments to the SEC. The reopening of the comment period is an excellent opportunity for members who have not submitted comments to the SEC to do so. You can submit comments easily and quickly by reviewing and responding to NAIFA's August 27 GovAlert, which can be read at www.naifa.org/advocacy/govalert/20080827_aa_sec.cfm.

NAIFA's strength is in our member's voices—let your voice be heard on this issue by reading and responding to the August GovAlert!

NAIFA Staff Contact: [Gary Sanders](#), Vice President of Securities and State Government Relations, (703) 770-8192.

NAIFA Encourages In-District Meetings with Federal Legislators During Congressional Recess

With Congress recessing after a tumultuous two weeks, Senators and Representatives are headed home to campaign. To remind elected officials about the vital role NAIFA members and insurance products play in the U.S. economy, we are asking you to seek opportunities to speak face-to-face with your Senators and/or Representative. We ask you to coordinate with other APIC grassroots contacts for your Members of Congress and go to the meetings as a team. You can find a list of your APIC colleagues at www.naifa.org/advocacy/apic/legis_contacts.cfm and click on your state. We also strongly encourage you to bring other members of your local association, especially the Young Advisors, with you.

Representatives and Senators should be easy to find at either their state or district offices or public forums (such as town hall meetings) as Election Day approaches. You can get all the contact information you need by going to capwiz.com/naifa.

Here's the message we'd like you to deliver:

- Thank the Member of Congress for the job he/she does and, if applicable let him/her know that you plan to vote for him/her.
- Mention that the recent crises in the financial markets highlight the importance of life insurance and the value of life insurance products for financial planning. Talk about the stability that those products bring to their constituents' (your clients) savings portfolios.
- Ask the lawmaker whether it is likely that Congress will consider further legislation in 2009 addressing the financial markets and point out that tax changes can encourage or discourage savings, and we definitely don't want to discourage savings by removing the current incentives in the tax code for life insurance.
- Help your members of Congress to understand that the current tax treatment of life insurance and annuities provides strong incentives for individuals to save for their future and provide for their families.
- Tell the Member of Congress that, as a local insurance and financial services professional, you will want to meet next year to provide more detail about the importance of the current life insurance and annuity tax rules. Offer yourself as a source of information on these important financial products. Don't forget to leave your business card and state that you are

a NAIFA member. (Better yet, write “Member of the National Association of Insurance & Financial Advisors” on your card.)

Special Note: It is critical that you let the NAIFA Government Affairs team know your Member’s views on these issues immediately after your meeting. You can use the form at www.naifa.org/advocacy/apic/documents/district_meeting_response_form.pdf and fax it back to (703) 770-8151 or simply write an email to apic@naifa.org – whatever is easier for you. Thank you. We truly appreciate all you do on behalf of our APIC grassroots program.

NAIFA Staff Contact: [Ryan Baird](#), Political Involvement Administrator, (703) 770-8154.

House Education and Labor Committee Holds Hearing Examining Losses to Retirement Savings

The U.S. House Committee on Education and Labor held a hearing on October 7, 2008 to assess the effect of the current financial market turmoil on the retirement savings of American workers.

The Hearing

The hearing—entitled “The Impact of the Financial Crisis on Workers’ Retirement Security”—was called by committee Chairman George Miller (D – CA) to examine the ways in which the current state of the financial market has affected pension plans, Individual Retirement Accounts (IRAs) and 401(k) plans. According to Miller, “A new poll just found that 63 percent of Americans are worried that they will not have enough savings for their retirement.” According to a study conducted by AARP, 20 percent of middle-aged workers stopped contributing to their retirement plans in the last year because they were having difficulty making financial ends meet. The panel of witnesses called to testify before the Committee included the following:

- Jerry Bramlett of BenefitStreet, Inc.
- Dr. Teresa Ghilarducci, a Professor of Economic Policy Analysis at the New School for Social Research
- Dr. Peter Orszag, Director of the Congressional Budget Office
- Dr. Christian Weller, Associate Professor of Public Policy at the University of MA and Senior Fellow for American Progress

Stability of 401(k) Plans Called Into Question

Congressional Budget Office Director Peter Orszag testified that \$2 trillion had been lost from workplace retirement plans in the last 15 months. According to Orszag, the greatest losses were felt in workers’ 401(k) plans, losses which are likely to result in later retirements for many Americans.

The hearing called into serious question the viability of 401(k) plans as a secure means of retirement savings. Dr. Teresa Ghilarducci of the New School for Social Research called 401(k)s a failed Congressional experiment which are “fundamentally flawed” with “little regulation.” Dr. Christian Weller, an Associate Professor at the University of Massachusetts, noted that the shift from pension plans to 401(k) plans has placed greater risk exposure on individuals rather than employers. Dr. Weller also said that, “the strength of America’s workers’ retirement security has been declining for many years and will likely continue to worsen...”

Next Steps

Since the hearing, Chairman Miller has expressed interest in looking at legislation that would eliminate the \$80 billion in tax breaks currently enjoyed by 401(k) investors and redirecting those funds to guaranteed retirement accounts. The plan was first mentioned by Dr. Ghilarducci during the October 7 hearing. Miller stopped short at officially endorsing the plan, but has—along with Rep. Jim McDermott (D – WA), chairman of the House Ways and Means Committee's Subcommittee on Income Security and Family Support—expressed a willingness to look at the plan in the future.

NAIFA Staff Contact: [Michael Kerley](#), Senior Vice President of Federal Government Relations, (703) 770-8155 or; [Jen Piantedosi](#), Legislative Assistant, Government Relations, (703) 770-8153.

Senators Offer Health Benefits Disclosure Discussion Draft

On October 7, the Senate's two lead tax writers—Senators Max Baucus (D-MT) and Charles Grassley (R-IA), chairman and ranking member respectively of the Senate Finance Committee—released a discussion draft of legislation that would require employers to report on their workers' W-2 forms the amount the employer pays for their health insurance. Senators Baucus and Grassley say that if employees know how much their employers spend on health insurance, they will be more careful consumers of health care. The Senators have requested comments on their idea by the end of the year.

Early reaction to the health insurance cost disclosure proposal was positive, but later reaction has raised concerns. Among them is the administrative cost of providing the information via a W-2 form. (The bill as drafted would require the employer to aggregate total cost of health, dental, and vision coverage, and to also total the amount of coverage received under multiple employer-provided plans.) Further, many employers already provide this information to their workers during compensation analysis meetings.

Another issue is that while the Senators say that some workers might prefer cash or some other form of benefits in lieu of health insurance, acceding to those preferences could be problematic. Letting the participants in an employer group opt in and out runs the risk of adverse selection, particularly in smaller and medium sized employer groups.

The AHIA Legislation Committee is drafting language for the AHIA Board to consider that would support the Senators' efforts to improve consumer knowledge and offer alternative ways to achieve this goal.

NAIFA/AHIA Staff Contact: [Diane Boyle](#), Executive Vice President of AHIA, (703) 770-8252.

NAIFA Government Relations Staff Announces Restructuring, Promotions

As part of the continuing effort to build out NAIFA's Government Relations operation, on September 29, it was announced that the Government Relations department is being divided into two parts; Federal Government Relations and State Government Relations.

As part of the reorganization, NAIFA is pleased to announce the following promotions:

- Gary Sanders has been promoted to Vice President, Securities and State Government Relations
- Jill Edwards has been promoted to Assistant Vice President, Federal Government Relations
- Magenta Ishak has been promoted to Assistant Vice President of Political Affairs

Michael Kerley will serve as Senior Vice President of Federal Government Relations, and Bill Anderson will serve as Senior Vice President of State Government Relations. Both departments will continue to work very much as a team as they have been operating for some time. "It is our hope, along with our CEO John Healy, that the new structure will enable the GR Department to grow, be more flexible, and respond to a more comprehensive set of issues as we continue to make Advocacy number one," said Bill Anderson of the restructuring.

NAIFA Staff Contact: [Bill Anderson](#), Senior Vice President of State Government Relations, (703) 770-8193 or; [Michael Kerley](#), Senior Vice President of Federal Government Relations, (703) 770-8155.

Did You Know?

Did you know that in addition to selecting a new President on November 4th, 435 U.S. Representatives, 35 U.S. Senators, 11 governors, 7 secretaries of state, 11 attorneys general and 5,800 state legislative seats will be filled?