

Read GovTalk online at www.naifa.org/govtalk

November 2008

Vol. 1, No. 20

- Insurance Agent and Financial Advisors Assess Election's Impact on Key Legislative Issues
- Key Committees Exercise Jurisdiction Over Tax Issues
- Insurance and Financial Services Regulation Committees Face Many Challenges in the Next Congress
- Positioning NAIFA Members for the Challenges of the 111th Congress

Insurance Agent and Financial Advisors Assess Election's Impact on Key Legislative Issues

With the November 4 elections fading in the rearview mirror, the process of assessing the impact of those elections on the near and long-term fate of government policies critical to the business interests of NAIFA members begins in earnest. Your New NAIFA has been at work on this process for some time; developing policy positions, creating legislative infrastructure and deploying the resources of IFAPAC and the Grassroots/Political Involvement Committee to position NAIFA as advantageously as possible following the elections.

The following analysis of the Congressional and Administrative framework that the November 4 federal election constructed takes a first look at the potential impact on legislative and regulatory issues that impact the business interests of NAIFA members and their clients.

The Obama Administration:

To be sure the strongest political, legislative and regulatory player in the federal government is the President of the United States. President-elect Barack Obama (D) gives every indication of hitting the ground running very fast, already having announced leaders of his transition team and his White House Chief of Staff. The appointment of Rep. Rahm Emanuel (D – IL) as Chief of Staff brings a seasoned former Clinton Administration policymaker back to the White House, but removes a central Democratic leader from the House of Representatives. Key Bush Administration officials such as Treasury Secretary Hank Paulson have committed to stay on during the transition and provide the Obama team unprecedented consultation during the transition period.

A smooth transition from President Bush and President-elect Obama will put the new administration in the best position to deal with some of the most pressing issues facing the country, at least for the near term. For example, Congress and the President will be faced with a grim budget picture. The \$455 billion deficit for FY 2008 just ended is forecast to grow to a much larger number for FY 2009 and thereafter due to a number of factors such as declining tax revenues as a result of the current economic slowdown, costs of economic rescue legislation

and corporate takeovers, and costs of recently-enacted tax relief. And, despite large and growing deficits, there is a pent-up Congressional demand for new spending initiatives, including an expansion of health insurance coverage, especially for children and their families, as well as a desire to extend at least a portion of the expiring Bush tax cuts and other expiring individual tax relief (e.g., the AMT “patch”). There will also be a desire to provide additional economic stimulus and relief for people affected by the economic downturn.

Any legislative environment containing these budget crosscurrents always present the potential to question the current tax incentives currently granted life and health insurance products.

The Makeup of the 111th Congress:

Overall, Congressional Democrats picked up a substantial number of seats in both the House and Senate, but the final results are not in. Here’s the breakdown as of November 7:

	Democrats	Republican	Still to be Decided
House of Representatives	254	173	8
U. S Senate	55	40	3

** 2 Independents (Caucus with Democrats)

The election of President-elect Barack Obama and increased Democratic strength of House and Senate Democrats means that the combined Democratic agenda will face relatively easier sailing in Congress, but not unfettered sailing. First, there are three Senate races yet to be decided. All three seats are currently held by Republicans. Were Democrats to win all three would get Senate Democrats close to the Nirvana of a filibuster proof Senate—the ultimate political goal of either Party. That assumes both Independents remain in the Democratic Caucus. Republicans hope to deny Democrats that luxury.

While party labels are important, right up there in importance is individual political and substantive philosophy. Senate and House Democrats are by no means a one size fits all political group. (The same holds true for Republicans.) There are among the House and Senate Democrats elected last Tuesday a number of “moderates.” Most political observers think these moderates will make themselves heard within the Democratic Caucus when Congress convenes next January.

Congressional Committees in the 111th Congress:

While most of the flash and dance in Congress is conducted on the House and Senate floors, the real work gets done in committees and the back rooms. Last Tuesday’s election will alter the individual and political make up of most Congressional committees although the change in the House tax writing committee could be the most profound.

Separate articles in this GovTalk take a first look at what the tax writing and financial services committees might look like come January 2009 and an overview of the legislative issues impacting NAIFA members within the jurisdiction of those committees. These four committees are ground zero for many of NAIFA’s most sensitive issues.

NAIFA Staff Contact: [Michael Kerley](#), Senior Vice President – Federal Government Affairs, at 703-770-8155 or; [Jill Edwards](#), Assistant Vice President – Federal Government Affairs, at 703-770-8158.

Key Committees Exercise Jurisdiction Over Tax Issues

Democrats have significantly expanded their majorities in the House and in the Senate and, as a result, will likely increase their majorities in the House Ways and Means Committee and the Senate Finance Committee. Sometime during the 111th Congress, the tax writing committees will almost certainly consider legislation in the following areas: individual alternative minimum tax relief, individual tax rates, estate and gift taxes, deferred compensation, miscellaneous individual tax credits proposed by candidate Obama, capital gains and dividend tax rates, expiring tax provisions, economic stimulus measures, numerous individual and corporate revenue raisers, State Children's Health Insurance Program ("SCHIP") expansion, employment-based health insurance changes, pension legislation, and energy tax legislation.

The key point for NAIFA members to remember is that any tax legislation taken up in the foreseeable future has potential to bring in tax changes to life insurance, annuities, LTC, DI, health insurance or investment products into the debate.

Among the life insurance issues most likely to surface are:

- **Federal Tax Challenges to Tax Treatment of Life Insurance Products:** As has been pointed out by tax experts many times, Congress does not have to mount a direct assault on inside build-up or tax free death benefits in order to, in effect, accomplish the same result. That's why NAIFA is always on the lookout for proposals to get at the tax advantages of life insurance and annuities indirectly as well as directly. The Nation's budget crisis raises the threat level dramatically.
- **Estate Tax:** Under current law, estate taxes are being reduced through 2009, disappear entirely for 2010, and return to their pre-2001 levels starting in 2011. Senator Obama has proposed freezing estate taxes permanently at their 2009 levels (i.e., a \$3.5 million per person exemption and a 45% maximum marginal rate on the excess). While the Obama proposal would raise revenue in 2010 (by substituting the 2009 levels for complete repeal), it would lose significant revenue in each year after that; the Obama estate tax proposal has been estimated to cost \$284 billion over the period of 2009-2018. It is likely that Congressional Democrats will seek to eliminate the 2010-only repeal of estate taxes (something many Democrats have viewed as a giveaway to the very wealthy), but it is unclear whether there will be the political will or available offsetting revenue to provide a permanent exemption as high as \$3.5 million per person or a permanent maximum rate as low as 45%. That said, it is unlikely that Congressional Democrats will simply allow the pre-2001 estate tax scheme (\$1 million exemption, 55% maximum rate) to snap back in place without some amelioration. A key selling point for estate planning life insurance is the ability, with proper planning, to keep insurance proceeds out of the taxable estate. NAIFA will need to be vigilant next year against possible efforts by Congress to pare back the ability to exclude life insurance proceeds from estate tax as a way of providing offsetting revenue to fund other estate tax relief.
- **Pensions:** Pension plans and the tax rules surrounding them will be a significant focus next years. The current financial crisis has created much uncertainty regarding retirement income. Defined contribution (DC) plans (e.g., 401(k) plans) have for some years been replacing traditional defined benefit (DB) pension plans, but DC plans have recently been hit by significant investment losses. Some Congressional Democrats have viewed DC plans as providing a tax-favored savings vehicle for the well-to-do and are using the current situation to argue for reduced contribution levels for DC plans.

They would favor using any increased revenues from reduced DC contribution limits to pay for additional incentives for employers to create or maintain DB plans.

- **Employer Owned Life Insurance:** Even though Congress enacted Employer Owned Life Insurance “best practices” in 2006, it may be an early target of those seeking to raise revenue from corporations. The Joint Committee on Taxation has estimated the tax revenue lost to the corporate exclusion for inside build-up to be \$13.7 billion over the period of 2008-2012.
- **Non-Qualified Deferred Compensation:** There will likely be a renewed focus on restricting executive compensation, including deferred compensation. Possibilities include extending to other entities the \$500,000 executive compensation deduction limit applied to financial institutions participating in the Treasury Department’s “Troubled Asset Relief Program.” In separate legislation enacted in early October, Congress passed legislation that eliminated the ability of offshore hedge fund managers to defer income under nonqualified deferred compensation plans. This is reminiscent of attempts early in the 110th Congress, when key Senate Finance Committee members proposed limiting all NQDC deferrals to \$1 million per year. This proposal could easily see the light of day early next year. Life insurance is often used to “fund” NQDC plans.

NAIFA and NAIFA members must remain vigilant.

Committee on Ways and Means:

Charles Rangel (D-NY) will remain the Chairman of the House Ways and Means Committee. While the Committee will continue its historic role as the place in which the details of tax legislation are hammered out, broad decisions on the direction of tax policy in the House of Representatives are likely to be made by House Speaker Nancy Pelosi (D-CA) in consultation with the Obama Administration. Republican leadership is expected to choose in December between Rep. Wally Herger (R-CA) and Rep. Dave Camp (R-MI) to step into the role of Ranking Member following Rep. Jim McCrery’s (R-LA) retirement.

The ratio of Democrats to Republicans on the Committee will be a hotly negotiated factor. In the 110th Congress, the Ways and Means Committee had 41 members – 24 Democrats and 17 Republicans. The size of the Committee in the 111th Congress will be one of the key issues taken up when the Democrats return to Washington for organizing meetings later in November and December.

If the Committee size remained unchanged, there would be 10 seats to fill as a result of the retirements and election defeats. But that outcome is unlikely. In light of their over 20 net House seat pickups, taking the Democrats from 54% of House seats in the 110th Congress to approximately 59% in the 111th, it would not be surprising if Democrats added one or two to their Committee number and reduced the Republican number by more.

Senate Committee on Finance:

The Senate Finance Committee will continue to be chaired by Senator Max Baucus (D-MT) who, in view of the fact that Democrats so far have not gained a filibuster-proof 60-seat majority, will likely continue his close working relationship with the Committee’s Ranking Republican, Senator Charles Grassley (R-IA).

In the 110th Congress, the Committee had 21 members – 11 Democrats and 10 Republicans. In light of their at least 5-seat Senate pickup, Democrats are likely to want to improve their Finance Committee ratio.

If the Committee size remained at 21, there would be one certain seat to fill as result of the election defeat of Senator John Sununu (R-NH). Sen. Gordon Smith (R OR) may be added to the casualty list. Senate Democrats could change their majority ratio by simply not adding replacements on the Republican side. The decisions as to the Committee's size, ratio, and the identities of its new members if any will be made in December.

NAIFA Staff Contact: [Michael Kerley](#), Senior Vice President – Federal Government Affairs, at 703-770-8155

Insurance and Financial Services Regulation Committees Face Many Challenges in the Next Congress

The current state of financial market crisis in this country and around the world has led many policymakers to question the current regulatory structure governing all financial institutions. Today, myriad regulatory agencies each understand a piece of the regulatory pie, but no regulatory body has a complete view of how all the different financial services entities are intertwined and what regulatory gaps exist.

It is almost guaranteed that Congress will quickly conduct a massive overview of the current structure with any eye toward creating a whole new one. To address the comprehensive picture, Congressional leaders are discussing the creation of a select committee to get beyond jurisdictional committee barriers as they work to craft a regulatory solution. The select committee would likely include House Financial Services Committee Chairman Barney Frank (D-MA), Ranking Member Spencer Bachus (R-AL), Senate Banking Committee Chairman Chris Dodd (D-CT) and Ranking Member Richard Shelby (R-AL). In addition, the committee is expected to include the Chairman and Ranking Members of the House and Senate Agriculture Committees that oversee the commodities market.

The following is a review of issues insurance agents and companies will likely encounter during the overview process and in the opening days of January 2009.

- **Optional Federal Charter:** The long debate over whether to create an optional federal regulator for insurance agents and companies will likely take on new meaning as Congress considers how to modernize the regulatory structure for all U.S. financial institutions. Among the issues for Congress to consider is whether insurance agents and companies should be included in any overhaul bill and, if so, should any financial institution or agents be allowed to choose (the "option" in optional federal charter) which regulator best suits its business model.
- **Credit Default Swaps:** Congress must consider how to regulate the estimated \$62 trillion credit default swap (CDS) market that has significantly contributed to the market crisis -- including the failure of AIG's holding company. Because a traditional CDS is similar to insurance, Congress must consider if it should regulate, or instead delegate to the state insurance departments, the regulation of these instruments – the discussion of which will likely be intertwined with a debate over state vs. federal regulation of

insurance. By regulating CDS as an insurance product, issuers of CDS contracts would be required to establish reserves to back up their CDS obligations. Further, Congress must consider if it will regulate or make illegal the “naked default swap” market that is described by many experts as a form of market gaming. The “naked default swap” market makes up an estimated 90% of the total CDS market. The complexity of the CDS market opens the door for a number of different regulators to be involved, including state insurance commissioners, the Securities and Exchange Commission, and the Commodity Futures Trading Commission. Insurance and securities fall under the jurisdiction of the Senate Banking and House Financial Services Committees, whereas CFTC oversight falls to the Agriculture Committees.

- **Financial Services Regulatory Czar:** Congress will likely consider if it will establish a systemic regulator that is charged with monitoring the risks and regulatory gaps of the interconnected financial services marketplace. The Bush Administration Treasury Department crafted a proposal last year called the [“Blueprint”](#) that contained that element and more. The “Blueprint” has languished since, but could easily be dusted off for consideration during the present crisis.

The two primary Congressional committees that are charged with addressing the issue are the Senate Banking Committee and the House Financial Services Committee. The election on Tuesday resulted in few losses to both committees.

Senate Banking Committee:

The Senate Banking Committee will continue to be chaired by Senator Chris Dodd (D-CT). Dodd was expected to leave the committee to become chairman of the Senate Foreign Relations Committee when the post is vacated by Vice President-elect Joe Biden (D-DE). In a surprise announcement, Dodd said that the nation’s financial crisis has led him to stay at the Banking Committee where he intends to shepherd through a major bill to modernize the regulation of U.S. financial institutions.

Of the remaining members of the committee, the Democrats experienced no losses and the lead Democrat pushing for an optional federal charter for insurance, Sen. Tim Johnson (D-SD), was reelected for a 3rd term. On the Republican side, three Senators will not be returning. Senators Wayne Allard (R-CO) and Chuck Hagel (R-NE) retired, while Senator Elizabeth Dole (R-NC) lost her reelection bid. Given the shift to a larger Democratic majority in the Senate, it is likely the Democrats will gain more committee seats and the Republicans will lose seats and it is uncertain which Senators will be appointed to the slots when the new Congress convenes.

House Financial Services Committee:

The House Financial Services Committee will continue to be chaired by Rep. Barney Frank (D-MA). In addition, the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises will continue to be chaired by Rep. Paul Kanjorski (D-PA). On the Republican side, Rep. Spencer Bachus (R-AL) will be the top ranking Republican for the full committee, but the ranking member slot for the Capital Markets Subcommittee will be vacated by retiring member Rep. Deborah Pryce (R-OH). Rep. Mike Castle (R-DE) is a likely successor to Rep. Pryce as the Subcommittee’s ranking member.

In addition to the retirement of Rep. Pryce, the full committee lost 5 members. Rep. Tim Mahoney (D-FL), Don Cazayoux (D-LA), Tom Feeney (R-FL), and Christopher Shays (R-CT) all lost their reelection bids. In addition Rep. Steve Pearce (R-NM) will vacate the committee after running and losing his bid for U.S. Senator from New Mexico. Reps. Mahoney, Cazayoux,

Feeney, and Shays all served on the Capital Markets Subcommittee. Like in the Senate, given the shift to a larger Democratic majority, the ratio of Democrats to Republicans is likely to shift with the new Congress and the new members of the full committee and the subcommittee will not be determined until the new Congress convenes in January.

NAIFA Staff Contact: [Jill Edwards](#), Assistant Vice President – Federal Government Affairs, at 703-770-8158.

Positioning NAIFA Members for the Challenges of the 111th Congress

NAIFA's ability to impact favorably legislative and regulatory issues that affect the business of NAIFA members and their clients rests directly on the strengths of the NAIFA federation's two premier political programs; **Grassroots/APIC and IFAPAC.**

Grassroots/APIC:

This is the "people" part of the program. Since NAIFA members are voters, tax payers and job creators in every Congressional District in the country, every political expert will tell you that there is simply no limit to the influence NAIFA members can bring to bear on critical issues. All it takes is individual recognition of the power that resides in each NAIFA member, and combining it with the will and organization to exert the power in the most effective way.

After every election cycle, NAIFA's Grassroots/APIC leaders have their work cut out for them. Prior to the elections, there were 13 members of the U.S. House of Representatives for which NAIFA had no listed contacts. Add that number to the 62 (as of today) newly elected members of Congress, and the National Grassroots/APIC Subcommittee will have to fill 75 legislative contact gaps. NAIFA members who have existing relationships with any of the representatives and members-elect on the gap list are urged to contact Magenta at mishak@naifa.org or 703-770-8152 and sign up for duty in NAIFA's all volunteer APIC army.

IFAPAC:

This is the "money" part of NAIFA's political strength. Money is, as one famous California legislator once observed, "...the mothers milk of politics." Through the generous contributions to IFAPAC of many NAIFA members, NAIFA as an organization is able to help elect candidates and incumbents who will be in a position to directly influence the outcome of issues. NAIFA/IFAPAC also amplifies financial contributions NAIFA members make personally to candidates.

IFAPAC's "win percentage" remained strong, particularly with incumbents, in the 2007-2008 election cycle. Overall, IFAPAC was involved in 294 U.S. House and U.S. Senate candidate campaigns. Of those, 237 won their campaigns & 21 decided to not to seek reelection. Additionally, IFAPAC contributed in seven races where the results will not be known until recounts and runoffs occur.

NAIFA Staff Contact: [Magenta Ishak](#), Assistant Vice President – Political Affairs, at 703-770-8152.

